Submission on Commonwealth Government Discussion Paper
Creeping Acquisitions – The Way Forward

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Summary

In theory, there is no logical reason why a series of small, temporally connected,[1] horizontal acquisitions ('creeping acquisitions') by a single entity which, combined, substantially lessen competition, should escape prohibition when a single merger having the same competitive impact does not. Where there is evidence that creeping acquisitions are having an impact on the economy it is, therefore, prudent to consider mechanisms by which they might be captured by competition laws.

There are, however, two key problems with the Government's proposal to move 'forward' with their creeping acquisition proposal. First, there is limited evidence that creeping acquisitions are having a deleterious effect on our economy. Second, the proposed mechanism for dealing with creeping acquisitions is seriously flawed; it appears to proceed from the assumption that if a corporation has market power it has necessarily acquired this from prior acquisitions (as opposed to organic growth) and that therefore *any* future acquisitions should be prevented, regardless of the severity of the competitive impact in the particular case. This is inconsistent with existing merger laws, with sound economic theory and with international best practice.

The Government's original discussion paper put forward two options for regulating 'creeping acquisitions'. The 'aggregation model', directly targeted at preventing a series of acquisitions having a net anti-competitive effect, and the substantial market power model (SMPM), which does not incorporate any requirement that there be a series of acquisitions involved prior to the acquisition in question.

The more recent discussion paper, 'The Way Forward' (let us hope not), abandons any consideration of an 'aggregation mode' for creeping acquisition laws in Australia, dismissing it as 'impractical', and instead focuses on the heavily flawed SMPM model.

If, as the report claims, the aggregation model, which is the only model genuinely and directly targeted to acquisition creep, is incapable of practical implementation, then any attempt to legislate for creeping acquisitions should be abandoned altogether. The SMPM model – or the related declaration/market cap model also proposed in the new discussion paper – is not only unrelated to acquisition creep, but is inconsistent with international best practice and sound economic policy.

[1] A series of acquisitions will normally only lead to a substantial lessening of competition when they occur within a reasonably short time frame, so as not to allow for natural market correction.

The need for creeping acquisition law

Before embarking on potentially onerous new laws, as both models now proposed by the government would appear to be, an assessment should be made of the necessity for legislation. Is there a gap in the law that is reducing the competitiveness of Australian markets? The answer is not clear. The industry most frequently cited by media and politicians as suffering from an absence of creeping acquisition laws, is the retail grocery industry. The majority of submissions to the Dawson Inquiry on creeping acquisitions[2] and the Senate Economics Reference Committee into the effectiveness of the *Trade Practices Act 1974* in protecting small business (2004) made reference to this industry as a prime example of creeping acquisitions which may ultimately result in a significant lessening of competition.[3]

However, recent investigation by the ACCC found little evidence of anti-competitive creeping acquisitions[4] in the grocery market,[5] concluding that growth of the major chains was largely organic rather than a result of acquisitions.

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2 The following submissions called for the introduction of creeping acquisition laws: Independent Paper Group, p 2; Small Business Development Corporation, p 5 ('… current merger provisions are inadequate to prevent growth by "creeping acquisitions" …'); Association of Consulting Engineers Australia, p 10 ('[a] new specific prohibition against anti-competitive creeping acquisitions is called for … While a large acquisition by a dominant corporation can, be subject to close scrutiny by the ACCC, a series of minor acquisitions that together would substantially lessen competition are less likely to be subject to the same scrutiny. Where in fact scrutinised the ACCC faces considerable limitations on its ability to assess the cumulative effect of the creeping acquisitions on the level of competition. … '); Fair Trading Coalition, p 37; NARGA, p 9 (recommends 'a new prohibition against anti-competitive creeping acquisitions be introduced … [p 29] … although individually these minor or one-off acquisitions may not substantially lessen competition, they may collectively substantially lessen competition to the detriment of consumers. …'); National Association of Retail Grocers of Australia, *Supplementary Submission 2 to the Review of the Competition Provisions of the Trade Practices Act 1974*, Public Submission 206, Trade Practices Act Review 2002, p 7 (recommends insertion of a new s 50(7) into s 50 'providing that where s 50(1) and s50(2) do not prevent the acquisition, yet the cumulative effect of the proposed acquisition and previous acquisitions in any relevant market is to SLC in any relevant market, the proposed acquisition is not to proceed unless authorized or subject to an enforceable undertaking … [p 24] … Creeping acquisitions are an obvious way to avoid scrutiny under the existing s50)'; Victorian Government, p 3 ('current merger law does not cover the gradual acquisition of small participants in an industry by a larger participant').

3 The Senate Committee also made reference to retail liquor sector in this respect.

4 The Grocery Inquiry described creeping acquisitions as follows (at 526): 'The term 'creeping acquisition' generally refers to the practice of making a series of acquisitions over time that individually do not raise competitive concerns, usually because the changes in competitive rivalry from any individual acquisition are too small to be considered a substantial lessening of competition. However, when taken together, the acquisitions may have a significant competitive impact. The term creeping acquisition might also refer to a player with existing market power making a small acquisition, even though the small acquisition does not substantially lessen competition in itself'.

5 *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries*, July 2008 ('Grocery Inquiry'). The Inquiry concluded that major supermarket chain growth has been largely a product of 'organic growth rather than growth through acquisitions' and that 'creeping acquisitions are not currently an issue in the grocery industry' (at 525).

Although the ACCC has expressed the view that, despite their findings in relation to the retail grocery industry, creeping acquisitions are a 'broad issue that can affect many industries'[6] there is limited concrete evidence of this.[7]

Consequently, while it is clear that there is potential for a series of small mergers to substantially lessen competition in a market (and in Australia's relatively small economy the market may not be in a position to readily correct for the resulting anti-competitive structural change), and that the existing prohibition is not always able to prohibit the last acquisition in a series,[8] in the absence of clear evidence that harm is being caused by creeping acquisitions the Government should reconsider enacting laws that would be inconsistent with international best practice and generate uncertainty for a great number of businesses.

Aggregation Model

The 'aggregation model', mentioned in the first discussion paper, was the most logical approach to creeping acquisitions and accorded with the underlying goal of competition policy in Australia to maintain competitive markets.

This model has, however, been criticised as impracticable by a number of interested observers, including the ACCC. Anthony Haly of Mallesons suggests the following flaws with the aggregation model, and this is consistent with much of the criticism levelled at the model:

> Acquisitions are currently assessed under section 50 using a forward-looking test which compares the likely state of competition *with* the acquisition to the likely state of competition *without* the acquisition. It is unclear how this 'with-and-without' test would function if the ACCC or a court could also 'look backwards' and aggregate previous acquisitions.
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> There are also temporal issues in terms of how far back the ACCC or a court would be able to go in assessing the effect of a series of acquisitions … It is unclear how changes in market boundaries or dynamics will be addressed (such as industry consolidation or disaggregation). An aggregation model is also likely to impose significant uncertainty and onerous compliance costs upon businesses seeking to assess the impacts of their merger activity over time.

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6 Grocery Inquiry, p 525.

7 Although last year the ACCC did begin analysing a series of acquisitions of Mitre 10 stores by Bunnings and has indicated it is also monitoring acquisitions in the taxi and childcare industries.See, for example, Blair Speedy, 'Wesfarmers might sell five Mitre 10 stores' *The Australian – Business*, 26 September 2008 (http://www.theaustralian.news.com.au/story/0,25197,24403094-20142,00.html)

8 Section 50 of the TPA is ill-equipped to deal with creeping acquisitions. First, the current prohibition requires analysis only of 'the' acquisition in question with no scope for regard to be paid to the cumulative effect of previous acquisitions; by definition creeping acquisitions do not factor in existing s 50 analysis. In this respect, Professor Henry Ergas recently likened creeping acquisitions to hair loss – no one lost hair will make you bald, but if it keeps happening you're in trouble. (H Ergas, 'Doubts about Dawson', NECG, June 2003, <http://www.necg.com.au/pappub_PSRSAP.shtml>. See also H Ergas, 'Good Report, Pity About All the Flaws', *Australian Financial Review*, 18 June 2003, p 63.)[8] Similarly, while no one merger in a particular industry may substantially lessen competition, several may do so without breaching the current provisions which analyse only the current merger

> An aggregation model is also likely to lead to an increase in the time taken by the ACCC to consider acquisitions under its popular informal clearance process, given the increased scope of the issues to be considered.[9]

These are legitimate concerns, although they may be overstated[10] given the relatively small proportion of mergers likely to be affected by the laws; in particular, they would apply only where there had been earlier acquisitions in the same market. However, if the Government accepts – as it appears to have done – that this model is, in fact, impractical, then any attempt to legislate for creeping acquisition should be abandoned.

Substantial Market Power Model (SMPM)

Pursuant to the 'substantial market power model' (SMPM), outlined in the first discussion paper, mergers by a firm having substantial market power would be prohibited where they resulted in *any* lessening of competition.

The Government has now modified the language of the proposed SMPM to replace the words 'any lessening of competition' with 'enhancing that corporation's substantial market power in that market'. The distinction is marginal at best. Just as any acquisition is likely to result in some – even if insignificant – lessening of competition, the corollary will be that it will also enhance market power, even if only marginally. It is possible the word 'enhance' is intended to mean something more than merely 'increase', but the issue of terminology has not been addressed in the discussion paper. However, the discussion paper does suggest that the change in phraseology was not brought about by any desire to reduce the scope of the provision, but rather because of a desire to avoid any apparent confusion in terminology between the phrase 'any lessening of competition' as proposed, and 'substantial lessening of competition' as appears elsewhere in the Act. Consequently, it is likely the intention is, in fact, to capture *any* increase in market power, regardless of its significance. Neither approach is sound either in economic or competition policy and should be rejected.

Implementation of this model would ultimately prove anti-competitive and harm small businesses in (at least) the following ways:

- Small business would be deprived of the opportunity to take advantage of their business goodwill through asset sales to larger businesses – this would deny small business access to its largest prospective buyer and thereby reduce competition for the purchase of the small business.[11]

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9 'Government releases discussion paper on creeping acquisitions', 1 September 2008 (http://www.mallesons.com/publications/2008/Sep/9596886w.htm). See also David Ball (of Clayton Utz) 'New Creeping Acquisitions Proposals Raise Real Concerns', 8 October 2008 (http://www.mondaq.com/article.asp?article_id=67286&lk=1&print=1).

10 See also David Ball (of Clayton Utz) 'New Creeping Acquisitions Proposals Raise Real Concerns', 8 October 2008 (http://www.mondaq.com/article.asp?article_id=67286&lk=1&print=1) who claims 'commercial parties are unlikely to welcome a clearance process which is more protracted or complex than the current timeframes'

11 See, for example, Stephen Bartholomeusz, 'Creeping Towards Absurdity', Business Spectator, 1 September 2008: 'It is … difficult to see how anyone would think it would help small business to devalue

- It would effectively prevent a firm with substantial market power (however that is defined) merging at all. By definition a horizontal merger reduces the number of competitors in the market,[12] thereby reducing competition and enhancing the market power of the acquiring party, even if only marginally. Where a merger enhances efficiencies in the market without significantly limiting competition, on any theory of competition law policy the merger should be allowed to proceed.

This model is similar to one suggested in a number of submissions to the Dawson Review, 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).[13] 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'.[14] They also accepted that a cap would prove 'unworkable' and could deny consumers access 'to the products or services offered by an efficient producer'.[15]

The approach is also inconsistent with international best practice.

- First, it requires a firm to make an assessment of whether it has 'substantial market power' in order to determine whether or not it is able to merge at all. This is not a simple task. It is clear that more than one party may have substantial market power and that market share is not a sufficient or necessary determinant of such power.[16]

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what might well be their lives' work by denying them access to the biggest and best-resourced prospective buyers of their business. …'

12 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.

13 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.

14 Dawson Report, p 67.

15 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).

16 It may also be argued that this is inconsistent with recommendations from the International Competition Network. Although these recommendations relate to pre-merger notification, they are relevant to a firms assessment of whether it should notify the ACCC of proposed

- Second, is it inconsistent with the goal of a competitive effects analysis. The ICN 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.'[17] (emphasis added)

  The proposed SMPM makes no assessment of whether the proposed merger is likely to 'harm competition significantly'.

The Declaration / Market Cap Model ('Declaration model')

For similar reasons the Declaration model should be rejected. While it might (desirably) narrow the operation of the law, it has the additional detriment of being the subject of undesirable political interference in the application of economic laws. It is, for example, interesting that the Government refers again to the grocery sector as one in which there may be concern about creeping acquisitions, despite the ACCC's own findings to the contrary.

Recommendation

In the absence both of demonstrable need for creeping acquisition laws and a workable 'aggregation model' for creeping acquisitions, any attempts to legislate in this area should be abandoned. The proposed models are flawed in terms of economic and competition law theory, would generate uncertainty, would harm small business and would be inconsistent with international best practice.

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conduct or seek authorisation. The ICN recommends thresholds be 'clear and understandable' and 'based on objectively quantifiable criteria' which do not include assessments about market power. ICN, Recommended Practices for merger Notification Procedures, Recommendation II

17 ICN, Recommended Practices for Merger Analysis, Recommendation IV(A)