Merger Regulation Reform: Do We Need a Formal Clearance Process? Reassessing the Relevance of the Trade Practices Legislation Amendment Bill (No 1) 2005

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The Trade Practices Legislation Amendment Bill (No 1) 2005 (hereafter the 'Bill') was introduced into and passed by the House of Representatives in early 2005.[1] Schedule 1 of the Bill contains proposed reforms to the merger regulation process, including a new formal clearance system that is to operate in tandem with the current informal system.[2] When the Bill was introduced into the Senate, Nationals Senator Barnaby Joyce sided with the non-government parties to oppose the proposed reforms to the merger regulation process, on the grounds that they would have a detrimental impact upon small business.[3] As a result of this dissension, the Bill was finally passed by the Senate in an amended form, with Schedule 1 being voted down.[4]

To date, the Bill remains in legislative limbo, as the government refuses to reintroduce it into the House in its amended form, and yet lacks the necessary impetus to drive the original Bill through the Senate. In this finely poised political environment, each new application for informal clearance dealt with by the Australian Competition and Consumer Commission (hereafter the 'ACCC') constitutes a de facto referendum on the future of the Schedule 1 reforms.

No one understands this political see-saw better than the ACCC Chairman Graeme Samuel. It is a matter of public record that Mr Samuel initially opposed the proposed changes to the merger clearance process,[5] and he appears to have attempted to stave off renewed calls for legislative reform by responding to any perceived shortcomings in the existing system with timely amendments to the way in which the ACCC conducts informal reviews. The most recent example of this approach was the introduction in July of this year of the new *Merger Review*

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1 The Bill was introduced into the House of Representatives on 17 February 2005, and passed by the House on 10 March.

2 These reforms are based upon the recommendations made by the Dawson Committee in its 2003 review of the competition provisions of the *Trade Practices Act* 1974 (Cth) (hereafter the 'TPA') *Review of the Competition Provisions of the Trade Practices Act,* Review Committee, 31 January 2003: <http://tpareview.treasury.gov.au/content/report.asp> (14 April 2006).

3 Barnaby Joyce, Cth, Senate, *Parliamentary Debates (Hansard)*, 11 October 2005 at 104–107.

4 The Bill was introduced into the Senate on 10 March 2005, and passed in an amended form on 11 October.

5 Graeme Samuel, 'Promoting Competition and Fair Trading,' paper presented at The Sydney Institute, 25 February 2004 at 13; Graeme Samuel, 'Balancing the Competitive Pressures,' paper presented at the National Press Club, 12 November 2003 at 8–10.

Process Guidelines (hereafter the 'Process Guidelines'),[6] which sought to address the problems with the existing system exposed by recent mergers, such as the merger between Toll Holdings Ltd and Patrick Corp Ltd.

This latest (and final) iteration of the ACCC's merger guidelines begs the question: *do we still need the formal clearance process provided for in the Bill?* The purpose of this commentary is to arrive at a considered answer to this question. To this end, section 1 will outline the informal merger clearance process as it operated prior to the introduction of the Process Guidelines (hereafter the 'Old Informal System'), while section 2 will examine its perceived shortcomings via a case study of the Toll/Patrick merger. Section 3 will then proceed to set out the proposed formal merger clearance process contained in Schedule 1 of the Bill (hereafter the 'Proposed Formal System'). Finally, section 4 will seek to answer the focal question by posing two further questions: (i) will the Proposed Formal System resolve the problems identified with the Old Informal System?; and (ii) have these problems already been resolved by the introduction of the Process Guidelines (hereafter the 'New Informal System')? The commentary will conclude with a brief postscript, which attempts to lay to rest concerns that the Proposed Formal System will give rise to a new set of problems.

1. The Old Informal System

Under the Old Informal System,[7] the merger review process commenced with the submission of a merger proposal to the ACCC by the party seeking clearance, typically known as the 'merger proponent'. Once this submission had been received, the Commission undertook a 'preliminary assessment' of the merger in order to identify any obvious competition issues. Having identified any such issues, the ACCC then conducted market inquiries. If, after market inquiries had been made, no competition issues had been identified, the Commission would grant an informal clearance, which in effect amounted to an undertaking not to challenge the merger in the Federal Court.[8]

If, however, competition issues *were* identified, then the ACCC would provide the merger proponent with a 'Statement of Issues'. Following the release of a Statement of Issues, the informal clearance process became what Doug Shirrefs referred to as a process of 'sophisticated horse trading', whereby the merger proponent and the ACCC sought to arrive at a merger proposal which was still commercially attractive without being anti-competitive.[9] The horse trading was conducted via the submission of undertakings by the merger proponent to the ACCC pursuant to s87B of the TPA.

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6 Australian Competition & Consumer Commission, *Merger Review Process Guidelines* (July 2006).

7 As set down in the now superseded *Guideline for Informal Merger Reviews*: Australian Competition & Consumer Commission, *Guideline for Informal Merger Reviews* (October 2004).

8 It should be noted that an informal clearance does not protect the merger from proceedings brought by a third party for divestiture under s81 of the *Trade Practices Act* 1974 (Cth).

9 Doug Shirrefs, 'Heavy Toll of Barnaby Blunder' *AFR* (14 Feb 2006) at 63.

2. The Perceived Shortcomings of the Old Informal System: A Toll/Patrick Case Study

As noted at the outset, the new Process Guidelines introduced in July 2006 sought to take into account the problems with the existing system exposed by recent mergers, such as the merger between Toll Holdings Ltd and Patrick Corp Ltd. In recognition of this fact, this section of the commentary will examine the perceived shortcomings of the Old Informal System via a case study of Toll Holdings' hostile bid for Patrick Corporation.

A. The Regulatory History of the Toll/Patrick Merger

On 25 August 2005, transport group Toll Holdings Ltd announced its proposal for the acquisition of stevedore company Patrick Corp Ltd. The informal clearance process commenced on 21 September 2005. After making its preliminary assessment and conducting market inquiries, the ACCC published its Statement of Issues on 10 November 2005. In response to this Statement, Toll proferred its first undertaking on 25 November 2005. While the Commission Chairman stated that the undertaking was 'a step in the right direction',[10] it was rejected on the grounds that it failed to address the Commission's concern over the lessening of competition in the rail freight market between the eastern states and Perth.

Following this rebuff, Toll then submitted two further undertakings, on 4 and 13 January 2006, which included a number of concessions in relation to the operation of Pacific National ('PN'), its 50-50 rail joint venture with Patrick. Each of these undertakings was, however, rejected, with the Commission Chairman stating that '[o]nly an offer of significant structural commitments … would address the concerns arising in rail'.[11] The ACCC subsequently announced on 25 January 2006 that it would seek an injunction if Toll went ahead with its bid. Thereafter followed a 'Mexican standoff' between Toll and the ACCC,[12] conducted through the media,[13] whereby the former accused the latter of dragging its feet in instituting proceedings, while the latter accused the former of failing to provide assurances that its bid was indeed 'live'. The standoff was finally resolved by the ACCC's commencement of proceedings on 9 February 2006.

While the commencement of proceedings was viewed as a victory of sorts for Toll, it ultimately opted to avoid a protracted legal battle by providing a fourth set of undertakings on 27 February 2006 which included the divestiture of a 50 per cent stake in PN. After some further refinement in consultation with the ACCC, these undertakings were finally accepted by the regulator on 11 March, and the proceedings discontinued.

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10 Tansy Harcourt, 'Toll concessions fail to satisfy' *AFR* (28 Nov 2005) at 14.

11 Australian Competition & Consumer Commission, *ACCC to Oppose Toll's Proposed Acquisition of Patrick Press Release*, MR 008/06 (18 Jan 2006).

12 Shirrefs, above n9 at 63.

13 See James Hall, 'ACCC's Pause Corners Toll' *AFR* (3 Feb 2006) at 90; Bryan Frith, 'It Might be Time to Bring the Watchdog to Heel Over Toll' *The Australian* (8 Feb 2006) at 38.

B. Problem One — Accountability

In 2001, the Federal Government announced an independent review of the competition provisions of the TPA, to be chaired by former High Court Justice Sir Daryl Dawson. In its final report, released in April 2003, the Dawson Committee commented that the informal merger clearance process suffered from a lack of accountability.[14] Technically speaking, an informal clearance decision made by the ACCC may become the subject of review in one of two ways: (i) if the Commission commences injunctive proceedings; or (ii) if a merger proponent seeks a declaration from the Federal Court that a merger does not breach s50. Neither of these options is considered to constitute an effective review mechanism, for the reasons that follow.

The principal problem with review via injunctive proceedings is that it is often, in reality, at the discretion of the decision-maker. In theory, a merger proponent may bring about a review of the Commission's decision by simply proceeding with the merger, as this will force the ACCC to seek an injunction. This presupposes, however, that a merger *can* go ahead once the ACCC has refused to grant clearance, and, as evidenced by the Toll merger, this is often not the case. Toll's offer was largely scrip based, which meant that its attractiveness to Patrick shareholders was heavily dependent on Toll's share price. Toll's share price was in turn heavily dependent upon the market's view of the merger's chance of success, which, of course, was heavily dependent upon the ACCC's clearance decision. Thus, in effect, Toll's ability to proceed with its bid was contingent upon clearance from the Commission. As such, once the ACCC refused to grant informal clearance, Toll was unable to force the Commission's hand with respect to injunctive proceedings. While the ACCC *did*, as noted, ultimately institute proceedings, while the ACCC *did*, as noted ultimately institute proceedings, the fact that this was a discretionary decision significantly diminishes the effectiveness of injunctive proceedings as a review mechanism.

This leaves review via declaration. According to the ACCC Chairman, the recent decision of the Federal Court in *The Australian Gas Light Company (AGL) (ACN 052 167 405) v ACCC (No 3)*[15] indicates that the Commission *is* held accountable by virtue of this avenue of appeal.[16] There are, however, two distinct problems with this contention. Firstly, an application for a declaration pursuant to s163A results in a reversal of onus. The ACCC is not required to establish that a merger breaches s50; rather, the applicant is required to establish that it does not. Second, it is arguable that the AGL/Loy Yang example is misleading with respect to the commercial viability of review via declaration. While the AGL/Loy Yang case was dealt with swiftly by the Federal Court, French J's decision to expedite proceedings was based in part upon the perceived public interest associated with resolving ownership of a major Victorian electricity generator. As such, there is no

14 Above n2 at 49.

15 (2003) 137 FCR 317. AGL sought to acquire a minority interest in the electricity generator Loy Yang. The acquisition was opposed by the ACCC on competition grounds, but AGL successfully sought a declaration from the Federal Court that it would not breach s50 of the TPA.

16 Samuel, 'Promoting Competition and Fair Trading,' above n5 at 14.

guarantee that future applications for a declaration will be dealt with in the same expeditious manner. The AGL/Loy Yang case was also relatively unique in that it featured a patient and cooperative seller. In many cases (especially those involving a hostile bid such as Toll/Patrick) a prospective merger would, from a commercial perspective, be all but dead by the time a favourable declaration was granted. Thus, for both legal and commercial reasons, a declaration cannot be considered to constitute an effective review mechanism.

C. Problem Two — Time

The most common criticism directed at the Toll merger clearance process is that it simply took too long; approximately six and a half months from start to finish. As Professor Baxt notes, mergers — especially in the context of a takeover scenario — need to proceed swiftly.[17] Delays can be disastrous, impacting negatively upon market confidence, which affects share prices; tying up vast amounts of capital; and, in many cases, leading to the evaporation of the market conditions which made the merger commercially attractive in the first place.

The ACCC *Merger Guidelines* and *Guidelines for Informal Merger Review*, which governed the operations of the Old Informal System, suggested that a minimum of 6–8 weeks was needed to consider mergers which raise competition issues.[18] According to Ian Tonking, this advisory 'minimum' timeframe increased significantly once anecdotal evidence was taken into account, a contention borne out by the Toll merger clearance process.[19] More problematic, however, than the length of the advisory minimum timeframe was the fact that it was *only* advisory. The ad hoc nature of the old informal regime — which placed no strict time limitations or other constraints on the regulator — meant that merger proponents and the market were left in the dark as to how long clearance may take.

3. The Proposed Formal System

Under the Proposed Formal System, a new formal clearance process will operate in parallel with the existing informal clearance process. A merger proponent may make an application for formal clearance pursuant to (the proposed) s95AC. This application is to be dealt with by the ACCC within 40 business days or is taken to have been declined, unless the applicant agrees within that period to an extension of time (s95AO). Clearance may be granted subject to conditions, including the making of an undertaking by the merger proponent pursuant to s87B (s95AP). If clearance is denied, the applicant has 14 days to lodge an appeal with the Australian Competition Tribunal (s111). An appeal may only be lodged by the applicant.

The Australian Competition Tribunal (hereafter ACT) has 30 business days to decide an appeal, although this period may be extended by a further 60 days if the

17 Bob Baxt, 'The Past 10 Years of Competition Law and the Future of Competition Regulation' (2003) 11 *CCLJ* 124 at 130.

18 Australian Competition & Consumer Commission, *Merger Guidelines* (June 1999) at 4.14: <http://www.accc.gov.au/content/index.phtml/itemId/304397> (2 August 2006); See ACCC, above n7.

19 Ian Tonking, 'Let the Sun Shine In: New Merger Approval Procedures Under the Trade Practices Act' (2005) 13 *CCLJ* 73 at 74.

ACT feels an extension is warranted (s118). In reviewing the ACCC's decision, the ACT may have regard only to information that was before the Commission, and to information which clarifies that information (s116). If clearance is granted (either by the ACCC or the ACT), then the applicant gains statutory immunity from proceedings brought by either the ACCC or a third party.

4. Will the Proposed Formal System Resolve the Problems With the Old Informal System, and is it actually Needed in Light of the New Informal System?

Given that two distinct problems were identified with the Old Informal System in section 2, it stands to reason that two distinct answers to this question must be provided.

A. Accountability

Turning first to consider the issue of accountability, it is safe to say that the avenue of appeal enshrined in the Proposed Formal System would mitigate the problem of accountability associated with the Old Informal System. Moreover, in light of the fact that the accountability mechanisms in the New Informal System remain unchanged from those outlined above, it is reasonable to conclude that the Proposed Formal System is still required. This leaves the issue of time.

B. Time

The strict legislative timeframe governing a formal application for clearance would ensure that both the merger proponent and the market knew how long the process would take. This answer, however, only deals with part of the problem identified in section 2.3. The more pressing question is; *would the availability of a formal clearance channel actually expedite the merger clearance process?* Assuming that the ACCC deals with an application without extending the 40 day time limit, the formal clearance process will take anywhere from two and a half to four and a half months, depending on the complexity of any appeal to the ACT. This timeframe is significantly shorter than the six and a half months taken to conclude the Toll merger.

A direct comparison of this nature is, however, misleading, as it fails to take into account the time-saving changes to the informal clearance process put in place by the New Informal System. These changes, which are designed to discourage the submission of iterative undertakings, will be briefly outlined in what follows.

While the ACCC should rightly have borne some of the criticism for the time taken to resolve Toll's application for informal clearance, in fairness to the regulator, a major cause of the delay was Toll's submission of multiple undertakings.[20] Each time the ACCC received Toll's latest set of concessions, it was forced to begin again the process of making market inquiries and coming to a view on whether or not the new version of the proposed merger would result in a substantial lessening of competition.

To say that the delay was principally caused by the submission of multiple undertakings is not, however, to lay the blame at Toll's door. One would expect the responsible board of a merger proponent to be loath to concede any more than was

absolutely necessary in order to bring about a merger. Thus, taking an incremental approach to the submission of undertakings would appear to be a natural course for a merger proponent in Toll's position. As such, any fault lay not with Toll or its advisors, but rather with the system by which undertakings were dealt with by the regulator.

This much would seem to have been recognised by the ACCC. While its Chairman warned prospective merger parties post-Toll that '[t]he ACCC [would] not tolerate progressive piecemeal [undertakings]', and that merger proponents 'should offer their best resolution the first time they make a submission,'[21] it attempted to ensure — via the New Informal System — that they would have adequate incentive to do so. Paragraph 4.78 of the Process Guidelines states that:

> When merger parties consider there are potential competition concerns that they can resolve with an undertaking, the undertaking should contain their best resolution in the first instance, on the basis that *the ACCC will clear the merger without it or accept only part of the undertaking*, if it finds ultimately [sic] there are no or few competition concerns to resolve.[22]

Assuming that this pledge is accepted by merger proponents,[23] the New Informal System will most likely succeed in remedying the time delays caused by iterative undertakings.

In light of this conclusion, it may perhaps be argued that the Proposed Formal System is no longer required to resolve the time issue identified in section 2. This argument would fail, however, to recognise that one of the principal problems identified in section 2.3 was the lack of certainty associated with the advisory timeframe for an informal review. As such, while the Proposed Formal System may no longer be required to reduce the time taken to complete a merger clearance review, it would still provide an invaluable degree of certainty with regards to the review timeframe.

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20 I leave aside here the issue of whether or not the ACCC was sufficiently clear in what it wanted from Toll at the outset. Some commentators have implied that the ACCC made Toll aware from the beginning that it would accept nothing less than the sale of a fifty percent stake in PN. See Joshua Gans, 'Toll Was Slow to Put its Cards on the ACCC's Table' *The Age* (14 March 2006) at 8. If, however, this is true, then it is hard to understand why Toll would choose (or indeed why Toll's advisors would advise it) to prolong the clearance process by seeking the acceptance of undertakings that it knew fell short of the mark. Rather, the facts might suggest that the ACCC was less than transparent in making known its concerns, although I concede that, without further examination, this contention remains just that.

21 Graeme Samuel, 'The ACCC's Merger Review Process Guidelines,' paper presented at the Trade Practices Law Council Workshop, 22 July 2006 at 9.

22 ACCC, above n6 at 21. [Emphasis added.]

23 It should be noted that this assumption is not without its own problems. The sufficiency of a 'best resolution' undertaking will presumably be determined by the ACCC via market inquiries. It is unlikely that a merger proponent's competitors will ever express the view that the conditions precedent to a proposed merger are unnecessarily onerous. Rather, competitors would be most likely to argue that the proposed undertakings still do not go far enough. As such, it is difficult to imagine how the ACCC would arrive at the view that a 'best resolution' undertaking was unnecessarily onerous. Taking this into account, it is perhaps naïve to assume that the new Process Guidelines will lead merger proponents to abandon iterative undertakings.

5. *Conclusion*

Having reached the above conclusions, the focal question presents itself again for consideration: *do we still need the formal clearance process provided for in the Bill?* The answer to this question is yes, for two reasons. Firstly, the Proposed Formal System is still required to resolve the lingering accountability issues which continue to plague the informal clearance process. Second, while the New Informal System may well prevent a reoccurrence of the six and a half month Toll/Patrick review process, it still lacks the certainty of a formal legislative timeframe.[24]

In light of this conclusion, and taking into account the fact that the existing informal system will continue to be tested by the consolidation now underway in the transport, resources and communications sectors, one might expect that the proposed merger regulation reforms will be revisited by the government in the not-too-distant future. The only question that remains is: how much will Barnaby make them pay?

6. Postscript: *Will the Proposed Formal System Give Rise to any New Problems?*

In concluding this commentary, it is necessary to briefly engage with two objections that have been made to the Proposed Formal System: (1) that it will marginalise third parties; and (2) that it will make the informal process redundant.

A. The Marginalisation of Third Parties

Some commentators have expressed concern that the Proposed Formal System may exclude third parties from the merger regulation process.[25] Under the formal system, the role of third parties would be limited to responding to market inquiries made by the ACCC. Combining this fact with the contention that, given the strict timeframes involved, formal applications for clearance will not be considered as thoroughly as informal applications, some commentators have come to the conclusion that third parties could effectively be excluded from the formal clearance process.[26] They contend that this marginalisation may lead third parties to seek judicial review of ACT decisions,[27] which would counteract any increase in efficiency brought about by the formal system.[28]

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24 This shortcoming is emphasised by the fact that the new Process Guidelines shy away from even providing an advisory minimum timeframe for the review of mergers which give rise to competition issues. The closest the Guidelines come to any such advisory timeframe is to state that it will take anywhere from 2–8 weeks to prepare a Statement of Issues. See ACCC, above n6 at 8.

25 Tonking, above n19; Frank Zumbo, 'Administration and National Competition Policy' (2005) 13 *TPLJ* 40 at 42.

26 See Zumbo, above n25 at 42.

27 Either pursuant to s163A of the TPA, or via an application made under s5 of the *Administrative Decision (Judicial Review) Act* 1976 (Cth) or s39B(1A) of the *Judiciary Act* 1903 (Cth).

28 See Tonking, above n19 at 79.

While commentators are correct that the proposed system would limit the way third parties can respond to, and object to, proposed mergers, their claims of marginalisation — with potentially litigious results — are highly questionable. Firstly, even under the 'strict' timeframes governing the formal process, third parties would still have 40 days to make submissions to the ACCC. Second, even if the ACCC was unable to properly assess third party submissions within this period, the Bill ensures that they would be placed before the Tribunal. As such, provided that third parties are reasonably diligent in responding to market inquiries, there is every likelihood that their concerns will be sufficiently addressed under the proposed formal system.

B. The Abandonment of the Informal Process

According to some commentators, the benefits associated with the statutory immunity conferred by formal clearance are such that, having received an informal clearance, a merger proponent 'for the sake of due diligence' would then activate the formal process in order to secure a formal clearance.[29] Given the obvious duplication of work that this scenario would create for the ACCC, Zumbo concludes that:

> … it would not be surprising to find [the Commission], upon enactment of the formal clearance proposal, downgrading (if not abandoning) in due course the informal process and simply requiring [merger proponents] to pursue the formal process.[30]

This conclusion is, however, predicated upon a view of the value of statutory immunity which is not necessarily shared by merger proponents. The Business Council of Australia has stated that it fully expects the vast majority of mergers to continue to be cleared solely through the informal process, indicating that any concern over the possibility of third party action would be outweighed by the added cost and regulatory burden associated with a formal application.[31] Supporting this view is the fact that, since the TPA came into force in 1974, only a handful of third party challenges to mergers have actually come before the Federal Court.[32] Taking this into account, the view that the informal clearance process will become redundant appears somewhat premature.

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29 See Zumbo, above n25 at 41.

30 Ibid.

31 Steven Münchenberg, 'Comments From Commerce' (2005) 13 *TPLJ* 235 at 236.

32 The only challenge to a merger by a third party under s50 in recent history occurred when the NSW Government-owned power generator Macquarie Generation sought a declaration that Coal & Allied Industries' acquisition of the Australian coal assets of the US-based Peabody group was in breach of s50. The proceedings were discontinued prior to judgment; *Macquarie Generation v Coal & Allied Industries Ltd* [2001] FCA 1349. See Annabel Hepworth, 'Rio Tinto's Purchase of Coal Assets Challenged' *AFR* (8 May 2001) at 13; Ben McGuire, 'Mining Acquisition Challenged' in Clayton Utz, *Competition Law Issues* (August 2001) at 15.