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Australian Competition Law Relating to the Resources Industry in a Global Context

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SUMMARY

This paper will consider the interaction between foreign investment law and competition law in Australia. Australian foreign investment law focuses upon what is in the Australian "national interest" while Australian competition law focuses upon ensuring that the competitive process delivers optimal outcomes for Australian consumers.

This paper considers the Commonwealth Treasurer's April 2001, Shell / Woodside decision against the background of Australia's foreign investment legislation, the Foreign Acquisitions and Takeovers Act (FATA). The introduction to the blue book on Australia's Foreign Investment Policy by Treasurer John Dawkins in 1992 states that:

> *"The Government's policy is … to encourage foreign direct investment consistent with the needs of the Australian community, including the expansion of private investment, the development of internationally competitive and export-oriented industries and the creation of employment opportunities."*

The Shell / Woodside decision was a political decision made by the Commonwealth Treasurer based upon what was considered to be in the "national interest". Media reports suggest that the decision was based on the Treasurer's concerns in relation to whether exports from the North West Shelf would be "promoted in circumstances in preference to all competing supplies" should the Shell takeover succeed.

The Australian Competition & Consumer Commission (ACCC) administers Australia's competition legislation, the Trade Practices

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Act 1974 (Cth) (TPA). One of the objects of the TPA is to "enhance the welfare of Australians through the promotion of competition" (s 2). The ACCC is also directed to take into account exports as public benefits when considering whether to authorise a merger which would substantially lessen competition.

This paper suggests that the interaction between foreign investment law and competition law arises because Australian competition law is intended to be focused upon delivering efficient market generated outcomes which enable Australian businesses to be competitive domestically and in global markets. Australian foreign investment law also takes into consideration economic factors in determining what is in the "national interest". That is, in important sectors of the economy, the focus is not solely on whether or not the acquirer is foreign, it is also on whether the acquisition will affect the dynamics of competition in the domestic market and in relation to the enhancement of exports.

This paper then considers the practical approach the ACCC has taken to allowing consolidation among resources companies in Australia where those companies have globally traded products. The ACCC is to be commended in relation to the practical approach that has been taken in allowing Australian or international mergers which deliver economic efficiencies. However, further progress in the energy sector is being limited by the resistance of governments to move away from State based regulation to a consistent national approach.

The paper concludes that there is a need for increased interaction between Commonwealth Government policy and competition policy in the form of an Australian energy policy to deliver consistent outcomes to the benefit of industry participants and Australian consumers.

INTRODUCTION

The title of this paper is "Australian Competition Law Relating to the Resources Industry in a Global Context". A somewhat long-winded title and topic! In order to try and do justice to the topic, the paper will take a high level approach to seek to draw together the various underlying economic principles in Australian foreign investment and competition laws to demonstrate a consistent approach.

In relation to the energy sector, it is submitted that the approach should be to make Australia a more efficient and effective competitor in a global environment. Unfortunately, government political concerns lead to the introduction of laws which become inconsistent

or create additional regulatory barriers to the efficient functioning of markets. In addition, different regulatory approaches under these laws create regulatory and therefore business uncertainty which detrimentally affects investment decisions in the large scale projects which are common in the resources industry.

AUSTRALIAN COMPETITION LAW: GLOBAL CONTEXT

The increasing size of Australian resources companies and the international focus of these companies, is resulting in more Australian mergers in the resources sector becoming subject to overseas regulatory review.

AME Mineral Economics in its 30th Annual Export Coal Industry Study, has stated that the top four export coal producers – Rio Tinto, BHP Billiton, Glencore and Anglo American – supply 37 per cent of the total traded coal market and that it is expected that over the next five years Australia will consolidate its position as the world's largest coal exporter ahead of South Africa, China, Indonesia and the United States. In this situation, it is not unexpected that mergers between RTZ Corporation PLC and CRA, BHP and Billiton and the takeover by BHP and Mitsubishi Corporation of QCT Resources have attracted the attention of the European Commission. The more important issue is to understand the application of overseas competition laws to these mergers so that their application can be factored into the regulatory aspects of Australian transactions.

In Europe, the relevant legislation is the EC Merger Control Regulation which applies where the transaction is a "concentration" within the meaning of Art 3 of the Regulation and it has a "Community dimension" in the sense of meeting the turnover thresholds of Art 1(2) - (3) of the Regulation. If a transaction qualifies for investigation under the Regulation, the Commission will assess whether the transaction "creates or strengthens a dominant position" in the European Community or a substantial part of it.

In the United States, parties to certain mergers and acquisitions are required to submit a pre-merger notification form under the *Hart-Scott-Rodino Antitrust Improvements Act* 1976 (HSR Act). It is quite complex to determine the precise application of the HSR Act in all cases. However, in general terms, the HSR Act will apply when two conditions are met:

(a) one party to the notified transaction has at least US$10 million in sales or assets and the other has at least US$100 million in sales or assets; and

(b) the acquired stock or assets are worth at least US$15 million, or the transaction leads to the acquisition of control over an acquired party with at least US$25 million in sales or assets.

There are of course certain exemptions such as those relating to goods and property acquired in the ordinary course of business and acquisitions of voting securities for investment purposes where the purchaser holds no more than 10 per cent of such securities. Moreover, transactions involving foreign assets or entities may be exempt where they involve little or no assets in the United States.

The Approach of Overseas Regulators

In December 1995, the European Commission considered the merger of RTZ Corporation PLC (RTZ) and CRA Limited (CRA). RTZ was at that time an international mining and metal producer based in the United Kingdom with mining interests involving copper, gold, borates, titanium, steaming coal, talc, zircon and uranium. These interests were primarily located in North America, South America, Southern Africa and Europe.

CRA was a mining and metals producer based in Australia with its principal mining operations being in iron ore, coal, bauxite (including alumina and aluminium), diamonds, gold and salt. In addition to its major operations in Australia, the group had interests in mines, smelters and fabrication plants principally in Indonesia, New Zealand and Italy.

The European Commission's 1995 decision is important because it expressly recognised that given the metals and minerals which formed the subject of the competitive overlap between the merger parties had prices quoted on the London Metals Exchange, the relevant markets were worldwide. The European Commission went on to find that having regard to the global market definition, the merged group faced competition from other global competitors such as Alcoa, Anglo American, Billiton, BHP and Cominco. In addition, the fact that their businesses were largely complementary from a geographic perspective, led the European Commission to the conclusion that the transaction did not create or strengthen a dominant position in any market.

In June 2001, the European Commission considered the merger between BHP and Billiton, two of the largest mining companies in the world. BHP is one of Australia's best known mining companies and is involved in the production of various minerals and metals, including carbon steel, coking coal, copper, iron ore, diamonds and oil and gas. Billiton is a United Kingdom mining company which also

produces a number of minerals and metals including aluminium, thermal coal, manganese, copper, chrome and nickel.

The transaction involved the creation of a dual listed company structure whereby while the parties would form a single economic entity, they would still retain separate stock exchange listings.

As with most regulators, the European Commission followed a standard overlap analysis and concluded that the operations of BHP and Billiton were largely complementary with the exception of their copper mining activities. In relation to their copper mining activities, BHP and Billiton were largely non-integrated copper producers in the sense that they do not transform the bulk of their mines' output into refined copper and instead sell it to independent smelters and refineries. The European Commission therefore focused on the likely impact on the so-called "custom concentrate market" which is the market for the sale of copper concentrate to these independent copper smelters and refineries.

The European Commission concluded that, while the merged entity would become the largest custom concentrate supplier in the world, this position would not be such as to allow the merged entity to enjoy a position of dominance.

In competition terms, it was considered that the merged BHP-Billiton would be unlikely to have either the ability or the incentive to reduce its output of copper concentrate or to increase the concentrate price. In other words, it could not "give less and charge more" and therefore was not in a dominant position. The European Commission formed this view for the reason that smelters and refineries have a number of alternative large mining companies to whom they can turn for supplies of copper concentrate.

In addition, the European Commission concluded that the custom copper concentrate market is to a significant extent dependent on the world copper price and that concentrate suppliers' freedom of action is constrained accordingly. As a result, the European Commission concluded that the merger was unlikely to lead to the creation or strengthening of a dominant position in the custom copper concentrate market.

Having briefly considered the approach of the European Commission, it is also important to consider the approach of the United States Department of Justice (DOJ), on antitrust matters in relation to global mergers in the resources industry. A useful example of the approach of the DOJ is demonstrated by the merger between two of the world's largest aluminium companies, Alcoa Inc and Reynolds Metals Company in May 2000. In that matter, the DOJ

required the divestiture of Reynold's controlling interest in the state of the art Worsley aluminium refinery in Western Australia.

The aluminium industry produces a wide variety of commercial and consumer products and is dependent upon supplies of alumina at competitive prices. In 1999, Alcoa was the largest aluminium company in the world with revenues of US$16 billion while Reynolds was the second largest aluminium company in the United States and third largest in the world with revenues of US$4.6 billion. Both companies using an overlap analysis were involved in the mining and refining of bauxite and smelter grade and chemical grade alumina respectively and the smelting of smelter grade alumina into aluminium.

Aluminium refineries basically produce two types of alumina. A powder refined from bauxite ore which is smelter grade alumina (SGA) and chemical grade alumina (CGA). SGA is a critical input in the production of aluminium metal, which is used to produce products such as aluminium foil, beverage cans, building materials and aircraft skin. CGA is used in the production of numerous industrial and consumer products such as detergents, countertops and flame retardants.

The key issue in the merger was whether the acquisition would have substantially lessened competition in the refining and sale of SGA and CGA. The Antitrust Section of the DOJ took the view that the initial merger proposal would have resulted in higher prices to aluminium manufacturers and their customers, as well as to consumers who purchase products containing alumina.

The initial proposal would have resulted in Alcoa owning or controlling approximately 38 percent of the world SGA market and in relation to CGA, 59 percent of the United States market. The revised merger proposal involved Alcoa divesting Reynold's controlling interest in the Worsley Refinery in Western Australia, Reynold's Corpus Christi, Texas refinery to meet United States Antitrust concerns and the divestiture of Reynold's refinery operation in Stade, Germany to address European Commission concerns.

In the context of this paper, I note the statement by Joel Klein, Assistant Attorney General in charge of the Antitrust Division of the DOJ in relation to the Alcoa matter, that: "These divestitures will protect against a loss of competition for the aluminium producers, businesses that use aluminium to manufacture products, and American consumers who buy these products."[1] Understandably, the DOJ were highly focused upon protecting American businesses and consumers.

[1] The media release is relevantly subtitled: "Divestitures Protect Competition in Aluminium Prices for American Consumers and Businesses".

The question then becomes if the relevant product is an internationally traded commodity and the relevant market is international or the key decisions which affect the Australian market occur offshore, should the ACCC intervene? The ACCC also reviewed the Alcoa and Reynolds merger in May 2000 in terms of the impact of the merger in Australia. However, there was still an overlap which arose in Australia because Alcoa operated three alumina refineries in Western Australia. The ACCC's market inquiries reached a similar conclusion to the ACCC's European and United States counterparts and considered that the divestiture undertakings addressed the ACCC's concerns as to the impact of the merger in Australia. Professor Fels, the Chairman of the ACCC, stated:

> "The ACCC's decision to recognise undertakings given to other competition authorities as an effective remedy shows that cooperation between competition authorities can lead to streamlined outcomes … As more and more global mergers occur, such cooperation will enhance the way in which competition issues are resolved."[2]

In the ACCC's analysis of the proposed acquisition of Ashton Mining Limited by either Rio Tinto or De Beers Centenary AG, the decision became more difficult as there was no direct overlap in Australia. In that transaction the principal asset of Ashton Mining was an effective 40.1 percent interest in the Argyle Diamond Mine Joint Venture in Australia. The Argyle Mine produces 5 percent of the world's diamonds by value or 26 percent by volume. In relation to the proposed takeover, the ACCC stated that:

> "The ACCC conducted extensive market inquiries, contacting market participants, overseas competition authorities, government and a range of other interested parties. In the course of its market inquiries, the ACCC examined both the national and global markets for the sale of rough diamonds …. The ACCC's inquiries found that market participants consider the market for rough diamonds to be global and the majority of sales occur in Europe. The ACCC concluded that there is unlikely to be a substantial lessening of competition in any substantial market in Australia."[3]

Reading between the lines of the ACCC's media release suggests that while the particular Australian resource was significant from a global perspective, the volume of finished diamonds returning for sale in Australia from the particular mine was small and in the order of 2-3 percent of diamonds sold at the retail level. Accordingly, the transaction did not substantially lessen competition in a market in Australia in contravention of Australia's merger laws.

[2] ACCC Media Release MR86/00, 4 May 2000.
[3] ACCC Media Release No MR 254, 21 September 2000.

It is of interest that while the ACCC did not oppose the proposed takeover by De Beers, the European Commission had announced an investigation of the transaction. Ultimately De Beers was unwilling to accept certain conditions offered by the Australian Foreign Investment Review Board (FIRB) to approve the transaction and Rio Tinto successfully acquired Ashton.

Conclusion

The key points from an analysis of these decisions are that where global mergers are occurring in the resources industry, the primary overseas regulators being the Antitrust Section of the DOJ and the European Commission are adopting a similar analysis, although with a slightly different merger test. The analysis is essentially that where the products of the merged firm are globally traded, it will only be in limited situations where the transaction will contravene the relevant merger laws (particularly where divestments are possible), because of the existence of global competitors or the countervailing power of large global customers.

In relation to a small country such as Australia, with relatively few trade barriers, the fact that the majority of resources exported from Australia are traded on the London Metals Exchange means that the relevant markets are likely to be global. This may mean that there is scope for continued consolidation in relation to industries involving these types of products. It is only in areas where the resources products are for domestic consumption purposes that they are likely to warrant closer scrutiny by the ACCC. These issues are considered in more detail under the heading "Australian Competition Law: An Overview" below.

More interesting questions arise where it is perceived that overseas regulators will not act in favour of Australian consumers because the transaction does not affect their domestic market. Alternatively, complex issues may arise where the rational use of scarce resources in economic regions (as part of normal profit maximising behaviour by firms), does not facilitate the development of the Australian economy through exports or domestic competition. At that point in time, Australian competition law issues are probably rightly superseded by national interest considerations under the FATA for the reason that such transactions do not strictly lessen competition substantially in an Australian market. This paper will now consider Australia's foreign investment laws and policy in this context.

AUSTRALIAN FOREIGN INVESTMENT LAWS

Under Australia's foreign investment laws, foreign persons are required to notify the Australian Treasurer of acquisitions by foreign persons of an interest of 15 percent or more in an Australian business with total assets, or a business valued at over A$50 million.

There are certain additional restrictions for important or sensitive sectors of the economy, such as media, where all direct investments, and all indirect (portfolio) investments of 5 percent or more, by a foreign person in the media sector, irrespective of value, require the approval of the Australian Treasurer. However, there is no specific policy for the energy sector.

As a matter of policy, the Australian Government will fully examine proposals to acquire existing businesses or assets valued at A$100 million or more.

The Australian Government may reject applications from foreign persons that are contrary to the "national interest". However, what constitutes "national interest" is not defined either by the foreign investment legislation or the Australian Government's foreign investment policy.

Application of Foreign Investment Law

The FATA is the primary legislation governing foreign investment law in Australia. The FATA requires that certain investment proposals by "foreign persons" must have the prior approval of the Australian Treasurer. The Australian Treasurer is advised by the FIRB.

An acquisition of a "substantial interest" by a "foreign person" in existing Australian businesses with total assets over A$50 million or where the proposal values the business at over A$50 million requires prior approval from the FIRB.

For the purposes of the FATA, a foreign person includes a corporation in which a natural person not ordinarily resident in Australia or a foreign corporation holds a controlling interest. A "substantial interest" occurs where a single foreign person (and any associates) has 15 percent or more, or several foreign persons (and any associates) have 40 percent or more in aggregate, of the ownership of any corporation, business or trust.

Under the FATA, the Australian Treasurer may make an order prohibiting a proposed acquisition of shares in certain types of

Australian corporations, including trading corporations, which carry on an Australian business if:

(a) the Australian corporation has assets worth at least A$5 million;
(b) the Australian Treasurer is satisfied that the proposed transaction would have the result that the corporation would become controlled by foreign persons, or if already foreign controlled, that it would result in a change in the foreign controllers; and
(c) that result would be contrary to the "national interest".

The majority of decisions by the Australian Treasurer under the Howard Government involving the rejection of foreign acquisitions, have been in relation to land.

Foreign Investment Review Board

A guide on Australia's foreign Investment Policy has been published by the FIRB. The Policy outlines FIRB's approach to administering its responsibilities under the FATA. Among other things, the Policy states that the Australian Government:

(a) will generally not object to proposals where the relevant total assets/total investment falls below A$100 million. However, proposals in sensitive sections of the economy which raise specific national interest issues may be subject to more detailed examination; and
(b) will fully examine proposals to acquire existing Australian businesses with total assets of A$100 million or more or establish new businesses with a total investment of A$100 million or more. However, the Australian Government will raise no objection to those proposals unless they are contrary to the "national interest".

What Constitutes "National Interest"?

What constitutes "national interest" is quite deliberately not defined in the FATA as it is what the Australian Treasurer considers Australia's national interest to be. This needs to be emphasised, "national interest" is not a legal concept, it is a political and policy concept and is capable of changing over time. In this situation, national interest could conceivably include economic, defence or even social interests at the time of assessment of the relevant proposal.

It is also important to note that although very few proposals for investment are formally prohibited, some are withdrawn by parties in light of advice from Treasury that they are likely to be considered contrary to the national interest or alternatively, because they are

subject to conditions which are not acceptable to the parties. As applications for foreign investment appraisal under the FATA are made in secret, details of such rejections are not made public and it is only in the rare cases, such as the Ashton Mining takeover, that debate in relation to conditions becomes the subject of public debate or scrutiny.

In terms of process, when the Federal Treasury receives notification of proposed investments under the FATA, it will consult with the relevant Commonwealth and State Government bodies. In addition, and importantly for this paper, the ACCC will be consulted on matters which may have an impact on competition in Australia. The paper demonstrates the linkage between foreign investment laws and competition laws in Australia.

The Shell / Woodside Decision

The Shell / Woodside decision is an interesting decision because it is a decision where it is quite clear that the management of the parties and the corporate cultures of the parties is well respected in corporate circles and the media alike. In terms of the previous background, it is quite clearly a "political" decision based on what the Treasurer, Mr Peter Costello, considered to be in the "national interest".

As the firm of which I am a partner was involved in this transaction on behalf of Woodside, I will try and give an objective assessment based on publicly available information and statements which I trust and hope will cause no offence to anyone involved in the matter.

Shell is an international vertically integrated resources company and holds a one-sixth interest in the North West Shelf Project. The North West Shelf Project is currently Australia's largest resource project and creates substantial export sales for Australia through the sale of liquified natural gas (LNG). Shell also holds a 34.27 percent interest in Woodside which in turn holds a one-sixth interest in the North West Shelf Project and is the operator of the Project.

In November 2000, Shell made an unsolicited bid for Woodside at $14.80 and one call option per share. During the course of the bid Woodside made a distribution to shareholders of $0.60 per share which reduced the bid price to $14.20 per Woodside share. Shell also proposed that if it obtained control of Woodside, Shell would put to Woodside shareholders a merger proposal under which certain of its oil and gas assets in Australia would be transferred into Woodside in return for further equity in Woodside.

On 24 April 2001, the Australian Treasurer, Mr Peter Costello decided that the acquisition of shares by Shell would be contrary to the national interest and made an order prohibiting Shell from increasing its percentage ownership of Woodside above 34.27 percent. The Australian currency dropped on 24 April from an intra day high of US51.95¢ to US50.40¢ in "little more than an hour" according to the *Australian Financial Review* (AFR) with the Woodside share price dropping $1.47 to $12.49.

Examining the decision clinically it should be noted at the time of writing this paper on 16 August 2001, the exchange rate is now $A/US52.34 and the Woodside share price is $14.49.

As the Treasurer's decision was not based on a legal test and no formal reasons were given for the decision, it is difficult to make any observations that will provide guidance for the future. Perhaps observations that are of some utility are as follows.

(a) The decision was made on the basis of being unique or a "one-off" and not a fundamental ground shift in Australian Government Policy. The AFR reported the Treasurer as having stated that: "Australia has a very liberal foreign investment regime. International investors know that. There's been no change of policy here."

(b) The Australian Government did consider imposing conditions on any approval it gave to Shell. The AFR suggested on 24 April 2001 (p 10), that Shell had agreed to six main conditions with FIRB after 151 days of negotiations. However, ultimately FIRB was unable to make any clear recommendation to the Treasurer notwithstanding the possible conditions. The AFR suggested that Shell had agreed to various conditions which included to:
   - maintain Woodside as a sharemarket listed Australian company and maintain its Perth headquarters;
   - retain an independent Chairman of the Woodside board and a cap of 56 percent of Woodside's total equity; and
   - the creation of an independent LNG marketing company in which each of the North West Shelf project partners had an equal level of ownership.

(c) The apparent difficulties with these conditions were that although the Australian Treasurer has power to impose conditions under the FATA, these conditions cannot be binding on third parties and there are difficulties in enforcing conditions after an acquisition has occurred. These are the same difficulties faced by the ACCC in unscrambling a merger once it has proceeded. Having regard to these difficulties, the Treasurer apparently was not satisfied that conditions could be imposed

which would give him confidence that Shell's other interests in the Asia Pacific region would not compromise the development of Australian interests. The Treasurer is reported in the AFR to have stated:

> "The concern I had was that the exports from the North-West Shelf of Australia be promoted in all circumstances in preference to competing supplies. I believe it is in the national interest of Australia that that resource be developed to its full and that exports from the North West Shelf promoted and sold in preference to exports that compete against it from any part of the world."

(d) The Treasurer's decision must be considered in a political context. A federal election is to be held by the end of 2001 and the Shell bid was very high profile and attracted significant publicity and comment from political leaders of all parties.

The Treasurer's decision is interesting as Australia has no specific policy regarding the energy industry, compared with industries such as media, banking, insurance and aviation. The Treasurer's reliance on the importance of exports from the North West Shelf is probably the most important indication of what in this particular transaction was considered to be of "national interest".

This policy question of supporting the Australian energy sector is a central theme of this paper. The importance of the North West Shelf energy project to the Australian economy is perhaps the clearest issue to come from the Shell / Woodside transaction and demonstrates that the Federal Government can take the view that in all the surrounding circumstances of the matter it was important to maintain the status quo.

The Federal Government is not alone in considering the political ramifications of takeovers and the South Australian Government's recent review of the *SANTOS Ltd (Regulation of Shareholdings) Act* 1989 is another case in point. The SANTOS legislation imposes a 15 percent shareholding cap on the number of shares a person may have in SANTOS. On 20 September 2000, the South Australian Minerals and Energy Minister announced a review of that legislation in accordance with the Competition Principles Agreement.

The September 2000 media release of the South Australian Minerals and Energy Minister, Mr Wayne Matthew MP stated that:

> "The restriction was originally put in place in 1979 to protect the State from any gas supply disruptions that might result as a consequence of corporate takeovers and consequent asset stripping … Restrictions on interstate gas trade have been removed since that time, so that any such takeover would certainly not affect supply to the same extent. The review will

determine if the South Australian gas sector is now mature enough to lift the cap altogether."

Having regard to the very carefully worded media release, on 11 July 2001 the South Australian State Government announced that it had considered the findings of the independent review and resolved to make no change to the legislation. The media release stated that: "Minerals and Energy Minister Wayne Matthew says that the decision to continue the present arrangement reflects the importance to South Australia of gas supplied from the Cooper Basin."

This decision would again appear to be essentially a "political" decision given a South Australian State election is required in the near future. However, while a political decision, the reasoning would appear to show some linkage with ensuring the continuation of gas supplies to the South Australian economy.

Conclusion

Australian foreign investment law provides certain compulsory notification requirements in relation to acquisitions of Australian businesses or land. The legislation and policy establishes a legal screening or filtering process for different types of investments. However, ultimately it is a political decision of the Treasurer whether something is in the "national interest" based on the Treasurer's assessment at that point in time taking into account recommendations from the FIRB. In key areas of the economy such as the resources industry, what is in the national interest may interact quite heavily with the economic principles underpinning Australian competition law. The next section of this paper considers Australian competition law in more detail.

AUSTRALIAN COMPETITION LAW: AN OVERVIEW

Australian competition law is governed by the TPA which is administered by the ACCC. The key competition provisions in relation to competitive conduct are set out in Pt IV of the TPA. The key section for the purposes of this paper is s 50 which deals with mergers. In my view, this section is probably the most important for the reason that merger law best demonstrates the changing nature of industries within Australia. However, an analysis of the law in this area needs to also take into account the National Third Party Access Code for Natural Gas Pipeline Systems.

Mergers – Section 50 of the Act

The prohibition

Section 50 of the TPA provides that a corporation must not, directly or indirectly:

(a) acquire shares in the capital of a body corporate; or
(b) acquire any assets of a person;

if the acquisition would have the effect, or be likely to have the effect, of substantially lessening competition in a market in Australia. As a result of recent amendments to the TPA, it may also be a substantial market in a region of Australia.

If the ACCC considers that an acquisition contravenes s 50, and the parties do not agree to modify or abandon the acquisition, the ACCC can apply to the Federal Court for an injunction, divestiture or penalties. Recent decisions suggest that the threshold for the ACCC to obtain an interim injunction is low. Accordingly, as a practical matter, mergers are seldom litigated against the ACCC as the pace of commercial activity would make such litigation of little utility.

Third parties (including competitors) can apply for a declaration that a merger has contravened the TPA and seek a divestiture order. The recent proceedings brought in the Federal Court in Sydney by *Macquarie Generation* against *Coal & Allied*[4] are an example of the exercise of the right of a third party to bring proceedings. However, only the ACCC can apply for an injunction in relation to merger matters.

Penalties which can be imposed for a contravention of s 50 can be up to $500,000 per contravention for an individual and up to $10 million for a corporation. In addition, any person suffering loss or damage as a result of a transaction which contravenes s 50 may apply for damages.

Transactions to which s 50 applies

The TPA does not distinguish between any form of acquisition, whether by takeover, scheme of arrangement, purchase of assets or otherwise. The TPA applies to both direct and indirect acquisitions. Section 4(1) makes it clear that "acquire" is not limited to acquisition by way of purchase, but also includes exchange, lease, hire or hire-purchase. Section 4(4) makes it clear that joint acquisitions, and acquisitions of legal as well as equitable interests would be subject to s 50.[5]

[4] *Macquarie Generation v Coal & Allied Industries Ltd* (unreported, Federal Court Proceedings N477 of 2001).
[5] *Trade Practices Commission v Arnotts Ltd* (1990) 93 ALR 657, confirms that the granting of an option over shares involves an acquisition pursuant to s 4(4) of the TPA.

In relation to joint acquisitions, it is important to consider joint ventures and strategic alliances in the context of s 50 as well as more straightforward mergers and acquisitions by and of single entities.

Any assessment of an acquisition by a consortium under s 50 will primarily be focused on the joint venture company, but may aggregate the competitive positions of each of the consortium participants and their parent companies. Accordingly, it is important to take into consideration the competitive positions of each of the parties in a consortium apart from the joint venture vehicle itself when considering whether or not there is a s 50 issue in relation to a particular transaction.

Substantial lessening of competition

The explanatory memorandum to the *Trade Practices Legislation Amendment Act* 1992 stated that the use of the word "substantially" in s 50 referred to an effect on competition which is real or of substance, and not one which must be large or weighty. However, the meaning of "substantial" and "substantially" is still uncertain, as has been pointed out in cases such as *Tillmans Butcheries Pty Ltd v Australasian Meat Industry Employees' Union*,[6] where Deane J commented that:

> "The word 'substantial' is not only susceptible to ambiguity; it is a word calculated to conceal a lack of precision…it can, in an appropriate context, mean real or of substance as distinct from ephemeral or nominal. It can also mean large, weighty or big. It can be used in a relative sense or can indicate an absolute significance, quantity or size."

The preliminary step in making an assessment of the competition impact of a merger is to identify the area of overlap and from that overlap delineate the relevant markets. Market delineation is quite complex and is beyond the scope of this paper. Once the relevant market is delineated, s 50(3) of the TPA sets out a number of criteria which must be considered by the ACCC when it assesses whether or not a transaction "substantially lessens competition" for the purposes of s 50. The list of criteria is not exhaustive, and includes:

(a) the actual and potential level of import competition in the market;
(b) the height of barriers to entry to the market;
(c) the level of concentration in the market;
(d) the degree of countervailing power in the market;
(e) the likelihood that the acquisition would result in the acquirer being able to significantly and sustainably increase prices or profit margins;

[6] (1979) 42 FLR 331 at 348.

(f) the extent to which substitutes are available in the market, or are likely to be available in the market;
(g) the dynamic characteristics of the market, including growth, innovation and product differentiation;
(h) the likelihood that the acquisition would result in the removal from the market of a vigorous and effective competitor; and
(i) the nature and extent of vertical integration in the market.

The key criteria in s 50(3) will now be considered having regard to the ACCC's approach as set out in their *Merger Guidelines* (Guidelines) and the application of those provisions to the resources industry.

It is important to note at the outset that while the ACCC's Guidelines are a useful indicator of its approach to s 50 assessments, they are merely guidelines and do not have the force of law. It is always up to a court to determine whether or not an acquisition does in fact contravene s 50. However, from a practical perspective, because of the importance placed on market definition in s 50 and the relatively low threshold of the substantial lessening of competition test, the ACCC has the ability to intervene in most mergers or acquisitions should it wish to do so.

Concentration thresholds

In assessing the competition risks of any proposed transaction, one of the key preliminary issues is whether or not the merger would exceed the ACCC's concentration thresholds and thereby warrant further scrutiny.

In its Guidelines, the ACCC has set two thresholds: one to deal with unilateral market power, and the other to deal with concentrated markets where there may be combined or oligopoly market power. The concentration thresholds are set so that the ACCC will not normally examine mergers or acquisitions where:

- in relation to unilateral market power, the merged firm would have less than 40 percent of the market; or
- in relation to combined market power: the four largest firms following the merger would have less than 75 percent of the market, or where the four largest firms following the merger would have more than 75 percent of the market, the merged firm would have less than 15 percent.

The ACCC has described the thresholds as "a bright green line, below which mergers are unlikely to be opposed, rather than a bright red line above which mergers are presumed to be anti-competitive". Naturally, if the market were to be defined as a global market due to

the nature of the relevant products, it would be unlikely that the transaction would exceed these thresholds. The ACCC takes a conservative approach and, unlike the European Commission or DOJ, will usually find a market in Australia rather than describing the market as global.[7] The ACCC will then consider the other merger factors and if the merger involves globally traded products will be extremely unlikely to oppose the transaction.

Import competition

Merger factor (a) requires the ACCC to consider the actual and potential level of import competition in the market.

For the purposes of s 50, the relevant market is a market in Australia, and therefore the effect on competition of any merger of firms within Australia may be ameliorated by the actual or potential level of imports. If import competition, or the potential for import competition (because the goods are internationally traded), is an effective constraint on the exercise of domestic market power, it is unlikely that the ACCC will intervene in a merger.

The ACCC has indicated that it does not generally object to any merger where comparable and competitive imports have held a sustained market share of 10 percent or more for the last three years, and as an indicative guideline, is unlikely to do so. However, this 10 percent figure is an indicative one only, as it is not the historical level of imports that is significant, but their potential to constrain the price and output decisions of the merged entity.

It would therefore normally be prudent to advise the ACCC in any event, given the qualitative nature of the assessment of any constraint which is or may be provided by import competition. Moreover, even if the actual level of imports does not exceed 10 percent, it is the potential for imports to constrain any market power which is important.

The recognition of the impact of imports is important for the reason that in some markets import competition may impose a constraint on the merged firm not only at the functional level of the market directly affected by the merger, but in a downstream market. For example, if the merged entity's customers are constrained in their ability to pass on the input price increase by effective import competition, the merged firm may not be able to significantly increase its prices. Accordingly, the level of competition at a lower level of the market may provide an effective constraint to increased concentration.

[7] This would appear to be intended to make it clear that it has jurisdiction and avoid some of the difficulties that arise with the remedies for a contravention of the offshore mergers provision in s 50A of the TPA.

Barriers to entry

Merger factor (b) requires the ACCC to consider the height of barriers to entry to the market. This means that even if a transaction exceeds the concentration thresholds and there is not effective import competition, if the barriers to entry to the market are low, it may be that the potential anti-competitive effects of the merger are offset or ameliorated by the threat of new entrants into the market. The potential competition may constrain the activities of the merged firm to act in a manner which is consistent with competitive market outcomes.

Barriers to entry may consist of a variety of factors, including:

- sunk costs;
- legal or regulatory barriers;
- access to scarce resources enjoyed by incumbent firms in the market;
- economies of scale and scope;
- product differentiation;
- brand loyalty; or
- the threat of retaliation by incumbents.

Essentially, barriers to entry are any features of a market which place an efficient prospective entrant into the market at a competitive disadvantage compared with existing market players. The "height" of barriers to entry is the extent to which incumbents can raise the market price above its competitive level without attracting the entry of new competitors into the market.

Countervailing power

Countervailing power exists where a supplier faces a buyer with market power or a credible threat of vertical integration or direct importing, or vice versa. In such circumstances, the ability for a merged firm to give less and charge more is decreased, since the relevant buyer could choose to either make the product themselves or to import. Again in this situation, the likelihood of a substantial lessening of competition diminishes.

In the resources industry consolidation is occurring at many different levels and in relation to many different products. The countervailing or buying power of the large international resources companies may allow mergers between their suppliers who are forced to achieve economies of scale to maintain margins.

Vigorous and effective competitor

This factor was introduced to deal with the situation of a small player which has a substantial impact on market pricing, but does not really have a high market share.

Vertical integration

Vertical relationships and vertical mergers will normally only raise competition concerns if there is a concentrated structure at one or more of the related or integrated stages of production or distribution. If all stages of the production or distribution process fall within the "safe harbours" established for horizontal mergers, the Commission is unlikely to scrutinise the merger further.

Dynamics of the market

Merger factor (g) is in some senses a catch all. It requires the Commission to consider the dynamic characteristics of the market. These include growth, innovation and product differentiation.

Markets which are growing rapidly are more likely to see new entry and erosion of market share, while markets which are characterised by rapid product innovation are likely to see market leaders replaced often.

Other factors

Another area of importance in the Guidelines is in relation to efficiency issues. Section 50 is concerned with the competitiveness of markets, not with the competitiveness of individual firms. Accordingly, an acquisition which increases the competitiveness of the merged firm may also increase (or not substantially lessen) competition in the market. Efficiency arguments generally arise as a question of public benefit to be considered under an authorisation test. They may, however, also be relevant in the s 50 context to the extent that they impact on the competitiveness of a market. For example, where a merger enhances the efficiency of the merged firm, such as by achieving economies of scale, it may have the effect of creating a new or enhanced competitive constraint on the unilateral conduct of other firms in the market.

Informal clearances and authorisation

A review of the competition aspects of mergers would be incomplete without a consideration of the practical issues for the parties where they are concerned that a merger may involve a

substantial lessening of competition or otherwise wish to ensure that the ACCC does not seek to intervene in or block the proposed merger. In these circumstances the parties may informally approach the ACCC to obtain the ACCC's view on whether the transaction lessens competition substantially in a market.

In Australia, the most common form of obtaining greater commercial certainty in relation to a merger transaction involving s 50 issues is to obtain an informal clearance from the ACCC. It is an "informal clearance" for the reason that there is no statutory power for the ACCC to grant a clearance and it is technically only an indication from the ACCC that on the basis of the facts presented and their market inquiries, they will not oppose the transaction. As no other party has the right to seek an injunction for a contravention of s 50, the informal clearance letter generally provides sufficient comfort to the merger parties.

In certain situations where the ACCC considers it has sufficient knowledge of a particular industry, the ACCC may consider giving a confidential clearance prior to the transaction being announced. These situations appear to be decreasing as the ACCC is becoming more conservative and unwilling to give a view until it has had the opportunity to make market inquiries.

If the ACCC or the parties believe the transaction will, or is likely to involve a substantial lessening of competition, then they may seek to have the arrangement authorised by the ACCC and obtain protection under the TPA in relation to the transaction whilst the authorisation is in force.

Authorisation

Division 1 of Pt VII of the TPA contains provisions relating to authorisation. The power to grant authorisation is outlined in s 88 of the TPA. Authorisation may be sought for the following categories of conduct:

- the making of, or giving effect to, a contract, arrangement or understanding which would have the purpose, or would have, or might have the effect, of substantially lessening competition within the meaning of s 45 (s 88(1));
- the making of, or giving effect to, exclusionary provisions (s 88(1));
- pricing fixing arrangements involving goods or services (s 88(1));
- covenants which have a substantial anti-competitive effect (s 88(5));

- secondary boycotts and arrangements affecting the supply or acquisition of goods falling within ss 45D, DA or DB (s 88(7));
- exclusive dealing (s 88(8));
- resale price maintenance (s 88(8)); and
- mergers and acquisitions (s 88(9)).

Grounds for authorisation

The tests upon which the ACCC must determine authorisation applications are contained in s 90 of the TPA. The first test is applicable to those types of conduct which the TPA prohibits on the basis of their effect on competition, the so-called competition test. This test involves the consideration of whether or not the conduct leads to a substantial lessening of competition and the impact of any countervailing public benefit.

The second test applies to conduct which is prohibited per se (except mergers) and relates to the following types of conduct:

- exclusionary provisions;
- secondary boycotts and related arrangements caught by s 45D;
- third line forcing;
- resale price maintenance; and
- mergers.

The second test involves the examination of whether public benefit resulting from the conduct justifies the grant of authorisation. A competition evaluation is not part of this test. This is because anti-competitive considerations are not part of the substantive offence in each of the five cases (other than in relation to mergers which involves competition analysis).

Authorisation applications are a public process, although confidentiality of documentation or parts of documentation as a part of submissions can be claimed. The ACCC has set time periods (at least four months – s 90(10)) in which to consider an authorisation application, but these may be extended in certain circumstances. Long time periods and the public nature of authorisation applications may not always be practical or desirable for the parties, especially in the case of a contested takeover or merger.

In considering the key competition provisions affecting the Australian resources industry, the provisions of Pt IIIA of the TPA and the Gas Pipelines Access Code also need to be considered. The

National Electricity Code is also relevant, although as it is a topic of its own, it will not be considered in this paper.

Part IIIA of the TPA and the Gas Code

In 1992 the Council of Australian Governments (CoAG) commissioned an independent committee of inquiry into a national competition policy. This inquiry became known as the "Hilmer Committee" which reported in August 1993. The Commonwealth Government responded to the Hilmer Committee's recommendations by introducing Pt IIIA of the TPA which sets out mechanisms for allowing third party access on commercial terms.

A government/industry forum known as the Gas Reform Implementation Group (GRIG) developed a framework to govern third party access rights to natural gas pipeline systems. In November 1997, the Commonwealth and all State and Territory governments signed the Natural Gas Pipelines Access Agreement which continued the Gas Pipelines Access Code (Gas Code). The regime seeks to operate under certified access regimes of each State and Territory as opposed to an industry code provided as an undertaking to the ACCC as is the case with the National Electricity Code.

Commonwealth bodies such as the National Competition Council (NCC), the ACCC, the Australian Competition Tribunal (Tribunal) and the Federal Court exercise functions under the gas access regime similar to those under Pt IIIA of the TPA. In particular:

(a) the NCC assesses the States' and Territories' access regimes and advises the relevant Ministers on whether a pipeline should be subject to the Code;
(b) the ACCC regulates transmission pipelines in all States and Territories (with the exception of Western Australia which has its own State based regulator); and
(c) State and Territory based independent regulators[8] regulate all distribution networks, including assessing and approving arrangements for access to pipelines.

In addition, a Code Registrar maintains the Code Register, which sets out details of each pipeline covered by the Code. A pipeline is "covered" when it becomes subject to the Code. For these purposes a "pipeline" is defined as gas transmission pipelines and distribution networks, together with related facilities, but excluding upstream facilities (that is, gas production facilities). Certain important consequences flow from whether a pipeline is covered. These are

[8] In broad terms, the Queensland Competition Authority in Queensland; IPART and ORG in NSW and the ACT; ORG in Victoria; SA Independent Pricing and Access Regulator in SA, OffGAR in Western Australia and the ACCC in the Northern Territory.

discussed below. The Code Register also contains all the documents provided to it by the NCC, the relevant regulators and service providers, including any access arrangements.

The Introduction to the Code provides that its underlying purpose is to establish a framework for third party access to natural gas pipelines that:

(a) facilitates the development and operation of a national market for natural gas;
(b) prevents the abuse of monopoly power;
(c) promotes a competitive market for natural gas in which customers may choose suppliers (including producers, retailers and traders);
(d) provides rights of access to natural gas pipelines on conditions that are fair and reasonable for both service providers and users; and
(e) provides for the resolution of disputes.

The Code also aims to:

(a) instil flexibility into negotiations for third party access to natural gas pipeline systems; and
(b) provide a transparent and predictable framework for third party access, with a view to minimising disputes.

Recent developments

In March 2001, the Productivity Commission issued a Position Paper on the Review of the National Access Regime which suggested a substantial review of the operations of the declaration criteria in Pt IIIA of the TPA.[9]… This review is still in progress. In addition, just before the Position Paper was released, the Tribunal delivered its decision in *Duke Eastern Gas Pipeline Ltd*[10] which involved an application by *Duke Eastern Gas Pipeline Pty Ltd and others (Duke)* under s 38(1) of the Gas Pipelines Access Law to review the decision of the Minister to cover the Eastern Gas Pipeline (EGP). The EGP is a transmission pipeline transporting Gippsland Basin natural gas from the Longford gas production facility in Victoria to Horsley Park, near Sydney, New South Wales.

When considering the question whether access by means of the pipeline would promote competition in at least one market, the Tribunal considered that the structure of the relevant market should be analysed. Applying this approach to the EGP, the Tribunal concluded that if the EGP were to be covered by the terms of the Gas Code, the opportunities and environment for competition in

[9] Productivity Commission, *Review of the National Access Regime*, Position Paper, 29 March 2001.
[10] [2001] Acomp T2.

upstream and downstream markets of the EGP would not be enhanced from the current position under the access arrangements offered by Duke. In particular:

(a) the commercial imperatives faced by the EGP to increase throughput given its high capital cost, low operating costs and spare capacity;
(b) the countervailing power of other market participants;
(c) the existence of spare pipeline capacity; and
(d) the competition which EGP faces from the Moomba to Sydney pipeline and the Interconnect,

would prevent the EGP from possessing market power within the next 10 to 15 years.

Accordingly, the Tribunal set aside the decision of the Minister, concluding that the coverage of the EGP would not promote competition in either upstream or downstream markets. The Tribunal considered that the EGP did not, and would not have market power.

Conclusion

The *Duke* Decision is interesting because it is a decision of a judge, an economist and a business person in relation to competition in a domestic Australian market which gives assistance on the delineation of product and geographic markets. The Tribunal followed the decision in *AGL Cooper Basin Natural Gas Supply Arrangements*[11] that:

(a) the product of concern for the matter was mainly gas as there was little competition between energy sources at this time;
(b) gas transmission services are provided in the gas transmission market which is functionally separate from other parts of the gas market;
(c) other functional areas are exploration, production/processing, sales and distribution/reticulation;
(d) the geographic scope of the market was South East Australia; and
(e) from a temporal perspective, the time dimension in which to assess the market was perhaps 10 to 15 years.

Accordingly, in Australia, at the moment there appears to be still distinct electricity and gas markets at this time mainly due to the lack of interchangeability of energy sources by consumers. In Europe, this distinction has blurred with the United Kingdom regulators of gas and electricity having merged their functions into one entity (The Office of Gas and Electricity Markets) and the European Commission reviewing matters on an “energy” market for some purposes. The

[11] (1997) ATPR 41-593.

comparatively long time frame in which to assess matters is also an important factor as it allows the development of alternative pipeline projects.

The close analysis by the ACCC and regulators in relation to domestic markets is to be contrasted with the comparatively liberal competition approach to mergers between companies which have products which are globally traded. The reasoning behind this approach is likely to be that in the case of internationally traded products, Australian or foreign companies located in Australia are likely to be efficient operators and subject to the constraints of international competition.

In relation to electricity and gas markets operating in Australia, these markets are still characterised by the disaggregation which occurred as part of State Government privatisation processes. Reaggregation which is occurring in States such as Victoria is being closely scrutinised by the ACCC and the Victorian regulator, the Office of the Regulator-General (ORG). In Victoria, the *Gas Industry Acts* 1994 and 2001… (the latter will replace the earlier on 1 September 2001), are attempts by the Victorian Government to regulate the reaggregation of the Victorian gas industry at the producer and retailer levels of the industry. Although the ORG is required to take into consideration the ACCC's views, the legislation again demonstrates the understandable political interests of State governments in regulating major services rather than risking a voter backlash should the industry restructure not succeed through market forces.

The re-emergence of State legislation has the potential to create regulatory divergences where the TPA is amended as a result of review processes. These divergences can have serious commercial consequences. Moreover, there is a danger that State regulators will take a different approach creating additional cost and uncertainty. It would appear that while the European Commission is seeking to achieve consistent legislation and approach in European Union countries, Australia is having similar issues with State based regulatory regimes.

CONCLUSION

This paper has sought to bring together the threads of how Australian foreign investment law interacts with Australian competition law. It is submitted that the respective legislation has a similar objective in ensuring the existence of competitive and

efficient companies operating in Australia and supporting the Australian economy through exports to the benefit of Australian consumers. Perhaps the best explanation is that the respective legislation approaches the same objective from different directions. Competition law is focused on industry operation and foreign investment law has a role to play in correcting any perceived market anomalies arising from foreign corporations having divergent interests to the economic interests of Australia in key industry sectors.

The Commonwealth Treasurer's decision to not allow the Shell takeover of Woodside has emphasised the importance of the energy industry in Australia. While regulators such as the ACCC are generally taking a sensible and practical approach to mergers in the energy sector, there is a risk of the return of over regulation by State governments creating added cost, complexity and regulatory uncertainty as they seek to protect their own State-based interests. Although this is understandable and the ACCC appears to be trying to work within these political realities by close liaison with State based regulators, in an industry sector of such importance to Australia, a definitive and focused energy policy would assist in delivering consistent outcomes to the benefit of industry participants and Australian consumers.

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