Chapter 1

Introduction

1.1 The Trade Practices Amendment (Material Lessening of Competition—Richmond Amendment) Bill 2009 was introduced into the parliament by independent Senator Nick Xenophon on 26 November 2009. The bill will amend section 50(1) of the *Trade Practices Act 1974* (TPA) with the aim of:

- strengthening Australia's anti-merger law; and
- addressing the issue of creeping acquisitions.

1.2 In terms of mergers, the bill intends to introduce a lower threshold by replacing the current test in section 50(1) of the *Trade Practices Act (1974)* (TPA) of a 'substantial' lessening of competition with a 'material' lessening of competition.

1.3 In terms of creeping acquisitions, the bill intends to prevent a corporation that already has a substantial share of a market from acquiring shares or an asset which would have the effect of lessening competition in the market.

1.4 These two issues—mergers and creeping acquisitions—are closely linked. The drafter of the bill has noted that unless the TPA 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 in section 50(1)'.[1] The effect will be that the merged entity will be able to raise prices to the detriment of consumers.

Mergers and creeping acquisitions

1.5 A merger is combination of two or more firms or corporations such that one is absorbed into the structure of the other(s) and loses its separate identity.[2] The value of merger and acquisition activity in Australia in 2009 is estimated at over A$174 billion.[3]

1.6 Companies merge for various reasons, including:

- to improve their efficiency by realising economies of scale and economies of scope;
- to increase their market power (and hence profits);
- as a defensive strategy to make the company less likely to become a takeover target itself; and

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1 Associate Professor Frank Zumbo, *Submission 14*, p. 6.

2 Butterworths Encyclopaedic Australian Legal Dictionary

3 Treasury, *Submission 15*, p. 1. Treasury gives the figure of US$160 billion.

- a management strategy seeking the greater prestige and salaries that come from running a larger organisation.

It is only if the first reason is dominant that mergers may be in the public interest rather than just in the interests of managers.[4]

1.7 However, merger activity may also impact adversely on competition, by concentrating market share and increasing the likelihood of price gouging. Competition (or anti-trust) laws regulate the extent to which companies are allowed to merge.

1.8 The TPA does not refer explicitly to a 'merger'. Rather, section 50 (1) and section 50(2) of the TPA prohibit either a corporation or a person from directly or indirectly acquiring shares in the capital of a body corporate or 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'. This test has been in operation since 1993.

1.9 Section 50(3) of the TPA provides a non-exhaustive list of matters that must be taken into account in determining whether there has been a substantial lessening of competition in a market. These are:

a. the actual and potential level of import competition in the market;

b. the height of barriers of entry to the market;

c. the level of concentration in the market;

d. the degree of counterveiling power in the market;

e. the likelihood that the acquisition would result in the acquirer being able to significantly and sustainably increase prices and profit margins;

f. the extent to which substitutes are available in the market or are likely to be available in the market;

g. the dynamics of the market including growth, innovation and product differentiation;

h. the likelihood that the acquisition would result in the removal from the market of a vigorous and effective competitor; and

i. the nature and extent of vertical integration in the market.

1.10 In Australia, the merger process is subject to both the provisions of section 50 of the TPA and formal and informal merger review processes. The Trade Practices Legislation Amendment Bill (No. 1) 2005 introduced a formal merger review process whereby parties can apply to the Australian Competition and Consumer Commission (ACCC) for clearance in respect of proposed acquisitions of shares or assets. If a

4 See Senate Economics References Committee, *Report on Bank Mergers*, September 2009, http://www.aph.gov.au/Senate/committee/economics_ctte/bank_mergers_08/report/report.pdf

clearance is granted by the ACCC, then section 50 does not prevent the acquisition of shares or assets.[5]

1.11 In addition, the ACCC operates an informal merger review based on its Merger Guidelines. Although they have no legal force, these Guidelines are a useful public guide to section 50 and the Commission's approach to its enforcement.

1.12 'Creeping acquisitions' refer to circumstances in which companies substantially lessen competition not by single large acquisitions but by incremental smaller acquisitions over a period of time. Each of these small acquisitions is not in breach of section 50, and the series of acquisitions are therefore permissible by law.

1.13 There are currently no provisions in the TPA to prevent or limit 'creeping acquisitions'. For some time, there has been discussion as to whether the existing merger provisions of section 50 are adequate to deal with 'creeping acquisitions' or whether specific provisions are needed.

Context of the inquiry

1.14 This inquiry is at least the fourth federal parliamentary committee inquiry that has considered the issue of creeping acquisitions. Three previous inquiries all considered that some action was necessary to prevent creeping acquisitions:

- in 1999, the Joint Select Committee on the Retailing Sector made a series of recommendations in response to creeping acquisitions concerns in the grocery sector. The committee observed that mandatory notification of acquisitions to the ACCC 'may expose more clearly whether a major chain is implementing a deliberate strategy of creeping acquisitions';[6]
- in 2004, the Senate Economics Committee recommended as part of its inquiry into the effectiveness of the TPA in protecting small business that provisions should be introduced into the Act to ensure that the ACCC has powers to prevent creeping acquisitions which substantially lessen competition in a market. The committee recommended that the TPA's divestiture powers in section 81 should be expanded to apply to contraventions of section 46, section 46A 'or any new section introduced to regulate creeping acquisitions';[7] and
- in 2008, the Senate Economics Committee considered a private members' bill from Family First Senator Steve Fielding which proposed an amendment to

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5 See T. John and J. Davidson, Trade Practices Legislation Amendment Bill (no 1) 2005, *Bills Digest*, Parliamentary Library, no. 130, 2004–05.

6 Joint Select Committee on the Retailing Sector, 'Fair Market or Market Failure?', August 1999, p. 58.

7 Senate Economics Committee, *The effectiveness of the Trade Practices Act in protecting small business*, March 2008, p. xix. Section 81 currently enables divestiture where a merger contravenes section 50 or 50A.

the TPA so that an acquisition would be deemed to lessen competition substantially if it and other acquisitions over the previous six years would have that effect. In response the committee recommended that the Senate defer consideration of the bill 'until the Government's legislation regarding this topic is presented'.[8]

- Coalition Senators considered that while the bill is 'meritorious', 'strong consideration should be given to exploring superior alternatives in preventing creeping acquisitions…through the enactment of a divestiture power'.[9]

The government's announcement

1.15 In January 2010, the federal government announced that it will amend the TPA 'to deal with creeping acquisitions'. The proposal is to give the ACCC the power to reject acquisitions that would substantially lessen competition in any local, regional or national market. In order words, a proposed acquisition could be rejected whether it substantially lessens competition in a local downstream market (retailing) or in a broader upstream market (wholesaling).

1.16 Currently, section 50(6) of the TPA requires that the relevant 'market' must be a substantial market for goods and services in Australia, a state or territory or a region of Australia. The Trade Practices Amendment Act (No. 1) 2001 amended the TPA to include a substantial market in a region of Australia, thereby extending the existing section which referred only to a substantial market for goods and services in Australia or in a state or territory of Australia. This amendment was recommended by the 1999 Joint Parliamentary Committee (see above).

1.17 The ACCC's Merger Guidelines note that in any particular merger case, it will be a matter of judgement as to whether the market is considered to be substantial. The Guidelines explain that the:

> …substantiality of a market is not necessarily related to geographic size. A market may be small geographically (for example, a local market) but may also be substantial within the region in which it is located. Alternatively, a market for the supply of a product that is an essential but small ingredient in the production of one or more other products sold in large markets may be considered substantial.

1.18 The Minister for Competition, the Hon. Dr Craig Emerson, has noted that some 'private legal opinion' has questioned whether the ACCC has the power to consider effects on competition in local markets. He argued that the government's intent was to clarify that the ACCC—in deciding whether an acquisition would

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8 Senate Economics Committee, *Trade Practices (Creeping Acquisitions) Amendment Bill 2008*, p. 9.

9 Senate Economics Committee, *Trade Practices (Creeping Acquisitions) Amendment Bill 2008*, August 2008, p. 11.

substantially lessen competition—can examine the market on either a national, regional or local market.

1.19 In addition, the Government proposes to ensure that the ACCC can examine the acquisition of greenfield sites and not just existing businesses. There have been some queries as to whether the ACCC has the power to review acquisitions of greenfield sites. In particular, the government's intent is to ensure that the ACCC can review acquisitions by the major supermarket chains of interests in new sites to investigate whether such acquisitions could substantially lessen competition.

1.20 At the time of writing, the Government's proposed legislation on creeping acquisition had not been introduced into the Parliament.

Conduct of the inquiry

1.21 On 30 November 2009 the Senate referred the bill for inquiry and report by 18 March 2010. On 24 February 2010 the Senate granted an extension of time for reporting until 13 May 2010.

1.22 The committee advertised the inquiry in *The Australian* newspaper and on the committee's website. It also wrote to stakeholders, inviting written submissions by 18 December 2009. The committee received 15 submissions, which are listed in Appendix 1.

1.23 The committee held a public hearing in Adelaide on 9 April 2010 where it took evidence from Treasury officials and officers from the Australian Competition and Consumer Commission, among others. Appendix 2 lists those who appeared at this hearing.

1.24 The committee thanks all who participated in this inquiry. It particularly thanks Senator Simon Birmingham for substituting at short notice during the public hearing.

Structure of the report

1.25 This report is divided into the following chapters:

- the example for the bill—the case involving Mr William Fares and how the bill relates to his situation;
- the basis for the bill—that the ACCC approves nearly all merger applications;
- the bill's proposals to:
  - (a) replace the phrase 'substantially lessening competition' with 'materially lessening competition' in sections 50(1) and 50(2) and;
  - (b) address creeping acquisitions by ruling that a corporation which already has a substantial share of a market must not directly or indirectly merge with or acquire shares or an asset which would have the effect of lessening competition in the market; and
- a concluding chapter on the committee's view of the legislation.