Parliament of Australia

Senate Economics Committee

Trade Practices Amendment (Material Lessening of Competition-Richmond Amendment) Bill 2009

Submission
by

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The dangers to consumers from highly concentrated markets caused by mergers and creeping acquisitions: The case for the Richmond Amendment

There is no doubt that the greater the levels of market concentration, the greater the likelihood that consumers will be price gouged. The reason for this is quite simple. As markets become more concentrated, the opportunities for either collusion or parallel conduct with respect to pricing and related matters grow considerably. Within this context, mergers across the economy present a real and very serious risk to competition and consumers.

Risks to competition and consumers arise because mergers and acquisitions lead to a reduction in competitors and, in turn, lead to less competitive behaviour amongst the remaining players or to less incentive to do so or to innovate. This reduction in the intensity of competition is detrimental to consumers as any “efficiencies” or reduced costs achieved by a merger are much less likely to be passed onto consumers and much more likely to be pocketed by the merged firm. Yes, mergers are typically justified on the basis of allowing efficiencies or a reduction in costs to be achieved, but such efficiencies, if any, will only be beneficial to consumers if they are passed onto them. Indeed, the danger of mergers is that any efficiencies or reduction in costs that may be realised through a merger will not be passed onto consumers for the simple reason that as mergers remove competitors from the market, there will be fewer competitors left to take an independent stance to drive down prices to consumers, especially over time.

More dangerously for competition and consumers, as the few remaining firms become even larger through further mergers or, in particular, through creeping acquisitions the market share of the remaining firms itself becomes a considerable, if not insurmountable, barrier to entry. Thus, the mere fact that the market is “locked up” by a few large and powerful firms itself becomes a powerful disincentive or barrier to any potential new entrant.

In short, as the number of firms in a market diminishes, so too does the incentive for potential new entrants or for the remaining firms to aggressively attack one another on price or other terms and conditions. It is far easier for the remaining firms to act as a cosy club for their self interested advantage rather than to aggressively attack one another on price or other terms and conditions. Indeed, why enter into a price war when that would only cut profit margins for the “club members,” namely the few remaining firms in a concentrated market? Why should club members sustain cuts in profit margins, when it is much easier for them to build profit margins by simply shadowing one another on price and other terms and conditions?

Of course, the club members will protest loudly that they “compete” with one another, but any such “competition” is conducted in a manner that is beneficial to the club members rather than in manner that produces the maximum benefit to consumers. In a less concentrated market, it would only take one independently minded player to lower prices for the others to be compelled to follow. In a more concentrated market the players are less likely, if at all, to be "independently minded" as such a mindset only serves to undermine the ability of the few remaining firms to maintain or grow profit margins.

In view of the importance of preventing markets from becoming highly concentrated, this submission recommends the enactment of the *Trade Practices Amendment (Material Lessening of Competition-Richmond Amendment) Bill 2009*, a Bill drafted by the author, on the basis that it has been designed with the specific aim of promoting consumer welfare by protecting and facilitating vigorous competition across all sectors of the Australian economy.

The Submission is divided into two parts with Part One explaining the background and rationale behind the Richmond Amendment and with Part Two rebutting the self-interested, misguided or ill-conceived "suggestions" made against the Richmond Amendment.

Recommendation

(1) Enact the *Trade Practices Amendment (Material Lessening of Competition-Richmond Amendment) Bill 2009*

PART ONE:
The background and rationale behind the Richmond Amendment

In Part One the Submission will consider:

- The need to amend s 50 of the *Trade Practices Act* to prohibit any merger or acquisition that "materially" lessens competition;
- Dealing with creeping acquisitions: The importance of preventing the destruction of competition by stealth.

In doing so, Part One of the Submission will outline the clear need to amend s 50 of the *Trade Practices Act* so as to ensure that Australia has the most effective anti-merger laws possible for the promotion of competition and consumer welfare.

Need to amend s 50 of the *Trade Practices Act* to prohibit any merger or acquisition that "materially" lessens competition

Currently, s 50 of the *Trade Practices Act* only prohibits a merger or acquisition if it substantially lessens competition:

> (1) A corporation must not directly or indirectly:
>
> > (a) acquire shares in the capital of a body corporate; or
> >
> > (b) acquire any assets of a person;
>
> if the acquisition would have the effect, or be likely to have the effect, of substantially lessening competition in a market.

Unfortunately for consumers and competition, the "substantial lessening of competition" test is far too high a threshold to meet and, accordingly, explains why the ACCC approves around 97% of mergers or acquisitions that it considers. The "substantial lessening of competition" test requires that in order for the merger or acquisition to be considered in breach of the test, the merged entity must have the ability to raise prices without losing business to rivals. In this way, the "substantial lessening of competition" test has come to be equated with the "substantial market power" test which also requires that it be established that the company have the ability to raise prices without losing business to rivals.

With the near perfect record of mergers being approved or escaping scrutiny under the current s 50(1) it is not surprising that Australia has some of the most highly concentrated markets in the world. Such near perfect approval rate provides compelling evidence of the failure of s 50(1), as currently drafted, to protect competition and consumers from the adverse effects of mergers or acquisitions This is particularly so as with a reduction in genuine competition between the fewer companies remaining post merger there is a much greater likelihood that the remaining companies will act as a cosy club to the detriment of consumers.

This failure of the current s 50(1) to prevent mergers and acquisitions having a detrimental effect on consumers and competition can be directly attributed to the view that the present “substantial lessening of competition” test is simply too high a test to act as an appropriate filter to protect competition. In short, because the “substantial lessening of competition” test is set too high, s 50(1) as currently drafted is failing to prevent anti-competitive mergers and acquisitions.

Proposed amendment to s 50(1) of the *Trade Practices Act*

Within this context, it would be submitted that the “substantial lessening of competition” test under the current s 50(1) is in urgent need of change to a more balanced test of a “material lessening of competition.” A “material lessening of competition” test as included in the Richmond Amendment would operate to lower the threshold for determining whether a merger or acquisition is anti-competitive in a manner that would allow the merger or acquisition to be tested by reference to whether it has a pronounced or noticeably adverse affect on competition and consumers rather than on whether the merged entity would, post merger, be able to exercise substantial market power as is currently the case.

Dealing with creeping acquisitions: The importance of preventing the destruction of competition by stealth

Dealing effectively with the issue of creeping acquisitions is essential to having a world's best competition law framework. Failure to deal effectively with creeping acquisitions undermines competition to the clear and longstanding detriment of consumers. Unless the *Trade Practices Act* effectively prevents creeping acquisitions there will be a considerable gap in the Act allowing large businesses to acquire competitors in a piecemeal manner that gets around the existing prohibition against mergers found in s 50(1) of the *Trade Practices Act*.

The issue of creeping acquisitions arises because of the current drafting of s 50 of the *Trade Practices Act*. First, as discussed above, s 50(1) is far too permissive in allowing around 97% of mergers to be approved by the ACCC. Second, s 50(1), as currently drafted, refers to an "acquisition" in the singular making it clear that it is each individual acquisition that needs to be assessed under s 50. Unless the particular acquisition, in itself, substantially lessens competition, it will not be in breach of s 50. As a result, the individual acquisition will be allowed under s 50(1) as currently drafted as the "substantial lessening of competition" test is too high a threshold to deal with mergers or acquisitions.

It is clear that s 50 can be easily circumvented by undertaking piecemeal or small scale acquisitions which individually don't substantially lessen competition, but which over time lead to the increased dominance of the merged entities. As noted above, this is clearly evident in the Australian banking sector where the series of acquisitions by the Commonwealth Bank and Westpac in recent years has led to the increased dominance of these 2 major banks in circumstances where s 50(1) as currently drafted has hitherto failed to prevent those piecemeal acquisitions.

Thus, while over time individual piecemeal acquisitions may, when taken together with previous acquisitions by the same entity, have the effect of collectively destroying competition, the current s 50(1) is powerless to stop the piecemeal acquisitions as can be so clearly seen in the Australian banking sector.

So under s 50(1), as currently drafted, the creeping acquisitions of individual competitors will not be prevented because their small scale will not be considered to substantially lessen competition and accordingly not breach s 50(1) of the *Trade Practices Act*. In this way creeping acquisitions lead to the destruction of competition over time in a manner that is not prevented by the current s 50(1) of the *Trade Practices Act*.

While, of course, those engaging in creeping acquisitions will justify the creeping acquisitions on efficiency grounds as possibly leading to greater economies of scale, it is essential to note that the removal of individual efficient competitors over time means that there is a reduction in the very competition required to ensure that any savings from any economies of scale gained from acquisitions are passed onto consumers.

Thus, unless there is sufficient competition to force the merged entities to pass efficiency savings onto consumers, the benefits of any economies from mergers or acquisitions will simply be a windfall for the merged entity and not be passed onto consumers. More dangerously for consumer, the weakening of competition through merger activity, along with the increased dominance of the merged entities, allows the merged entities to raise prices and/or product choices to detriment of consumers. As noted above, we are now seeing a clear example of this in the Australian banking sector as direct a result of the acquisitions by the Commonwealth Bank and Westpac.

Current Federal Government proposals fail to deal with creeping acquisitions

In a discussion paper issued by the then Minister for Competition Policy and Consumer Affairs on 6 May 2009 and entitled *Creeping Acquisitions - The Way Forward*, the Federal Government outlined the following proposal for dealing with creeping acquisitions:[1]

> *(1) A corporation that has a substantial degree of power in a market must not directly or indirectly:*
>
> > *(a) acquire shares in the capital of a body corporate; or*
> >
> > *(b) acquire any assets of a person;*
>
> *if the acquisition would have the effect, or be likely to have the effect, of enhancing that corporation's substantial market power in that market.*

This proposal requires that the company would have to have substantial market power in the first place before the proposal would stop any of its subsequent acquisitions. So if the company does not have market power, then it would not be covered by this proposal at all. As discussed above, the market power threshold is a very high threshold as there is a need to prove that company has "the ability to raise prices without losing business to its rivals." Very few companies, if any, have substantial market power. In fact, only monopolists, or near monopolists, can raise prices without losing business.

Since a company needs to be a monopolist or near monopolist before it will have a substantial degree of market power, the Federal Government's creeping acquisitions proposal will, with all due respect, be ineffective in preventing the destruction of competition by stealth. Indeed, under the Federal Government's creeping proposal, few, if any, companies will have substantial

[1] The discussion paper can be accessed at: http://www.treasury.gov.au/documents/1530/PDF/Discussion_paper_Creeping_Acquisitions.pdf

market power on the basis that few, if any, companies have the ability to raise prices without losing business to rivals.

In addition to the real problem that under the Federal Government's proposal very few, if any, companies would have a substantial degree of market power, the Federal Government's proposals will also fail to prevent creeping acquisitions on the basis that the need to show an "enhancement" of market power under the proposals will be a further insurmountable hurdle to the application of the Federal Government's creeping acquisition proposals. Given that a company having substantial market power already has the ability to raise prices without losing business, it is especially questionable for the proposals to refer to an "enhancement" on the basis that there is real uncertainty as to what that would mean in practice.

Does an "enhancement" mean that under the Federal Government's creeping acquisition proposals it would need to be shown that a company already possessing substantial market power can raise prices even higher after the acquisition? How much higher? Given that the company already has the ability to raise prices in order to have substantial market power, it would be extremely unlikely, if ever, possible for a creeping acquisition, given its small scale, to "enhance" the pricing power of a company already having substantial market power.

In short, the Federal Government's proposals will fail, with all due respect, to prevent creeping acquisitions that can be so destructive of competition to the clear and longstanding detriment of consumers.

Proposed amendment to s 50 of the *Trade Practices Act*

In view of the considerable concerns with the Federal Government proposals for dealing with creeping acquisitions, it would be submitted that an alternative approach to effectively dealing with creeping acquisitions is needed. The Richmond Amendment offers such an effective alterative in relation to creeping acquisitions.

Given that creeping acquisitions become a very real concern where they are being engaged in by companies already having a substantial market share it would be submitted that the focus of a prohibition on creeping acquisitions should be on those companies having a substantial share of the market. It is these companies with substantial market share that can engage in a destructive, but well organised, pattern of creeping acquisitions in order to increase their strength in the market through piecemeal acquisitions in circumstances where individually those acquisitions are not prevented by the current s 50(1).

PART TWO:
A rebuttal of the self-interested, misguided or ill-conceived “suggestions” made against the Richmond Amendment

Sadly, a number of self-interested, misguided, or ill-conceived suggestions have been made against the Richmond Amendment. In Part Two of the Submission these flawed “suggestions” will be rebutted.

A “material lessening of competition” is a lower threshold than “substantial lessening of competition”

A material lessening of competition under the Richmond Amendment would be triggered where the merger or acquisition would have a clear, imminent and noticeable adverse impact on competition and consumers. A material lessening of competition test would focus attention on whether or not the merger or acquisition would lead to a reduction in the number of efficient competitors in the marketplace and whether such a reduction would reduce the diversity or range of goods or services available to consumers. A material lessening of competition would also look to see whether the merger or acquisition would allow or facilitate “price coordination” behaviour between the market players remaining following the merger or acquisition.

In contrast, the substantial lessening of competition test effectively requires that the merged entity would have the ability to raise prices without losing business. This is an extremely difficult test to prove as evidenced by the fact that the ACCC will approve 97% of the mergers and acquisitions.

Misunderstanding of the effect and impact of extremely high ACCC approval rate for mergers and acquisitions

Suggestions that the extremely high ACCC approval rate for mergers and acquisitions merely reflects a view that around 97% of mergers or acquisitions do not “raise competition concerns” is fallacious. Clearly, the ACCC approval rate depends on the particular narrowness or width of the competition test embedded in the particular anti-merger law. Indeed, a very narrow competition test as is currently the case under s 50(1) of the *Trade Practices Act* will inevitably mean that very few mergers or acquisitions are opposed under that presently very narrow competition test. By effectively focussing on the merged entity’s ability to raise prices without losing business before a merger or acquisition is stopped, the current competition test in s 50(1) makes it easier to get mergers and acquisitions past the ACCC, a fact confirmed by the around 97% ACCC approval rate.

Clearly, the narrowness of the competition test in the current s 50 of the *Trade Practices Act*, means that only very few mergers or acquisitions raise “concerns” under that very narrow test. That is certainly <u>not</u> the say, or to assume, that other mergers or acquisitions do not raise competition concerns. It is simply that other mergers or acquisitions that may have a materially detrimental impact on competition and consumers are not caught by the narrowness of the competition test in the current s 50 of the *Trade Practices Act*. These other mergers or acquisitions should be of concern because of their adverse impact on competition and consumers.

Under a “material lessening of competition” test a wider range of mergers and acquisitions that have materially detrimental impact on competition and consumers would come within the scope of the Richmond Amendment.

Suggestions that “material” always equates with “substantial” need to be dismissed

Suggestions that “material” always equates with “substantial” need to be dismissed. Indeed, while a factor considered to be “substantial” will obviously also be considered “material” by one considering the matter, a factor that is less than substantial can still quite easily be considered “material” to one’s assessment of a particular matter. In other words, in considering a matter there will be a range of factors with different degrees of materiality ranging from substantial through to trivial or “immaterial”.

In short, factors, others than trivial or “immaterial” factors, will all be material or “of substance”, but they may not all be “substantial” in terms of size or impact. Therein lies the problem with the “substantial lessening of competition” test in that the size or impact of the merger or acquisition before it can be stopped under the current s 50(1) of the Trade Practices Act needs to be of such overwhelming size or impact that it would allow the merged entity to be able to raise prices without losing business. This is an extremely difficult test to satisfy as evidenced by the around 97% ACCC approval rate.

“Uncertainty” argument is misguided and needs to be dismissed

The uncertainty argument made against the Richmond Amendment is misguided for the simple reason that the *Trade Practices Act* and the concepts under that Act are ordinarily open to interpretation and debate as to their application. As a statute where legal and economic ideas and concepts interact or intersect, applying the *Trade Practices Act* is not like applying a mathematical formula. Accordingly, there will ordinarily be will debate or differences of opinion, but that does not equate to “uncertainty.”

It is, however, disappointing when the area of debate is narrowed to the point where a concept under the Trade Practices Act such as a “substantial lessening of competition” effectively comes to be equated with the need to prove that a merged entity will have the ability to raise prices without losing business.

The point of the Richmond Amendment is quite simply to widen the area of debate in relation to Australia anti-merger tests in a measured and balanced manner in the interests of competition and consumers. As debate is implicit in the application of a statute like the *Trade Practices Act*, a widening of the debate in a measured and balanced manner is to be welcomed in the consumer interest as it leads to a more robust assessment of the true impact of mergers and acquisitions.

Dangers of vested interests

Sadly, the narrowing of the debate on mergers and acquisitions under the “substantial lessening of competition” test to a point that the ACCC approves around 97% of mergers and acquisitions it considers has certainly been welcomed by those vested interests wanting all or nearly all mergers and acquisitions to proceed.

Quite simply, mergers and acquisitions are very lucrative for those involved and, of course, the vested interests involved as represented by such groups as the Business Council of Australia, the Shopping Centre Council of Australia and the Australian National Retailers Association, as well as their legal advisers, would strenuously oppose any widening of the debate regarding Australia’s anti-merger laws. Those vested interests will, for self-interested reasons, obviously like the around 97% ACCC approval rate.

Proposed “substantial market share” test in Richmond Amendment consistent with another section of competition provisions of the *Trade Practices Act*

The reliance on the substantial market share test within the Richmond Amendment is consistent with the use of the substantial market share test in s 46(1AA) of the *Trade Practices Act*, more commonly known as the Birdsville Amendment dealing with anti-competitive below cost pricing with corporations having “substantial market share.”

Significantly, the Birdsville Amendment, also drafted by this author, amply demonstrates federal parliamentary acceptance of the “substantial market share” test as a legitimate one under the *Trade Practices Act* for the protection of competition and consumers. “Market share” is a concept that is well understood in commercial terms and is regularly used in analysing market structure. “Substantial” is ordinarily taken to mean “large” or “weighty” and, in this regard, “substantial market share” means a large market share having regard to the particular dynamics of the relevant market. Needless to say, more than one corporation can have substantial market share.

“Market cap” argument is ill-conceived and needs to be dismissed

The “suggestion” that the Richmond Amendment will impose a “market cap” is ill-conceived and demonstrates a fundamental misunderstanding of the Richmond Amendment and, more importantly, Australia’s anti-merger laws. Firstly, there is no mention of any so-called “cap” in the Richmond Amendment. The Richmond Amendment proposes a prohibition of anti-competitive mergers or acquisitions that contravene the competition test found in the Richmond Amendment. In that sense, the Richmond Amendment, in principle, takes the very same approach as the current s 50(1) of the *Trade Practices Act*. The only difference is that the Richmond Amendment would be triggered at a lower threshold than the current s 50 of the *Trade Practices Act*.

Secondly, the prohibition contained in the Richmond Amendment is not an absolute prohibition. In contrast, a so-called “cap” would, by implication, involve an absolute prohibition or “ceiling.” Rather, the Richmond Amendment needs to be considered within the context of Australia’s anti-merger framework. That framework allows for mergers or acquisitions that contravene the competition test in s 50 of the *Trade Practices Act* to be considered under the authorisation process under the *Trade Practices Act*. The authorisation process would continue to be available in relation to the mergers or acquisitions contravening the competition test in the Richmond Amendment.

Competition in key sectors of the Australian economy not as vigorous as it could be if Australia had strong anti-merger laws

The greater the number of efficient competitors, the greater likelihood of vigorous competition in the market place. The fewer the competitors and the more concentrated the relevant market, the greater likelihood of “price coordination” or, even collusion. A cosy club can quite easily transform into a cartel. Even where the cosy club remains cosy there is no real incentive to innovate or to engage in other efforts that “rock the boat.” To the cosy club, the “easy life” is preferable to vigorous competition.

In contrast, consumers deserve the benefits of vigorous competition. Vigorous competition requires vigorously independent competitors. Mergers and acquisitions are designed to remove competitors and especially vigorously independent competitors. Dangerously for competition and consumers, such vigorously independent competitors are too often allowed to be acquired by larger and more powerful corporations under the current s 50(1) of the *Trade Practices Act* on the pretext that there will be “sufficient” competition remaining in the marketplace. Again, it becomes a question of definition of what amounts to “sufficient” and having markets dominated by only 2, 3 or 4 large and powerful corporations is certainly not sufficient to promote vigorous competition as those 2, 3 or 4 corporations will typically act as a cosy club and engage in “price coordination” to the detriment of competition and consumers.

Significantly, the substantial market share of the remaining 2, 3 or 4 large and powerful corporations becomes a substantial, and insurmountable, barrier to entry to any potentially new competitor considering entering the market. Clearly, in highly concentrated markets substantial market share becomes an excellent measure of the ability of the corporations having substantial market share to distort competition to their advantage. Thus, in highly concentrated markets there is a greater need to protect competition and to ensure that competition is not destroyed by stealth as a result of creeping acquisitions. The Richmond Amendment strikes a balance between targeting mergers and acquisitions that are materially detrimental to competition and allowing mergers and acquisitions to proceed where they are beneficial to consumers.