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AUSTRALIA - MERGERS IN THE REGULATORY SPOTLIGHT: FOCUS ON INDUSTRY CONCENTRATION LEVELS, INVESTMENTS IN CRITICAL INFRASTRUCTURE AND ON PRIVATE EQUITY ROLL UPS, AS DEBATE ON MERGER REVIEW REFORMS CONTINUES

BACKGROUND

ACCC starts merger reform discussion

In August 2021, the previous Chair of the Australian Competition and Consumer Commission (**ACCC**), Rod Sims proposed various reforms to Australia's antitrust merger control regime. The recent announcement of ANZ Bank's proposed acquisition of Suncorp Bank is set against a background of a renewed discussion on concentration in Australian industry, with a focus on common industry ownership and merger reform.

Now that the new Labor Government has moved on reform of the penalty regime and unfair contracts regime in the Competition and Consumer Act 2010 (**CCA**), as it indicated it would, it is likely that merger law reform will be on the agenda in 2023.

Concerns with industry concentration

While the Australian Treasurer, Dr Jim Chalmers will take advice from the ACCC and the Australian Prudential Regulation Authority in relation to the Suncorp Bank acquisition, recent statements by the Assistant Minister for Competition, Charities and Treasury, Dr Andrew Leigh, indicate he is concerned with concentration in Australian industries. Dr Leigh was recently quoted in The Guardian as stating that a key priority for the new Government is preventing "excessive market concentration" and that a key focus of his role will be to encourage more competition to the benefit of both workers and consumers. Dr Leigh said:

> *"One of my favourite barbeque games is let's go through the Australian economy and name more than a handful of industries where there is more than just a couple of dominant players. Whether it is banking or baby food or beer, the Australian economy is characterised by a few firms dominating the market."*

Dr Leigh has also previously suggested that some asset managers and superannuation funds may be inhibiting competition in Australia by owning large stakes in rival businesses, raising the question of whether common portfolio ownership of companies suppresses the incentive to compete vigorously.

Key issues

- Under the new Labor Government in Australia, mergers will remain an area of Government focus, reflecting concerns that market concentration in some Australian industries is too high.
- Following the unveiling of the suggested reforms to the merger review regime by the previous ACCC Chair, Rod Sims in August 2021, mergers continue to be an enforcement priority for the new ACCC Chair Gina Cass-Gottlieb, including in relation to common fund management and ownership.
- A similar focus on industry concentration and mergers, including PE transactions, is evident in other jurisdictions such as the United States.
- Although no legislative proposals have yet been put forward in Australia, these are anticipated, with the key areas of debate to be the jurisdictional thresholds and the proposed changes to the substantive merger test.
- An appropriate balance is needed in any reform, given that legislative changes may bring about uncertainties for merger parties and an increased time and cost burden, if the changes are not appropriately calibrated.
- Debate on the proposed merger reforms will be set against the scene of ANZ Bank's proposed acquisition of the regional bank Suncorp Bank.

Against the background of these statements, Dr Leigh noted that he was open to considering merger law changes suggested by the ACCC.

Concerns with common fund management and ownership, particularly in critical infrastructure sectors

Dr Leigh recently reiterated his concerns regarding concentration in a speech to the Australian National University on 25 August 2022. The following day, when confirming that the Spirit Super and Palisade Investment Partners Consortium had withdrawn its request for merger clearance for its acquisition of the Port of Geelong, the ACCC affirmed it shared these concerns, in the context of common industry ownership of critical infrastructure assets.

In late 2021, Australia amended its critical infrastructure legislation to significantly expand the number of sectors of the economy that are considered to be critical. Prior to the reforms only five sectors were covered (water, electricity, gas, ports and, albeit under a separate legislative regime, telecommunications). Now eleven sectors are regulated, including financial services and markets, health care, food and grocery and transport.

In its media release relating to the Port of Geelong withdrawal, the ACCC commented:

> *"Superannuation and other investment funds have interests in many of Australia's critical infrastructure assets. The issue of common fund management and ownership among competing firms, including via minority interests, has increasingly become a focus of economic regulators and has most recently been the subject of a Standing Committee on Economics Inquiry."*

The Chair of the ACCC, Gina Cass-Gottlieb stated:

> *"Common fund management and ownership that allow a degree of control or influence by minority interests have the potential to detrimentally affect competition."*
>
> *…*
>
> *"Parties proposing to acquire interests in critical Infrastructure should expect the ACCC's review will be careful and thorough. Such transactions may have long term consequences for competition. The ACCC conducts merger reviews with the rigor warranted by the complexity and significance of a transaction."*

In this context, this Briefing will review trends in merger enforcement and possible changes to Australia's merger control regime.

PROPOSED REFORMS TO AUSTRALIA'S MERGER REVIEW REGIME – THE DEBATE CONTINUES

In August 2021, the then ACCC Chair Rod Sims unveiled the ACCC's suggestions to amend the existing merger review regime, to change it from a voluntary, non-suspensory enforcement-based regime to a mandatory one with prescribed thresholds (and presumably waiting periods during which completion of a transaction could not occur, though this was not discussed at the time). At that time, the ACCC Chair indicated he was not proposing specific legislative amendments to the merger provisions in section 50 of the CCA, but rather hoped to start a debate, leaving it in the Government's hands to progress any reforms.

While the former Coalition Government showed little enthusiasm for the ACCC Chair's recommendations, the new Labor Government is likely to pursue these reforms. It is anticipated that key areas of debate will be what thresholds should be applied and how the proposed lowered standard for the substantial lessening of competition test (**SLC**) will likely operate in practice, particularly for mergers and acquisitions in sectors of interest to the ACCC and those concerning regional and/or rural Australian markets.

Australia has been experiencing a surge in M&A activity, resulting in a high number of merger notifications to the ACCC, as compared to historical averages. In 2021, 472 mergers were notified to the ACCC, up 41% on the previous year, and the number of mergers considered by the ACCC in 2021 was 63% higher than the average over the last five years.[1] This has created more of a sense of urgency for the Australian Government in addressing its industry concentration concerns.

The ACCC's long-held concerns that Australia's merger review regime is not fit for purpose have previously been voiced (most prominently following a loss by the ACCC in merger litigation), and the ACCC's calls for reform have become more strident, with the view that the current merger review regime is "*skewed towards clearance*".[2] In her first address to the International Competition Network (**ICN**) since her appointment as the new Chair of the ACCC, Ms Cass-Gottlieb raised the possibility of merger control reform, including a move toward a formal, compulsory regime and a new substantive merger review test. One emerging trend that appears to be on the ACCC's radar is companies taking a "*strategic approach to seeking clearances across different jurisdictions*" and that "*the absence of a mandatory notification requirement in Australia means that we are often approached comparatively late*".

To be balanced, however, Australia is a relatively small country, and it is sensible in approach and arguably an efficient use of resources, to deal with larger and more problematic jurisdictions and their competition regulators first, so as to ascertain key issues and potential divestments that may occur on a global basis.

Does the current merger regime actually provide a more powerful regime because it provides the flexibility to look at any transaction, irrespective of size and the fact that even though there are no standstill periods under the current merger regime, the ACCC is well placed to obtain interim injunctions.

As the substantive test in the current Australian merger law review regime is a purposive one that requires the ACCC to consider whether a particular transaction would have the effect, or likely effect, of SLC in any "market" (with "market" being defined to include a market for goods or services in Australia, a State, Territory or a region of Australia), the ACCC is able to (and has done so in the past) scrutinise any transaction, regardless of the deal value or market concentration.

If a new merger regime is imposed which has thresholds in it, an interesting debate before a Court will be whether the legislature has permitted transactions below that threshold to proceed because they cannot, in an economy the size of Australia, have an effect of substantially lessening competition in a relevant market. No doubt the ACCC will resist such

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[1] See Mr Rod Sims' Speech, *ACCC's enforcement and compliance policy update 2022-23*, Committee for the Economic Development of Australia (CEDA) Conference, 3 March 2022: https://www.accc.gov.au/speech/acccs-enforcement-and-compliance-policy-update-2022-23

[2] See Mr Rod Sims' Speech, *Protecting and promoting competition in Australia,* Competition and Consumer Workshop 2021 - Law Council of Australia, 27 August 2021: https://www.accc.gov.au/speech/protecting-and-promoting-competition-in-australia.

arguments and seek to have a general "call in" power to review mergers below the thresholds in any event. This immediately highlights the potential for uncertainty and delay created by such changed merger processes.

Interestingly, in its 2022 / 2023 *Enforcement and Compliance Policy Update*, the ACCC specifically called out the Virtus Health (**Virtus**) / Adora Fertility (**Adora**) transaction as an example of the practical challenges it faces with the current informal merger review regime from a regulatory perspective, where parties do not have to wait for the ACCC's approval prior to closing a transaction.

The Virtus / Adora transaction related to Virtus' proposed acquisition of Adora and three day-hospitals from Healius (a listed Australian health company) for approximately $45 million. Virtus originally informed the ACCC of the proposed transaction in August 2021 and provided the ACCC with "*very limited information*", but later indicated that it would complete the transaction even though the ACCC had not completed its informal review of the transaction. The ACCC was primarily concerned that the acquisition would increase Virtus' "*already significant market share in Brisbane and Melbourne*" and that "*[w]hen there are fewer IVF providers, there is a significant risk the cost of IVF treatment will increase, adding further to the financial impact on consumers.*"[3]

The ACCC commenced proceedings in October 2021, seeking an urgent injunction to restrain Virtus from proceeding with the transaction, which was granted by the Federal Court. The transaction was ultimately abandoned by the parties due to the costs and burden of defending it in Court and may be seen as an example of keen regulatory scrutiny in sectors of interest, particularly where the ACCC is concerned that a transaction may lead to increased prices and adverse patient outcomes in the healthcare sector, even if the deal value is relatively small.

Similarly, in its ex-post review of six merger decisions in February 2022, the ACCC considered its previous review of the Caltex Australia Petroleum Pty Ltd / Milemaker Petroleum transaction, which involved the acquisition of Milemaker's retail petrol sites in Melbourne, Geelong and regional Victoria for approximately $95 million. The ACCC indicated its view in the ex-post review that price competition appeared to have decreased post-merger despite the parties having a combined share of only 11%,[4] signalling that perhaps going forward the ACCC may look beyond market shares when considering mergers, particularly those involving industries like fuel and where there are rural / regional markets involved.

For more information on the anticipated changes to Australian competition law policies more broadly, please see our earlier briefing here.

International cooperation set to continue

At the same time, the ACCC continues to work closely with its international counterparts on global mergers (that often involve very significant transaction values) and looks to regulators in other key jurisdictions for emerging trends. Given this, it is unsurprising that new ACCC Chair, Ms Cass-Gottlieb, is committed to continuing the ACCC's policy of strong collaboration with other competition regulators, as Australia prepares to assume the presidency of the

[3] See ACCC Media Release, 17 December 2021: https://www.accc.gov.au/media-release/virtus-abandons-proposed-acquisition-of-adora
[4] ACCC, Ex post review of ACCC merger decisions, February 2022, pages 6 and 11: https://www.accc.gov.au/system/files/Ex%20post%20review%20of%20merger%20decisions.pdf

International Consumer Protection Enforcement Network for the 2022-2023 period.

REGULATORY FOCUS IS REFLECTED IN THE UNITED STATES

Mergers remain on the radar of competition regulators globally, with regulators in the US looking to hone in on private equity (**PE**) M&A activity, particularly in sectors like healthcare. Given that buyout transactions in the US healthcare sector have grown from approximately USD$42 billion in 2010 to USD$120 billion in 2019, M&A activity in this sector looks to be attracting increasing scrutiny from US regulators. In a recent interview, head of the US Department of Justice (**DoJ**) Antitrust Division, Jonathan Kanter expressed his view that "*Sometimes [the motive of a private equity firm is] designed to hollow out or roll up an industry and essentially cash out*", warning that the DoJ will be taking a tougher stance on PE firms rolling up large parts of the American economy, seeking to block anti-competitive deals rather than pursue complex settlements.

While in the past, acquisitions involving private equity buyers may have been perceived as less problematic from a competition law perspective compared to "strategic acquirers", this approach appears to be changing, with a growing perception amongst regulators that "traditional" antitrust issues can arise in the context of private equity acquisitions, particularly as private equity firms buy multiple players in the same space. Lina Khan, Chair of the US FTC has expressed similar concerns regarding private equity acquisitions in the healthcare segment. In a statement relating to JAB's proposed acquisition of SAGE Veterinary Partners, LLC (**SAGE**)[5] FTC Chair, Lina Khan voiced strong concerns as to the approach by private equity. The following paragraphs from the statement are provided in full.

> *"Provisions like the ones in this matter will also allow the FTC to better address stealth roll-ups by private equity firms like JAB/NVA and serial acquisitions by other corporations. Antitrust enforcers must be attentive to how private equity firms' business models may in some instances distort incentives in ways that strip productive capacity, degrade the quality of goods and services, and hinder competition. Private equity firms' playbook for purchasing or investing in companies can include tactics such as leveraged buyouts, which saddle businesses with debt and shift the burden of financial risk in ways that can undermine long-term health and competitive viability. While private equity firms can support capacity expansion and upgrades, firms that seek to strip and flip assets over a relatively short period of time are focused on increasing margins over the short-term, which can incentivize unfair or deceptive practices and the hollowing out of productive capacity.*
>
> *Meanwhile, serial acquisitions or "buy-and-buy" tactics can be used by private equity firms and other corporations to roll up sectors, enabling them to accrue market power and reduce incentives to compete, potentially leading to increased prices and degraded quality. Private equity firms have been particularly active in health care,*

[5] US FTC, Statement of Chair Lina M. Khan joined by Commissioner Rebecca Kelly Slaughter and Commissioner Alvaro M. Bedoya in the matter of JAB Consumer Fund / SAGE Veterinary Partners, Commission File No. 2110140, 13 June 2022: https://www.ftc.gov/system/files/ftc_gov/pdf/2022.06.13%20-%20Statement%20of%20Chair%20Lina%20M.%20Khan%20Regarding%20NVA-Sage%20-%20new.pdf

> *including anaesthesiology, emergency medicine, hospice care, air ambulances, and opioid treatment centres. A focus on short-term profits in the health care context can incentivize practices that may reduce quality of care, increase costs for patients and payors, and generate appalling patient outcomes. Research and reporting suggests these effects are especially pronounced in specialty practices, such as elder care and disability care facilities. Research has shown that private equity ownership of elder care facilities is correlated with increased deaths at those nursing homes, potentially owing to cost-cutting measures like staffing reductions. In another case, as one firm consolidated ownership of group homes for people with disabilities, media reporting revealed repeated failed inspections, overworked staff, and even deaths."*

While this may well seem to be a particularly strident series of statements, FTC Chair Lina Khan has followed up strong statements with litigation. This was recently highlighted by the FTC's proceedings against Meta in relation to its proposed acquisition of an emerging competitor Within, given the FTC's stated concerns as to so called "killer" acquisitions of nascent competitors.

As regulators globally seek to tackle what they perceive to be problematic market concentrations and so called "killer" acquisitions of emerging competitors that fall below merger control thresholds, the ACCC will likely continue looking to its international counterparts as it implements its own enforcement priorities and looks ahead to the debate on the proposed reforms to the Australian merger review regime.

WHAT DOES THE CURRENT FOCUS AND POTENTIAL REGULATORY REFORM MEAN FOR BUSINESSES?

As noted earlier, in terms of areas of focus, the ACCC and Government have indicated they will be looking at acquisitions of critical infrastructure from both a competition and national interest perspective. This is important because if the ACCC has competition concerns in respect of a particular acquisition, it is unlikely the Government will be forthcoming on foreign investment approval.

In terms of reform, reform proposals in the past have been largely limited to the introduction of a rebuttable presumption (i.e., a merger is presumed to be anticompetitive where certain structural market factors exist and is typically activated based on the market shares of the parties and / or merger induced levels of market concentration), but the most recent proposals are comparatively much broader. While the ACCC has not put forward specific legislative proposals at this stage, the proposed reforms broadly fall into three categories, being: (i) introduction of a new formal merger review process; (ii) changes to the substantive merger test; and (iii) reforms to deal with acquisitions by large digital platforms.

A shift to a mandatory, suspensory merger review regime will likely bring forth some important changes in the way companies engage with the ACCC when seeking to undertake M&A activity. Given this, it is anticipated that each of the proposed reforms will be subject to considerable scrutiny and consultation. In particular, careful thought and debate will likely be needed on the below areas.

- **Jurisdictional thresholds**, which determine the transactions that will be caught for ACCC review, will need to be set carefully so as to not over capture transactions which would lead to increased time and cost burdens on both the ACCC and on merger parties, noting that the ACCC in any

event proposes to have a "call in" power to review transactions that fall below the jurisdictional thresholds. While it is understandable that regulators may focus on this in relation to so called "killer acquisitions", that ability to focus on maverick, smaller competitors currently exists, in the current section 50(3) criteria in the CCA. An ability to "call in" and review appropriate mergers already exists.

- **Substantive changes to the "SLC" test**. The ACCC proposes to place the onus on merger parties to *satisfy* the ACCC that a transaction is not likely to SLC in certain circumstances. This is more onerous compared to regulatory approaches in other key jurisdictions such as the UK and Europe. In addition, the ACCC proposes to lower the standard of proof required to find that a merger is *likely* to SLC, by changing the meaning and interpretation of "likely" from "*a real chance*" to "*a possibility that is not remote*". This change, if it were taken forward, would involve a material change to the architecture of the SLC test which is the fundamental test for not just mergers, but also other anti-competitive conduct provisions in the CCA. Competition needs to be robust to drive innovation and the most efficient use of resources. Long held theory has been that typically M&A will see inefficient firms acquired. Therefore, it is questionable whether the threshold should be lowered for merging parties to make M&A more difficult.
- **Structural market factors that would give rise to a transaction being deemed to be anticompetitive so that merger parties must show they do not SLC.** As market shares are highly dependent on the approach to defining a relevant market, a practical consideration will be how to apply such a deeming provision without creating significant uncertainty for merger parties, given the lack of meaningful ACCC decisional practice (and jurisprudence) around the approach to market definition in Australia. From a competition perspective, mergers which create or enhance market power has been the determining factor. Great care is needed in relation to such proposed changes that effectively reverse the onus of proof, that they are not an overreach and stifle efficiency enhancing M&A.

While many of these ACCC proposals are thought provoking, it will be important for the new Australian Government not to undermine a merger review process that has been found in countless independent Government inquiries (e.g., Hilmer, Dawson and Harper), to be working well and in particular not undermining the ability to have mergers properly reviewed in a commercially timely manner that provides regulatory certainty in which to invest.

Companies should remain abreast of the developments and debate to come in Australia in relation to merger control, and keep in mind the potential changes on the horizon when preparing for M&A activities.

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