Submission on the proposed Richmond Amendment

Senate Economics Legislation Committee
Inquiry into the Trade Practices Amendment (Material Lessening of Competition – Richmond Amendment) Bill 2009

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Summary

The *Trade Practices Amendment (Material Lessening of Competition – Richmond Amendment) Bill 2009* (the Bill) proposes two key changes to Australia's merger laws:

1. To replace the word 'substantial' in s 50(1) of the Act relating to the prohibition of anti-competitive mergers with the word 'material'

2. To insert a new provision, effectively prohibiting any horizontal mergers by companies holding a substantial market share in an Australian market

Both should be rejected. The first would generate uncertainty with no clear countervailing benefit. The second would be inconsistent with the objective of competition policy in Australia and globally.

Material lessening of competition

The *Trade Practices Act 1974* (the Act) currently prohibits mergers that would substantially lessen competition. The Explanatory Memorandum (EM) claims that the word 'material' would lower the threshold for merger review under the Act and that this is desirable because the current threshold sets the bar too high for the prohibition of anticompetitive mergers.

Consistency and the desire for certainty

The current test for mergers is consistent with other competition law provisions of the Act. It is also consistent with the approach taken by most OECD jurisdictions, which is to prohibit mergers which 'substantially' or 'significantly' impede or lessen competition (see Appendix).

A change to the Act in the way proposed would generate uncertainty for business at a time when the increasing incidence of transnational mergers requiring review in multiple jurisdictions has triggered a desire for international consistency of merger regulations whenever practical.

Lowering the bar

The EM claims that the current 'substantial lessening of competition' test is set at 'too high a threshold' and that the proposed test would lower this threshold.

First, the claim that the bar is set too high appears to be based entirely on the observation that the ACCC approves appropriately 97 per cent of mergers.[1] In fact the ACCC does not approve or disapprove of mergers under its informal review process, but rather indicates an intention to challenge or not to challenge a notified merger based on its assessment of whether the merger will infringe the substantive law. While it is true that the ACCC generally opposes less than 5% of mergers notified to it in any given year, this does not necessarily mean the bar is set too high. This percentage is consistent with the percentage of notified mergers challenged in most other OECD jurisdictions. In the United States, for example, the percentage of notified mergers challenged is routinely lower than that challenged in Australia. This statistic simply reflects the fact that the vast majority of mergers do not raise competition concerns. It does not imply that the law itself is too lenient.

[1] Senator Nick Zenophon, Second Reading Speech, Senate Hansard, Thursday 26 November 2009, p 6.

Second, the claim that replacing the word 'substantial' with 'material' would 'lower the threshold for determining whether a merger or acquisition is anti-competitive', lacks merit. The meaning of the word 'substantial' in the context of s 50(1) of the Act has not been judicially determined. The only case in which its meaning was considered in this context was *Australian Gas Light Company v Australian Competition & Consumer Commission (No 3)* [2003] FCA 1525. In that case Justice French, now the Chief Justice of the High Court of Australia, stated:[2]

> *A description of the kind of judgment required by the word 'substantially', which appears recently to have been approved in the High Court, is that the effect of the acquisition be 'meaningful or relevant to the competitive process' – Rural Press …*

This does not appear to set the bar any higher than would a 'material lessening of competition' test. As Prof Stephen King recently pointed out,[3] 'materially' has been at times defined by the courts as being synonymous with 'substantially'.

Third, the claim in the EM that the change would 'allow the merger or acquisition to be tested by reference to whether it has a pronounced or noticeably adverse affect on competition, rather than on whether the merged entity would be able to exercise substantial market power post-merger, as is currently the case' is misguided and demonstrates a lack of understanding of the current test and its application. It appears that reference has been made to the ACCC *Merger Guidelines 2009* which state that the ACCC will take the 'view that a lessening of competition is substantial if it confers an increase in market power on the merged firm that is significant and sustainable'.[4] This view is, of course, not binding and appears nowhere in the Act. However, it is consistent with economic understanding of when mergers are likely to generate competitive concerns. There will be limited, if any, circumstances in which competition will be harmed in a 'pronounced or noticeable' way in the absence of an increase in market power of the kind described in the Guidelines. In this respect, the International Competition Network recently adopted (June 2009), *Recommended Practices for Merger Analysis* which state that the

> *'goal of competitive effects analysis in the review of horizontal mergers is to* ***assess whether a merger is likely to harm competition significantly*** *by creating or enhancing the merged firm's ability or incentives to exercise market power, either unilaterally or in coordination with rivals.'*[5] *(emphasis added)*

International best practice therefore acknowledges that competitive harm is normally caused when and if a merger enhances a party's ability to exercise either unilateral or coordinated market power.

For all of these reasons the proposal to replace 'substantially' with 'materially' in s 50(1) of the Act should be rejected.

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[2] Australian Gas Light Company (ACN 052 167 405) v Australian Competition & Consumer Commission (No 3) [2003] FCA 1525 at para 351

[3] Prof Stephen King, *Mergers, synonyms and the Richmond amendment*, Core Economics: Commentary on economics, strategy and more, 1 December 2009 (http://economics.com.au/?p=4756&utm_source=feedburner&utm_medium=feed&utm_campaign=Feed%3A+com%2FJUlM+%28CoreEcon%29&utm_content=Netvibes)

[4] At para 3.5

[5] ICN, Recommended Practices for Merger Analysis, Recommendation IV(A)

Market share cap

All horizontal mergers have some impact on competition,[6] with the result that the proposal to prohibit a corporation with substantial market share from acquiring shares and assets whenever the acquisition would have the effect of lessening competition, will effectively prevent all mergers by firms with substantial market share. This does little, if anything, to address concerns expressed about creeping acquisitions and instead will generate uncertainty and prohibit significant levels of pro-competitive conduct, to the detriment of the consumer public.

The problem with any cap on mergers

Some submissions to the Dawson Review argued that a 'cap' should be placed on the market share of companies, beyond which acquisitions should not be permitted (or at least not permitted without approval).[7] This suggestion was criticised by the Dawson Committee in its report, which considered that a cap would 'stifle competition and protect the unsustainable position of inefficient competitors'.[8] They also accepted that a cap would prove 'unworkable' and could deny consumers access 'to the products or services offered by an efficient producer'.[9] Small business wishing the sell would also be denied access to prospective buyers, lowering the value of small business goodwill. The reasoning of the Dawson Committee on this point remains sound.

The problem with the use of market shares

There are at least three key problems with the use of a market share based test such as that proposed in the bill. The first is the uncertainty it generates. The second is the false assumption it makes about the correlation between market power and market share. The third is that it is inconsistent with international best practice.

First, the use of market share generates significant uncertainty and increases transaction costs for all business involved in merger activity when assessing their compliance with the Act. Rigorous economic analysis is required to determine first what the relevant market is and then what market share is held by the merging parties and other participants. Economists can and will differ in their views on each of these issues, generating considerable uncertainty for business. Once this analysis is conducted merging parties must predict whether or not the ACCC or the courts will consider the share that they hold within the

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6 The only exception may be where the corporation to be acquired was a failing firm and there were no other potential buyers; although even then there is an argument that the increase in market share acquired by the firm having pre-existing substantial market power might have a slight impact on competition sufficient to trigger a contravention of this proposed test.

7 These submissions include those by: Association of Consulting Engineers Australia, p 11; Fair Trading Coalition, pp iv & 37; NARGA, p 81 (propose that a 'concentrated market notice' be issued when markets are identified as highly concentrated); Pharmacy Guild of Australia, p 2; Spier Consulting, p 22; WA Independent Grocers Association (Inc), *Submission to the Review of the Competition Provisions of the Trade Practices Act 1974*, 'Restoring Competitive Equality in an Increasingly Anti-Competitive Environment', Public Submission 158, Trade Practices Act Review 2002, p 13.

8 Dawson Report, January 2003, p 67*.*

9 The Committee claim that the Baird Committee and ACCC both agree this would be unworkable (Dawson Report, p 67). The Baird Committee reported in 1999: Report by the Joint Select Committee on the Retailing Sector (the Baird Committee), *Fair Market or Market Failure? A Review of Australia's retailing sector,* Parliament of the Commonwealth of Australia, Canberra, 1999 ('Baird Report'). This report (at p viii and pp 47-53) states that the Committee heard compelling evidence that a market cap (of the nature suggested to that Committee – which would have required divestiture of existing assets) would prove unworkable. The ACCC's submission to the Dawson Report does not contain any suggestion that a cap as proposed in Dawson Review submissions would be unworkable. The Baird Committee Report does, however, indicate that the then Chairman of the ACCC, Professor Allan Fels, provided evidence to the Baird Committee that there would be 'significant mechanical problems associated with a market cap' (Baird Report, p viii; see also p 51).

market to be substantial. This definitional problem also exists in the flawed 'Birdsville Amendment' to s 46 of the Act and has yet to be resolved.

Second, and more importantly, market share cannot be considered an accurate proxy for market power. Market share has repeatedly and increasingly been rejected as an imperfect proxy for market power around the world, particularly in OECD jurisdictions.[10] A company may have substantial market share without having any significant market power by virtue of a number of factors, including low barriers to entry and the threat of imports.

Third, the use of a market-share based test to the prohibition of merger activity is inconsistent with international best practice. The International Competition Network *Recommended Practices for Merger Analysis*, as developed in 2008 and extended this year, make clear that market shares should not be considered 'determinative of possible competition concerns'[11] because they may 'either underestimate or overestimate the future competitive significance of a firm or the impact of a merger.'[12] The clearly recommend that:[13]

> *Jurisdictions that use market concentration and/or market shares to presume competitive harm should ensure that any such presumption may be overcome or confirmed by a detailed review of market conditions.*

For these reasons the proposal should be rejected.

Recommendation

The bill is seriously flawed in terms of economic and competition law theory. It would generate uncertainty, would harm consumers and small business and would be inconsistent with international best practice. It should be rejected.

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[10] For example, Belgian authorities increasingly recognize the fact 'that market shares do not correctly reflect the dynamic process of a bidding market, that he key issue is that actual effect of the merger on competitive constraints, and that high market shares alone are not sufficient to justify prohibiting a merger.' Laurent Garzaniti, Thomas Janssens and Vincent Mussche in John Davies (ed), *Getting the Deal Through: Merger Control 2010* http://www.gettingthedealthrough.com/books/20/merger-control/

[11] International Competition Network *Recommended Practices for Merger Analysis*, Recommendation II(A) http://www.internationalcompetitionnetwork.org/media/library/Cartels/Merger_WG_1.pdf

[12] International Competition Network *Recommended Practices for Merger Analysis*, Recommendation II(A), Comment 1. http://www.internationalcompetitionnetwork.org/media/library/Cartels/Merger_WG_1.pdf

[13] International Competition Network *Recommended Practices for Merger Analysis*, Recommendation II(C). http://www.internationalcompetitionnetwork.org/media/library/Cartels/Merger_WG_1.pdf

Appendix: Substantive approach in other OECD jurisdictions[14]

Country	Test	Theory of harm
Australia	Substantial lessening of competition	Unilateral and coordinated effects
Austria*	Creation of strengthening of dominant position	Various, including vertical foreclosure, conglomerate effects, collective dominance
Belgium*	Significant impediment to effective competition (particularly as a result of the creation or strengthening of a dominant position)	Single dominance (focus), unilateral effects, coordinated effects, conglomerate effects, vertical foreclosure
Canada	Substantial prevention or lessening of competition	Unilateral and coordinated effects
Czech Republic*	Material interference with competition, particularly due to strengthening or establishment of dominant position	Unilateral and coordinated effects
Denmark*	Significant impediment to effective competition (particularly as a result of the creation or strengthening of a dominant position)	As for EU
EU	Significant impediment to effective competition (particularly as a result of the creation or strengthening of a dominant position)	Various – predominantly dominance but also unilateral effects, coordinated effects, conglomerate effects and vertical concerns
Finland*	Creation or strengthening of dominant position as a result of which competition would be significantly impeded	Horizontal, vertical and conglomerate effects
France*	Significant lessening of competition, particularly by 'creating or strengthening an individual or collective dominant position'.	As for US – recent emphasis on risk of coordinated effects
Germany*	'Creation or strengthening of a dominant market position'	Unilateral and coordinated effects
Greece*	Significant restriction on competition, particularly by creating or reinforcing a dominant position	Predominantly market dominance. Also unilateral, coordinated, vertical and conglomerate effects
Hungary*	Significant impediment to effective competition (particularly as a result of the creation or strengthening of a dominant position)	Horizontal, vertical, portfolio and conglomerate effects

[14] All data taken from John Davies (ed), *Getting the Deal Through: Merger Control 2010*, http://www.gettingthedealthrough.com/

Iceland	Substantial reduction in effective competition or obstruction of effective competition by giving one or more undertakings a dominant position or strengthening an existing dominant position	No single theory. Predominantly dominance, but also unilateral effects, coordinated effects, conglomerate effects and vertical foreclosure
Ireland*	Substantial lessening of competition	Includes, but not limited to, unilateral effects, coordinated effects, conglomerate effects and vertical foreclosure
Italy*	Creation or strengthening of a dominant position 'as a result of which competition is eliminated or substantially reduced'	Coordinated effects and unilateral effects where the merger leads to a dominant position
Japan	Substantial restraint of effective competition	Horizontal, vertical, conglomerate, unilateral and coordinated effects
Korea	Not clear but based on anti-competitive effect (presumption of anti-competitive effect based on market share; monopoly presumed where market share of single company is 50% or aggregate market share of three or less companies is 75% or more and post-merger company would be the largest company and post-merger market share exceeds that of the next largest company by at least 25%)	Primarily unilateral and coordinated effects
Luxembourg*	Restriction or distortion of competition (not merger-specific – applies to all agreements)	-
Mexico	Reduce, impair or prevent competition	Recent focus on market dominance, unilateral effects and vertical foreclosure
Netherlands*	Significant impediment to effective competition (particularly as a result of the creation or strengthening of a dominant position)	See EU
New Zealand	Substantial lessening of competition	Unilateral, coordinated and conglomerate effects
Norway	Creation or strengthening of a significant restriction of competition	Unilateral, coordinated, vertical and conglomerate effects
Poland*	Significant restriction of competition	Horizontal (focus) , vertical and conglomerate effects
Portugal*	Creation or reinforcement of dominant position resulting in significant impediment to effective competition	Various – market dominance, unilateral effects, coordinated effects, conglomerate effects and vertical foreclosure.

Slovakia*	Creation or strengthening of dominant position resulting in significant barriers to effective competition	-
Spain*	Prevention of the maintenance of effective competition	Include market dominance, unilateral effects, coordinated effects, conglomerate effects and vertical foreclosure
Sweden*	Significant impediment to the existence or development of effective competition, particularly as a result of the creation or strengthening of a dominant position.	-
Switzerland	Creation or strengthening of a dominant position eliminating effective competition	Coordinated effects, unilateral effects, conglomerate effects and vertical foreclosure
Turkey	Creation or strengthening of a dominant position and significant impediment of effective competition	Primarily unilateral effects. More recently more consideration given to coordinated effects.
UK*	Substantial lessening of competition	Focus on unilateral and coordinated effects. Also vertical effects and conglomerate effects
USA	Substantial lessening of competition or tendency to create a monopoly	Focus on unilateral and coordinated effects. Less concern about vertical effects and conglomerate effects.

* Indicates member of European Union. Where the merger has a Community Dimension the EU test will apply.