PROPOSED MERGER REFORMS: ACCC SEEKS TO INCREASE POWER TO BLOCK DEALS

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Legal Briefings – By **Liza Carver, Linda Evans, Stephanie Panayi, Philip Aitken, Patrick Clark, Heydon Letcher and Tomas Kemmery**

The Australian Competition and Consumer Commission (**ACCC)** has proposed radical changes to the way mergers are regulated in Australia recommending the introduction of a mandatory and suspensory merger review process with limited merits review by the Australian Competition Tribunal.

KEY TAKEAWAYS

We have three key takeaways:

1. compared to the current process, parties will be required to meet a substantially higher standard to obtain merger clearance with some mergers being 'deemed' to substantially lessen competition – which will likely lead to pro-competitive and efficiency enhancing deals being blocked;

2. the proposed reforms will significantly reduce oversight of ACCC decision making; and

3. the proposed reforms create a highly restrictive investment environment that is out of step with global standards – particularly for digital platforms.

At this stage, these are reform proposals only. There is no draft legislation or implementation timeline proposed. However, if these reforms are implemented, many transactions that are lawful under the current regime would face significant and potentially fatal challenges in the future.

OVERVIEW OF REFORMS

INTRODUCTION OF A MANDATORY AND SUSPENSORY MERGER REVIEW PROCESS WITH LIMITED MERITS REVIEW

Currently, parties seeking approval of a transaction can apply to the ACCC for informal merger clearance or for merger authorisation, or (in rare circumstances) may apply to the Federal Court for a declaration that a transaction does not substantially lessen competition.

The ACCC has proposed the introduction of a formal mandatory and suspensory merger control regime which would replace all existing clearance processes:

- Notification to the ACCC of any merger above certain thresholds (currently unspecified) will be mandatory and mergers above such thresholds will be prohibited unless clearance has been granted.
- The test for clearance will reverse the onus of proof, which currently requires the ACCC to find the transaction would have, or be likely to have, an anti-competitive effect.
- The ACCC's decisions will be subject only to limited merits review by the Australian Competition Tribunal (effectively removing the opportunity for parties to approach the Federal Court for a declaration that a transaction will not contravene the rules).
- The informal clearance 'pre-assessment' process will continue for mergers below the mandatory notification thresholds however the ACCC will have the power to 'call in' transactions to bring them within the formal review process.

CHANGES TO THE MERGERS TEST

The ACCC is proposing 3 key changes to the merger test.

- The merger factors in section 50(3) are revised including to add factors to address whether the acquisition may result in the loss of potential competitive rivalry and/or increase access to or control of data, technology or other significant assets.
- Changing the test. Currently, the test requires that the transaction is 'likely' to substantially lessen competition in the sense of a 'real commercial likelihood'. The ACCC proposes to change the meaning of 'likely' to mean 'a possibility that is not remote'. This is a substantially lower standard than 'real commercial likelihood' and, if implemented, would involve a profound change to Australia's merger laws. An applicant will have the burden of proof in demonstrating that a substantial lessening of competition is not likely.

- Including a deeming provision prohibiting firms that possess substantial market power from engaging in mergers/acquisitions that entrench, materially increase or materially extend positions of substantial market power.

REFORMS TARGETED AT ACQUISITIONS BY LARGE DIGITAL PLATFORMS

The ACCC has proposed sector specific changes relating to digital platforms.

A different test will be applied to acquisitions by certain digital platforms. Affected digital platforms will be specified in advance by the ACCC based on factors including the size and scope of services of the digital platform. While the ACCC has not identified what this merger test will be, or whether the ACCC's determination will be reviewable, it states that the probability of competitive harm that needs to be established should be lower than that which applies for acquisitions in the economy more broadly.

COMPARISON OF PROPOSED REFORMS

Current Approach	ACCC Proposed Reform
MERGER CLEARANCE PROCESS	
Three clearance paths: ACCC merger authorisation, informal merger clearance; or Federal Court declaration	One path only: ACCC formal review Appeals involve only limited merits review by Tribunal.
No compulsory pre-notification requirement. Merger parties are encouraged to notify where: • the products of the parties are substitutes or complements and; • the post-merger share is >20%.	Compulsory notification thresholds. ACCC yet to outline basis of thresholds. Overseas tests suggest basis could be based on parties' revenues/assets, transaction size and/or market shares. ACCC power to 'call in' any merger below thresholds. Parties can apply for exemption from notification. ACCC yet to detail basis for exemptions
Enforcement model: anti-competitive mergers prohibited. No suspensory process and parties otherwise free to complete, but face risk of ACCC action to prevent merger (including interim injunction while case heard), or unwind merger.	Mergers above thresholds prohibited, unless clearance obtained.
THE SLC TEST	
The term 'likely' not currently defined. Court has defined likely to mean a 'real chance' or 'real commercial likelihood'.	Likely will be defined to mean 'a possibility that is not remote'. This is a substantially lower threshold than 'real commercial likelihood.
ACCC bears the burden of proof in demonstrating that a transaction is likely to substantially lessen competition.	The onus of proof is reversed and the Applicant must prove that a transaction is not likely to substantially lessen competition.
Factors mandated in section 50(3) but list non-exhaustive: • actual and potential level of import competition • height of barriers to entry; • level of concentration; • degree of countervailing power; • likelihood acquirer could significantly and sustainably increase prices or profit margins; • whether substitutes are available; • dynamic characteristics of the market; • likelihood of acquisition removing a vigorous and effective competitor; and • nature and extent of vertical integration in the market.	Factors to be revised to focus on the structural conditions for competition that are changed by the acquisition to the detriment of competition. Insert the following additional factors: • the likelihood that the acquisition would result in the removal from the market of a potential competitor; and • the nature and significance of assets, including data and technology, being acquired directly or through the body corporate.
No equivalent	A new 'deeming' provision will be inserted to the effect that mergers that entrench, materially increase or materially extends a party's market power will be prohibited. Based on ACCC's assessment.
Pre-existing agreements between parties considered under general prohibitions: purpose or likely effect of substantially lessening competition test.	Pre-existing agreements between parties taken into account during merger assessment.
No sector-specific legal standards: all mergers subject to same test.	Tailored merger test for certain digital platforms. Platforms would be those of a certain size and scope, whether a 'gateway' firm and have market power. Test would include a lower probability of competitive harm. There would also be a lower threshold for notifications.

RAISING THE BAR FOR CLEARANCE

The ACCC's reform proposals will make it more challenging to obtain clearance in three ways:

- reversing the onus of proof;
- substantially reducing the test of likelihood to a 'possibility that is not remote'; and

- deeming acquisitions that entrench, materially increase or materially extend positions of substantial market power to substantially lessen competition.

When considered in isolation, each of these reforms is problematic. However, in combination, they create a hostile merger clearance regime, which, if implemented, will result in pro-competitive or competitively neutral mergers being unnecessarily blocked.

REVERSING THE ONUS OF PROOF

The proposal requires that the ACCC be satisfied that the proposed acquisition is not likely to have the effect of substantially lessening of competition.

This reverses the onus of proof. Currently, if the ACCC were to seek an injunction blocking a transaction in Court, or otherwise bring proceedings in relation to a completed transaction, it must prove that a transaction is likely to substantially lessen competition. This reversal of the onus of proof is out of step with other significant jurisdictions around the world, including the European Union.

Reversing the onus in this way substantially changes the nature of merger clearance in Australia. No longer will mergers that substantially lessen competition be prohibited. Rather, mergers that are subject to the notification obligation and have not received ACCC clearance will be prohibited.

Applicants will be in the unenviable position of being required to satisfy the ACCC of a negative relating to the future effects of a merger in circumstances where they will not have sufficient access to the information provided to the ACCC by third parties.

REDUCING THE STANDARD OF LIKELIHOOD

The Full Federal Court recently considered the meaning of 'likely' in the context of the Pacific National/Aurizon merger. The Full Court found that, consistent with earlier Federal Court decisions, a transaction will be 'likely' to have the effect of substantially lessening competition where there exists a 'real chance' or 'real commercial likelihood' of that happening. The 'real chance' test was first adopted by the Court in the 2003 AGL case,[1] and has generally been applied since then, including by Justice Middleton in the Vodafone/TPG merger case.[2]

The ACCC's proposal is to change the standard for likelihood from 'a real commercial likelihood' to 'a possibility that is not remote'. This is a substantially lower standard and, if implemented, would be amongst the most significant of the proposed reforms.

If this reform is made, applicants will, in effect, be required to satisfy the ACCC that there is no possible future in which the merger could substantially lessen competition. The insertion of a merger factor explicitly allowing the ACCC to take into account the loss of potential competitive rivalry will increase this burden further. Such a high burden will be difficult or impossible to meet in many pro-competitive transactions.

INTRODUCTION OF DEEMING PROVISION FOR FIRMS WITH MARKET POWER

The ACCC has proposed the insertion of a new deeming provision that will prohibit a transaction by a firm with substantial market power where the transaction would be likely to entrench, materially increase or materially extend such market power.

This is a substantively different test to the existing substantial lessening of competition test which requires the ACCC and the Federal Court to find that the likely future with the transaction (factual) involves a substantial lessening of competition compared to the future without the transaction (counterfactual). The ACCC Chairman noted challenges in satisfying this test, stating: '[a] particular challenge with the current law is the requirement for the ACCC to prove the likely future state of competition with and without the merger to the civil standard of proof required by our courts.'

The effect of the deeming provision will be to remove the need for an assessment of the factual and counterfactual. If a firm has a substantial degree of market power any acquisition which entrenches, materially increases or materially extends that power will be deemed to contravene the rules.

However, the introduction of a deeming provision may just shift the focus of contested legal proceedings to the question of whether or not a firm has a substantial degree of market power. The ACCC will be required to undertake the complex economic assessment of whether a firm possesses substantial market power, which is often a highly contestable. For instance, some cases suggest that market power can exist at relatively low market shares (e.g. Safeway was found to have market power with a 20-25% market share) and it can be the case that more than one firm in a market may possess substantial market power. The challenges that can arise in determining whether a firm has substantial market power can be seen from the recent *ACCC v Pfizer* proceedings, where the ACCC initially failed at first instance to establish that Pfizer relevantly had market power, but successfully appealed this point in the Full Federal Court.

REDUCED OVERSIGHT OF ACCC DECISIONS

ARE THERE REAL REASONS FOR CHANGE?

The ACCC has highlighted that markets in Australia are dominated by a small number of market participants in key areas including banking, supermarkets, mobile telecommunications, internet service provision, energy retailing, gas supply and transport, insurance, pathology services, domestic air travel, internet search and social networking services and the ACCC believes that without action 'market power in Australia will become further entrenched and certainly will not reduce'.

The Chairman has stated that the ACCC has had a team conducting post-merger reviews of acquisitions, the findings of which 'are interesting and also troubling in some cases' and will be published by the ACCC in due course. Merger reform is but one tool available to the legislature to influence and shape the Australian economy, development of industry and investment. Australia is a small and open economy which will naturally have correspondingly more concentrated markets. Introducing a merger regime that increases uncertainty for business may itself damage the economy by discouraging investment and cutting off exit strategies for small and innovative businesses.

We do not have details of the thresholds for the mandatory and suspensory regime. They are likely to be based on one or more metrics of revenue/assets, transaction size or market share[3] and, given our relatively small economy with correspondingly higher market concentration ratios, any transactions involving large businesses are likely to be subject to the regime or indeed the deeming provision with limited merits review (and the loss of the right to seek declaratory relief) leaving ACCC decision making largely unchecked. Subjecting transactions to potentially extended mandatory and suspensory filing processes also adds to the regulatory burden on transaction parties, with the target company potentially in commercial 'limbo' while merger clearance is completed.

In support of the reform proposals for merger review in Australia the ACCC highlights that the Australian regime is out of step with most merger regimes internationally and out of step with international best practice. Ensuring that Australia's merger review process aligns with international best practice is a laudable goal. However, it is important to ensure that the ACCC does not just cherry pick those aspects of other jurisdictions' merger regimes that suit its purpose without giving full consideration to the manner in which merger reviews occur in those jurisdictions. A key issue here is procedural fairness.

WHO WILL GUARD THE GUARDS?

As was pointed out by the ACCC Chairman, Australia relies on a 'merger enforcement' model. Parties considering mergers and acquisitions understand that if the ACCC opposes a transaction it can take action in the Federal Court including for substantial penalties and orders for divestiture. That enforcement model is the same model that applies in respect of other key prohibitions in the CCA, including the prohibition on engaging in cartel conduct and the prohibition against misuse of market power. Under that model, the Court process allows parties to tender evidence, call and cross-examine witnesses and seek, via subpoena, access to information and documents. This allows parties to probe and test the ACCC's case and its theory of harm and facilitates a full ventilation of all relevant facts and issues.

In outlining his proposal for reform, Mr Sims indicated that the ACCC would produce detailed reasons for its decision to clear or to decline to clear a proposed acquisition. A decision not to clear an acquisition would be subject to only limited merits review by the Australian Competition Tribunal, not the Federal Court, and that review would be limited to the material before the ACCC when its decision was made. In our view, access to limited merits review will provide little, if any, confidence to applicants that errors in the ACCC's analysis would be corrected.

When drawing on international experience, it is important to also understand the process and procedures adopted in international jurisdictions to enhance transparency and procedural fairness for applicants and other impacted parties. There are many examples around the world of merger assessment using an administrative model, including the merger assessment models in the European Union, UK and Singapore which adopt different processes to address procedural fairness concerns .

For example, during the course of a Phase I and Phase II merger investigation under the EU model, the European Commission:

- holds formal 'State of Play' meetings with notifying parties at key stages of its investigation;
- issues a formal Statement of Objections during a Phase II investigation setting out its concerns and allows the parties to respond in writing and at an oral hearing;
- facilitates the merger parties' right of access to the European Commission's file (subject to confidentiality considerations) following the issuing of a Statement of Objections to enable the parties to examine the non-confidential submissions of third parties; and
- as a matter of practice, may make available to the merger parties some key documents before the Statement of Objections is issued in a Phase II investigation.

In other jurisdictions adopting an administrative decision-making model, the decision-makers are generally separated from competition authority staff and often bring a broader perspective to their review. For example, the Phase II decision-maker in the UK is an Inquiry Group comprised of independent experts selected from a wider panel of individuals with, for example business, legal or academic experience. In Singapore the Merger Review Committee is drawn from the Commission which is staffed by part-time commission members (save for the Chief Executive who is a full-time Executive of the CCCS).

The ACCC has lost its last seven high profile contested merger cases.[4] In our view, this is evidence of the system working. Thousands of mergers have been cleared by the ACCC. The cases that end up in the Federal Court are by definition the most difficult contestable cases. In those cases the Federal Court has found that the ACCC has not produced sufficient evidence to support its case theory regarding the counterfactual state of competition. Oversight by the Federal Court of the very small number of most difficult cases provides confidence in the integrity of the regime.

AUSTRALIA – COMPETITION LAW'S HERMIT KINGDOM

ADDRESSING ACQUISITIONS BY DIGITAL PLATFORMS

The ACCC is also considering a 'more tailored merger test' that would apply to digital platforms. The ACCC did not specify to which platforms the test would apply, but put forward factors it would consider, including the size and scope of a platform's services in Australia, whether a platform is a 'gateway' platform that is able to control how other businesses interact with consumers and a platform's market power.

A tailored test would attempt to address a perceived gap in Australia's merger law that allows a digital platform to acquire a 'nascent rival'. The concern put by the ACCC is that as the rival is nascent, at the time of the deal, the acquisition would have a low probability of lessening competition. Over time, however, its impact could prove substantial and long-lasting, allowing the platform to 'increase or entrench [its] market power'.

The ACCC is still forming a view on how the test would be formulated, but it has indicated that there would be lower notification thresholds for acquisitions by digital platforms. It also indicated – as part of the tailored test – the probability of competitive harm needed to block these mergers would be lowered.

Competition authorities around the world are grappling with this issue. For example:

- Germany and Austria introduced transaction value-based merger notification thresholds (€400 million or €200 million, respectively, provided the target has 'significant' activities in Germany or Austria). The intention is to capture acquisitions where the target does not meet revenue thresholds but has perceived 'great competitive market potential' as reflected in the amount paid.

- Japan revised its Merger Guidelines to request parties notify the JFTC when the total consideration for the acquisition is large and the acquisition is expected to affect domestic consumers. The JFTC also provided guidance as to when it would use its power to review non-notifiable mergers.

- The FTC issued Special Orders to Google, Amazon, Apple, Facebook and Microsoft requiring them to provide information about prior unreported acquisitions. The FTC stated it would use the information to examine whether these non-notifiable acquisitions might have raised competitive concerns.

- In the UK, the government has proposed a bespoke merger control regime for firms designated by the CMA as having Strategic Market Status (SMS).[5] Under this regime, certain transactions engaged in by designated SMS firms would be subject to mandatory and suspensory filing processes and the CMA can prohibit any reviewable transaction by

a SMS firm if the CMA concludes there is a 'realistic prospect' the transaction will substantially lessen competition.

The ACCC's proposals appear to go even further than changes made by many leading authorities around the world.

These proposals may have profound implications for Australia's startup and digital tech ambitions. As a general point, acquisitions of startups by larger companies provide a number of benefits. For consumers, the product or service provided by that startup, which may only have a couple of thousand customers, suddenly can be available to millions or hundreds of millions of customers. For founders, early employees and investors, an acquisition provides a return that justifies the effort and risk that went into building the startup, that is, an exit strategy, and that return is often reinvested into the next generation of startups. Acquisitions, therefore, are an important source of liquidity that drives innovation.

There is a risk that this proposal could be implemented more widely. The ACCC has noted the gap in Australia's merger law 'is not limited to acquisitions in digital markets'. The influential paper that coined the term 'killer acquisitions' actually focused upon mergers and acquisitions in the pharmaceutical sector.[6] And in Germany, almost half of the cases caught by a new regime intended to capture those types of acquisitions related to the pharmaceutical sector, and only a couple to the technology sector.

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1. AGL v ACCC (No 3) (2003) 137 FCR 317.

2. Vodafone Hutchison Australia v ACCC [2020] FCA 117.

3. For example, notification thresholds under EU merger control rules include measures based on the parties' global, EU-wide and/or EU member state-specific turnover and Canadian merger control rules rely on measures related to the Canadian assets and revenues of the target and the parties collectively.

4. AGL v ACCC (2003), ACCC v Metcash (2011), AGL/Macquarie Generation (2014), Sea Swift/Toll (2016), Tabcorp/Tatts (2017), ACCC v Pacific National (2019/2020) and Vodafone v ACCC (2020) The HSF contested mergers team has acted in and won six of these seven contested merger cases and includes partners Linda Evans, Liza Carver, Patrick Gay, Sarah Benbow, Grant Marjoribanks, Merryn Quayle, Christine Wong and Bruce Ramsay.

5. See our briefing here.

6. Colleen Cunningham, Florian Ederer, and Song Ma, Killer Acquisitions.

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.

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