AUSTRALIAN MERGER CONTROL: SLC V INDUSTRY ENGINEERING OR ECONOMIC THEORY – TAKEAWAYS FROM VODAFONE/TPG & PACIFIC NATIONAL

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IN BRIEF

- Two recent contested merger cases, the Vodafone/TPG merger and Pacific National's (PN) acquisition of Aurizon's Acacia Ridge Terminal (ART) (PN acquisition), have provided valuable guidance for the appropriate application of merger law in future mergers in Australia. To date, there has only been nine contested merger cases in the last four decades.
- Under section 50 of the *Competition and Consumer Act 2010* (CCA), mergers are prohibited if they would have the effect, or be likely to have the effect, of substantially lessening competition in the relevant market(s) (the SLC Test). The Australian Competition and Consumer Commission (ACCC) can authorise a proposed merger if it considers it would result in a net benefit to the public.
- Both mergers further clarified that 'likely' in the context of a merger assessment means 'a real commercial likelihood'. Specifically, the SLC test places the onus on the ACCC to prove the relevant SLC effects in the market.
- The quality of factual evidence will be key to determining the relevant counterfactual and assessing whether the merger will pass the SLC Test. Future states of competition cannot be engineered based on economic theories if they cannot be substantiated by reality.
- There may also be a shift in the ACCC's historical reluctance to accept behavioural undertakings from the merger parties to alleviate any anti-competitive impacts of the proposed merger. The PN acquisition demonstrates that behavioural undertakings may be appropriate even for concentrated markets, providing future merger parties with greater scope to negotiate potential undertaking remedies.
- Given that the ACCC did not succeed based on factual findings in both merger cases, it may not be appropriate or necessary to reform current merger laws. However, in the event that such a merger law reform is forthcoming, it is clear that further consultation and regulatory consideration will be required to ensure any reforms will be holistic and commercially workable.

FACTUAL SNAPSHOTS

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Vodafone v ACCC (Vodafone/TPG Merger)

Vodafone is one of three Australian mobile network operators and TPG is a leading supplier of domestic fixed broadband services.

Following Vodafone and TPG's announcement in July 2018 regarding a proposed merger of the two entities, the ACCC conducted a public review and decided to oppose the merger. The key issue in the ACCC's assessment and the later litigation was whether, as a counterfactual to the proposed merger, TPG would invest in rolling out its own 5G mobile network, and then compete with the existing networks operated by Telstra, Optus and Vodafone.

Vodafone commenced court action seeking a declaration that the transaction would not result in a substantial lessening of competition in the supply of retail mobile services in Australia. In February 2020, the Federal Court (Middleton J) granted the declaration and allowed the merger to proceed. The ACCC did not appeal the decision.

ACCC V PACIFIC NATIONAL (PN ACQUISITION)

In late 2017, Aurizon announced an intention to sell its interstate, intermodal freight business and PN agreed to buy the business, which included the ART, a significant multi-user rail terminal connecting interstate freight in Queensland. PN is a major ART user and is also the largest provider of intermodal freight services in Queensland (and more broadly, Australia).

The ACCC, during the informal merger clearance process, objected to the transaction despite PN offering a number of voluntary behavioural undertakings intended to ensure other freight providers' access to the ART.

In July 2018, the ACCC commenced Court action against PN, alleging amongst other things, that the proposed acquisition of the business would substantially lessen competition in the supply of interstate rail line haul services as PN would be able to price discriminate against other ART users and deter new entrants. During the course of the litigation, the focus narrowed from the intermodal business to the ART as a standalone asset.

PN proposed undertakings near the conclusion of the trial/hearing that it suggested could be considered as part of a final outcome. That course was opposed by the ACCC on the basis that the Court could not provide a view on "draft" proposals as part of a trial. Instead, the Court was required to assess whether a proposed transaction would substantially lessen competition and then consider remedies, which may include an undertaking in the form of an injunction.

In May 2019, the trial judge accepted that PN's behavioural undertaking that it would not engage in discriminatory conduct against its competitors when providing third party access to the ART (PN Undertaking) was sufficient to mitigate any anti-competitive effects from the Proposed Acquisition.

In June 2019, the ACCC appealed the trial judge's decision both on the competition assessment and the procedural point regarding consideration of an undertaking. Aurizon and PN cross appealed, claiming that the transaction would not substantially lessen competition, so the undertaking should not be required.

In May 2020, the Full Federal Court (Full Court) dismissed the ACCC's appeal and allowed the merger parties' cross appeals. In doing so, it released PN from its undertaking and held that even in the absence of the PN Undertaking, the PN Acquisition did not the SLC as alleged by the ACCC.

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CONTEXTUALISING THESE CASES IN AUSTRALIA'S MERGER REGIME

There have only been nine contested merger cases over the last four decades, so two contested merger cases in one year is a very rare opportunity to allow the Court to provide clarity on relevant legal principles and other compelling insights for future transactions.

Under s50 of the CCA, the ACCC can have regard to a range of factors in deciding whether to allow a merger, including considering barriers to entry, existing competitive dynamics in the market, what the market is likely to look like in the absence of the merger (Counterfactual).

Australia's merger process is unusual in that the most common path is for the merger parties to seek informal clearance from the ACCC. The ACCC conducts its own investigation and decides whether it considers the merger will substantially lessen competition compared to the Counterfactual, including any undertakings offered by the parties. If the ACCC is satisfied there will not be an SLC effect, it advises the parties that it will not seek an injunction and the transaction may proceed. Although third parties may later challenge the transaction and seek damages, they do not have standing to apply for an injunction against mergers.

In rare instances, where the merger parties are concerned that the transaction is likely to contravene the SLC Test, they have the option to go through the public authorisation process and request the ACCC to assess the merger based on the 'public benefits/detriments' test (only two parties have done so since November 2017). Out of all the mergers publicly reviewed by the ACCC, the overwhelming majority of these mergers is approved. In the minority merger cases, the merger parties may have chosen not to proceed due to unsatisfactory commercial negotiations or in anticipation of an unfavourable ACCC determination.

PRACTICAL LESSONS FOR FUTURE MERGERS

1. Clarification of the relevant legal tests for merger assessment

The Court in both merger cases affirmed the meaning of 'likely' in determining whether a transaction is 'likely' to satisfy the SLC Test. There was previously some uncertainty in the jurisprudence (notwithstanding earlier judgments regarding this issue such as in proceedings relating to the grocery wholesale acquisition of Franklins by Metcash) regarding the relevant formulation for 'likely', that is, whether it should be 'a probability that is not less than 50 per cent' or 'more probably than not' or 'a real, not remote chance'.

In *Vodafone/TPG*, Middleton J supported a statutory construction of 'likely' in the context of s50 of the CCA as requiring the demonstration of a 'real chance'. Similarly, in the PN Acquisition, the Full Court affirmed that 'likely' in this context means "*a real commercial likelihood, whether or not the likelihood is greater or less than 50%*".

In *Vodafone/TPG*, the Court also made an important observation that s50 of the CCA does not require merger parties to prove that the merged entity would become a more effective competitor as compared to the competitive restraint absent the merger. That is, there is no positive duty imposed by statute on the merger parties to demonstrate that their merger will increase competition; it is enough that it is not substantially lessened.

2. Competition cannot be engineered from economic theories alone

Determining the correct counterfactual is a key step to accurately predicting the future state of competition, as part of determining whether the merger will pass the SLC Test (unless the parties seek authorisation as referred to above).

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In the Vodafone/TPG merger, the Court considered and accepted evidence demonstrating the technical, financial and timing difficulties TPG faced in attempting to roll out a 5G mobile network. In doing so, the Court rejected the ACCC's theory that it was likely there was a real chance that TPG could become a 'fourth' mobile network operator in Australia.

Middleton J also opined that executive views regarding what the merger parties are likely to do in the future, in the absence of the merger, cannot be completely dismissed only because they may be self-serving.

His Honour was persuaded by TPG's executive chairman and CEO, David Teoh's view that TPG was unlikely to enter the market as a fourth retail mobile operator . This was on the basis of Mr Teoh's extensive industry experience and his history of rational commercial decision making particularly contextualised against the real commercial challenges that TPG has encountered in attempting its 5G network roll out.

Similarly, in the PN Acquisition, the Court accepted factual evidence supporting the merger parties' contention that the prospect of new entry into the relevant markets were speculative (including in light of adverse statements made by the most likely prospective entrant, Qube). The Full Court also cast some doubt on the economic theories and views of experts, when tested against the facts that emerged during the course of the proceedings.

Both mergers suggest that economic theories must be contextualised and supported by evidence. Otherwise, they will fail to be relevant for determining counterfactuals. In this regard, evidence relating to the merger parties' financials, past attempts to pursue alternative options, community pushback/complaints, Board papers/minutes regarding competitive strategy, even executive views are likely to be useful in assisting the merger parties in crafting a compelling and accurate counterfactual.

3. Behavioural undertakings may be appropriate - even for concentrated markets

The ACCC (similar to other competition regulators) has expressed a consistent disinclination to accept behavioural undertakings as a remedy for mitigating the anti-competitive effects of a transaction as it largely relies on the goodwill of the merger parties and is practically difficult to monitor and enforce such remedies on a permanent basis.

The ACCC looks more favourably on structural undertakings, often in the form of divestitures of the merger parties' businesses. The ACCC's view is that structural changes to the market are quicker to monitor and enforce with permanent effects.

The ACCC rejected PN's proposed behavioural undertaking. The PN Undertaking involved a number of mechanisms to prevent discrimination in the terms offered to users of the ART and to facilitate the detection of any price discrimination. The undertaking also included internal information sharing barriers to prevent non ART PN employees from accessing other ART users' confidential information and compulsory and independent dispute resolution mechanisms.

The Full Court in the PN Acquisition held that the relevant undertaking is not 'impermissibly vague' and contains many reference standards that are familiar to the Court and has been determined by it in the past. These include criteria such as requiring ART users to prove to PN's 'reasonable satisfaction' that they fulfil various commercial factors before being allowed by PN to access the ART, and the inclusion of a 'no less favourable clause' for pricing terms under the relevant access agreements.

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The judgment may prompt merger parties to propose more favourable and flexible behavioural undertakings in future, either in addition to, or as an alternative to more traditional structural undertakings. The ACCC may also become more open to considering behavioural undertakings as a sufficient remedy in merger contexts in light of the PN Acquisition.

Is it Time for Australia's Next Merger Law Reform?

It may be timely to consider whether the ACCC's consecutive losses in these contested merger cases suggests that there may be an inherent gap in merger law that needs to be remedied by legislation.

The ACCC's Chairman, Rod Sims, has stated publicly that following these decisions, he would "work up some suggestions" to change current merger law. The exact content of these suggestions would have to be revealed in due course, but Mr Sims has foreshadowed that he wants Australia's merger laws to focus on a change in market power rather than predicting the future.

It is likely that the rationale of any proposed changes to the current merger regime would be to enable the ACCC, at least in part, to have a lower evidentiary threshold to prove that a proposed transaction would contravene the SLC Test. In both contested mergers, in essence the courts found that the ACCC was not able to support its theory of the likelihood of new entry absent of the merger based on the factual findings.

In light of the ACCC's comments of its desire in a shift of emphasis in approach to Australia's merger regime, there is also a scintillating possibility that any future merger reforms in Australia may provide a greater level of statutory guidance to prospective merger parties, about the evaluative process involved in determining whether a proposed merger or acquisition is green lighted or not.

While the likelihood, timing or content of the merger regime reform remains uncertain, what is certain is that further public consultation and regulatory consideration is required to implement a holistic merger law reform that will result in more competitive markets and improve outcomes for consumers.

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