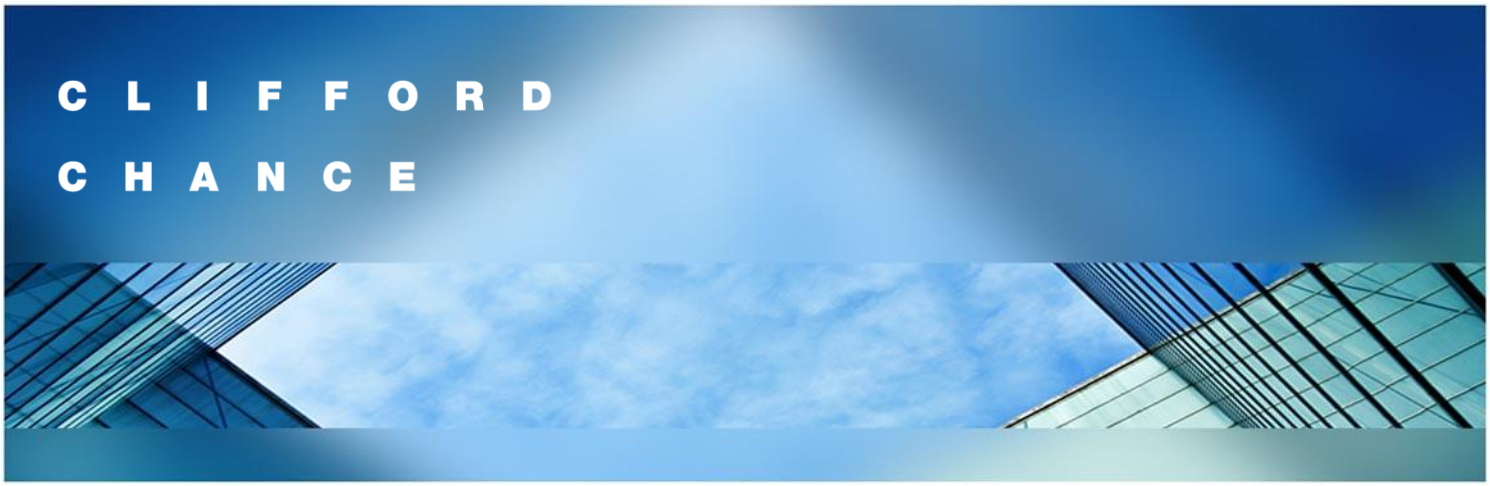

WHAT CAN BE LEARNED FROM THE ACCC VS PACIFIC NATIONAL/AURIZON MERGER APPEAL

On 6 May 2020, the Full Federal Court of Australia dismissed the appeal by the Australian Competition and Consumer Commission ('**ACCC**') of the decision of the Federal Court to allow Aurizon's sale of its Queensland Acacia Ridge Terminal to Pacific National ('**PN**') for $205 million. The decision is another loss for the ACCC in respect of contested mergers but provides helpful guidance on the merger provisions of the *Competition and Consumer Act 2010* (Cth) ('**CCA**'), the substantial lessening of competition ('**SLC**') test, and the use of behavioural remedies to address competition concerns that arise out of mergers. The decision remains subject to a possible appeal to the High Court of Australia and may also be used by the ACCC as a further basis to press for law reform to Australia's merger control regime notwithstanding that the ACCC arguably failed on the evidence and not on theories of law.

Key issues

- The Full Court of the Federal Court has clarified that in order for an acquisition to contravene the section 50 merger test it must be established that there is a 'real commercial likelihood', but not more probable than not, that the acquisition will result in a SLC. This decision will have broader application to other provisions of the CCA that also include a SLC test.
- In undertaking a competition assessment under a SLC-style test, a contravention requires more than mere speculative evidence. In this case the assessment of the effect on competition of the Proposed Transaction turned on the likelihood of new entry (rather than the one entity the ACCC put forward in Qube), the competitive landscape and changes that would occur within the relevant time period with and without the Proposed Transaction.
- Undertakings cannot be used as part of a court's assessment as to whether there is a contravention of section 50 – they must be remedial in nature and can only be considered once a contravention has been established.
- Behavioural undertakings remain an appropriate merger remedy in certain circumstances. The form of an undertaking that the Court can accept is not limited to the form of relief sought by the ACCC. There are no constitutional issues associated with the Court accepting an undertaking from merger parties in such circumstances.

BACKGROUND TO THE CASE ON APPEAL

The case centred around the proposed sale of the Acacia Ridge Rail Terminal ('**ART**') by Aurizon to the PN group of companies. The sale also involved a number of related agreements including a Terminal Services Subcontract (whereby PN would replace Qube as the operator of the Brisbane Multi-User Terminal), a commitment to provide PN exclusive preferred bidder status for the sale of Aurizon's Queensland Intermodal Business, and an announcement by Aurizon to close its Queensland intermodal business if the ACCC did not approve the sale ('**Proposed Transaction**').

At the time of the sale, the merger parties were the only two suppliers of intermodal freight and bulk line rail services within Queensland. They were also two of three providers supplying such services in and out of Queensland. PN is the largest provider of intermodal rail linehaul services in Australia.

Following a public informal review of the Proposed Transaction, the ACCC announced on 18 July 2018 that it would oppose the Proposed Transaction.

As a result of the merger parties not abandoning the sale, the ACCC instituted proceedings in the Federal Court of Australia against PN and Aurizon alleging that the Proposed Transaction would result in:

- PN becoming the dominant supplier of rail linehaul services on interstate routes and that would allow PN to limit or deny access to the ART facility to competing rail operators (access to which was alleged to be essential for interstate linehaul services) in contravention of section 50 of the CCA (the prohibition against mergers that are likely to have the effect of SLC) ('**Merger Case**'); and

- PN acquiring substantial control of the Brisbane Multi-User Terminal via the Terminal Service Subcontract in contravention of section 45 of the CCA (the prohibition against agreements that have the purpose, effect or likely effect of SLC) ('**Section 45 Case**').

Prior to the case being heard, the ACCC successfully sought an interlocutory injunction that required Aurizon to continue operating its Queensland Intermodal Business until the primary case had been heard. This was in fact sold to Linfox prior to trial.

The essence of the ACCC's case was that the sale of the ART to PN would increase barriers to entry effectively deterring a new entrant from providing interstate linehaul services in competition with PN, by reason of its ability (and incentives) to discriminate against a new rail linehaul service provider wishing to use the ART or commence providing linehaul services on the relevant routes.

On the last day of the trial PN offered the Court an unconditional undertaking ('**the Undertaking**') to address concerns that the acquisition of the ART facility would result in heightened barriers to entry, with both incentives and an ability for PN to discriminate against rivals.

THE PRIMARY JUDGE DISMISSES THE ACCC'S CASE

In respect of the Merger Case, on 15 May 2019 Justice Beach of the Federal Court made the following findings:

- In assessing the competitive harm of PN's ownership of the ART, Justice Beach focused on whether new entry was likely, and when it might occur. Justice Beach considered PN's ability to deter entry would cease on the construction of a new rail terminal as part of the Inland Rail Project;

- The ACCC would have succeeded in establishing that the Proposed Transaction had the effect of SLC due to heightened barriers to entry (either real or reasonably perceived) had PN not offered the l Undertaking. Justice Beach indicated that his conclusion would have been materially different absent the obligations imposed through the Undertaking offered by PN; and

- Justice Beach found that the Undertaking, when unconditional in nature, removed any meaningful ability for PN to discriminate against third parties. Therefore, to the extent that the Undertaking was taken

into consideration as part of the competitive assessment, the ACCC failed to establish a contravention of section 50 of the CCA.

In respect of the Section 45 Case, the Court clearly indicated that a counterfactual analysis requires the consideration of the future likely effect of competition with and without the impugned agreement. In the latter instance, in dismissing the ACCC's case, the Court found that it had neglected to attribute appropriate weight to the existence of the disciplining effect that would be imposed by Aurizon on PN in discriminating against a new entrant. The ACCC was also found to have relied upon an 'impermissible causation analysis' that was limited to the commercial relationship between the merger parties without giving proper regard to the effect on competition but for the impugned agreement.

THE FULL FEDERAL COURT DISMISSES THE ACCC'S APPEAL

In June 2019, the ACCC lodged an appeal to the Full Federal Court against the primary decision of Justice Beach. PN and Aurizon also lodged cross-appeals. The ACCC's appeal was primarily based on the ability of courts to consider and rely on undertakings of an unconditional nature as part of determining the competitive impact of a transaction under section 50 of the CCA and the effectiveness of such undertakings in mitigating competition concerns arising from mergers. The appeal and cross-appeals also concerned the interpretation of section 50, the primary judge's approach to market definition and the application of the facts to each of these matters. The ACCC withdrew its allegations and did not appeal the decision relating to the Section 45 Case.

On 6 May 2020, the Full Federal Court (consisting of Justices Middleton, O'Bryan and Perram) found that the Proposed Transaction was unlikely to SLC in the relevant market thereby dismissing the ACCC's appeal, allowing the cross-appeals of Aurizon and PN, and releasing PN from the Undertaking.

The meaning of "likely" in the context of the SLC test

The Court provided further clarity on the meaning of "likely" within the context of the SLC test in section 50 of the CCA, which will also have broader application to sections 45, 46 and 47 of the CCA (all of which include a similar SLC-style test). The merger test is whether an acquisition would have the effect, or likely effect of SLC in a relevant market.

The majority Justices Middleton and O'Bryan endorsed the primary judge's finding that the proper construction of "likely" within the context of section 50 means "real commercial likelihood" (but not more probable than not), as explained by Justice French in *AGL No.3.*[1] The decision clearly indicates that the application of section 50 requires a single evaluative judgment that has regard to the degree of likelihood of any particular future fact existing or arising rather than needing to establish predictions about each future fact as being "likely" in its own right.

However, Justice Perram did take issue with the primary judge's application of the standard stating that being unable to 'rule out the realistic commercial

[1] *Australian Gas Light Company v Australia Competition and Consumer Commission (No.3)* [2003] FCA 1525 [347].

chance of another potential new entrant emerging…' incorrectly reversed the onus of proof; rather the correct application should have been whether the ACCC had established that there was a real commercial chance that a new firm would enter the market if the acquisition did not proceed.

Competition analysis

The primary issue considered on appeal was whether PN's acquisition of the ART would increase barriers to entry (perceived or real) such that new entry of a rail linehaul provider would be deterred due to PN's ability to engage in foreclosure strategies (i.e. conduct that discriminates against a new entrant) in circumstances where Aurizon's interstate intermodal business had been closed, Aurizon's Queensland intermodal business had been sold to Linfox and another potential buyer, Qube, gave evidence that it would not enter the interstate rail linehaul market.

The Court found that the primary judge had erred when holding that competition would have been substantially lessened, in the absence of the Undertaking, due to an inability to exclude the possibility of future entry.

The Court found that it was uncontroversial that the height of barriers to entry is relevant to the assessment of competition in a market and, as a general proposition, increasing barriers to entry would be expected to lessen competition (by lessening the competitive constraint afforded by the potential for new entry). However, the Court went on to state that it 'does not follow that in every case in which barriers are raised by an acquisition that competition will be substantially lessened unless new entry is impossible or close to impossible'.

Ultimately an assessment of the effect on competition of the Proposed Transaction turned on the likelihood of new entry if it did not proceed. Justice Perram clearly pointed out that the relevant question was 'not whether the likelihood of a new entrant could be excluded. It was whether it has been established'.

The majority went on to find that the prospect of new entry was merely speculative and that any new entry would be unlikely to occur within five years. As such, the Proposed Transaction was considered to not affect the competitive constraints facing PN in any real or meaningful way.

The ability of the Court to accept undertakings

A distinct but related issue was whether the primary judge's acceptance of, and reliance on, the Undertaking in finding that the sale of the ART would not contravene section 50 was appropriate and permissible.

In assessing the approach adopted by the primary judge the Court found that:

- An undertaking made to a court does not constitute part of the relevant facts on which a court is to decide the issue of contravention (i.e. the undertaking cannot be considered as a relevant fact when determining whether a transaction contravenes section 50). The Court's power to accept an undertaking in the context of a proceeding under the CCA in respect of a contravention of section 50 must be regarded as remedial in nature.

- The fact that section 87B of the CCA empowers the ACCC to accept undertakings in connection to an acquisition does not affect the power of the Court to accept such an undertaking. A party to an acquisition might offer an undertaking to the ACCC under section 87B of the CCA and, if it is rejected by the ACCC and the ACCC subsequently brings a proceeding to prevent the acquisition under section 50, the party can then also offer it to the Court in lieu of injunctive relief.

- There is no legal requirement for the Court to give special status to the ACCC's submissions in relation to undertakings. The central issue and standard in assessing the effectiveness of an undertaking is whether it contains terms that are vague and incapable of enforcement in a contempt proceeding. However, care must be exercised in not relying solely on the feasibility of enforcing the undertaking by such means as a way of assessing its effectiveness to address competition concerns.

The Court was also of the view that the form of an undertaking capable of being accepted by the Court (in lieu of injunctive relief) is not limited to the form of relief sought by the ACCC. An undertaking imposing behavioural obligations was viewed as appropriate in the circumstances with the form of an undertaking ultimately being a matter for the Court. The Court expressly stated that there is no legal requirement to afford greater weight to the views of the ACCC in respect of an undertaking.

KEY IMPLICATIONS AND TAKEAWAYS

The decision of the Full Federal Court (and certain reasoning of the primary judge endorsed by the decision) provides some helpful guidance on Australia's merger test and considerations that are relevant to the assessment of mergers. Key takeaways include:

- Evidence of a contravention of section 50 must be more than merely speculative – rather it must be established that there is a real commercial chance that the transaction will result in a SLC;

- Undertakings cannot be used as part of a court's assessment as to whether there is a contravention of section 50 – they must be remedial in nature and can only be considered once a contravention has been established.

- There remains an inherent degree of trepidation by courts around the general appropriateness of behavioural undertakings – but they remain an appropriate form of remedy (in lieu of an injunction) if they are viewed by the Court as effectively addressing competition concerns arising from the transaction; such an assessment appears to remain a difficult task compared to evaluating a structural remedy such as a divestment.

- The framework through which to assess vertical mergers remains otherwise unchanged – regard must be had to the ability of the merged entity to engage in anti-competitive (foreclosure) conduct, the incentive of the merged entity to engage in such conduct, and the effect of the conduct on competition.

- Courts remain reluctant to place significant weight on economic theory for the purposes of importing or creating a legal standard.

Whilst the ACCC has not yet indicated whether it will consider appealing this decision to the High Court, recent comments from ACCC Chairman Rod Sims continue to reiterate the ACCC's concerns (or difficulties) in successfully discharging its onus in respect of establishing a SLC. The ACCC Chairman has stated that: 'we've got a merger law at the moment that is probably damaging the productivity of the economy so I would have thought this is as an important a reform as others that are being mentioned in the context of the post-COVID recovery'.[2]

The ACCC appears likely to use this loss as another basis upon which to advocate for further law reform to Australia's merger control regime (including the introduction of a rebuttable presumption where if a merger results in a significant increase in concentration, the parties will need to provide evidence to prove otherwise in order for it to be permitted to proceed). However, the ACCC will face the difficulty that the Full Federal Court's decision is primarily based on the ACCC not being able to prove that there would not have been entry in general (as opposed to entry by one competitor in Qube), had the Proposed Transaction occurred.

Nonetheless, time will tell whether the ACCC will seek to appeal the Full Court decision on the basis that it should have been up to PN to prove entry was likely, rather than the ACCC.

[2] Australian Financial Review, 'Sims says merger law 'damaging productivity', 7 May 2020 <https://www.afr.com/companies/infrastructure/merger-law-changes-even-more-important-after-covid-19-says-rod-sims-20200506-p54q9j>.

CLIFFORD
CHANCE

CONTACTS

Authors:

Dave Poddar
Partner

T +61 2 8922 8033
E dave.poddar
@cliffordchance.com

Mark Grime
Senior Associate

T +61 2 8922 8072
E mark.grime
@cliffordchance.com

Jacqueline Song
Law Graduate

T +61 2 8922 8032
E Jacqueline.song
@cliffordchance.com

Other contacts:

Elizabeth Hersey
Senior Associate

T +61 2 8922 8025
E elizabeth.hersey
@cliffordchance.com

Philip Arnold
Senior Associate

T +61 2 8922 8503
E philip.arnold
@cliffordchance.com

Holly Cao
Associate

T +61 2 8922 8098
E holly.cao
@cliffordchance.com

Angel Fu
Associate

T +61 2 8922 8089
E angel.fu
@cliffordchance.com