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If you've had an informal merger clearance recently, chances are it took longer than the "standard" 6-8 weeks we're told to expect. A significant number of matters this year that did not prompt a Statement of Issues still took 12 weeks to assess. In response to sharp media criticism of its timeframes, the ACCC has claimed the need for "good regulatory practice". Meanwhile, another review of the ACCC's processes is in the wind. With lessons both from the past and from New Zealand in mind, here we pose some questions to ponder this time around.

Howzat! The ACCC's war on merger reviews

Of the 2 million viewers who recently re-visited 1976/77 while watching *Howzat! Kerry Packer's War* (the mini-series on World Series Cricket), there probably weren't too many whose thoughts turned to the 1976 Swanson Report and the 1977 amendments to the mergers regime set out in the *Trade Practices Act* (as it was then known). But if there's one thing we at *The State of Competition* obsess about more than competition law, it's sport. And there are some interesting parallels between that decades-old battle and the equally contentious debate currently afoot in the "gentleman's game" of ACCC merger reviews. Indeed, when it comes to the merger review process, it seems to us that there are two teams out there and neither of them is playing cricket.

Increasingly, the business community is concerned that the ACCC is taking "too long" reviewing mergers under its informal clearance process. The ACCC Chairman has countered that, *as a regulator*, the ACCC's bigger responsibility is to "get the decisions right". Reviews certainly do appear to be taking longer (see the next page). At the Law Council's annual workshop in August, Rod Sims acknowledged this, saying it was partly due to a more cautious approach post *Metcash* but that it also reflected a slowing down of the process due to increased engagement with merger parties and transparency; in other words, a flow-on effect of "good regulatory practice".

"The strengths of the current informal process stem from its informal nature, as do its weaknesses" (Dawson Report, 2003)

Battlelines have been drawn, with the media a key front

So what is informal clearance exactly?

Fundamentally, merger parties have a single statutory obligation and that is a compliance responsibility. Put simply, they must refrain from breaching section 50. In that sense, mergers are no different from any other conduct falling for consideration under the competition provisions of the *Competition and Consumer Act*. Businesses with a best practice compliance culture will be familiar with their general responsibility to ensure all arrangements they enter into (regardless of their formality) do not substantially lessen competition.

On the other hand, if the ACCC believes a merger is likely to substantially lessen competition, it may take action (see the toolbox on page 4). In that sense, the ACCC's statutory role in relation to mergers is no different to its role for any other type of anti-competitive conduct: its responsibility is to enforce the Act. Being an "enforcer" is not the same as being a "regulator", a point to which we'll return later.

While businesses have no formal obligation to seek ACCC approval for mergers, they do have two statutory *options* for obtaining a tick (one is which is barely used, and the other not at all). The first is authorisation on public benefit grounds. This has always been available for a wide range of conduct but it's rarely employed for mergers these days. The second is formal clearance, a friendless process introduced in 2007 following the Dawson Review; five years on, there's yet to be an application.

Informal clearance is, as its name suggests, a practice that has arisen informally outside the statute. As it currently stands, the ACCC conducts **non-public reviews** (on a confidential or pre-clearance basis) and **public reviews**. The latter is what most people mean when talking about ACCC merger clearances and it is the main subject of this discussion.

Public reviews can have 2 phases. The first starts with market inquiries, after which the ACCC either makes a decision not to oppose the merger or issues a Statement of Issues (**SOI**) identifying areas of potential concern, at which point the review progresses to phase two. This involves further market inquiries and, if required, consultation on any undertakings before the ACCC decides whether or not to oppose the merger. An initial timeline is established at the start of every review, with a secondary timeline if an SOI is issued.

In 2006 the ACCC introduced process guidelines articulating these steps and providing indicative timing. The target timeframes are 6-8 weeks for the first phase and around 12 weeks in total for a two phase review without undertakings. These target timeframes are subject to any suspensions of the timeline, or "clock stoppers", along the way. Clock stoppers are important because ACCC merger statistics do not count days when the timeline is suspended.

How long is it *actually* taking?

According to the ACCC, most matters are dealt with in 8 weeks or less. But let's look at calendar time and see how long public reviews took over the first 8 months of 2012.

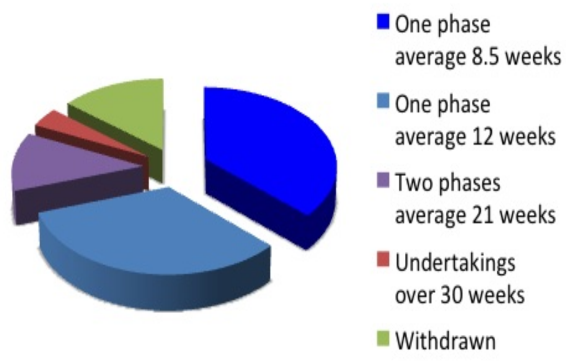
During this period, the ACCC completed 43 public reviews comprising:

- 30 decisions (70%) involving one phase only;
- 7 decisions (16%) going to phase two, including 2 with undertakings; and
- 6 matters (14%) which were withdrawn or discontinued prior to any decision.

For 16 of the one phase reviews, the average timeline was around 8.5 weeks, or just outside the ACCC's target timeframe. But that accounts for just 37% of all the public reviews under consideration. Phase one reviews with clock stoppers (14 in total – or one third of all the public reviews concluded in this period) actually averaged just over 12 weeks. That's as long as the target timeframe for a two phase review. (For completeness, we note that the 5 two phase reviews not involving undertakings averaged around 21 weeks.)

Matters involving an SOI can be expected to take time, especially if undertakings are involved. The issue is really the timeline for public reviews that involve only one phase – one third of matters are apparently not sufficiently complex to warrant an SOI, but are still taking 3 months to assess.

Three months is a long time for a merger to be in the public domain with the "sword of Damocles" hanging over the parties (as Justice French said in *AGL v ACCC*). A lot can happen to the target business. Contracts come up for renewal; customers desert; a business needing a white knight can go from financially troubled to virtually insolvent. Three months of public review may itself *change* the market under consideration.



Calendar timing for public reviews, January – August 2012

So why the clock stoppers? Is it that businesses are not doing their homework, failing to provide sufficient information to the ACCC; are markets becoming more complex, making the merger test harder to apply; or has the ACCC's task become too big (looking at too many markets or trying to cover too many possibilities)?

To ask the right questions, it's helpful to look back to the Swanson Review undertaken when the *Trade Practices Act* (and one of your co-authors) was in its infancy. As well as resulting in several substantive changes to the law, the Swanson Report is important for articulating the policy reasons underpinning our merger regime.

Dig out your ABBA records & rewind to 1976

The original mergers test in the 1974 *Trade Practices Act* was similar to the present "substantial lessening of competition" formulation. In 1977, a year after the Swanson Report, the bar was raised to a "dominance" test, partly to make it easier for firms to achieve economies of scale through merger and to improve their international competitiveness.

The 1974 Act also contained a statutory clearance mechanism, as well as authorisation. Both were well used in the first few years. But statutory clearance was repealed in 1977 and, with the bar set at the dominance level, the use of authorisation decreased as fewer merger parties felt at risk of contravening section 50. Our present informal clearance process largely took hold as a risk management tool following the reintroduction of the "substantial lessening of competition" test in 1992.

The original clearance mechanism allowed parties to voluntarily notify proposed mergers to the ACCC's predecessor (the Trade Practices Commission). Importantly, and as per the current position with informal and formal clearance, a failure to obtain clearance did not mean a merger was prohibited.

From the start, our merger regime has reflected what the Swanson Committee called a "self-enforcing" approach (a statutory prohibition, reliant on compliance by business and enforcement by the ACCC). This can be contrasted with a "registration plus examination" approach involving mandatory reporting and clearance as a statutory pre-condition to a transaction.

The Swanson Committee concluded:

> *In the view of the Committee it is preferable… to have a prohibition-type law rather than a registration plus examination-type law. A good reason for this is that, given the existence of a prohibition-type law and some experience of its workings, the business community can arrange its affairs in mergers (and for that matter in relation to other types of conduct)* ***in a way which it believes complies with the law.***

Did you know?

In 1976... the Hawks were premiers, TV rights were in the news (cricket), and we were reviewing our merger processes

In addition:

*David Bradbury (current Minister for Competition Policy & Consumer Affairs) was born

*Steve Jobs & Steve Wozniak form Apple

*Matsushita introduces the VHS cassette

*IBM releases the first laser printer

> *The present system of clearance and authorisation offers a reasonable opportunity* ***for parties who believe that they have complied with the law****, or are entitled to the benefit of the exception which the authorisation procedure provides, to obtain assurance of their position by application to the Commission.* ***This is not to say that the Committee believes that the business community should apply for clearance or authorisation in respect of all mergers.***

The Swanson Committee also considered the appropriate timeframe, noting that some submissions said the clearance timetable (then 30 days) was too long, while others said it was "not long enough for the Commission to make a proper investigation, especially in complex cases…".

After considering the commercial constraints inherent in a merger, as well as other relevant timeframes (eg under takeovers law), the Swanson Committee concluded that a 30 day review period, with a maximum extension of 21 days, was appropriate. (In other words, not too different from the current target timeline of 6-8 weeks for informal clearance.) It observed that "time is quite critical in many merger matters" and it did not want to "detract from the incentive and urgency for the applicant to supply information, and the Commission to give its decision".

The implications of how we cast the net for mergers

Relying on a compliance and enforcement approach requires businesses to understand where the line is drawn. In its terms of reference, the Swanson Committee was specifically asked to consider the need to ensure that businesses could understand the law with sufficient certainty to enable compliance. So to assess whether the current *process* works, we need to consider the mergers *test* – and what has been done to broaden its scope since 1992.

A 2009 roundtable of the OECD Competition Committee debated international experiences with the two main tests used in merger regulation: substantial lessening of competition versus dominance. The main reason presented for using a dominance test was that it "provides bright line rules and therefore offers firms a higher degree of legal certainty". Conversely, the more flexible substantial lessening of competition test may "introduce a degree of uncertainty and unpredictability as to how mergers will be assessed, which may ultimately discourage firms from planning pro-competitive mergers in the first place".

The roundtable considered the consequences of each alternative:

> *The choice between a more rigid or a more flexible test also has policy implications on the type of merger regime that a jurisdiction wishes to put in place. The trade off is between more rigid rules, which may provide more certainty to firms but run the risk of letting some anti-competitive mergers go through, and more flexible rules, which can potentially catch all anti-competitive mergers but bear the risk of prohibiting some pro-competitive mergers.*

Australia, of course, has vacillated between the two tests – the last change being an intentional broadening of section 50 with the return to the "substantial lessening of competition" test in 1992. More recently, the 2003 Dawson Committee considered and rejected an efficiency test for section 50, in part because it would need a "more structured" and lengthy process than informal clearance allowed:

> *An economic efficiency test ... at the clearance stage would require more extensive economic analysis to be undertaken by the ACCC. This would require access to additional information and require more time to assess proposals. The ACCC might also need to consult more extensively with third parties than is necessary for the purpose of considering the likely effect of a proposed merger on competition. These circumstances would be likely to extend considerably the time taken to complete the clearance process.*

The policy dynamic for the gradual broadening of section 50 since 1992 has been concerns about "creeping acquisitions". Amendments over the last decade have included various minor changes in language to clarify the ACCC's ability to consider multiple markets when assessing mergers and to focus on narrow geographic markets at a regional and local level.

But little consideration has been given to the consequences of this constant focus on creeping acquisitions. Is it pressuring the ACCC to look at every possible market affected by a merger and to chase down every (local) burrow in case a creeping acquisition is lurking somewhere in the shadows?

Certainly, the ACCC seems to want more and more information, and a higher degree of certainty in informal reviews – seeking to reach the "right" decision, in a manner similar to the authorisation process. In the mergers context, the ACCC Chairman has recently made several statements of the following ilk:

> *We accept that the onus is on the ACCC as the regulator to make our processes as efficient as possible. Our bigger responsibility, however, is to get the decisions right. If there are delays in gaining information then there will be delays in decision making; while we will be as efficient as we can, we will not work to a fixed timetable.*

But, in the mergers space, the ACCC is an *enforcer*. And understanding the difference is critical. As is often the case, our New Zealand colleagues have done some hard yards in this area, if we'd only care to look.

It's critical to remember that, in the mergers space, the ACCC is an enforcer not a regulator

A regulatory model vs an enforcement model

New Zealand has the same merger test as we do (set out in section 47 of the *Commerce Act*), with a voluntary statutory clearance process in section 66. This permits the Commerce Commission (**NZCC**) to grant clearance if satisfied that an acquisition is unlikely to substantially lessen competition. If clearance is not granted within the statutory timeframe, then it is deemed to have been declined. The relationship between sections 47 and 66 was the subject of considerable discussion in the 2008 *Warehouse* case.

As a brief précis of the case, the two major supermarket chains in New Zealand were each seeking to acquire a new entrant (Warehouse). The NZCC declined their respective clearance applications. Both supermarket chains appealed successfully to the NZ High Court, before that decision was overturned by the Court of Appeal.

One of the issues facing the courts was how to deal with uncertainty. Could the NZCC legitimately say "we are not sure" and decline to give clearance until it had seen how future developments panned out?

The NZ High Court accepted that the NZCC might be in a position of uncertainty if available evidence was missing or withheld. Otherwise, though, it did not think it appropriate for clearance to be declined on the basis of uncertainty. It was concerned that this approach could result in potential acquisitions being put on hold until such time as the NZCC could make a decision.

The Court of Appeal disagreed, concluding that it was open to the NZCC to say "We are not sure and therefore we are not satisfied that there will be no substantial lessening of competition". (The Court of Appeal suggested, however, that it might be better to avoid the word "sure" given its use in the criminal law as a synonym for proof beyond reasonable doubt.)[1]

The Court of Appeal sharply distinguished the clearance process from litigation under section 47. It considered that the High Court's approach would effectively make the clearance test the same as the judicial test in enforcement proceedings. While the supermarkets argued that this was appropriate because the risk of uncertainty might discourage use of the clearance process, the Court of Appeal was unconvinced.

Indeed, it observed, "A potential acquirer does, of course, have the option of proceeding with an acquisition despite a failure to obtain clearance… and defending its actions if litigation later takes place". This is not as shocking as some may think; after all, it simply reflects the fundamental premise of a compliance/enforcement approach. Businesses deal with other legal obligations in this exact manner every day.

The Court of Appeal noted that originally the *Commerce Act* *required* clearance or authorisation: "Thus the Commission was very much the primary *regulator*, in contradistinction to the present situation in which the lawfulness or otherwise of an acquisition may fall ultimately to be determined under section 47 and thus by the High Court". But with the framing of section 47 as a general prohibition, and the creation of a voluntary clearance process, the NZCC's role changed:

> *Under the original scheme, the ultimate decision on an acquisition (subject of course to rights of appeal) was for the Commission. But under the scheme introduced in 1991, **a withholding of a clearance does not preclude an acquisition**. In such a case, the acquisition may proceed and any challenge to it is determined by the High Court under s 47. **The effect of a clearance is to preclude any later challenge.***

1 *In a link to Issue 3 of TSOC ("Metcash & beyond..."), the Court of Appeal also discussed the complexity of the standard of proof.*

Over the years, business has bowled an underarm delivery or two

If the clearance process isn't working as we'd like, business is hardly without blame. Those with even a passing acquaintance with the merger process know the games that can be played: the use of media; failures to provide sufficient information; running mergers through a clearance process when authorisation is more appropriate; creating time pressures by going to the ACCC too late.

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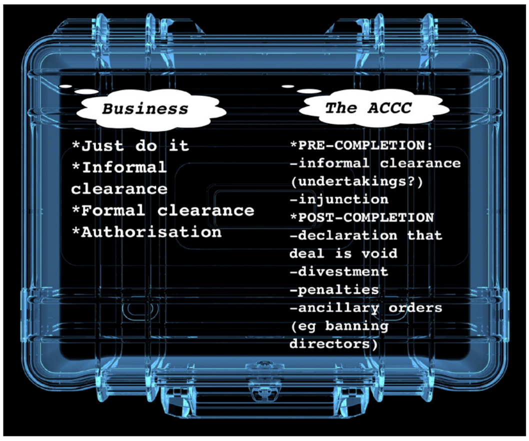

Both parties have an array of options from which to choose

It seems that business expects the ACCC to provide a "one size fits all" clearance process, whilst forgetting that there are other options available. Confident your merger won't breach? Just do it. (Notwithstanding claims to the contrary – and a certain piratical attraction to the title – this does not make you a "rogue".) Facing particularly tricky competition issues? Deal with the rigour of an authorisation. After all, the timing for two phase reviews lately is not too different from the statutory timeframe for authorisation. But don't only use a spoon when you have a knife and fork, and then complain that you can't cut your steak.

Questions to ponder

Informal clearance challenges us to ask under what circumstances is it appropriate for the ACCC *as an enforcer* to preclude any later challenge. Given the policy decision to adopt the "self-enforcing" prohibition approach and the fact that parties retain the option of proceeding if clearance is denied, should we accept that sometimes the "right" outcome might be for the ACCC to say "we are not sure"?

Might the public interest sometimes be better served by allowing a merger to proceed without clearance, but equally without ruling out a later challenge?

Our current system seems premised on the notion that once a merger completes, you can't do anything about it. But is that true? Even if divestment is too hard (and, frankly, overseas research suggests that the jury's still out), does that rule out penalties and injunctions as effective remedies? After all, they're the only enforcement responses to misuses of market power.

And why don't we ever look back and evaluate past merger decisions, as for example the UK Competition Commission does (see the link in the *Further reading* section below). The benefits of hindsight can't be over-rated.

Perhaps we could think of more nuanced variations of clearance – for example, a quick review whereby the ACCC provides clearance in the form of declining to seek to injunct or void a deal, but reserving the right to subsequently seek divestment, penalties and other orders.

Or we could consider implementing a mandatory review period – say, 1 year out from completion – as a trade-off for a quicker upfront review? The ACCC could grant clearance, but reserve the right to take action if this review reveals a problem.

Could these ideas speed up those 70% of one phase reviews that are currently spending 8-12 weeks in public limbo? Would businesses value shaving off a few weeks for the risk of action post-completion? If they have done their homework, one assumes they should be confident that there is no section 50 problem. This is not very different from a company with market power refusing supply when it knows that it can defend its position. But realistically, how many businesses treat section 50 in this way and do a really thorough assessment?

The ACCC has flagged an overhaul to its process guidelines. The time is right to do this. Merger reviews are taking too long and getting bogged down with increasingly detailed information requests – but arguably this outcome has been shaped by policy makers and businesses, as much as by the ACCC.

When conducting this review, we should remember the constraints imposed by the statutory test. The above discussion takes the current test as a given. But are we comfortable that section 50 as it stands is capable of compliance? If businesses are looking to the ACCC to determine whether they are breaching section 50 (instead of forming their own view) then perhaps they need to ask whether its operation is too broad (remembering that the 1977 shift to the dominance test was in part to provide more certainty).

If we want the ACCC to be a regulator (standing like St Peter at the Pearly Gates, holding the keys to completion), then we need to switch from the "self-enforcing" approach. That means considering notions such as mandatory notification, which have always been strongly resisted.

Whether we decide that it's the process or the test that isn't working, the answer won't be found in tinkering with the current system. World Series Cricket changed the way the game was run, played, watched and marketed. It required some big shifts in mind-set. Let's hope for an equally game changing re-think of our merger regime.

About the authors (then & now)

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Both Rachel and Alexandra are Australian Legal Practitioners within the meaning of the Legal Profession Act 2004 (Vic), with liability limited by a scheme approved under Professional Standards Legislation.

Further reading

• Rod Sims' speech to the Law Council in August 2012, containing a number of representative statements about the ACCC's role as a "regulator", merger timeframes and expectations: http://www.accc.gov.au/content/index.phtml/itemId/1075480/fromItemId/8973
• The UK Competition Commission's evaluations and analysis page: http://www.competition-commission.org.uk/publications/academic-analysis
• For a comprehensive list of, and links to, inquiries/reports into the *Trade Practices Act/Competition & Consumer Act*, see http://www.australiancompetitionlaw.org/reports.html
• The citations for the NZ *Warehouse* case are (High Court) [2008] 8 NZBLC 102,128 and (Court of Appeal) [2008] 12 TCLR 194
• And for the legislative framework and a brief history of section 50, look at French J's judgment in *AGL v ACCC* (2003) 137 FCR

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