Merger Market Event

The ACCC's role in M & A – a mythbuster!

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INTRODUCTION

Thank you for having me here this afternoon.

I am going to talk today about the Australian merger law, and the Australian Competition and Consumer Commission's (ACCC) role in merger applications. But before I get on to outlining our process and approach, it's useful to get some context and take a snapshot look at the Australian M&A market.

The Thomson report for the first half of 2010 (until 30 June 2010) found that M&A activity in Australia decreased by 33.8 per cent – from US$91.4 billion in 2009 to US$60.5 billion. It found that this was the lowest first-half total since 2006.[1]

By that count it would be fair to say that some of you here may have had a lean past six months. As John M Green wrote in *Business Spectator* earlier this month: 'last year's buzz about green shoots seems to have died down, and the mergers and acquisitions (M&A) vine is still thin and scrappy, we know that it will start sprouting eventually.'[2]

Despite the downturn, the last 12 months has been a period of significant activity merger reviews for the ACCC, including: NAB-AXA, Caltex–Mobil, Link–Newreg, GUD–Breville, and the current review of the proposed BHP-Rio production joint venture.

BENEFITS OF MERGER REGULATION

Merger regulation is a key element of any effective competition law. Section 50 of the *Trade Practices Act 1974* (the Act) is designed to allow the ACCC to take action when a merger threatens to damage the competitive structure of a market. It's aim is to preserve competitive market structure and market participant's incentives to compete rather than rely on ex post regulation of anti-competitive conduct.

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[1] Thomson Reuters, M&A Legal Advisory Review, First Half 2010, Legal Advisers.
[2] John M Breen 'Cut the cut-price capital raisings', Business Spectator (Melbourne) 15 September 2010.

This in turn delivers significant benefits to consumers, including business consumers, and the economy as a whole. Competition drives better prices, more choice, innovation and economic efficiencies.

Ex post regulation of conduct including prohibitions on cartel behaviour, misuse of market power and the enforcement of consumer protection laws are also fundamental to achieving an effective competition regime. It would be naïve to expect that even in workably competitive markets no competition concerns will ever arise. However, by preventing transactions that damage the competitive structure of markets, section 50 reduces the likelihood of such competitive conduct issues arising.

The importance of section 50 as a preventative tool was recognised when, nearly 20 years ago, the provision was strengthened so that it would not only capture mergers that resulted in dominance, but would also capture mergers likely to result in a substantial lessening of competition.

The substantial lessening of competition test is internationally recognised and applied in many other major jurisdictions including the United States.

It is recognised under the section 50 test that not all mergers are harmful – many are benign or in some cases beneficial to competition. It is important to have an active market for corporate control to ensure that inefficient owners and managers are replaced by more efficient ones.

Accordingly, section 50 regulates mergers selectively, and aims to capture only those transactions that raise substantial competition issues.

The ACCC is continually working to make its merger review process as streamlined, efficient, flexible and transparent as possible to minimise the impact of the review process on non-problematic mergers, but at the same time, deal with problematic mergers effectively.

THE ROLE OF THE ACCC IN MERGER REVIEWS

Key threshold issues for firms considering a merger or acquisition are:

- what is the role of the ACCC
- and what can they expect when dealing with the ACCC.

Many of you who have worked in this area for some time are very familiar with the ACCC's merger review process and its analytical approach. However, recent commentary shows that there are still some misconceptions about the ACCC's administration of mergers.

Not surprisingly, the concerns seem to relate to those mergers which have been opposed. Parties whose mergers have been cleared and third parties involved in merger investigations have been universally supportive of ACCC merger review processes.

We are well aware that the more complex merger reviews tend to be handled by a few major law firms who have developed expertise in competition law

and M&A transactions. The ACCC is in continuous engagement with practitioners in these areas, and the community more generally to ensure our merger processes are working efficiently - to achieve the dual objective of

- providing practitioners and their clients with an efficient means of dealing with their merger processes, but at the same time
- allowing the ACCC to effectively deal with the enforcement of the *Trade Practices Act 1974* (the Act).

The ACCC welcomes comments on our processes as it is a good opportunity for self review and, where indicated, we will look to implement changes. That is the benefit of the informal system in that we are not locked into the legislative processes and timeframes required under formal merger clearance regime.

So, today I am going to take the opportunity to explain in some detail the ACCC's approach to mergers, and clarify some areas of our practices that are less well understood, including:

- the merger test and how the merger review process operates
- some recent issues raised about the merger review process, particularly the level of transparency of the ACCC's process, and the time taken to conduct a review
- the ACCC's approach to merger analysis under the 2008 Merger Guidelines including some recent examples of merger matters considered by the ACCC like NAB/AXA, Caltex/Mobil and GUD/Breville.

The test

Section 50 of the Trade Practices Act prohibits acquisitions of shares or assets that result in, or are likely to result in a substantial lessening of competition in a market.

The ACCC's analytical approach to assessing mergers is set out in the 2008 Merger Guidelines[3]. This document sets out in some detail what the ACCC means when it talks about "a substantial lessening of competition" and types of factors it takes into account.

If the ACCC considers that a proposed acquisition is likely to breach section 50, it may institute proceedings in the federal court seeking a range of orders, including injunctions to prevent the transaction proceeding. Where a merger has already completed, the ACCC may take court action to have the relevant assets divested, and seek other remedies it considers appropriate.

The ACCC's merger review system provides merger parties with the opportunity to obtain its views on whether it will oppose a transaction and whether any court enforceable undertakings offered by the parties would address the ACCC's concerns.

[3] Available at: http://www.accc.gov.au/mergerguidelines

Once a review has been completed by the ACCC and our views are made known to the merger parties, if the ACCC has concluded that it has competition concerns, parties have a number of courses of action open to them –

- to accept the views of the ACCC and not proceed with the merger
- to attempt to address the ACCC's concerns by submitting a variation to the proposed transaction, most often by the process of court enforceable undertakings
- to test the ACCC's view by proceeding with the merger and challenging the ACCC to seek an injunction in the Federal Court
- to test the ACCC's view by seeking a declaration from the Federal Court that the merger would not breach S. 50 of the Act – the course pursued by AGL in 2003 in relation to its acquisition of the Loy Yang generating assets.

It is important to note that a review under section 50 does not include any public interest test. In addition, merger reviews necessarily require there to be some acquisition element but in some unique cases the ACCC may conduct a pre-transaction review in relation to other types of arrangements. For example, having conducted a full review of BHP/Rio Tinto merger in 2008, the ACCC is currently conducting a review of the production joint venture proposal focussing on whether market factors have changed since that time. I might note that this review is not a typical section 50 review, but rather an assessment of whether the joint venture would constitute a contract, arrangement or understanding that would fall for consideration under section 45 of the Act. The same "substantial lessening of competition" test applies, even though this isn't a merger as such.

I have been questioned recently on whether the ACCC is blocking more mergers, particularly in the last two years. This line of questioning arises from a very simplistic and piecemeal statistical comparison of the proportion of matters opposed or allowed subject to undertakings over past years.

To draw such overarching conclusions from the data is superficial nonsense.

First, such comparisons are generally unhelpful because statistical comparisons fail to take into account that the number of matters opposed in a particular period ultimately depends on the nature of the transactions that are proposed during that period, and whether they raise competition issues.

Further, the actual number of mergers reviewed in each financial year will vary, depending on a whole range of factors. For example, in 2009/10 the ACCC refined its methodology by further breaking down the number of mergers considered to differentiate between mergers that were pre-assessed as not requiring review and mergers that were subject to review. Another extraneous factor that has influenced the number of mergers reviewed by the ACCC is the change to notification thresholds by the Foreign Investment

Review Board (FIRB), which meant fewer merger notifications by FIRB to the ACCC.

I do not intend to enter into a battle of statistics over this. The ACCC provides quantitative information about the number of matters it considers each financial year and I think this reporting is important for a regulator to ensure accountability.

However, as we are all aware, statistics can be interpreted in different ways to provide different conclusions. You may recall that last year, some commentators were, on the basis of exactly the same figures that are being cited now, saying that the ACCC was letting through too many mergers. Now apparently, the same data is being used to say that the ACCC is blocking too many mergers.

The process

In each of the mergers it examines and the process it adopts, the ACCC works to achieve the dual objective of:

- providing practitioners and their clients with an efficient means of having mergers reviewed, while at the same time
- allowing the ACCC to effectively enforce the Act.

The ACCC is committed to the timely, consistent and transparent assessment of mergers. The flexibility of the process is one of the key strengths of the ACCC's merger review process as it is not mandated by legislation.

The Merger review process guidelines[4]outline the practicalities of how the ACCC conducts a merger review, addressing issues including timelines, transparency and consultation. The various revisions to the guidelines since they were introduced in 2004 reflect our commitment to respond to continuing dialogue with trade practices practitioners and others involved in the process.

Formal review is available under the legislation, but to date this option has not been pursued by any applicants.

Today I will step you through the key elements of the ACCC merger review processes including:

- confidential reviews
- commencement of public reviews including market inquiries
- timelines
- engagement with the merger parties on competition issues throughout the process
- use of section 155 formal information gathering powers
- possible release of a Statement of Issues

[4] Available at: http://www.accc.gov.au/processguidelines.

- ACCC decision and release of summary of reasons/public competition assessment
- possible remedies – undertakings.

In describing these processes to you today, where possible I will attempt to provide some context by reference to some of the major reviews we have conducted. In particular, I will refer to the processes involved in the NAB/AXA review—as you would appreciate I cannot comment on the actual decision, but I can comment on the processes that took place up until the time I recused myself from the decision making on that matter.

Confidential reviews

In 2009/10, the ACCC undertook 46 confidential reviews and identified competition concerns in relation to 6 of those matters. Separately, the ACCC pre-assessed another 153 mergers confidentially as not requiring review, as it was clear on its face that no competition concerns would arise that warrant investigation.

One of the benefits of the merger review processes is that merger parties can seek the ACCC's views on a confidential basis prior to the public announcement of a proposed acquisition.

When the ACCC considers a merger on a confidential basis, it will keep the fact of the proposal and the ACCC's consideration of it confidential.

Any feedback given to the parties at the confidential stage is of a preliminary nature, and often will be subject to the ACCC making public inquiries about the merger when confidentiality is lifted.

If a matter proceeds and is made public, relevant third parties will have the opportunity to provide views to the ACCC through the public review process. If a matter does not proceed, then there is no utility in it being raised in a public arena.

The ACCC encourages confidential reviews because it:

- enables parties to obtain some indication of the ACCC's views prior to disclosing a proposal to the market. Matters that raise serious concerns are often withdrawn at this stage.
- enables the ACCC to gather valuable information prior to the commencement of a public review to expedite its investigation.

Merger parties can generally expect to receive one of three responses from the ACCC in relation to a confidential merger.

- the ACCC may advise that it considers that the proposed merger raises competition concerns and is likely to result in a substantial lessening of competition in a market. In many cases the parties will abandon a proposal at this point, and accordingly, the proposal and the ACCC's consideration of it will never be publicly known.

- the ACCC may advise that it cannot form a view without obtaining information from third parties. If the parties do pursue the proposal, the ACCC will conduct a public review when it is no longer confidential. Nevertheless, the scope of issues to be examined in a public review may be significantly narrowed through the confidential review process.
- the ACCC may advise that it considers that the proposed merger appears unlikely to raise competition issues, but reserves the right to conduct a public review when it is no longer confidential.

Public reviews

This of course is the area of our work that excites the most interest and accounted for 122 merger reviews undertaken over the last financial year.

When the ACCC publicly reviews a merger, the fact of the review and key information regarding that review are transparent and accessible via our website. The ACCC retains an up to date list of each active public review, including details of the transaction, the ACCC's indicative timetable, and key milestones in the investigation. It is clear that there is a great deal of the interest in our mergers register given the exponential increases we are seeing each month in the number of hits on these web pages.

The ACCC focuses on the evidence before it—an important part of the evidence gathering exercise involves inviting third party submissions and engaging closely with key stakeholders which often include customers, competitors, relevant industry bodies, and other interested parties. A point I will cover later in more detail is that the merger parties are made aware of any competition concerns that arise from market inquiries.

Where, following an initial investigation of typically 4-6 weeks, the ACCC has identified competition concerns or issues that may raise concerns, it may issue a Statement of Issues to signal to all interested parties any preliminary concerns identified by the ACCC. If a matter proceeds to a Statement of Issues, the ACCC will investigate further, engaging in dialogue with the merger parties and other market participants. Following this, it will reach a decision which is subsequently published in the form of a Public Competition Assessment, or on the ACCC's merger register.

It should come as no surprise to anyone here that the ACCC does not take into consideration, and is not influenced by media speculation about what issues the ACCC should or should not take into account, or how its process should be run.

I made some public comments in this context, in relation to what I described as the "unprecedented, unproductive and unacceptable" behaviour by certain parties (not necessarily the merger parties) in the NAB/AXA acquisition.

Some commented that this was an extraordinary outburst by the ACCC Chairman. One commentator called it a "tantrum"! No it was not. My comments were carefully considered and were in particular a response to the

request by AXA that its shares be suspended from trading as it perceived that the market was at best in an uninformed state.

I have spent many years in M & A activity, as a lawyer then investment banker, and am well aware of how the media can be used to try and influence shareholders and sometimes even directors in a hard fought takeover battle.

But in all my seven years at the ACCC I have never witnessed such innuendo and rumourtrage as we saw in the NAB/AXA transaction – and so much of it directed at the ACCC's processes. It is important that I make this very clear: it has had no impact on our processes, nor I am assured by my colleagues, on our decison.

The ACCC took the step of commenting publicly on the NAB/AXA deal not because the market was being uninformed but because it was being misinformed.

The integrity of our processes was being impugned and I was not going to sit by while this was played out by vested interests behaving badly.

The purpose of my public comments was quite deliberate – to send a message to market participants. If any of you are thinking of encouraging parties you act for to go down the path of attempting to manipulate the ACCC by using the media then you will be doing your clients absolutely no favours.

Timelines

Agencies are generally cautious about measuring their performance by the average time (and indeed the number) of their merger reviews. This is because mergers can differ in their complexity, the availability of relevant information, (the ACCC often doesn't receive all information upfront like other jurisdictions) and the level of cooperation provided by merger (and other interested) parties. Having said that, there are clearly links between average timing of reviews and efficiency of operations. As one dissects the types of matters reviewed and time taken, you get a better picture of the performance of the agency in dealing with complex merger reviews.

The ACCC's timelines for merger review are best practice, and are considerably shorter than many other jurisdictions. In 2009/10, 89% of reviews were undertaken in 8 weeks or less.

Time taken to review merger proposals 1 July 2009 to 30 June 2010

Time taken to undertake merger reviews (cumulative)	Number of reviews	Percentage of mergers
Two weeks or less	12	10%
Four weeks or less	57	55%
Six weeks or less	32	80%
Eight weeks or less	11	89%
More than eight weeks	14	11%

These figures do not include 153 matters that were pre-assessed (most within 2 weeks) as not requiring review, 16 matters where no decisions were made as the ACCC could not form a view or the proposal was withdrawn, three reviews of variations to existing undertakings, or 23 reviews of completed mergers. In comparison:

- in the EU, phase one mergers are completed generally within 5 weeks, but reviews that extend to phase two investigations generally extend the review period by a further 4 or more months.
- in the US, merger parties must wait for an initial 30 day period, and typically a merger review will take 3 to 4 months, and can be longer in more complex matters.
- in the UK, where a formal merger notice is filed, the OFT has 4 weeks (extendable by 2 weeks) to decide whether to refer a matter to the Competition Commission. Where OFT refers a matter of concern to the Competition Commission, the Competition Commission must publish its report within 24 weeks (this period may be extended by a further 8 weeks).

The ACCC's quick (2-4 week) confidential clearance process is widely regarded as a valuable service to the business community, and can truncate subsequent public reviews.

The ACCC seeks to complete its reviews within a very tight timeframe. However, if the parties decide to take more time then timelines may be extended. A critical issue to remember is that when parties cooperate with the ACCC and seek a review, they to an extent own the process. If they want the ACCC to delay the decision, for example to provide new information, the process allows for that.

Where there are delays in a matter, this is in fact in the hands of the merger parties. For example, the ACCC may suspend its timeline for the merger parties to provide further information or, in some cases, to provide draft undertakings to the ACCC. In those cases, it is for the merger parties to decide how quickly they will respond.

Two recent matters highlight these issues - the NAB/AXA and BHP/RIO matters. It may be useful if I were to outline the relevant facts.

In NAB/AXA, the review was undertaken and a decision reached within the ACCC's usual timelines. The public review was commenced on 19 January, following receipt of NAB's submission. A Statement of Issues was released three weeks later on 10 February. Following further inquiries after the release of the Statement of Issues, a final decision was made on 19 April. This matter, despite its complexity, was dealt with within the ACCC's usual tight timeframes.

Subsequent to the decision, NAB approached the ACCC and indicated that it wished to consider the possibility of offering undertakings to alleviate the ACCC's concerns. The undertaking process that followed our April decision to oppose the NAB acquisition, was in the hands of NAB and AXA. Without going into details, the fact is we didn't have an undertaking capable of being

consulted upon until 9 August and, after receiving that undertaking, a decision on the undertakings was made in less than 5 weeks, including a two to three week public consultation period.

The current ACCC review of the BHP/Rio Tinto proposed joint venture arrangements is a good example of a review where taking the start date for the review and the current or end date does not give the actual picture of the process. As the timeline on our website indicates, this review timeline has been suspended on numerous occasions in order to allow the parties to respond to information requests or provide additional information. In fact, since 7 July the timeline has been suspended at the request of the parties and as you may have noted from our recent press release, the parties have requested that we further delay making any decision until after they have had further discussions with overseas regulators and provided additional information to the ACCC.

Statement of Issues

In 2009-10 financial year the ACCC issued 11 Statements of Issues. To give you an idea of how our approach on Statements of Issues has changed over the years, the first Statement of Issues was released in January 2005, and was two and a half pages long. In February 2010, the Statement of Issues released on the NAB/AXA proposal was 24 pages long—while it is noted that the Statement of Issues also covered the AMP/AXA proposal, the paper provided a substantially higher level of detail and analysis of the matter.

The Statement of Issues has a spectrum of uses. It can provide the merger parties and other interested parties with the preliminary ACCC's views and it can also provide guidance on what further information would assist the ACCC in finalising its views. It is an opportunity for merger parties and industry participants to respond to the issues identified by the ACCC to date, and identify any further areas that should be explored. In some cases, it is also an opportunity for merger parties to consider whether to put forward undertakings to address competition concerns that have been raised.

However, as I have said on many occasions, a Statement of Issues is not necessarily a good anticipator of the ACCC's final decision, and is never intended to be a draft decision. It is designed to provide preliminary guidance on the ACCC's concerns, focus market attention, and provoke comment and information flow on areas of interest.

The Merger Review Process Guidelines state that -

> *A statement of issues published by the ACCC is not a final decision on a proposed acquisition, ……[it] may perform a spectrum of functions such as indicating the ACCC's unresolved concerns, the type of further information it would like and in some cases may go so far as to provide the ACCC's preliminary view as to whether a merger is likely to substantially lessen competition.*[5]

[5] Merger review process guidelines, 2008, para 4.67.

Information received after the Statement of Issues is released may well raise new issues or perspectives – that is their fundamental purpose – and these may have an effect on the final decision.

So the Statement of issues should not be regarded as indicative of that final decision.

Following market enquiries undertaken prior to and following the release of a Statement of Issues, ACCC staff will update the merger parties, both in a written and oral form, on the issues of concern, and identify any further issues arising post - Statement of Issues that may raise concerns and still require further consideration.

At the completion of an investigation the ACCC advises the merger parties of its decision and then publicly announces it on the ACCC website—in some cases a press release is also issued.

Public Competition Assessments

In 2010 to date, the ACCC has issued eight Public Competition Assessments (PCAs), outlining its views on proposed mergers in a diverse range of industries – from petrol retailing to food manufacturing to retail electrical appliances.

Where the outcome of a review is a decision by the Commission to oppose, or accept enforceable undertakings, or where we think there are important issues that should be made public, or in instances where the parties request it, the ACCC will issue a Public Competition Assessment..

A PCA will outline the principal reasons for the ACCC's decision—but as the preamble to the PCA clearly states, it is not the definitive and all embracing statement of the ACCC's reasons. Other matters may potentially be raised if the matter goes to court.

There are good reasons for this approach.

First, it is simply not practical or particularly helpful to include each and every matter within a PCA.

Second, certain aspects of market inquiries and the ACCC's analysis may need to be held back due to confidentiality requirements.

Third, in cases where a matter is opposed by the ACCC and the parties seek to proceed, further evidence and issues may well come to light during the course of court proceedings.

While PCAs may be interesting for close watchers of ACCC merger activity, the merger parties are always fully aware of the issues well before the PCA is published.

In matters where a PCA is not issued, a summary of the ACCC's decision is retained on the Mergers Register which can be accessed via the ACCC's website.

In the case of NAB/AXA, we did not publish a Public Competition Assessment directly following our decision to oppose the proposal in April. This was

because, after the decision to oppose, NAB approached the ACCC indicating its intention to examine the possibility of proposing an undertaking to address the competition concerns. It was considered that there were benefits in delaying the release of the Public Competition Assessment until the outcome of the deliberations on possible undertakings were known, as a possible outcome of proffered undertakings could have been the withdrawal of the ACCC's decision to oppose the transaction.

Transparency

One of the key values of the ACCC is that the process be transparent, but at the same time provide sufficient protection of confidential information.

While the ACCC will never satisfy merger parties in matters that the ACCC opposes, no matter how transparent the engagement, it does recognise the need for merger parties to be informed of the key issues on which it is making its decision.

We endeavour to ensure that parties are kept well informed of all key issues during the course of an investigation, and provided with reasons for the ACCC's decision at the time of an announcement, both through private briefings if requested, and through the publication of reasons on the ACCC's website or in matters of public interest, a comprehensive Public Competition Assessment. Because of the level of ongoing engagement and transparency, there should be no surprises as to the reasons for the ACCC's decisions.

The ACCC has recently refined its processes whereby staff will provide merger parties with more detail, in writing, of how the investigation is progressing, particularly at the pre and post-Statement of Issues stages.

Accordingly, the merger parties are kept very well informed during the market inquiry process, and ACCC staff engage in an open and candid manner which encourages meaningful and timely engagement on key issues.

Feedback from practitioners to date indicates that this refinement to the process is working well. However, this must not be confused with, or raise expectations that merger parties will be provided advance notice of the ACCC's final decision.

There is a distinction between the decision making body and investigative staff. There are good reasons for this – there is usually an ongoing investigation, and staff are cognisant that they are not the final arbiters – there is a formal decision making process through the Mergers Review Committee and the Commission that must be observed. It is the Commission and not the staff who ultimately decide which factors are most critical to the analysis, and whether or not a merger will be likely to substantially lessen competition. And it would be a mistake to assume that because staff investigating a merger are demonstrating a predilection to one view or another, that this is necessarily the view that will prevail at the Commission.

I am well aware that many business people and indeed their advisers, believe it would be to their advantage to meet with commissioners, and in particular the chair of the Merger Review Committee or the Chairman of the

Commission. Generally as a matter of courtesy I will accede to requests to meet with the CEO or Chairman of a corporation seeking our views on a merger, but the truth is these sorts of meetings don't take us far – they are relatively brief and superficial, and in all honesty, don't assist with the final deliberations. Further, individual Commissioners will not be able to express a view as to what the final decision of the Commission will be prior to making it.

As much as some company executives and their advisers would like to meet with Commissioners, so we too at the ACCC will often believe it necessary to have direct access to key executives who can provide us with valuable information on the commercial dynamics of a proposed merger. It is important for advisers to give us access to the main players, for we are conscious that on occasion, communication lines can break down through the intermediation of advisers and lawyers.

In this context, I would make the observation that advisers from time to time may be over-promising ACCC clearance before an investigation is complete, and this can shape, falsely, the expectations of merger parties.

Section 155 – formal information gathering powers

In the vast majority of reviews, voluntary information requests provide the relevant information for the ACCC to assess a merger.

The ACCC's information requests are tailored to the nature of the issues under examination, and the level of detail required varies depending on the matter at hand.

It is one of the key advantages of the ACCC's merger review process that it allows a very flexible approach to seeking information. Unlike the statutory clearance process, the ACCC's information requests are generally very light at the outset, and will only ramp up where there are clearly contentious issues to be examined.

Detailed information may be required in some matters – for example, lists of employees may be very relevant when considering an undertaking that purports to transfer those employees to a divestiture business – but is not relevant or sought in other matters.

In some cases 155s notices are determined to be necessary to obtain the necessary information and within a specified timeframe – for example

- when we are concerned that we are not receiving full and accurate disclosure of all relevant information in a timely way from merger parties or third parties
- when issues can't be verified from other sources for example regarding the likely counterfactual
- when requested to do by parties – the so called "friendly 155" process - when for example parties feel constrained to respond to voluntary information requests due to confidentiality restrictions

The number of matters in which section 155 notices are issued is very low against the number of reviews undertaken by the ACCC. Only 8 of the 321 matters that were either reviewed or pre-assessed as not requiring review in 2009–10 involved the use of section 155s. In almost all those cases, the merger was opposed or undertakings accepted.

But we are mindful of the fact that these notices impose a level of responsibility on the ACCC regarding their use given they impose a burden on recipients – usually the merger parties but also sometimes third parties.

I am also conscious of the fact that when I sign off a section 155, that is expressed in very formal terms -

- WHEREAS, I, Graeme Julian Samuel, Chairman of the Australian Competition and Consumer Commission (ACCC), have reason to believe that Company X is capable of furnishing information and producing documents relating to matters that constitute or may constitute contraventions of section 50 of the Trade Practices Act 1974 (the Act), namely: THE MATTERS THAT CONSTITUTE OR MAY CONSTITUTE CONTRAVENTIONS OF SECTION 50 OF THE ACT

a business person thinks “What is going on!”

We endeavour to scope the notices as narrowly as we can to balance the need to obtain the relevant information for our assessment under section 50 of the TPA.

- However, this is a balancing exercise since the narrower the scope of the notice, the greater the risk that the ACCC will not obtain information highly relevant to the assessment.
- Minimal requests for variation of substance of notices seems to support that this balance is being achieved
- Further, it is not in ACCC’s interest to have large amount of unhelpful information in merger reviews that necessarily involve tight timeframes. ACCC is therefore careful about focusing section 155 requests.

Formal information requests are an invaluable tool in obtaining truthful information. In a recent matter, the information provided pursuant to a section155 on a key issue (regarding future price rises post-merger) completely contradicted the information voluntarily provided by the merger parties. In other recent matters, a small amount of information had been returned voluntarily, whereas section 155s asking the same questions generated substantially more comprehensive and accurate information (which should have been provided initially).

Access to third party information

Although the ACCC has implemented a greater level of transparency in the deliberation and decision making process, there must necessarily be some limits regarding the extent of this transparency.

It is understandable that merger parties would like access to third party submissions so that they can see the issues directly and respond to them.

The ACCC is aware of the importance of providing merger parties with the opportunity to respond to third party submissions – and allows this to happen while maintaining confidentiality.

However, the merger review process is heavily reliant on third party assistance and therefore care needs to be taken to preserve this – in particular through our treatment of the information they provide. In the majority of cases, third parties freely provide us with information on the basis that this information (and often the fact that they are assisting us) will not be disclosed to the merger parties and therefore would not affect their ongoing relationship with either merger party – whether or not the merger proceeds.

In every case where it has identified marketplace concerns, the ACCC has raised those concerns usually both in writing and orally with the merger parties, to allow the parties an opportunity to address them.

We are sometimes referred to the practices in overseas jurisdiction as support for making third party submissions publicly available. These comparisons are superficial. For example, the EC has a practice of allowing merger parties access to the investigation file, although it should be noted that this only occurs after a Statement of Objections has been issued and a second phase investigation has been instituted. Most importantly, the file is redacted of all confidential information, and in any event is more comparable to our discovery process given the EC is an administrative rather than prosecutorial regime, and makes final decisions unlike the ACCC.

Process for examining section 87B undertakings

In some cases, merger parties may offer court enforceable undertakings pursuant to section 87B of the Act which are aimed to address the ACCC's concerns and thus allow the merger to be cleared. The nature and level of complexity of undertakings will vary, depending on the circumstances and this will also impact on both the time that it will take for parties to engage with the ACCC on undertakings and the time it will take for the ACCC to assess any undertakings put to it.

In the majority of cases, undertakings will be put to us during the review and will be taken into account in our final decision. In a smaller number of cases, such as Baiada Poultry/Bartter Enterprises and NAB/AXA, the parties will proffer undertakings some time after the ACCC has opposed the transaction.

Regardless of the stage at which undertakings are proffered to us, the ACCC will in most cases publicly consult on proposed undertakings before deciding whether to reject or accept them unless it considers that the undertakings are

so deficient that there is no utility in commencing a consultation process with third parties at that point.

The discussion and negotiation of undertakings is necessarily iterative. It is not uncommon for parties to initially put forward high level principles regarding a possible undertaking and seek comment from ACCC staff on subsequent revisions in order to put forward their best possible remedy. Without this assistance through the process, it would be unlikely that any or many undertakings would be accepted.

This necessarily exposes a tension between the ACCC's desire to accommodate consideration of undertaking proposals and the fact that the ACCC must be satisfied that undertakings are sufficient to address the competition concerns. By erring towards assisting merger parties to develop undertakings for consideration, there is a risk that merger parties can come to have a false expectation regarding the likelihood of their undertakings to be ultimately accepted by the ACCC, notwithstanding the repeated written cautions given by the ACCC throughout the process. But it is a difficult call for us to make – on the one hand being absolutely fair to parties and giving them every chance to address our competition concerns, or on the other hand, simply advising merger parties that they would be better to accept that the merger is not going to receive an ACCC clearance.

In the case of NAB/AXA, the undertakings were very complex and it was necessary for them to be developed to a sufficiently high level to enable the ACCC to assess the risks associated with the undertakings and their ability to address the competition concerns. It is unlikely that the ACCC would have been able to consult on the undertakings or come to a decision on the basis of less developed undertakings.

The ACCC does not make any public comment as to whether parties have signalled that they may wish to offer a section 87B undertaking, or that it has discussed a potential section 87B undertaking with the merger parties unless or until an undertaking is offered in a form that the ACCC considers it would consult on.

Frankly, until such time, public dissemination of information about a possible undertaking that may never eventuate does not assist the ACCC in its deliberations and is only likely to arouse misinformed speculation.

Equally, given that it is a matter for the parties to determine whether to offer a section 87B undertaking, and when they may do so, the ACCC does not comment on the timing or anticipated timing for when it may receive a section 87B undertaking.

MERGER ANALYSIS

The publication of the ACCC's revised analytical Merger Guidelines in 2008 have brought to the fore the qualitative assessment of competitive dynamics that is undertaken by the ACCC when it reviews a merger.

The 2008 Merger Guidelines highlight the fact that the ACCC does not simply examine the market shares of the merger parties pre and post transaction in order to reach its decision about a merger.

In each case, the ACCC carefully examines a broad range of factors to identify the dynamics of competitive rivalry in the market in question, and how it may be affected if a merger proceeds. Factors such as the height of barriers to entry and import competition are often critically important to the ACCC's assessment of a merger. For example, if barriers to entry are low, a merger between existing market participants may not substantially alter the competitive structure of the market due to the potential for new players to enter to replace any potential loss of competitive tension.

The 2008 Merger Guidelines emphasize that the test is forward looking. It is not based on a comparison of competition pre and post merger. Rather, the ACCC must compare the likely state of competition <u>with</u> the merger to the likely state of competition <u>without</u> the merger.

Accordingly, predicting likely states of competition can never be exact or perfect. The statutory test requires consideration of whether a merger is likely to result in a substantially less competitive outcome, meaning a real chance, not whether an outcome is more probable than not.

The way in which the ACCC examines the likely impact of a merger is guided by well accepted and recognised economic principles.

Broadly, there are two key theories of competitive harm examined – unilateral effects and coordinated effects.

Unilateral effects

Unilateral effects occur when a firm has the ability and incentive to raise its prices or otherwise reduce its competitive behaviour (for example by reducing service, quality or pulling back on innovation) independently of the reaction of other firms. Mergers raise unilateral effects concerns if the merger makes it profitable for the merged firm to increase its prices or otherwise exercise market power, regardless of the response of other firms in the market.

The ACCC's decision in relation to GUD's proposed acquisition of Breville illustrates the issues arising from unilateral effects.

In that case, it was found that GUD and Breville are the two closest competitors for a range of small electrical appliances.

The ACCC's inquiries showed that these firms' products were the number 1 and number 2 choice for a large number of customers and imposed the strongest competitive constraint on each other.

The two firms drove each other to price competitively, match each other's products at certain price points, and invest in new product design and innovation.

If the merger had proceeded, the ACCC believed that this competition would be lost and that GUD would have increased its unilateral market power, enabling it to increase prices for certain products, reduce choice of products at particular price points, and reduce the quality of products as the merged firm would have less incentive to design innovative new products.

The ACCC took the view that it was unlikely that other existing suppliers would have the ability and incentive to replace this loss of competition, and barriers to entry and expansion by competitors were significant.

Coordinated effects

Coordinated effects issues differ from unilateral effects because they revolve around concerns about the post-merger behaviour of a group of firms rather than a single firm.

Some commentators have described coordinated effects as my "new toy". Actually, that's not the case at all. The ACCC has always examined mergers on the basis of coordinated, as well as unilateral effects.

In fact, the main reason why section 50 was amended from a dominance test to a substantial lessening of competition test in 1992 was to ensure that the ACCC could tackle coordinated effects.

There has been increased focus on coordinated effects arguments in some of the ACCC's decisions, as it has been a key issue in a number of prominent recent matters. Further, as the ACCC has increased the transparency of its processes, and is now issuing more detailed PCAs, I think there has been a corresponding increase in commentator's awareness of the ACCC's analytical approach and coordinated effects arguments.

Coordinated effects occur when some or all firms in the market have an incentive not to compete vigorously because they recognise their mutual interdependence and decide not to compete as aggressively as they otherwise would.

For example, it may be profitable for a firm to increase its prices (i.e not to act competitively) because it anticipates that other firms will respond by increasing their own prices by the same or similar amounts.

Predicting when coordinated effects will occur is not an exact science. However, there are a range of factors that assist in determining when coordination is more or less likely.

Those factors include, but are not limited to market concentration, barriers to entry, similarity of products in the market, the presence of a maverick competitor, transparency of pricing or other aspects of competition, and the potential for innovation to destabilise coordinated conduct.

In the context of a merger review, the ACCC assesses how the merger is likely to change any of the factors that make coordination more or less likely, and accordingly, whether there is likely to be a substantial lessening of competition.

That is, merger analysis is aimed at preventing conditions which encourage unlawful cartels and otherwise lawful tacit coordination becoming worse, as compared to the conditions if the merger did not proceed.

Maverick firms are particularly important in assessing coordinated effects issues in mergers.

A maverick firm is generally one that is seen to be aggressively competing in a market. It may be taking the lead in discounting or price cutting, or competing aggressively in other ways including service or innovation. Accordingly, a maverick may potentially disrupt coordination in a market.

Mergers involving the acquisition of a maverick firm can lead to the removal of this competitive force from the market and remove an element that was constraining the incentives of a number of firms to engage in coordinated conduct.

The Link/Newreg proposed acquisition, which the ACCC opposed, illustrates the importance of mavericks in assessing mergers. In that matter, the ACCC found that the acquisition of Newreg, which at the time had only a small market share, would have resulted in the removal of an important competitive discipline on Link, and the only other major competitor, Computershare.

Without Newreg competing, the ACCC considered there was likely to be increased ability and incentive for Computershare and Link to engage in co-ordinated conduct in the form of customer allocation and market sharing.

Newreg was found to play a destabilising maverick role in the market and provide an important third option for a broad range of customers. It was found that Newreg was likely to disrupt the prospect of co-ordinated conduct occurring.

Caltex's proposed acquisition of 302 service station sites from Mobil was another matter where coordinated effects concerns resulted in the ACCC opposing the transaction.

In that matter, the ACCC took the view that conditions currently existed for coordinated behaviour. In particular:

- it noted that retail petrol pricing in certain metropolitan areas followed a cyclical pattern.
- during the restoration phase of the cycle (when prices would rise following a period of discounting), one firm would increase prices, and others would follow very soon thereafter.
- the ability of firms to access detailed and timely information about the pricing of their competitors enabled a firm to signal a price increase and to monitor the responses of its competitors.

If others did not also increase their prices, the price leader could roll back price increases, thus reducing the risk associated with leading prices upwards, and limiting any temporary competitive advantage for other retailers in keeping their prices down.

The ACCC found that repeated interaction of major retailers over time had led them to recognise that it was in their mutual interests to raise prices in this manner.

The ACCC was concerned that the merger would significantly increase the retail presence of Caltex, one of the leaders of price restorations in the weekly cycle, as compared to the likely alternative outcome that if the merger did not

proceed a large number of the sites would be sold to retailers who do not lead in price restorations.

The ACCC considered that an acquisition of sites by such other retailers would lead to more uncertainty among retailers in their pricing decisions in the restoration phase of the price cycle in contrast with an acquisition by Caltex.

The ACCC found that even a few additional failed restorations in a year may have a significant impact on the average retail price for petrol over the year.

CONCLUSION

Section 50 of the *Trade Practices Act 1974* is designed to allow the ACCC to take action when a merger threatens to damage the competitive structure of a market.

This in turn delivers significant benefits to consumers, including business consumers, and the economy as a whole. Competition drives better prices, more choice, innovation and economic efficiencies.

Nevertheless, it is recognised that not all mergers are harmful. Accordingly, the ACCC's merger review process aims to be as streamlined, flexible, and transparent as possible to minimise the impact of the review process. At the same time, the process ensures that mergers that damage competitive market structures are dealt with effectively for the benefit of consumers and economic efficiency.

We understand that our merger decisions can have major short and long term implications for many stakeholders – shareholders, creditors, suppliers, customers, competitors and the community at large. In some cases they can have far reaching national economic implications. We therefore seek to ensure that our investigations are undertaken rigorously, with as much transparency as the circumstances will allow, and exhibiting the maximum fairness to merger parties and other interested stakeholders.

The ACCC will be always sensitive to the implications of our processes and determinations on those affected by them, and adapt our approach to strike the appropriate balance between meeting the imperatives of businesses with whom we are dealing, consumers whose welfare is our fundamental mandate and the rigorous enforcement of the law pursuant to the duty entrusted to us by Australian Parliaments.