

## Mergers & Acquisitions

# Competition Law Considerations following the Metcash decision

### Stephens Lawyers Competition Law Update: October 2011

Businesses or companies seeking to directly or indirectly acquire shares or assets of a company or business need to consider whether they require clearance from the competition regulator, the Australian Competition and Consumer Commission ("ACCC"). Clearance will be required from the ACCC if the proposed acquisition of shares or assets, would have the effect or be likely to have the effect, of substantially lessening competition in the relevant market.

The recent Federal Court decision in relation to the Metcash and Franklins proposed acquisition, highlights the commercial challenges that companies or businesses will face, if the competition regulator, the ACCC, refuses the merger/acquisition clearance and takes legal action to restrain the acquisition. This update provides a summary of the Federal Court decision, *ACCC v Metcash*, and highlights some of the factors that the court will consider in reviewing the ACCC's approach to merger/acquisition clearances.

### *Metcash* Litigation

On 20 September 2011, Justice Jacobson of the Federal Court dismissed the Australian Competition and Consumer Commission's ("the ACCC") application for an interim injunction to restrain Metcash Trading Limited ("Metcash") from acquiring the supermarket business of Interfrank Group Holdings Pty Limited ("Franklins"). The ACCC's interim injunction application follows the Federal Court decision on 25 August 2011, where Justice Emmett dismissed the ACCC's initial application to oppose the acquisition. Whilst the acquisition has since proceeded, the ACCC is currently appealing Justice Emmett's decision to the Full Federal Court, and had sought an interim injunction on the basis that it would be too difficult to unscramble the transaction, once it had been completed.

With the hearing of the ACCC's Full Court appeal due to begin on 24 October 2011, this legal update discusses and analyses Justice Emmett's decision, and reviews its implications for future merger cases. This is first merger decision to proceed to the Federal Court since 2003, and provides clarification of the factors that the court will consider in assessing the relevant market and whether the proposed merger or acquisition will substantially lessen competition.

Significantly, Justice Emmett's decision emphasizes that:

- Market definition will be assessed with reference to commercial realities of what was and is actually occurring in the relevant market, rather than relying on economic theories.
- The ACCC should only oppose mergers where it can establish that the counterfactual is **more probable than not** to occur. This is a higher threshold than previously applied by the ACCC in its merger analysis to date.
- The ACCC must have clear evidence to support any claims that an alternative credible buyer may come forward to acquire the business subject to the acquisition.

Further, pending the outcome of the Full Federal Court Appeal, this case may prompt the ACCC to review the way it manages its informal clearance processes.

## ACCC's initial Injunction Application: ACCC v Metcash Trading Limited [2011] FCA 967

### Litigation background

Metcash had entered into an agreement with South African company Pick n Pay Retailers Pty Limited ( "**Pick n Pay**") to acquire Franklins for \$215million, in July 2010 and applied to the ACCC for informal clearance. The ACCC sought to obtain an injunction from the Federal Court to prevent the proposed acquisition by Metcash of all of the shares in the capital of Franklins owned by Pick n Pay, from proceeding. The ACCC argued that the transaction would result in a contravention of section 50 of the *Competition and Consumer Act 2010*, [\[1\]](#) as the acquisition of Franklins by Metcash would be likely to have the effect, of substantially lessening competition in the market for the wholesale supply of packaged groceries to independent supermarket retailers in New South Wales ( "**NSW**") and the Australian Capital Territory ( "**ACT**"). Metcash and Pick n Pay argued that the proposed acquisition was likely to have little effect on competition in the relevant market.

### The Decision

Justice Emmett outlined the proper tests and considerations that the moving party, the ACCC, must demonstrate in order to successfully restrain a proposed acquisition. The ACCC needed to establish in this case and future cases, the relevant market in which the corporation's product competes. As part of his analysis, Justice Emmett considered what would occur in the market if the acquisition proceeded and what would occur if the acquisition did not proceed, including whether there was an alternate, credible buyer for Franklins. In considering whether the proposed acquisition would have the effect or likely effect of substantially lessening competition in the market, his Honour took into account the factors listed in section 50(3) of the *Competition and Consumer Act*, namely:

- actual and potential level of import competition in the market;
- height of barriers to entry to the market;
- level of concentration in the market;
- degree of countervailing power in the market;
- likelihood that the acquisition would result in the acquirer being able to increase prices or profit margins significantly and sustainably;
- extent to which substitutes are available in the market or likely to be available in the market;
- dynamic characteristics of the market;
- likelihood that acquisition would result in removal from the market of a vigorous and effective competitor; and
- nature and extent of vertical integration in the market.

### The Relevant Market

Pursuant to s 4E of the *Competition and Consumer Act*, the meaning of the term market includes a market for goods or services and other goods or services that are substitutable for, or otherwise competitive with, the first-mentioned goods or services. After identification of the appropriate product is established, in this case the grocery wholesale market, the Court said it was necessary to describe accurately the parameters of the market in which the

relevant corporation's product competes. Too narrow a description of the market will create the appearance of more market power than in fact exists; too broad a description will create the appearance of less.

There are four main categories of participants in the grocery industry in Australia.

1. The consuming public, being acquirers of grocery products that are supplied by retailers.
2. Retailers of grocery products being, self-supplying supermarket chains, such as Woolworths, Coles, Aldi and Franklins. The second group also consists of independent retailers such as IGA supermarkets.
3. The third category of participants in the grocery industry consists of wholesalers, such as Metcash, and numerous other specialist wholesalers. The wholesalers supply grocery products to independent retailers such as IGA supermarkets.
4. (Lastly, there are manufacturers and primary suppliers, who supply grocery products to the self-supplying supermarket chains, to wholesalers and directly to independent retailers.

There are two groups of manufacturers and primary suppliers. One group consists of large national manufacturers and primary suppliers of numerous types of consumer goods, such as Coca Cola Amatil, Nestlé, Unilever and Procter & Gamble. There are also smaller manufacturers and primary suppliers, such as Saxbys Soft Drinks, McDonnell's Fruit Supply and fresh produce farms.

Under section 50 of the *Competition and Consumer Act*, the Court must determine whether a proposed acquisition would have the effect, or be likely to have the effect, of substantially lessening competition in a relevant market. The test is twofold. On the one hand, the Court might be satisfied that an acquisition would have the necessary effect. On the other hand, the Court might not be able to reach that conclusion but, nevertheless, might be able to conclude that the acquisition in question would be likely to have the necessary effect of substantially lessening competition.

The ACCC argued that Metcash operates alongside Franklins in a market for the supply of wholesale packaged groceries to independent supermarket retailers in New South Wales and the ACT. The ACCC further argued that the main players in this market are Metcash and Franklins. Metcash disagreed, arguing that the wholesale grocery market also included Coles and Woolworths.

Justice Emmett rejected the ACCC's market definition. His Honour found that the true competitive constraints on Metcash came from Coles and Woolworths, not Franklins. These constraints were identified by looking to the commercial realities, not just the economic theories. His Honour went on to say that he did not find helpful the application by the economists of economic principles to the specific circumstances of the case. Thus rejecting the parts of this evidence that expressed opinions about the application of the relevant principles to the facts. His Honour was not persuaded by economic theories that did not yield to the commercial realities of what was and is actually occurring in the relevant market.

## **The Counterfactual(s) against which the Merger should be Assessed**

When assessing the effect of a proposed merger on competition in the market, the court will apply a counterfactual analysis. This analysis involves comparing the likely state of competition both without and with a proposed acquisition.

Justice Emmett clarified the test for the counterfactual and said that the ACCC must establish that the counterfactual is **more probable than not** to occur. This is a higher threshold than previously proposed by the ACCC and applied in its merger reviews to date.

The ACCC contended that, in considering the counterfactual, the correct approach is to ask whether:

- there is a **real chance** that the counterfactual will come to pass, and
- there is a **real chance** of a substantial lessening of competition relative to the counterfactual.

Justice Emmett rejected the ACCC's contentions and stated that the ACCC had to demonstrate that:

- it is **more probable than not** that one of the ACCC's counterfactuals will come to pass, and
- there is a **real chance** of a substantial lessening of competition relative to that counterfactual.

Justice Emmett said that the better view to take when considering the counterfactual arguments, between the two limb tests, is that it is more probable than not, that one of the counterfactuals will come to pass. In coming to this conclusion, His Honour also had regard to the onus of proof applicable in proceedings under Part IV of the *Competition and Consumer Act* and as such established the threshold to be on the balance of probabilities.

The parties were in disagreement about what would happen if Metcash was prevented from acquiring Franklins. The ACCC argued that there was another credible buyer that would come forward to acquire the share capital in the Franklins business. This credible buyer was identified by the ACCC as being a consortium of Metcash-supplied retailers (named "KKK" at trial).

Justice Emmett was not persuaded that it was more probable than not that there was a credible buyer in the market place that would acquire the Franklins shares. His Honour noted that the ACCC's evidence was not sufficient to meet the lower, "real chance" test.

Moreover, Justice Emmett was not persuaded that, if Metcash purchased Franklins, there would be, or would likely to be, a substantial lessening of competition in the market.

## **Whether there was a Substantial Lessening of Competition in the Defined Market**

Justice Emmett rejected the proposition that the proposed merger of Franklins by Metcash would lessen competition in the marketplace. His Honour was not satisfied that if Metcash did not acquire the shares, a third party (KKK) would be likely to acquire Franklins and successfully establish a competing wholesale operation in NSW and the ACT. His Honour was not satisfied that such a merger would lessen competition in the relevant market.

On the contrary, his Honour concluded that it was quite likely that the acquisition would strengthen the capacity of independent retailers to compete more vigorously with Coles and Woolworths in the marketplace. The merger would provide Metcash with increased scale to obtain better terms from suppliers which in turn would enable it to compete more effectively with Coles and Woolworths.

## **Interim Injunction Application - ACCC v Metcash Trading Ltd [2011] FCA 1079**

On 15 September 2011, the ACCC made an application for an urgent interlocutory injunction under section 80(2) of the *Competition and Consumer Act*, to restrain Metcash and Pick n Pay from completing the share sale agreement, pending the determination of the appeal brought by the ACCC against Justice Emmett's decision.

In arguing that there was a serious question to be tried, the ACCC contended that Justice Emmett's judgment contained serious errors and that the balance of convenience rested with granting the injunction, rather than forcing divestiture should the ACCC's appeal succeed. Justice Jacobson rejected the application for interim relief for the following reasons:

- The ACCC could not point to any "glaring error or obvious oversight" in the primary judgment of Justice Emmett and that the concerns raised by the ACCC were "debatable". [\[2\]](#)
- The appeal would not be "rendered nugatory" if the injunction was refused, as the basis of the ACCC's appeal, the challenge to legal principles surrounding the counterfactual test, could be undertaken without the need for injunctive relief. [\[3\]](#)
- Whilst the ACCC expressed concerns about the risk of anti-competitive behaviour in the period between the completion of the sale agreement and determination of the appeal, these concerns could be ameliorated by an order for an expedited appeal hearing. [\[4\]](#)
- The ACCC could not present sufficient evidence to support their claim that a third party would purchase the Franklins shares and operate the wholesale assets if the share sale agreement did not proceed. [\[5\]](#)
- Given the expedited hearing, the ACCC's concerns about divestiture were not insurmountable, given that all potential buyers of the stores would be sufficiently apprised of the appeal process. [\[6\]](#)

## Implications

Justice Emmett's judgment is not a mandate for wide market definition, despite suggestions to the contrary by some commentators. Merger deals of this nature are rare and as such, this decision is unlikely to open the floodgates of proposed mergers to the ACCC, or open the door to a rethinking of previous merger informal clearance processes.

Justice Emmett found that rather than the proposed merger reducing competition, such a deal would in fact enhance competition as it would give independent retailers greater ability to compete with major supermarket players, Woolworths and Coles. The ACCC misconstrued the market by focusing solely on the wholesale market rather than on the retail market, and as such, failed to include Woolworths and Coles in its market assessment.

The ACCC has considered the outcomes of this case and the implications for the future of merger clearance processes. There are likely to be changes emerging from this case to the way in which the ACCC manages its informal clearance processes. This may mean additional time is taken in reviewing mergers and acquisitions, resulting in the potential for increased costs and may encourage remedies such as divestments to alleviate the ACCC's competition concerns. Nevertheless, this case is a reminder that corporations upon an adverse finding by the ACCC, opposing the suggested merger and acquisition, can seek review of that decision by the Federal Court.

Stephens Lawyers & Consultants can advise on all aspects of the *Competition and Consumer Act*.

**Our** lawyers represent leading companies in both litigious and commercial matters.

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[1] Section 50 provides that a corporation must not acquire shares in the capital of a body corporate if the acquisition would have the effect, or be likely to have the effect, of substantially lessening competition in a market.

[2] *ACCC v Metcash Trading Ltd* [2011] FCA 1079, at [79].

[3] *ACCC v Metcash Trading Ltd* [2011] FCA 1079, at [84].

[4] *ACCC v Metcash Trading Ltd* [2011] FCA 1079, at [87].

[5] *ACCC v Metcash Trading Ltd* [2011] FCA 1079, at [92].

[6] *ACCC v Metcash Trading Ltd* [2011] FCA 1079, at [97].