AUSTRALIAN INVESTMENT COUNCIL

30 January 2024

Competition Taskforce
The Treasury
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To whom it may concern

Merger Reform – Consultation Paper

The Australian Investment Council welcomes the opportunity to provide this submission to Treasury for the consultation on Merger Reform.

The Australian Investment Council (**the Council**) is the peak body for private capital in Australia and has over 220 members, including the leading domestic and international private capital firms operating in Australia. Private capital spans private equity, venture capital, private credit, family offices, superannuation, and sovereign wealth funds.

The Council represents Australia's private capital industry on policy issues that impact investment into Australia, including maintaining a steady and reliable flow of domestic and foreign investment capital, building, and retaining a world class talent pool, harnessing, and empowering innovation to support the national interest, and addressing the challenges of climate change to realise the opportunities of a net zero world.

Many of the Council's members invest in existing and new businesses, and technologies that will drive innovation and support the transition of the economy to net zero and other positive social outcomes. Merger activity can serve multiple investment purposes such as:

- Helping fast-growth companies access new markets, talent, products and services to support their growth and expansion strategies;
- Adding value to, and reshaping, companies which otherwise, may not remain independently viable; and
- Assisting companies in achieving strategies that support growth, innovation and productivity in the Australian economy.

Our response to this consultation is based on the perspectives and experience of private capital investors within our membership. Key issues for our members include:

- Ensuring the regulatory framework facilitates commercially viable merger transactions and supports vigorous competition;
- Recognising the unique merger needs and practices across the business spectrum ranging from early-stage to growth and buyout businesses; and,

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- Establishing a framework that is consistent with the requirements of Australia’s growing investment environment and broader M&A activity both domestically and internationally.

The Council recognises the challenge of achieving the desired objectives for the reforms given the significantly wide breadth of the industries and industry participants surrounding merger activity. The Council would welcome further consultation on the issues raised in this submission as part of Treasury’s consultation process.

If you have any questions about specific points made in this submission, please do not hesitate to contact me or our policy team via email at policy@investmentcouncil.com.au.

Yours sincerely

Navleen Prasad
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Australian Investment Council

1. Merger Reform Consultation

External investment and company growth including through merger and acquisition activity is critical for the productivity of our nation.

Merger regime settings are of vital importance to private capital. A merger clearance regime is a significant factor in determining how easy – or difficult – it will be for SME founders, and their investor-backers, to exit through a sale process. An unnecessarily restrictive merger regime risks diminishing investment, creating a barrier to entry by increasing the height of the barriers to exit. By stifling investment incentives, there is a significant risk to the likelihood of entry and innovation, and ultimately, on the likelihood of disruption that fuels competition.

A regime that significantly increases the risk of opposition to proposed mergers or acquisitions while further limiting a business' ability to fully challenge a decision, would undermine Australia's flourishing innovation ecosystem, running contrary to the purpose of Australia's competition law framework – to enhance the welfare of Australians that benefit from that entrepreneurship and innovation.

The Council supports a merger regime that encourages vibrant competition and avoids chilling investment, risking the diversion of capital and innovation to other markets.

2. Current status of the merger regime

Each year, the majority of mergers assessed by the ACCC are of no competitive concern and are approved by pre-assessment. This is evidenced by the 305 mergers assessed by the ACCC in FY23, where 284 were finalised by pre-assessment and 21 were subject to public review.[1]

The regime has been working effectively in its current form with the overwhelming majority of mergers approved without the need for any further public consultation. This means that in most instances, merger activity can be completed in a timely manner and that Australia has remained an attractive place to invest.

The broader merger environment in Australia has been active and vibrant in recent years, where more than one thousand transactions have been completed on an annual basis in the three years to FY2023.

Analysis by advisory and chartered accounting firm HLB Mann Judd shows 1,077 M&A deals were completed in Australia in FY2023 while 1,455 and 1,314 were completed in FY2022 and FY2021 respectively[2] (as depicted in Figure 1 below).

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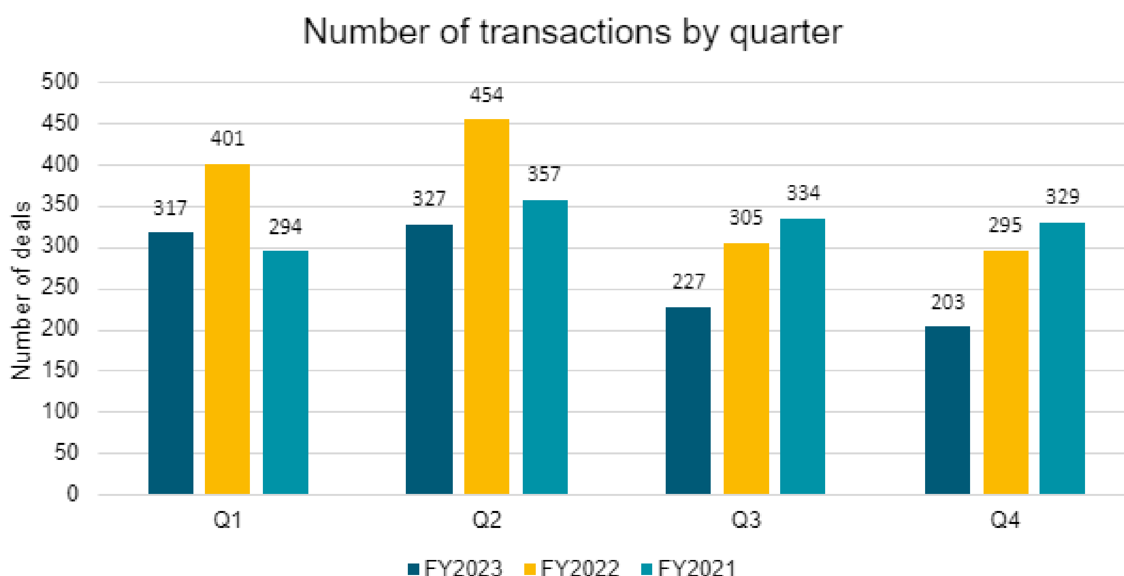
[1] ACCC and AEC Annual Report 2022-23

[2] Mergers & Acquisitions Annual Report - FY2023 and Beyond, HLB Mann Judd, October 2023.

Figure 1: Mergers and Acquisitions in Australia FY2021 to FY2023



The experience of the industry has been that typically, the ACCC has worked efficiently in intervening in relation to transactions that raise competition concerns and in finding solutions:

- As outlined above, the majority or mergers assessed by the ACCC are given pre-approval under the current regime which is working effectively.
- Merger parties in Australia have very rarely taken cases to court. Since 2002, merger parties have challenged only approximately eight per cent of the cases that the ACCC has opposed.[3] Instead, the parties have generally found solutions in either negotiating remedies or deciding to withdraw from a transaction.
- Cases that do go to court are generally complex and it is, therefore, important in these instances for companies to have a right to appeal.
- Of the total merger cases reviewed by the ACCC over the past five years, only two cases have been challenged in court.[4] The relatively few court cases determined in the ACCC's favour is only a small measure of its efficacy in intervening in mergers. Cases rarely go to court as merger parties rarely choose to contest ACCC oppositions in the informal clearance process. It is only in very rare cases where merger parties have a strong conviction that they would be prepared to challenge the ACCC in court. Nevertheless, despite the relative infrequency with which the right to challenge the ACCC's view is exercised, its availability as a remedy is fundamental to due process and the rule of law.

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[3] Only six of the approximately 69 ACCC-opposed cases since 2002 have been appealed by the merger parties to the Court, see Justice M. O'Bryan, 'Section 50: Should the Burden of Proof be Shifted', Current Issues in Competition and Consumer Law, 2021, p183.

[4] Vodafone Hutchison Australia Pty Ltd v Australian Competition and Consumer Commission [2020] FCA 117; Australian Competition and Consumer Commission v Pacific National Pty Ltd (2020) 277 FCR 49

3. Policy design and purpose

The Council agrees that the overarching policy objective of Australia's merger control regime should be to promote competition that enhances the welfare of Australians, consistent with the object of the *Competition and Consumer Act* 2010 (Cth) (CCA). An efficient and effective merger control regime should seek to achieve its policy objectives at the lowest cost possible and in a timely manner, with appropriate powers and resources for the competition authority.

Ideally, mergers that are pro-competitive (or do little or no competitive harm) should proceed, while anti-competitive mergers should be prevented. While in practice this goal is challenging to achieve, given it is hard to predict the future effects of a proposed merger, there is little evidence to demonstrate that there are fundamental failures or shortcomings in Australia's current regime contributing to ill effects.

Where the Consultation Paper suggests that productivity growth in Australia has slowed, measures of dynamism have declined – namely industry concentration, incumbency, and firm mark ups – and competition indicators suggest a deterioration in competition in Australia since the early 2000s, there is no evidence to suggest that this is because of failure of Australia's merger regime.

In contrast, typically mergers are efficiency enhancing, particularly in the absence of overlaps or where there are only minor overlaps as defined under Section 45 (7) of the *Competition and Consumer Act 2010 (Cth).* Primarily, mergers provide individuals who have invested in, and built up a business, with the opportunity to realise a return on their efforts and investments. They also provide an opportunity for efficiency enhancing measures to be implemented in a business, to drive down costs, produce better products and lower prices for consumers. The primary purpose of a merger is to drive efficiencies, to combine assets and leverage the better resources, talent and capital available between the two merging entities. This should not be forgotten in the rush to reform.

Merger activity in Australia has been relatively consistently spread across industries from FY2021 to FY2023 as demonstrated in Figure 2. [5]

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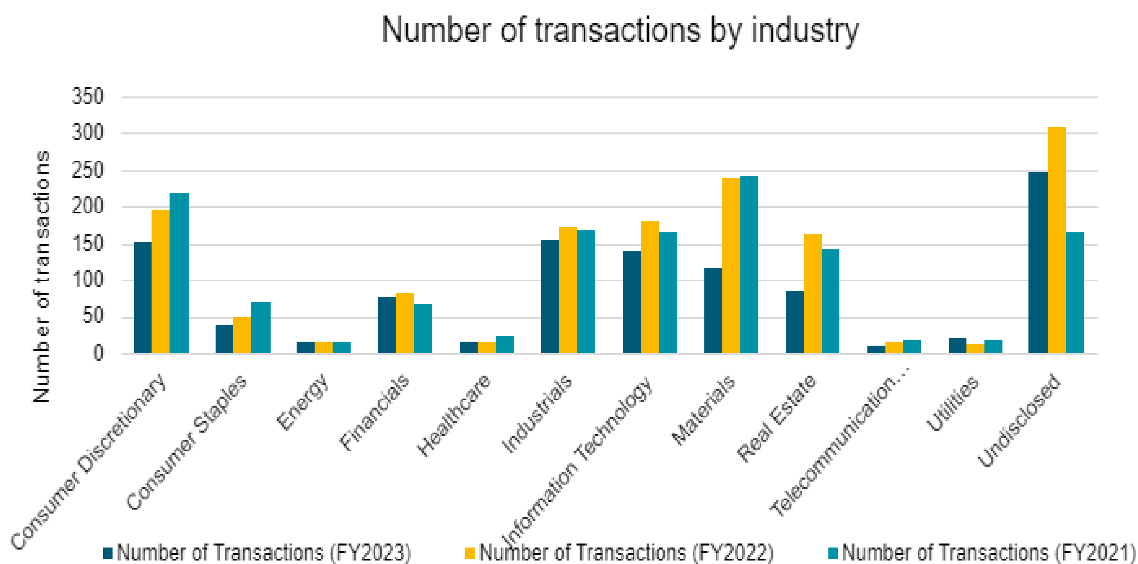
[5] Mergers & Acquisitions Annual Report - FY2023 and Beyond, HLB Mann Judd, October 2023.

Figure 2: Mergers and Acquisitions by industry FY2021 to FY2023



4. Changes to the Merger Reform process

Option 1 – A voluntary formal clearance regime would be introduced, where businesses could choose to notify a merger and the ACCC could grant legal immunity from court action if satisfied the merger would not be likely to substantially lessen competition (SLC).

The Council and its members do not support this option for the following reasons:

- It would involve reversing the burden of proof (where the merger parties must prove the merger is not likely to SLC, rather than the ACCC needing to prove the merger is likely to SLC) and implementing a limited merits review to the Australian Competition Tribunal (Tribunal) for all mergers.
- It is not clear what the role of the Tribunal versus the Court is in this model.
- A reversed onus of proof would be out of step with merger regimes globally and overly burdensome by requiring merger parties to prove a negative. Given the inherently uncertain nature of the future, it will frequently be impossible for the ACCC to be satisfied that no substantial lessening of competition is likely. In contrast, under the current informal clearance regime, the ACCC may only obtain an injunction to block a transaction if, inter alia, it establishes (on the balance of probabilities) that the merger has a real chance of substantially lessening competition.
- In relation to the review process, a full merits review would be significantly preferred due to the procedural fairness it encourages, in allowing for third-party discovery and cross examination.

Option 2 – A mandatory and suspensory regime would be introduced, with compulsory notification of mergers above a threshold. Transactions would be suspended for a period while the ACCC conducted its assessment. To prevent an anti-competitive merger, the ACCC would need to prove to the court that the merger would be likely to substantially lessen competition.

The Council believes that this option is most consistent with procedural fairness as it gives merging parties the opportunity to gather evidence to support a proposed merger, and it reserves the ability of an independent body (the Federal Court) to test the regulator's initial decision.

As seen in Australia's current merger review framework, the courts have been efficient in assessing merger cases with judgments generally made well within a year. The Council and its members believe the courts play an important role in the review process and have demonstrated efficacy, and therefore prefer this option to a limited tribunal review.

The Council believes that the time period for the ACCC to consider the notification of a merger should be fixed by statute and there should be limited scope to extend the timetable. A merger should be conditionally approved if the time period expires and the ACCC has not applied to the court to prevent the merger. If there is a mandatory filing process, there should also be a well-developed, efficient, and timely simplified process for transactions which raise no concerns.

There is also a question about the extent to which mergers falling below the clearance regime would be treated.

Option 3 (ACCC's proposal) – A mandatory formal clearance regime would be introduced, with compulsory notification of mergers above a threshold and allowing the ACCC to 'call-in' transactions below the threshold where there are competition concerns. The ACCC would only grant clearance if it was satisfied the merger was not likely to substantially lessen competition.

The Council and its members do not think this option is workable as it also features the reversed onus of proof and limited merits review, noted in our comments against Option 1.

It is also important to consider that M&A activity is not the exclusive domain of large, well-resourced businesses: being acquired or merging with another business is a common way for small and medium-sized businesses to grow, and potentially provide stronger competition for larger incumbents in a given industry. Mandatory clearance regimes typically raise cost and complexity and, in this case, risk posing as a disincentive to what might otherwise be positive M&A activity.

5. Areas of concern

As noted above, the Council's key areas of concern are highlighted as follows:

Onus of proof

As stated above, changing the onus of proof and making the test an administrative requirement for the party to prove there is no SLC is an extremely difficult test to satisfy.

Limited merits review

Also as noted above, the proposal to have a limited merits review by way of evidence submitted to the ACCC, with no discovery rights – which would be submitted to the Tribunal – would be problematic for the Council and its industry members.

A regime that provides transparency and procedural fairness for all steps in the transaction clearance process would be most preferable.

Clarity needed for thresholds

There are several areas where clarity is needed regarding the proposed thresholds contained within the Consultation Paper.

Transaction notification

- One area for improvement is in relation to when notification of a transaction needs to be made to the ACCC. This could be remedied by having a mandatory regime with de minimis exemptions, with legislation providing clarity on the thresholds for when the parties are required to notify the ACCC on a transaction.

Application

- Consistency must be applied to transaction based on turnover and transaction value to determine whether a merger meets the threshold for review. Thresholds must be applicable to all relevant transactions. This is particularly important for global transactions to ensure relevant merger processes are assessed early and to mitigate against unnecessary costs and delays.

Transaction types

- Work needs to be done in establishing relevant thresholds that are set at the right level for all transaction types and that consider the size of the companies involved.

Threshold scope

- The Council notes the ACCC's indication of two potential thresholds being a combined turnover threshold of A$400 million or a global transaction value threshold of A$35 million.
- The average transaction value for all mergers in FY2023 was A$92.9 million[6], well above the threshold of A$35 million that is being proposed.
- The proposed thresholds appear low compared to other jurisdictions and warrant more consideration.
- For example, in the EU, the European Commission only examines larger mergers with an EU dimension that reach larger turnover thresholds. This is assessed in two alternative ways.

[6] M&A Activity Year in Review 2023, HLB Mann Judd

The first alternative requires:

1. a combined worldwide turnover of all the merging firms over €5 000 million; and
2. an EU-wide turnover for each of at least two of the firms over €250 million.

The second alternative requires:

1. a worldwide turnover of all the merging firms over €2 500 million;
2. a combined turnover of all the merging firms over € 100 million in each of at least three Member States;
3. a turnover of over €25 million for each of at least two of the firms in each of the three Member States included under ii (see Article 1 of the EU Merger Regulation) [7]; and
4. (EU-wide turnover of each of at least two firms of more than €100 million. In both alternatives, an EU dimension is not met if each of the firms archives more than two thirds of its EU-wide turnover within one and the same Member State.

- Work needs to be done in establishing relevant thresholds to ensure they are set at the right level for all transaction types and consider the size of the companies involved.

Turnover and deal value thresholds

- In general, turnover or transaction value are better thresholds in comparison to market share thresholds as turnover or deal value thresholds are not plagued with the question of what is the appropriate definition of the 'market' faced by applying market share thresholds. This often requires parties to engage with the authority to be satisfied the same view of the market is adopted, which is often an area of considerable contention in competition law and economics.
- If turnover and transaction value thresholds are adopted, these should be consistent with regimes in other jurisdictions; eg: the European Union, where there are existing detailed rules and guidance, and would reduce the need to perform separate calculations for Australia, which would otherwise create inefficiencies. The turnover thresholds should also require some effect of the transaction on a market in Australia for the regime to apply (eg: by requiring both acquirer and target to have a presence or sell to customers in Australia).

The Council would welcome the opportunity to work with Treasury through further consultation to set thresholds.

6. Market concentration

The Council has reservations on the market concentration statements that have been used to justify the reform options outlined in the Consultation Paper and the suggestion that a loss of

[7] Article 1, EU Merger Regulation

productivity in Australia is attributable to market concentration as outlined in a report published by Treasury.

In contrast, there is also significant research that rejects attributing any productivity loss to market concentration. This is demonstrated in a paper published by the Reserve Bank of Australia in 2018 which shows that while the concentration of businesses in the retail sector had increased, mark-ups had declined as outlined in the case study below.

Business Concentration and Mark-ups in the Retail Trade Sector

A study by Jonathan Hambur and Gianni La Cava published in December 2018 by the Reserve Bank of Australia, *Business Concentration and Mark-ups in the Retail Trade Sector*, found the opposite when considering the impact of concentration and mark ups in the Retail Trade Sector. In that article the authors explored trends in competition among Australian businesses using two key indicators: the share of sales accounted for by the largest firms in an industry (or business concentration); and the ratio of prices to marginal cost (or mark-ups).

The authors found that business concentration had risen in recent years, most notably in the retail trade sector. But, at the same time, mark-ups in the retail trade sector had declined, after increasing over the 2000s. The authors said that although puzzling – how can a sector become increasingly dominated by a few large players and yet be more price competitive? However, this could be explained by the fact that 'Microeconomic theory has shown that business concentration is not the same thing as competition. An industry can be very concentrated and highly competitive. An industry can be very dispersed and uncompetitive too. The level of competition in an industry partly depends on how many businesses there are and how big they are. But it also depends on other factors, such as how easily new firms can enter the industry, and whether consumers can easily switch between different firms' products.

In the case of retail trade, the authors said that 'trends in business concentration and mark-ups in retail trade can be reconciled by recognising that competitive dynamics in the sector are not well captured by concentration measures. For example, the entry of a large player in an industry that has two big incumbent firms and many small businesses is likely to lead incumbents. In either case, the entry of this large market player is likely to be seen by the small businesses as increased competition.' to greater market concentration but could represent more competition for the large incumbents. In either case, the entry of this large market player is likely to be seen by the small businesses as increased competition.' [8]

[8] Competition, dynamism and productivity - Speech - Productivity Commission (pc.gov.au); Volume 1 - 5-year Productivity Inquiry: Advancing Prosperity (pc.gov.au).

There is substantial economic evidence that warns against assuming concentration alone leads to loss of productivity as outlined in the ACCC Digital Platforms Services Inquiry's *Discussion Paper for Interim Report No. 5* (see Global Antitrust Institute, George Mason University). This evidence also warns against assuming that mergers increase prices, and relatedly, assuming that allowing mergers is a risk (rather than a benefit) to Australians.[9]

Instead, as Treasury itself has noted, Australian consumers and businesses often benefit from M&A activity. The Council and its members strongly agree with Treasury on this point and encourage Treasury to consider this important principle in the context of the settings to be adopted by the reforms.

7. Encourage innovation

Innovation is crucially important to the Council's members, as well as the Australian economy more broadly. There is a real risk that, if the bar is set too high, strategic buyers will lack the appetite to engage in a challenging process and therefore withdraw from the Australian market, thereby limiting competition among buyers to acquire innovative businesses. In turn, this will undermine the incentives of institutional capital to invest in start-ups, as the risk that these investors will not be able to realise their initial investments could be significant.

Similarly, start-up businesses may not be able to enter the market because they may lack access to capital, thereby reducing incentives to innovate. Consequently, far from protecting competition, the proposed reforms may have exactly the opposite effect, supressing competition by limiting incentives to enter the Australian market.

An example of this would be where the innovation of a product is in the domain of a start-up or early-stage company, but a large company may be better placed and required to commercialise the innovation of the start-up and make its benefits available on a large scale.

8. Better transparency in processes and decision-making

There are opportunities to enhance the transparency in the ACCC's processes and decision-making which, relative to some other jurisdictions, are somewhat opaque.

In reforming the regime, consideration could be given to the introduction of procedural rights for merger parties such as those that currently exist in foreign jurisdictions. For example, the right to be heard and respond to the evidence and arguments against the merger (including the right to an oral hearing before the decision-makers) and full access to the file.

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[9] See Global Antitrust Institute, George Mason University, 'On the ACCC Digital Platforms Services Inquiry's Discussion Paper for Interim Report No. 5', Comment on the Global Antitrust Institute Antonin Scalia Law School, Georg Mason University

In the interests of transparency, there should also be obligations on the ACCC to present all of its evidence to the parties by a particular deadline in the review timetable to allow the parties sufficient time to review and respond.

Providing more detail on the ACCC's decisions would help to improve the precedential value of those decisions and their outcomes.

9. Potential impact on private capital investment in Australia

Australia has traditionally been a net importer of investment capital which has meant households, businesses and governments have spent more on investment in areas such as new housing, infrastructure and business equipment than they could finance from their own savings through borrowings or investment from offshore.

As a net importer of capital, Australia has benefited with an economy that grew faster, and a standard of living that improved more rapidly, than what would have been achieved if the investment was done from onshore.

However, in 2019 the situation reversed; Australia had more in savings than incoming investment and become a net exporter of capital. Consequently, a reduced flow of foreign investment capital has led to a lower rate of investment into business improvement and expansion. This is evidenced by the decline in the intensity of research and development (R&D) activities undertaken by Australian businesses which reached its lowest level in 20 years in FY22 at 0.93 per cent of GDP. [10] This decrease in R&D intensity made Australia an outlier when compared to the OECD and G7 major economies.[11] Labour productivity also decreased by 4.6 per cent in the year to March 2023.[12]

Achieving improved productivity will depend on our capacity to continue to innovate and invest for growth to create new employment opportunities across the economy. High growth Australian businesses and our leading innovators and entrepreneurs will play a central and pivotal role in driving productivity, especially when they are backed by the investment and strategic support which comes from partnering with private capital firms.

Private capital relies on domestic and foreign capital which is pooled into a fund then deployed with the support of human capital to help companies scale and grow, to provide a return to investors, and to transition the business to the next owner.

When private capital fund managers invest into Australian businesses they have a clear mandate to help those businesses grow and to bring their innovations to market to support consumer and business outcomes. In order to deliver long-term returns for investors into private capital funds, it is necessary to have a clear vision for how investments will be exited

[10] ABS Research and Experimental Development, Businesses, ABS National Accounts, Ai Group Research & Economics

[11] OECD MSTI Database, Ai Group Research & Economics

[12] PC productivity insights, Bulletin 2023, Productivity Commission, July 2023

at the time that initial investment decisions (on entry) are being made. The most appropriate exit option will be determined by specific criteria, including the size and maturity of the business, the desires of the founders, market conditions and the business' future needs for debt and equity funding.

Merger and acquisition activity is crucial in two ways:

- as a part of the investment cycle at the fund level; and
- as an enabler for businesses to grow and to access new markets.

If the proposed reforms limit mergers, their primary impact on Australia's Private Capital Industry will be reduced investment in Australia due to a perceived reduction in exit opportunities for investors.

If the proposed reforms increase the timeline for the regulator assessing the validity of a prospective merger, the impact will be varied. The impact of delay on a transaction can vary depending on the specific circumstances, the nature of the deal and the regulatory requirements involved. These include:

Extended timelines

- Delays inevitably extend the overall timeline for completing the transaction. This may affect the buyer's strategic planning, financing arrangements, and other aspects of the deal.

Increased costs

- Delays may result in increased transaction costs, including legal and advisory fees, financing costs, and other expenses associated with maintaining the deal over an extended period.

Increased uncertainty

- Prolonged regulatory reviews introduce uncertainty into the transaction. The buyer may face challenges in making strategic decisions, such as integration planning and personnel decisions, without knowing when regulatory approval will be obtained.

Market conditions

- Market conditions can change during the regulatory process, impacting the valuation of the target company. Fluctuations in economic conditions, industry trends, or interest rates could affect the perceived value of the deal.

Financing challenges

- Securing financing for the transaction may become more challenging if the regulatory process is prolonged. Lenders and investors may be hesitant to commit funds over an extended period, potentially leading to re-negotiations or adjustments to financing terms.

Competitive landscape

- Regulatory delays may provide an opportunity for other potential buyers to enter the picture or for the target company to explore alternative transactions. The competitive landscape can change during an extended regulatory process.

Contractual implications

- The parties involved may need to revisit, and potentially amend, the terms of the acquisition agreement to account for the extended timeline. This may involve negotiating extensions, revising conditions, or addressing other contractual considerations.

Employee and stakeholder concerns

- Prolonged uncertainty can create concerns among employees, customers, and other stakeholders. Communication and management of expectations are crucial to maintaining trust and stability.

Strategic re-evaluation

- The buyer may need to reassess the strategic rationale for the acquisition. Changes in market conditions, business dynamics, or the regulatory landscape could necessitate a re-evaluation of the deal's benefits.

Termination rights

- The acquisition agreement may include provisions allowing either party to terminate the deal if certain conditions, including regulatory approval, are not met within a specified timeframe. Delays may trigger termination rights and require re-negotiation or extension of these provisions.

10. Conclusion

A merger regime that sensibly welcomes foreign investment capital, vibrant competition, and avoids diminishing investment will be critical for Australia's economic growth., It will also help to safeguard against the diversion of capital and innovation to other markets.

It is therefore crucial that the proposed regulatory reforms do not tip the balance between encouraging and discouraging the flow of foreign investment capital needed to help businesses grow and expand, create new employment opportunities and boost productivity.

A regime that significantly increases the risk of opposition to proposed mergers or acquisitions while further limiting a business' ability to fully challenge a decision would undermine Australia's flourishing innovation ecosystem, running contrary to the purpose of Australia's competition law framework – to enhance the welfare of Australians that benefit from that entrepreneurship and innovation.

To ensure Australia's merger regime remains attractive on a global scale and continues to achieve its policy objectives, the Council and its members believe close consideration will need to be given to the proposals on:

- **Onus of proof** – As stated above, changing the onus of proof and making the test an administrative requirement for the party to prove there is no SLC is an extremely difficult test to satisfy.
- **Limited merits review** – A regime that provides transparency and procedural fairness for all steps in the transaction clearance process is preferred to the proposal to have a limited merits review by way of evidence submitted to the ACCC, with no discovery rights – which would be submitted to the Tribunal. This option would be problematic for the Council and its industry members.
- **Thresholds** – Work needs to be done to establish relevant thresholds to ensure they are set at the right level for all transaction types and consider the size of the companies involved.

The Council would welcome further consultation with Treasury on the issues outlined in this submission.