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Consultation on Exposure Draft of Treasury Laws Amendment Bill 2024: Acquisitions

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Submission to Treasury

1 Overview

Herbert Smith Freehills (**HSF**) welcomes the opportunity to provide comments to Treasury in response to the Exposure Draft of Treasury Laws Amendment Bill 2024 (**Exposure Draft**).

HSF supports reforms to simplify and speed up the process for merger review. Most mergers are efficiency enhancing and benefit both the Australian economy and Australian consumers. In that context, a more streamlined and more timely process would be to the benefit of both merger parties and the broader economy.

We have no in principle objection to the introduction of a compulsory and suspensory regime. Many jurisdictions have such regimes and, globally, businesses successfully interact with regulators in the context of those regimes.

However, in its current form, it is doubtful that the Exposure Draft will, in fact, deliver a faster, stronger and simpler system.

In our view, without material changes to the drafting, the proposed system is likely to introduce legal and procedural uncertainties which will increase the length of time for merger review, including by reason of increased likelihood and frequency of review applications to the Australian Competition Tribunal (**Tribunal**). A system which increases the likelihood and frequency of Tribunal review will not be a successful one. It will increase costs and introduce uncertainties which will have negative impact on merger activity and, ultimately, the Australian economy.

Clients hold that view. We have received feedback that clients would be less inclined to pursue acquisitions in Australia if the reforms are implemented in their current form.

We also consider that the regime is unnecessarily complex in its concepts and legislative drafting, which will inevitably lead to further uncertainty and the potential for challenge. We would encourage Treasury to consider all opportunities to materially reduce the complexity of the regime.

We expect that Treasury will receive a large number of submissions which cover various aspects of the proposed drafting. The below is not intended to be exhaustive but highlights particular areas/issues for further consideration.

2 Submission

2.1 Notification threshold: Uncertain concept of “control”

The merger clearance regime will apply to the direct or indirect acquisition of shares or assets. In the case of shares, the acquisition provisions apply if the transaction gives rise to “control”. Control is defined in proposed section 51ABC(3) as the capacity to directly or indirectly determine the policy of the body corporate in relation to one or more matters.

Under the Exposure Draft, any transaction resulting in an acquisition where the acquiring party obtains 20% or more of “voting power" is presumed to involve an acquisition of control. The 20% threshold is, in our view, too low and may capture passive and minority investments which are unlikely to raise any relevant concerns. The definition is also not consistent with the use of the well-understood term “control” as used in the *Corporations Act 2001* (Cth) (**Corporations Act**).[1]

[1] *Corporations Act 2001* (Cth) s 50AA.

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Notwithstanding the existence of a rebuttable presumption, the potential consequences of failing to make a clearance filling are likely to result in increased clearance applications even in the absence of control.

We are also concerned that an assumption of control at a level of 20% may impact on the substantive consideration of minority acquisitions which we consider may be inappropriate.

In the circumstances, our view is that:

- For entities which are subject to the takeover rules in Chapter 6 of the Corporations Act,[2] the notification requirement should be assessed against a clear, bright line (objective) test where acquisitions of a "*relevant interest*"[3] in more than 20% of the "*voting shares*"[4] must be notified.

  The concept of "*voting power*"[5] is not the appropriate definition to use as a person can technically have "voting power" (as defined) but have absolutely no direct or indirect power or control whatsoever over the relevant voting shares.[6]

  There should be no presumption that a relevant interest in more than 20% equates to control. Rather, this would simply be a threshold for notification.

- For entities which are not subject to the takeover rules in Chapter 6 of the Corporations Act, or if the above approach is not adopted with respect to entities which are subject to the takeover rules in Chapter 6, the definition of control set out in section 50AA of the Corporations Act should be used.

  And, for these purposes, the existing (long accepted and well-understood) concept of section 50AA should apply (and not the version of section 50AA in proposed section 51ABC(3)-(5)).[7]

  It is not appropriate to apply the Chapter 6 concepts to entities that are not subject to the takeover rules in Chapter 6. By way of example, if a person acquires a single share in a private company that has a shareholders agreement containing pre-emptive rights over shares (which rights are very common), that person will almost certainly acquire "voting power'" of 100% in that company. It cannot be that such acquisitions should be required to be notified for clearance.

It is very important that the drafting of the legislation takes into account the technical nature of the concepts of "relevant interest", "associate" and "voting power" in Chapter 6 of the Corporations Act. Whilst we agree with the use of well-established concepts that the market knows and understands – and we would include "control" (as defined in

[2] As to which, see s 606(1)(a) of the Corporations Act (being listed companies and unlisted companies with more than 50 shareholders). Chapter 6 also applies to listed registered managed investment schemes (see s604 of the Corporations Act).

[3] As defined in s 608 of the Corporations Act. In summary, a person will have a relevant interest in voting shares if (among other things) they have the power to control the voting or disposal of those shares.

[4] As defined in s9 of the Corporations Act.

[5] As defined in s 610 of the Corporations Act.

[6] This is because a person's "voting power" is calculated by reference to (a) the voting shares in which that person has a relevant interest plus (b) the voting shares in which that person's associates have a relevant interest.

The concept of "associate" is defined in s 12 of the Corporations Act and includes entities that the person (i) is acting in concert with or (ii) has a "relevant agreement" with. Those entities do not have to be related bodies corporate of the person.

[7] Section 50AA(3) of the Corporations Act has not, but should have, been carried across into the new provision. That provision makes it clear that a person does not control a body corporate merely because they jointly have the capacity to determine the outcome of decisions about the body corporate's financial and operating policies. By way of example, a single shareholder in a widely held body corporate should not be treated as controlling that body corporate merely because, in theory, if it teamed up with multiple other unrelated shareholders it would have the capacity to determine the outcome of decisions about the body corporate's financial and operating policies.

section 50AA of the Corporations Act) in that category – the indiscriminate use of such concepts will inevitably have unintended consequences (as is already apparent from the draft provisions).[8]

2.2 Public notification register: Implications for bid processes

Under the proposed regime, the Australian Competition and Consumer Commission (**Commission**) will be required to maintain a public register listing all notified mergers and containing a copy of each acquisition determination and the Commission's reasons for making the determination.[9]

This raises three practical concerns for bid processes.

- **Confidential bids**. Under the existing regime it is possible to seek confidential "pre-assessment" of transactions, which allows acquirers to obtain Commission clearance prior to signing a transaction with a target. The absence of a confidential clearance process is likely to reduce parties' willingness to make unsolicited bids or approaches – for example, where bidders may be unwilling to disclose their interest in a target prior to an unconditional transaction being signed. Because market moves can affect the viability and ability to execute transactions (the saying "time kills deals" is accurate), it is important to bidders that the time between announcement and implementation is minimised. We are already seeing slower regulatory approval processes making it challenging to implement transactions, and expect this to be exacerbated if even transactions which are uncontroversial but are subject to mandatory notification cannot be cleared on a confidential basis at or shortly after announcement.
- **Competitive bid processes**. Vendors who run competitive processes may also face reduced optionality and certainty, as they would need to "pick a winner" and factor in Commission clearance risk, rather than requiring bidders to seek Commission clearance prior to signing.
- **On-market takeover bids**. Where the thresholds for notification are met, parties will not be able to launch on-market takeover bids for an ASX-listed company until Commission clearance is received, as such bids must be unconditional. Under the Exposure Draft, the Commission cannot make a determination earlier than 15 business days after the effective notification date.[10] Due to these features, the merger reforms are likely to, in practice, prevent parties from pursuing on-market takeover bids, and deny ASX shareholders the opportunity to benefit from takeover bids which would otherwise be made on-market. The merger reform regime should provide for an exception or other mechanism that will enable parties to continue to make unconditional on-market takeover bids.

In our view, the concerns above should be addressed by allowing, consistent with current practice, for notifiable transactions to be submitted on a confidential basis. Where a confidential clearance is provided, the Commission's determination should be made public only if the bid is pursued. Consistent with current practice, the Commission could make a determination that clearance on a confidential basis is not possible in appropriate cases.

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[8] For an explanation of these important concepts, see R Levy, *Takeovers Law and Strategy*, Lawbook Co., Thomson Reuters, Sixth Edition, 2023, at Chapter 3.

[9] Exposure Draft, s 51ABZB(1).

[10] Exposure Draft, s 51ABZB(1).

2.3 Substantive threshold: Standard of "reasonably believes" is too low

The Exposure Draft proposes to alter the legal standard by which mergers will be assessed by requiring the Commission to assess substantial lessening of competition on a "reasonable belief" standard. In particular, the Commission must not determine that a merger may be put into effect (subject to any specified conditions) unless the Commission "reasonably believes" (a) that there is a real, and not merely a remote, possibility that the acquisition, if put into effect, would have the effect, or would be likely to have the effect of substantially lessening competition in a market and (b) any conditions imposed would "comprehensively address" that possibility, including by addressing the adverse effects of a substantial lessening of competition.[11]

A "reasonably believes" standard is used in elsewhere in the *Competition and Consumer Act 2010* (Cth) (**CCA**) and has been interpreted by the Courts as being a low threshold, requiring only that the belief is not formed on the basis of "improbable or idly speculative" facts.[12]

The test used in the present merger authorisation context is that the Commission (and in turn, the Tribunal) has be to affirmatively satisfied. This is the appropriate standard. Its adoption would not result in the imposition of an unreasonable standard, it is a standard which is already applied in a merger clearance process and is one which is understood by the Commission, relevant legal practitioners and the market.

2.4 Substantive threshold: Merger factors

Proposed section 51ABX introduces a number of new merger factors which the Commission must and may have regard to. These include, for example, "the need to maintain and develop effective competition in markets". In our view, the factors may empower the Commission to make or prefer determinations that it considers likely to increase competition, rather than merely avoiding competitive harm – for example, "promotion of competition", "develop effective competition" and the express focus on "obstacles to competition" arising from presumably pro-competitive factors like innovations and productivity gains. Merger factors should be targeted at the relevant issue (ie, is there an effect or likely effect of substantially lessening competition). These factors do not do that and therefore there is a question as to how they are in fact intended to operate.

It is noted that section 51ABX refers to section 51ABW which includes a reference to an acquisition being put into effect subject to specified conditions it might be possible to assert that some of these factors are better targeted to an assessment of relevant conditions. If that is the intention, they should be appropriately delineated from factors which are relevant to the assessment of any substantial lessening of competition.

2.5 Substantive threshold: Changes to net benefit test

The current merger authorisation "net public benefit" test requires that the public benefits outweigh any public detriments. Proposed section 51ABZL introduces a substantive change to this requirement such that the Commission will need to be satisfied that the relevant benefits "would substantially outweigh" relevant detriments.

The basis for this significant change is not apparent. The object of the CCA contemplates competition as a form of benefit to the public in that it is "to enhance the welfare of Australians". Where alternative public benefits arise as a result of a transaction, and can

[11] Exposure Draft, s 51ABW(2).

[12] *WA Pines Pty Ltd v Bannerman* (1980) 41 FLR 175 at 186; *Seven Network Ltd v Australian Competition and Consumer Commission* (2004) 140 FCR 170 at 173 [5].

be demonstrated to the satisfaction of Commission or Tribunal, it is not apparent why such public benefits are to be discounted (such that they can only be considered to meet the requirements of the CCA where they substantially outweigh any public detriments).

The measurement of a comparison of public benefits and detriments is inherently difficult. The proposed amendments may require a precise quantification of detriments and benefits which may not be possible. In addition to introducing a new standard, which is not consistent with prior practice and decisions, the amendments would, by necessity, result in transactions being not approved despite a demonstrable net public benefit. We consider that such transactions should be approved, and consequently, that the current test should be retained.

2.6 Timing: Commission's ability to "stop the clock"

Under the Exposure Draft, the Commission may extend the period for its determination, or "**stop the clock**", where a party to the acquisition is *served* a notice under section 155(1) to furnish information, produce documents or appear before the Commission.[13] The extension must be for the number of days it takes the recipient to respond to the section 155(1) notice.[14]

Accordingly, the Commission may extend the period for its determination, even if the recipient of the section 155(1) notice responds in full within the time permitted by the notice.

Section 155(1) notices are a widely used, ordinary course evidence gathering tool used by the Commission in investigate and assess complex mergers – in particular, any merger likely to proceed to Tribunal review. It is appropriate that the Commission continue to use those powers in such cases.

There is therefore a strong possibility that the Commission will be able to "stop the clock" in complex cases, which runs counter to timing certainty and the objectives of the regime.

In our view, it is not appropriate that the Commission merely *serving* a section 155(1) notice results in an ability to "stop the clock" and delay its determination. An ability to "stop the clock" should only arise where a party fails to respond to a section 155(1) notice within the period permitted by the notice (provided that the period is reasonable having regard the scope of the notice).

2.7 Procedural fairness: Merger parties' ability to respond to evidence the Commission receives and relies on

In the context of an administrative decision-making model, it is important that parties to an acquisition are provided an opportunity to clearly understand the evidence before the Commission, and on which the Commission proposes to rely, and are provided a reasonable opportunity to respond.

Under the proposed administrative decision-making model, the Commission will become the sole first-instance decision marker. This, by necessity, should result in greater transparency and procedural fairness protections.

Merger parties will no longer have the option to seek a Federal Court declaration. The merger reforms will remove any ability for parties (and the Commission) to call witnesses and test evidence through the traditional evidence giving process of cross-examination. All evidence, including written and oral statements of executives, will primarily be tested

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[13] Exposure Draft, s 51ABZT(2)(c).

[14] Exposure Draft, s 51ABZT(2)(c)(ii).

during the Commission's assessment; Tribunal review process provides very limited scope for evidence beyond the record before the Commission.

In that context, the merger reform regime should provide a positive requirement for the Commission to disclose the evidence before it, and an appropriate mechanism for evidence to be tested, given that the Commission's role (and Tribunal's role on review) is to weigh the evidence before it. That is important to ensuring procedural fairness, and may also reduce the frequency of parties seeking Tribunal review. Access to file is one of the procedural guarantees to protect notifying parties' rights of defence and to equality of arms in European Commission merger control.

In our view, the merger reform regime should provide for the following.

- Parties to an acquisition should have a reasonable opportunity, during the Commission's assessment process, to have access to the Commission's file of evidence collected from third parties. That opportunity should be appropriately limited in time, and subject to appropriate confidentiality restrictions (including arrangements that highly commercially sensitive information be available only to limited persons and/or external legal counsel, as commonly occurs in current Court and Tribunal processes).
- If the proposal above is not adopted, then parties to an acquisition should have the opportunity to introduce additional evidence during a Tribunal review, in response to any evidence that the Commission relied on which was not previously disclosed to the parties. The currently proposed circumstances in which parties can introduce additional evidence before the Tribunal is too limited in this respect.[15]

2.8 Remedies: Remedy proposals

Under the Exposure Draft, a transaction can be approved subject to conditions, if the Commission "reasonably believes" that those conditions would "comprehensively address" any substantial lessening of competition.[16]

It is uncertain whether the proposed regime permits the Commission to unilaterally impose conditions not contemplated by the parties, including on ancillary contractual restrictions agreed between the parties and notified. The potential conditions are not necessarily limited to undertakings given under section 87B.

The regime should make express that the Commission can only consider and impose conditions that have been proposed by the parties. The Commission should not be permitted to unilaterally interfere with or alter the commercial deal reached between merger parties.

The standard of "comprehensively address" is too prescriptive and may result in the Commission rejecting appropriate remedy proposals. The Commission should be capable of accepting a remedy where it is satisfied by reason of a condition that there will be no effect or likely effect of substantial lessening of competition or that the net benefit test is satisfied.

[15] Exposure Draft, s 100N(5), which requires that the Tribunal be satisfied that the new information, documents or evidence "was not in existence" at the time the Commission made the relevant determination.

[16] Exposure Draft, s 51ABW(2)(b).

2.9 Review: Third parties' ability to seek Tribunal review

Similar to the current merger authorisation process, non-merger third parties will be able to seek review of the Commission's determination in the Tribunal. The Tribunal must review the determination, if satisfied that the applicant has a "sufficient interest".[17]

Under the current regime, the vast majority of mergers do not rely on the merger authorisation process. In such circumstances, the prospect of Tribunal review by a third party is uncommon, and can be avoided by parties seeking informal merger clearance from the Commission or a Court declaration.

Under the proposed regime, all notified mergers will face the possibility of third parties seeking Tribunal review. This will be the case even though their views will have been considered by the Commission in its assessment process.

A Tribunal review triggered by a third party would add a further 90 calendar days or more to the review period,[18] with associated uncertainty and delay for the merger parties. An acquisition cannot be implemented while undergoing Tribunal merger review.[19]

It is acknowledged that third parties seeking Tribunal review will incur a fee[20] and face the risk of some scope for adverse costs orders.[21] However, this may not be sufficient to deter strategic review applications by competitors. In our view, Treasury should consider removing third party rights to Tribunal review, or increasing the legal and/or financial burden on third parties seeking Tribunal review.

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[17] Exposure Draft, s 100C(2).

[18] Exposure Draft, s 100M(3). The Tribunal may determine to extend the review period to up to 180 calendar days in total: Exposure Draft, s 100M(4). The Tribunal may (but is not required) to dismiss an application for review if satisfied the application is "frivolous or vexatious": Exposure Draft, s 100J. The Tribunal may only conduct a "fast track" review, if the third party applicant consents: Exposure Draft, s 100D(2).

[19] Exposure Draft, s 51ABI and 51ABJ.

[20] The Tribunal may otherwise dismiss the application, but is not required to do so: Exposure Draft, s 100G.

[21] Exposure Draft, s 111.