Chapter 4

The bill's amendments

4.1 This chapter analyses the arguments for and against the bill's two key provisions.

Replacing 'substantially' with 'materially'

4.2 The bill proposes replacing the word 'substantially' with 'materially' in sections 50(1) and (2). The Explanatory Memorandum (EM) notes that:

> …a "material" lessening of competition test would lower the threshold for determining whether a merger or acquisition is anti-competitive and 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.[1]

4.3 The ACCC's Merger Guidelines (2008) note that:

> The precise threshold between a lessening of competition and a substantial lessening of competition is a matter of judgement and will always depend on the particular facts of the merger under investigation. Generally, the ACCC takes 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. For example, a merger will substantially lessen competition if it results in the merged firm being able to significantly and sustainably increase prices.[2]

Arguments for replacing 'substantially' with 'materially'

4.4 In his submission to this inquiry, Associate Professor Zumbo argued that the bill's proposed amendment of 'a material lessening of competition' would allow the merger or acquisition to be tested by reference to whether it has 'a pronounced or noticeably adverse effect on competition' and consumers.[3] He envisaged that this 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 and services available to consumers.

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1 *Explanatory Memorandum*, p. 1. Emphasis added.

2 ACCC, *Merger Guidelines*, 2008, p. 11.

3 Associate Professor Frank Zumbo, *Submission 14*, p. 5.

4.5 Associate Professor Zumbo noted that the concept of materiality 'is not a foreign concept' and is referred to in the International Competition Network's recommended practices for merger notification procedures.[4]

Arguments against replacing 'substantially' with 'materially'

4.6 Several submitters to this inquiry claimed that changing the wording in subsections 50(1) and 50(2) to a 'material' lessening of competition would create confusion and uncertainty.

4.7 The Law Council of Australia argued that the existing 'substantial lessening of competition' threshold in section 50(1) is a 'well understood test' that is reflected in the competition regimes of comparable jurisdictions.[5] It claimed that the bill's proposed change to this test would 'create uncertainty, undermine existing legal practice and discourage investment in Australian business'. The Council also expressed concern that if the threshold in section 50(1) is amended, there would be uncertainty as to the application of the 'substantial lessening of competition' tests in sections 45 and 47 of the TPA.[6]

4.8 In evidence to the committee, Mr Stephen Ridgeway of the Law Council's Trade Practices Committee, articulated his concerns with the use of the word 'materially' and the benefit of retaining the word 'substantial' in the context of section 50:

> The committee does not see how the substitution of ‘materially’ for ‘substantially’ in the key threshold test in section 50 will have any beneficial effect…The…main concerns about materiality are that we do not have an established case law on what it means. It has only recently been introduced into the act in part 3A with a promotion of material increase in competition and that is yet to be interpreted. Otherwise, we have a test which has been in since 1993, is internationally accepted as the standard and is well understood by business both here and overseas. So there is a concern as to what would be achieved by changing the current test, other than to introduce uncertainty.[7]

4.9 The Law Council's submission noted that the EM does not define 'materially', and nor is it defined in the TPA. There is no case law or use of the term 'materially' in overseas competition law from which to derive its meaning in competition law in Australia. The Council did note a New Zealand High Court decision which equated the words 'material' and 'substantial'. However, the federal government's 2004

4 Associate Professor Frank Zumbo, *Proof Committee Hansard*, 9 April 2010, p. 25.

5 Law Council of Australia, *Submission 2*, p. 1.

6 Law Council of Australia, *Submission 2*, p. 2. See also Mr Stephen Ridgeway, *Proof Committee Hansard*, 9 April 2010, p. 12.

7 Mr Stephen Ridgeway, *Proof Committee Hansard*, 9 April 2010, p. 12.

response to the Productivity Commission Report on the Review of the National Access Regime defined 'materially' as 'less than substantial'.[8]

4.10 Treasury emphasised that it would be unclear as to how the bill's threshold of 'materially' would be interpreted by the courts. It noted that:

> …it is conceivable that a court may interpret 'material' as being a far lower threshold than 'substantial', which may have the effect of prohibiting many mergers which would have been allowed to proceed under the present test, or that it may instead interpret 'material' as being almost indistinguishable from 'substantial', meaning that the amendment may have little practical effect.[9]

4.11 Treasury argued that in the absence of a clear definition of 'material', it is difficult to assess whether the amendment strikes an appropriate balance between the achievement of positive benefits from merger activity while preventing competitive detriment.[10]

4.12 Ms Clarke observed that the meaning of the word 'substantial' in the context of section 50(1) of the TPA has not been judicially determined. It was considered in this context in *Australian Gas Light Company V Australian Competition and Consumer Commission No. 3* [2003] FCA 1525 where Justice French related 'substantially' to 'meaningful or relevant to the competitive process'. Ms Clarke noted the recent comment of Professor Stephen King that 'materially' has been at times defined by the courts as being synonymous with 'substantially'.[11]

4.13 Ms Clarke also critiqued the EM's claim that the word 'materially' would allow mergers to be assessed on whether they have a pronounced or noticeably adverse affect on competition rather than the current test of whether the merged entity would be able to exercise 'substantial market power'. This claim, she noted, appears to have been based on the ACCC's Merger Guidelines. However, these are not binding and appear nowhere in the Act. Moreover, she argued that:

> [T]here 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.[12]

4.14 In Treasury's view, the current legislation provides an 'appropriate framework' for the assessment and consideration of mergers by the ACCC and the courts. It noted that the test of 'substantially lessen competition' is 'consistent with merger laws in

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8 Law Council of Australia, *Submission 2*, p. 6.

9 Treasury, *Submission 15*, p. 7.

10 Treasury, *Submission 15*, p. 7.

11 Ms Julie Clarke, *Submission 6*, p. 3.

12 Ms Julie Clarke, *Submission 6*, p. 3.

many other OECD countries including the US, Canada, UK and New Zealand'.[13] Further, no other comparable jurisdiction has introduced a test based on a 'lessening' of competition without further clarifying the quantum of the 'lessening' to be prohibited. Treasury has noted given the increasing number of cross-border mergers, consistency with overseas laws should be a consideration in opposing the bill's amendments.[14]

4.15 This point was also raised by Ms Clarke. She noted that:

> 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.[15]

A 'creeping acquisitions' test based on market share

4.16 The bill's other provision is to amend section 50 such 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. The intent is to correct the current situation where companies can circumvent section 50 by:

> ...undertaking small scale acquisitions which individually do not appear to substantially lessen competition, but which over time do result in a lessening of competition and the increased dominance of the merged entities.[16]

Arguments for a creeping acquisitions provision

4.17 Associate Professor Frank Zumbo argued in his submission to this inquiry that the issue of creeping acquisitions arises because the current drafting of section 50(1) is 'far too permissive'.[17] Specifically, section 50(1) refers to an 'acquisition', in the singular—unless a given acquisition in itself substantially lessens competition it will not be in breach of section 50. Accordingly, he argued that piecemeal acquisitions can—and do—circumvent the anti-merger laws, giving the examples of the Commonwealth Bank's acquisition of Bank West and Westpac's acquisition of St George.[18]

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13 Treasury, *Submission 15*, p. 1.

14 Treasury, *Submission 15*, p. 4.

15 Julie Clarke, *Submission 6*, p. 2.

16 *Explanatory Memorandum*, p. 1.

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

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

Arguments against the bill's creeping acquisitions provision

4.18 The Law Council of Australia argued in its submission that the bill's proposal for a new test to account for small scale acquisitions is 'problematic and inappropriate'.[19] It cited several reasons:

- first and most fundamentally, it claimed that it is not clear what a 'substantial share of a market' would be;[20]
- second, the use of a 'lessening of competition' test would alone risk prohibiting any acquisition by a firm with substantial market share. Given that any acquisition would have an effect on competition that is 'nominal, insignificant or irrelevant', the Law Council argued that the provision would establish a de facto market share cap for companies in Australia (see below);[21]
- third, market share is not in itself a good indicator of the dynamic nature of competition. The Law Council noted that the limitations of relying on market share and competition analysis are clearly recognised by the ACCC in its current merger guidelines;[22]
- fourth, the concept of substantial market share is 'unsound' in the context of section 50. The Law Council argued that given the established approach to the meaning of 'substantial' in section 50, the bill's provision would extend to any company with a market share which was not 'insignificant' or 'nominal'. Even firms with relatively small market shares would be prohibited from making acquisitions;[23] and
- fifth, the merger threshold test of a 'substantial lessening of competition' has worked well in comparable jurisdictions. Treasury noted in its submission that the 'substantially lessening competition' test is 'serving Australia well for the majority of merger cases and that any consideration of changes should be based on sound evidence of a problem'.[24]

A market share 'cap'

4.19 The Law Council was one of several submitters who were critical that the bill would effectively impose a market share 'cap'. They emphasised the following three problems.

4.20 First, market share cannot be equated with market power. A firm may have a substantial degree of power in a market even though its market share in that market is

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19 Mr Stephen Ridgeway, *Proof Committee Hansard*, 9 April 2010, p. 12.

20 Law Council of Australia, *Submission 2*, p. 2.

21 Mr Stephen Ridgeway, *Proof Committee Hansard*, 9 April 2010, pp. 12–13.

22 Mr Stephen Ridgeway, *Proof Committee Hansard*, 9 April 2010, pp. 12–13.

23 Mr Stephen Ridgeway, *Proof Committee Hansard*, 9 April 2010, pp. 12–13.

24 Treasury, Submission 15,

quite low. Conversely, a firm with high market share can hold little or no market power and acquisitions by those firms can lead to no competitive detriment.[25]

4.21 Treasury recognised that section 50(3) of the TPA identifies market concentration as a factor that the ACCC and other competition agencies consider in assessing the likely competition affects of a proposed merger (see paragraph 1.9). However, it emphasised that market concentration is only one of a number of considerations and that opting to focus solely on market share may obscure the true competition effects of a merger.[26]

4.22 Mr Tim Grimwade of the ACCC explained to the committee the regulator's concerns in using a test of market share to assess merger applications. He noted that:

> There are, for instance, mergers that will lead to a high level of concentration or a substantial market share which will not be substantially anticompetitive or indeed anticompetitive. The issue in merger review is to assess the level of constraint imposed on a merged entity. That is how we detect and elicit the extent to which a merger is going to be anticompetitive. Having a substantial market share test does not enable you to capture that… …Having a substantial market share is not necessarily indicative of their having market power that would warrant what the bill suggests, a lower threshold, a lessening of competition rather than a substantial lessening of competition test. That is really where our concern sits. The substantial market share is not an effective reference to market power.[27]

4.23 The second concern is that the bill's provision on creeping acquisition will create uncertainty given it is a 'significant departure' from the current approach.[28] Setting a percentage market share as a benchmark would be an arbitrary exercise with practical problems.

4.24 Treasury noted that if the threshold was set at 20 per cent, many mergers which do not breach the current section 50 may be prohibited and section 50(1) would be irrelevant. On the other hand, if the threshold was set at 80 per cent, the provision would be unlikely to block many mergers that would not already be blocked under section 50(1).[29]

4.25 Ms Julie Clarke observed that:

> [R]igorous 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.

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25 Treasury, *Submission 15*, p. 8.

26 Treasury, *Submission 15*, p. 8.

27 Mr Tim Grimwade, *Proof Committee Hansard*, 9 April 2010, p. 28.

28 Treasury, *Submission 15*, p. 8.

29 Treasury, *Submission 15*, p. 9.

> 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 market to be substantial.[30]

4.26 The third problem with a market share 'cap' is that it would have adverse consequences for companies and the economy at large. Many modest-sized firms in a local market with a market share in excess of the 'cap' would be prevented from efficiency-enhancing and pro-competitive acquisitions. The 'cap' would also prevent many small business owners from selling their business because they would have fewer potential bidders and could therefore face a reduced sale price.[31]

4.27 The 2003 Dawson Review of the competition provisions of the TPA also cited these anti-competitive consequences as the basis for its opposition to a market share cap. Ms Clarke highlighted this finding in her submission noting that 'the reasoning of the Dawson Committee on this point remains sound'.[32]

4.28 Associate Professor Frank Zumbo has countered criticism that the bill would impose a market share 'cap'. He noted in his submission that 'there is no mention of any so-called "cap" in the Richmond Amendment'. Rather, the bill proposes a prohibition of anti-competitive mergers in the same way that the current section 50(1) prohibits certain mergers: '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'.[33]

30 Ms Julie Clarke, *Submission 6*, pp. 4–5.

31 Treasury, *Submission 15*, p. 9.

32 Ms Julie Clarke, *Submission 6*, p. 4.

33 Associate Professor Frank Zumbo, *Submission 14*, p. 12.