Merger Guidelines

November 2008*

*November 2017 – amended to include Harper reforms to the *Competition and Consumer Act 2010*

Important notice

This publication has been updated to refer to the *Competition and Consumer Act 2010* which replaces the *Trade Practices Act 1974* on 1 January 2011 and to reflect the 2017 amendments to the *Competition and Consumer Act 2010*.

ISBN 978 1 xxxxxx xx x

ACCC_11/10_23916_222

www.accc.gov.au

Contents

Foreword

The Australian Competition and Consumer Commission's (ACCC's) approach to merger assessment has evolved significantly since the ACCC last published analytical guidelines in the area of mergers in 1999. The changes in the ACCC's approach have been developed in line with international best practice, contemporary views on anti-trust analysis and the ACCC's experience since 1999. These revised guidelines have benefited from valuable input from the business and trade practices advisory community on an earlier draft, which was released for consultation in February 2008.

These revised guidelines outline the general principles underpinning the ACCC's merger analysis under s. 50 of the *Competition and Consumer Act 2010* (the Act), formerly the *Trade Practices Act 1974*. It is important to note that the approach taken in the revised guidelines is not radically different from the approach contained in the 1999 guidelines — the competition test is the same and analysis of the market and merger factors remains a vital element in merger assessment.

However, the approach to merger assessment has been developed with an increased emphasis on the competitive theories of harm and the effect of constraints, which facilitates a more integrated analysis. The changes to the guidelines do not represent a new approach by the ACCC but are rather a better reflection of the approach being undertaken by the ACCC to merger reviews.

The ACCC will continue to assess each merger on its merits according to the specific nature of the transaction, the industry and the particular competitive impact likely to result in each case. The general principles set out in these guidelines provide a framework within which mergers will be reviewed. Importantly, the application of those principles to different facts and situations may give rise to different results.

It is not possible for these guidelines to cover every issue or circumstance that may arise in a merger review. In practice, individual mergers involve a great variety of facts and situations, and the analysis of particular issues may need to be tailored to the specific circumstances of a merger or deal with competition issues not specifically considered in these guidelines. Therefore the ACCC proposes to apply the revised guidelines flexibly.

The ACCC's case-by-case approach to merger analysis is reflected in both the public competition assessments issued for mergers considered to be of major public interest and in the shorter summaries of reasons for merger decisions, which are available on the ACCC website for all public merger reviews. These guidelines, supplemented with the growing body of public competition assessments and reasons for decisions, should provide an enhanced level of predictability and certainty to merger parties, their advisers, the business community and the public.

1. Introduction

1.1. Mergers and acquisitions are important for the efficient functioning of the economy. They allow firms to achieve efficiencies, such as economies of scale or scope, and diversify risk across a range of activities. They also provide a mechanism to replace the managers of underperforming firms.

1.2. In the vast majority of mergers, sufficient competitive tension remains after the merger to ensure that consumers and suppliers are no worse off. Indeed, in many cases consumers or suppliers benefit from mergers. In some cases, however, mergers have anti-competitive effects. By altering the structure of markets and the incentives for firms to behave in a competitive manner, some mergers can result in significant consumer detriment.

Section 50 of the Act

1.3. Section 50 of the Act prohibits mergers that would have the effect, or be likely to have the effect, of substantially lessening competition in a market.

1.4. Section 50(3) requires the following non-exhaustive list of matters (or 'merger factors') to be taken into account when assessing whether a merger would be likely to substantially lessen competition:

(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

(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

(i) the nature and extent of vertical integration in the market.

1.5. These matters or 'merger factors' illuminate the policy intent underlying s. 50.[1] In particular, they highlight key potential constraints on a merged firm (for example, new entry and imports) and identify market characteristics that could potentially affect the impact of a merger on competition (for example, growth in demand, innovation or the level of vertical integration). Other factors not listed in s. 50 may also be relevant to a merger assessment.

Types of s. 50 merger assessments

1.6. Merger parties have two avenues available to have a merger considered and assessed:[2]

---

[1] Australia, House of Representatives 1992, *Debates*, vol. HR186, p. 2406.

[2] A reference to a 'merger' in these guidelines includes a proposed merger, unless the context otherwise specifies.

- the ACCC assesses the merger on an informal basis applying a substantial lessening of competition test or
- applicants apply to the ACCC for merger authorisation for a proposed acquisition which will be assessed under test outlined in paragraph 1.10.

1.7. As merger parties are not legally required to notify the ACCC of a merger, they also have the option of proceeding with the merger without seeking any regulatory consideration.[3] However, this will not prevent the ACCC from subsequently investigating the merger, including making public inquiries to assist its investigation and, if necessary, taking legal action. Proceeding without regulatory approval may put merger parties at risk of the ACCC or other interested parties taking legal action on the basis that the merger would have the effect, or be likely to have the effect, of substantially lessening competition in one or more substantial markets in contravention of s. 50.

Informal review

1.8. The informal review process enables merger parties to seek the ACCC's view on whether it will seek an injunction under s. 50 to stop a merger from proceeding. Information on the procedural aspects of informal clearances can be found in the ACCC's *Informal Merger Review Process Guidelines*.

1.9. If the ACCC forms the view that a merger proposal is likely to contravene s. 50, the merger parties may decide:

- not to proceed with the merger
- to provide a court enforceable undertaking to address ACCC concerns
- to apply to the ACCC for merger authorisation, or
- to proceed and defend court action under s. 50.

If the merger parties seek to proceed with the proposal, the ACCC can apply to the Federal Court of Australia for an injunction to prevent the merger from proceeding, as well as divestiture or penalties.[4]

Merger authorisation

1.10. Merger parties may also seek legal protection from court action under s. 50 by applying to the ACCC for merger authorisation. Pursuant to s. 90(7), the ACCC can grant merger authorisation if it is satisfied that either:

- the proposed acquisition would not be likely to substantially lessen competition or
- the likely public benefit from the proposed acquisition outweighs the likely public detriment.

1.11. Information on the procedural and analytical aspects of applications for merger authorisation are set out in the *Merger Authorisation Guidelines*.

[3] Parties may also seek a declaration from the Federal Court that the acquisition will not contravene s. 50.

[4] Other parties (such as customers, competitors or other interested parties) may also apply to the Federal Court for a declaration (that the acquisition will not contravene s. 50) and/or divestiture, and any person suffering loss or damage as a result of a merger that breaches s. 50 can apply for damages.

Types of mergers

1.12. As outlined in appendix 2, s. 50 applies to a wide variety of mergers and acquisitions. A 'merger' involves the shareholders of two companies becoming the shareholders of a new merged company. An 'acquisition' occurs when one company acquires a shareholding in, or the assets of, another company. Generally, when assessing its impact on competition, little turns on whether a transaction is, strictly speaking, a 'merger' or an 'acquisition'. For convenience, these guidelines refer to 'mergers' and 'merger parties'.

1.13. These guidelines discuss three types of merger — in each, the merger may involve firms that are either actual or potential competitors:

- horizontal mergers — involving actual or potential suppliers of substitutable goods or services
- vertical mergers — involving firms operating or potentially operating at different functional levels of the same vertical supply chain
- conglomerate mergers — involving firms that interact or potentially interact across several separate markets and supply goods or services that are in some way related to each other, for example, products that are complementary in either demand or supply.

1.14. Each type of merger has the potential to affect competition in a different way and will therefore be analysed differently. While some competition issues and theories of competitive harm are presented separately in these guidelines, the ACCC will adopt an approach tailored to the particular nature of the merger.

Acquisition markets

1.15. These guidelines focus on potential competition concerns in supply markets into which the merged firm supplies goods and services. However, there could also be competition concerns in acquisition markets in which the merged firm acquires goods and services. In particular, the merged firm may be able to depress the price paid for the inputs below their competitive price by restricting its purchase of those inputs. The ACCC will apply an approach to acquisition markets that is analogous to that set out in these guidelines for supply markets.

Purpose of these guidelines

1.16. These guidelines provide an outline of the broad analytical framework applied by the ACCC when assessing whether a merger is likely to substantially lessen competition under s. 50. These guidelines have been developed by the ACCC in relation to its functions under s. 50.

1.17. These guidelines are designed to provide reliable, comprehensive and detailed information that merger parties, the business community, their advisers and the public can draw on to:

- assess the likely level of scrutiny a merger will receive from the ACCC — in particular, guidance is provided on when merger parties should notify the ACCC of a merger (the threshold for notification is outlined in chapter 2)
- increase understanding of the application of s. 50
- assist in structuring (or restructuring) mergers to avoid raising competition concerns

- identify the types of information that will assist the ACCC to reach a view on how a merger is likely to affect competition — to make informed and timely decisions, the ACCC relies on the cooperation of the merger parties, customers, competitors, suppliers and any other persons or bodies holding relevant information
- identify the ACCC's broad approach to remedying possible anti-competitive mergers through undertakings (see appendix 3).

1.18. These guidelines do not have any legal force in determining whether a merger is likely to contravene the Act — final determination of the issues is a matter for the courts.

1.19. It is not possible for these guidelines to cover every issue or circumstance that may arise in a merger review. In practice, individual mergers involve a great variety of facts and situations, and the analysis of particular issues may need to be tailored to the specific circumstances of a merger or deal with competition issues not specifically considered in these guidelines. Therefore the ACCC will apply these guidelines flexibly and may adapt the framework to specific issues where appropriate.

1.20. These guidelines are supplemented by public competition assessments published by the ACCC. These competition assessments outline how the principles contained in the guidelines have been applied to specific mergers.

1.21. These guidelines replace the 1999 *Merger Guidelines*. They reflect the ACCC's analytical approach at the time of publication and may be revised periodically, as necessary, on the basis of new legal precedent, evolving insight and best practice. The latest version of the guidelines will be the version published on the ACCC website. In developing these guidelines, the ACCC has considered guidelines issued by overseas competition authorities and the work done by the International Competition Network.

Contact with the ACCC

1.22. Any inquiries about the ACCC's administration and analysis of merger reviews should be directed to:

Executive General Manager
Merger and Authorisation Review Division
Australian Competition and Consumer Commission
GPO Box 3131
Canberra ACT 2601

Email: mergers@accc.gov.au
Tel: (02) 6243 1368
Fax: (02) 6243 1212

2. Notification threshold

2.1. While there is no compulsory pre-notification requirement for mergers in Australia, it is recommended that certain mergers that may be subject to the Act (see appendix 2) be voluntarily notified to the ACCC for review, well in advance of completion.

2.2. To assist merger parties and their advisers to determine whether they should notify the ACCC, the ACCC has developed a notification threshold, outlined below. This threshold has been established by the ACCC to filter and thereby limit the merger reviews it conducts to those mergers which, in its view, may potentially raise competition concerns. The notification threshold is set at a level that reflects the ACCC's experience in determining which mergers are more likely to raise competition concerns and therefore require further investigation.[5]

2.3. If merger parties believe their merger proposal will meet the notification threshold, they are encouraged to approach the ACCC on a confidential and informal basis as soon as there is a real likelihood that the merger may proceed to discuss possible competition issues and options for having the matter considered.

2.4. Merger parties are also encouraged to approach the ACCC where the ACCC has indicated to a firm or industry that notification of mergers by that firm or in that industry would be advisable.

2.5. Parties may choose to seek informal review or merger authorisation from the ACCC. The informal review process provides flexibility in terms of timeframes, information requirements and confidentiality, while the merger authorisation process has mandated timeframes and transparency requirements.

2.6. If mergers that raise competition concerns are not notified to the ACCC in adequate time for it to conduct a review, the ACCC may seek to use its formal information-gathering powers and/or injunctive relief, to enable it to properly consider such mergers to ensure no anti-competitive harm arises.

2.7. Mergers that fall outside the notification threshold will rarely require investigation by the ACCC. However, the notification threshold is indicative only. It is intended to provide a starting point for identifying those mergers that may raise competition concerns and therefore require investigation in accordance with these guidelines. Importantly, the notification threshold should not be confused with the concentration threshold (set out in chapter 7) which the ACCC has regard to as part of an overall assessment of whether a merger is likely to substantially lessen competition under s. 50.

2.8. As market shares are an imprecise indicator of likely competition effects, a merger that does not meet the notification threshold may still raise competition concerns. The ACCC may therefore investigate such mergers, even if they have not been notified to it.

2.9. For simplicity, the notification threshold is based on market shares. The calculation of market shares depends critically on market definition. If there is uncertainty as to the relevant market, it is preferable that market shares be calculated on the basis of the market definition most likely to raise competition concerns. This will usually mean

[5] The ACCC determined the level of the notification threshold based on an analysis of all previous merger reviews where the ACCC released a statement of issues. A statement of issues is released by the ACCC where, after an initial assessment, it believes the merger requires further detailed assessment. The notification threshold is based on the market shares of the merged firm in matters that proceeded to this stage.

adopting a conservative rather than broad definition of the market, unless doing so would reduce or eliminate the overlap between the merger parties.

Notification threshold

Merger parties are encouraged to notify the ACCC well in advance of completing a merger where both of the following apply:

- the products of the merger parties are either substitutes or complements
- the merged firm will have a post-merger market share of greater than 20 per cent in the relevant market/s.

3. The competition test

3.1. Competition is a state of ongoing rivalry between firms — rivalry in terms of price, service, technology and quality. Market participants are mutually constrained in their pricing, output and related commercial decisions to some extent by the activity of other market participants (or potential market participants). In other words, the greater the degree of competition in a market, the less market power each market participant will possess.

3.2. Mergers can alter the level of competition in a market. Some mergers enable the merged firm to meet customer demand in a way that facilitates more intense competition. Many mergers do not affect the level of competition at all because there are sufficient substitution possibilities to effectively constrain the merged firm.

3.3. Other mergers, however, lessen competition by reducing or weakening the competitive constraints or reducing the incentives for competitive rivalry.[6] Mergers that increase the market power of one or more market participants may be detrimental to consumers because they may lead to an increase in price, or deterioration in some other aspect of the service offering (see the text box below) — the level of market power will be dependent on whether alternative actual or potential supply options are available post-merger to effectively constrain the merged firm. If market structure and circumstances mean that there is limited potential for alternative supply options or substitution possibilities to constrain the merged firm, then it will be profitable for the merged firm to raise prices despite the potential for lost sales to alternative suppliers.

3.4. Further, mergers that increase market power may decrease economic efficiency (because transactions at the margin are deterred) thereby reducing gains from trade and total welfare.

Market power and increases in price

The most obvious and direct manifestation of an increase in market power is the ability of one or more firms to profitably raise prices post-merger for a sustained period. Market power can, however, be exercised in other ways. For example, a firm with market power may:

- lower the quality of its products without a compensating reduction in price
- reduce the range or variety of its products
- lower customer service standards, and/or
- change any other parameter relevant to how it competes in the market.

While the exact nature of competitive detriment caused by a merged firm's increased market power will vary depending on the particular circumstances of the matter, the ACCC often characterises an increase in market power as the ability to raise prices. References to 'raising prices' in these guidelines should therefore be read as implicitly incorporating the exercise of market power in other non-price ways.

[6] For convenience the guidelines refer to any increase in market power as accruing to sellers in a relevant market. A merger can also lead to a substantial lessening of competition among buyers in a market. In such a situation, the increased market power of a buyer may enable it to profitably reduce prices or otherwise engage in behaviour that is detrimental to suppliers.

Substantial lessening of competition

3.5. Not all mergers that lessen competition are prohibited by s. 50 of the Act; only those that lessen competition **substantially** are prohibited.[7] The term 'substantial' has been variously interpreted as meaning real or of substance,[8] not merely discernible but material in a relative sense[9] and meaningful.[10] The precise threshold between a lessening of competition and a substantial lessening of competition is a matter of judgement and will always depend on the particular facts of the merger under investigation. Generally, the ACCC takes the view that a lessening of competition is substantial if it confers an increase in market power on the merged firm that is significant and sustainable. For example, a merger will substantially lessen competition if it results in the merged firm being able to significantly and sustainably increase prices.

3.6. The level at which an increase in market power is likely to become significant and sustainable will vary from merger to merger. For example, an increase in price that is very small in magnitude might also be significant. The ACCC considers that firms would generally be deterred from instituting a price increase, or only be able to institute it for a transitory period, where effective competitive constraints exist or where constraints are likely to become effective within a period of one to two years.

3.7. In some markets, particular characteristics, such as the prevalence of certain types of long-term contracts between buyers and sellers, may prevent a merged firm from exercising any market power it gains through the merger until some point in the future — for example, at contract renewal. If the exercise of market power is likely to be delayed in this way, the ACCC will focus on the period commencing at the point where market power would be exercised (for example, at contract negotiations).

3.8. As outlined in chapter 4, a substantial lessening of competition must arise in a market to contravene s. 50. However, this does not imply that a lessening of competition must apply to the entire market or to all aspects of competition in the relevant market.[11]

Competitive constraints and the 'merger factors'

3.9. In assessing whether a merger is likely to result in a significant and sustainable increase in market power, the ACCC must consider each of the 'merger factors' set out in s. 50(3) as well as any other relevant factors (see paragraph 1.4). These merger factors provide insight as to the likely competitive pressure the merged firm will face following the merger and the possible competitive effects of the merger. The assessment of the competitive effects is based on the theories of competitive harm — namely, unilateral and coordinated effects. Mergers result in unilateral and/or coordinated effects when they weaken or remove the competitive pressure on firms in a market. In cases where unilateral and/or coordinated effects amount to a significant and sustainable increase in the market power of the merged firm and/or other firms in a market, the merger is likely to substantially lessen competition in contravention of the Act.

---

[7] Under s. 4G, a lessening of competition includes, but is not limited to, preventing or hindering competition. Mergers likely to have the effect of substantially preventing or hindering competition are therefore also prohibited by s. 50.

[8] Trade Practices Legislation Amendment Bill 1992, explanatory memorandum, paragraph 12.

[9] Australia, Senate 1992, Debates, vol. S157, p. 4776.

[10] *Rural Press Limited v Australian Competition and Consumer Commission* [2003] HCA 75 at 41.

[11] *Dandy Power Equipment Pty Ltd v Mercury Marine Pty Ltd* (1982) ATPR 40–315 at 43,888.

3.10. The merger factors cover a broad range of possible actual and potential competitive constraints[12] faced by the merged firm — some assist in identifying the presence of direct constraints[13] while others provide insight into less direct forms of constraint relating to either the structure and characteristics of the market[14] or the behaviour of actual and potential participants in a market.[15]

3.11. The ACCC recognises that competitive constraints are not static and strategic behaviour by market participants can affect competition. The significance of the merger factors, and the weight that is placed on them, will depend on the actual matter under investigation.

3.12. The likely presence of effective competitive constraints post-merger is a key indicator that a merger is unlikely to result in a substantial lessening of competition. While all the merger factors must be taken into consideration, it may not be necessary for all factors to indicate that the merged firm would face effective competitive constraints. In some cases a single effective constraint can be sufficient to prevent a significant and sustained increase in the market power of the merged firm, while in other cases the collective effect of several constraints may be required. Conversely, the absence of a single particular constraint is unlikely to be indicative of an increase in market power as a result of a merger.

3.13. Unilateral and coordinated effects are discussed in chapters 5 and 6 of these guidelines, while chapter 7 sets out in more detail the relevance of each merger factor in deciding whether a merger is likely to result in a substantial lessening of competition in a market.

The forward-looking nature of the competition test

3.14. Section 50 requires a forward-looking analysis into the effects or likely effects of a merger, since analysis is generally conducted before the impact of a merger on competition can be observed. The ACCC therefore focuses on the foreseeable future (generally within one to two years) when considering market definition and each of the merger factors to determine whether a substantial lessening of competition is likely to occur. This raises a number of issues.

Likely effect

3.15. Mergers are prohibited under s. 50 if they would have the effect, or be **likely** to have the effect, of substantially lessening competition. Clearly a substantial lessening of competition must be more than speculation or a mere possibility for it to be likely, but it does not need to be a certainty. Importantly, a substantial lessening of competition need not be 'more probable than not', for the merger to contravene s. 50. Mergers are prohibited when there is a 'real chance' that a substantial lessening of competition will occur. However, a 'mere possibility' would be insufficient.[16] Ultimately, the determination of whether a substantial lessening of competition is likely will depend on the facts of the particular matter.

---

[12] In these guidelines, the term 'competitive constraints' refers to both actual and potential competitive constraints.

[13] For example, the level of actual and potential imports, the height of barriers to entry, the degree of countervailing power and the availability of substitutes.

[14] For example, the dynamic characteristics of the market, the level of concentration in the market, and the nature and extent of vertical integration.

[15] For example, the likelihood that the acquirer would be able to significantly and sustainably increase prices or profit margins, whether the acquisition will result in the removal of a vigorous and effective competitor and other relevant factors.

[16] *Australian Gas Light Company (ACN 052 167 405) v Australian Competition and Consumer Commission (No 3)* [2003] FCA 1525, at [348].

With and without test

3.16. Merger analysis requires comparing likely future states — the future **with** the merger and the future **without** the merger. This comparison isolates the merger's impact on competition. For this reason, the competition test in s. 50 is sometimes referred to as a future 'with and without' test.[17]

3.17. The likely future state of competition without the merger (the counterfactual) will generally be similar to the state of competition prevailing at the time of the merger. However, in some cases taking the state of competition prevailing at the time of the merger as the benchmark for analysis could risk attributing a change in the level of competition to a merger, when the real cause is some other development that is unrelated to the merger and likely to occur regardless of the merger. Focusing on the state of competition prevailing at the time of the merger might also disguise a substantial lessening of competition in situations where a merger hinders or prevents competition that would otherwise have emerged.

3.18. The ACCC therefore uses information about the state of competition prevailing at the time of the merger to inform its assessment of the likely future state of competition without the merger. This applies to market definition and all the merger factors outlined in chapter 7. It also applies to likely developments involving the merger parties — in particular, mergers involving firms that are likely to be more effective competitors in the future and those involving failing firms.

3.19. However, the ACCC will not take into account counterfactuals it considers have been manipulated for the purposes of making clearance more likely. Signs that a counterfactual may have been manipulated include:

- a change of policy or intention by the merger parties that occurs after the merger is proposed
- any course of action by the merger parties which cannot be demonstrated to be profit maximising and/or in the interests of shareholders (for example, refusing to sell the business to a strong competitor if the proposed merger does not proceed).

Expected competition

3.20. The state of competition prevailing at the time of a merger will **understate** the future state of competition without the merger in situations where the merger parties are not presently constraining one another but would be likely to constrain one another in the foreseeable future. For example, the target firm may be on the verge of entering the relevant market or may already operate in the relevant market but be likely within the next one to two years to benefit from new technology or intellectual property that would enhance its competitiveness with the acquiring firm. Alternatively, if it can be established with strong and credible evidence that, in the absence of the merger, a particular alternative firm would acquire the target, the relevant counterfactual may involve a competitive outcome that differs from the status quo. The ACCC notes that such circumstances are likely to be rare.

3.21. As specified in s. 4G of the Act, a lessening of competition includes preventing or hindering competition. Mergers likely to eliminate the prospect of more aggressive competition in the future may therefore result in a substantial lessening of competition.

[17] See, for example, *Australian Gas Light Company (ACN 052 167 405) v Australian Competition and Consumer Commission (No 3)* [2003] FCA 1525, at [352].

The following are examples of the types of information the ACCC may require to assess whether the merger parties are likely to be effective competitors in the relevant market in the future:

- board papers and internal plans demonstrating that the target firm has the capability and intention to vigorously compete in the future
- evidence of vigorous entry in the past that may be replicated on a broader scale
- evidence of similar successful entry in other markets either in Australia or overseas.

The range and extent of information and documents required by the ACCC will be assessed on a case-by-case basis and will depend on the complexity of the matter and the potential competition concerns raised.

Failing firms

3.22. The state of competition prevailing at the time of a merger will overstate the future state of competition without the merger in situations where one of the merger parties is likely to exit the market in the foreseeable future (generally within one to two years). In such situations, the merger party that is likely to exit is referred to as a 'failing firm'. Although the likely state of competition with the merger may be substantially less than the state of competition prevailing at the time of the merger, the relevant test is whether the future state of competition with the merger would be substantially less than the future state of competition without the merger (where the firm fails).

3.23. Mere speculation that the target firm will exit in the near future or evidence of a recent decline in profitability is insufficient to establish that an absence of competition between the merger parties is the counterfactual. In general, to demonstrate that a merger will not substantially lessen competition due to the prospective failure of one of the merger parties, it is necessary to show that:

- the relevant firm is in imminent danger of failure and is unlikely to be successfully restructured without the merger
- in the absence of the merger, the assets associated with the relevant firm, including its brands, will leave the industry
- the likely state of competition with the merger would not be substantially less than the likely state of competition after the target has exited and the target's customers have moved their business to alternative sources of supply.

4. Market definition

4.1. Section 50 of the Act requires that a substantial lessening of competition occur in a substantial market for goods and services in Australia, or a state, territory or region of Australia.[18] Accordingly, in assessing whether a merger substantially lessens competition, the ACCC will examine the competitive impact of the transaction in the context of the markets relevant to the merger.

4.2. Market definition establishes the relevant 'field of inquiry' for merger analysis, identifying those sellers and buyers that may potentially constrain the commercial decisions of the merger parties and the merged firm, and those participants, particularly customers, that may be affected if the merger lessens competition.

4.3. While market definition is a useful tool for merger analysis, by itself it cannot determine or establish a merger's impact on competition. Accordingly, market definition should not obscure factors relevant to competition that fall outside the relevant markets. Similarly, there is no presumption that other firms within a relevant market necessarily provide an effective competitive constraint on the merged firm. Other factors also relevant to merger analysis are outlined in chapters 5, 6 and 7.

4.4. It is rarely possible to draw a clear line around fields of rivalry. Indeed, it is often possible to determine a merger's likely impact on competition without precisely defining the boundaries of the relevant market. For example, if the consolidation of the merger parties' activities is unlikely to substantially lessen competition in a narrow product and geographic area, then it is also unlikely to do so in a more broadly defined product and geographic area and, therefore, a conclusive view on the relevant market may not be necessary. Similarly, when a merger is likely to substantially lessen competition in any number of potential markets, it may be unnecessary to define the precise market boundaries.

4.5. This chapter explains the concept of a market and the ACCC's approach to identifying and defining the scope of markets that are relevant to assessing a merger under s. 50 of the Act.

The concept of a market

4.6. A market is the product and geographic space in which rivalry and competition take place.

4.7. Section 4E of the Act provides that a market includes goods or services that are substitutable for, or otherwise competitive with, the goods or services under analysis. Accordingly, substitution is key to market definition.

4.8. The ACCC focuses on two key dimensions of substitution in characterising markets: the product dimension[19] and the geographic dimension. In some cases, market definition requires close attention to the functional levels of the supply chain that are relevant to a merger or the particular timeframe over which substitution possibilities should be assessed. Generally, however, these functional and temporal considerations form part of the product and geographic dimension analysis. Consistent with the forward-looking nature of merger analysis, the ACCC focuses on the foreseeable future when considering the likely product and geographic dimensions of a market.

[18] Section 50(6).

[19] The term 'product' encompasses both goods and service for the purpose of discussion in these guidelines.

4.9. Market definition is purposive, which means that the definition of a relevant market cannot be separated from the particular merger under investigation. Market definition always depends on the specific facts and circumstances of a merger, and current evidence from market participants will often be critical. Decisions relating to market definition in previous, albeit similar, merger inquiries will provide only limited guidance.

The ACCC approach to defining a market

4.10. The ACCC's starting point for delineating relevant markets to assess a merger under s. 50 of the Act is identifying the products and geographic regions actually or potentially supplied by the merger parties.[20] The ACCC then focuses on defining markets in areas of activity where competitive harm could occur. This must be assessed on a case-by-case basis. Generally, the ACCC focuses on overlaps between the products or geographic regions supplied by the merger parties, or some other meaningful economic relationship — such as an actual or potential vertical relationship or where the products supplied by the merger parties are complementary in nature. It is not uncommon for more than one market to be identified in any particular merger review.

4.11. The ACCC then considers what other products and geographic regions, if any, constitute relevant close substitutes in defining the market.[21] Importantly, the ACCC defines markets by reference to products and regions not by reference to the firms actually supplying those products or regions at the time of the merger.

Substitution

4.12. As outlined above, identifying relevant substitutes is key to defining a market. Substitution involves switching from one product to another in response to a change in the relative price, service or quality of two products (holding unchanged all other relevant factors, such as income, advertising or prices of third products). Market definition begins by selecting a product supplied by one or both of the merger parties in a particular geographic area and incrementally broadening the market to include the next closest substitute until all close substitutes for the initial product are included.

4.13. There are two types of substitution: demand-side substitution, which involves customer-switching; and supply-side substitution, which involves supplier-switching.

Demand-side substitution

4.14. Whether or not a product or region is a close substitute for a product supplied by one or more of the merger parties, depends on likely switching behaviour in response to an increase in the price, or decrease in the service or quality of that product. The likelihood that a product (or group of products) will be a **demand-side** substitute for a product of one of the merger parties will be assessed according to:

- the characteristics or functions of the product (the **product** dimension of a market). Comparable product characteristics and functionality will often be indicative but are not sufficient to determine whether products are demand-side substitutes. Demand-side substitution depends on the willingness of customers to switch from one product to another in response to a price increase

[20] There need not be trade in a product for a separate market to exist — the potential for exchange can be sufficient. See, for example, *Queensland Wire Industries Pty. Ltd v The Broken Hill Proprietary Company Limited & Anor* [1989] HCA 6; (1989) 167 CLR 177 F.C. 89/004; ATPR 40–925, Deane J at p. 50,013 (ATPR).

[21] Note: there are some circumstances where the approach to market definition does not depend solely on the analysis of substitution possibilities. Some of these circumstances are discussed in paragraphs 4.41 to 4.44.

- the availability of the product for purchase, and use, at the present location of the merger party's customers, or within a wider geographic area (the **geographic** dimension of a market). Demand-side substitution depends on the willingness of customers to switch from a product supplied in one location to the same product supplied in another location in response to a price increase.

4.15. It will often be possible on the demand-side, in some degree, to substitute a wide variety of products in various geographic regions for the products of the merger parties. Not all of these substitutes will be included in the relevant market. For instance, some customers might view seemingly remote products as substitutes under some circumstances. This simply illustrates that an economy is essentially 'a network of substitution possibilities'.[22]

4.16. On the other hand, substitution does not have to be complete or instantaneous, and products do not have to be 'perfect' substitutes to form part of the same market. To be included in the relevant market, the ACCC's view is that a product in a particular geographic region (or a group of products or regions) must be a close substitute in demand.

4.17. A product in a particular geographic region (or a group of products or regions) is a close demand-side substitute if a significant proportion of sales would be likely to switch in response to a small but significant increase in the price of the merger party's product, quickly and without significant switching costs. In cases where only a small proportion of sales is likely to switch, the ACCC's view is that the alternative product or geographic region (or group of alternative products or regions) is not part of the relevant market.

4.18. Qualitative and quantitative information may be requested from the merger parties and market participants to examine substitution possibilities. The ACCC draws on the conceptual framework provided by the hypothetical monopolist test (HMT) to define the relevant markets, particularly in relation to demand-side substitution.

The hypothetical monopolist test

4.19. The HMT determines the smallest area in product and geographic space within which a hypothetical current and future profit-maximising monopolist could effectively exercise market power. In general, the exercise of market power by the hypothetical monopolist is characterised by the imposition of a small but significant and non-transitory increase in price (SSNIP) above the price level that would prevail without the merger, assuming the terms of sale of all other products are held constant.

4.20. The process of applying the HMT starts with one of the products and geographic areas supplied by one or both of the merger parties. If a hypothetical monopolist supplier of this product cannot profitably institute a SSNIP because of customers switching to alternative products, the next closest demand substitute is added. If a hypothetical monopolist supplier of this extended group of products cannot profitably institute such a price increase because of customers switching to alternative products, the next best substitute is added. The collection of products is expanded until a hypothetical monopoly supplier of all those products could profitably institute a SSNIP.

4.21. A SSNIP in the context of the HMT usually consists of a price rise for the foreseeable future of at least 5 per cent above the price level that would prevail without the merger.

[22] *Re Tooth & Co. Ltd* (1978) ATPR 40-065, in *Re Tooheys Ltd* (1979), ATPR 40–113, at pp. 18,196–18,197.

4.22. While the HMT is a useful tool for analysis, it is rarely strictly applied to factual circumstances in a merger review because of its onerous data requirement. Consequently, the ACCC will generally take a qualitative approach to market definition, using the HMT as an 'intellectual aid to focus the exercise'.[23]

Supply-side substitution

4.23. In defining the product and geographic dimensions of the market the ACCC will also consider supply-side substitutes. A product (or group of products) may be a **supply-side** substitute for a product of one of the merger parties if in response to an increase in the price of the product:

- the production facilities and marketing efforts used for that product can be switched quickly and without significant investment to supply a demand-side substitute for the product of the merger party (the product dimension of the market)
- the distribution network used by the product can be modified quickly and without significant investment to supply the merger party's customers at their present location or within a distance they would likely travel (the geographic dimension of a market)
- it would be profitable for the current suppliers of the product to make these changes — that is, the profits earned on the assets in their current use would be less than if they were switched to supply a demand-side substitute for the product of the merger party.

4.24. The ACCC will treat one product as a supply-side substitute for another in cases where all (or virtually all) of the capacity for producing that product could profitably be switched to supply an effective substitute to the other product quickly and without significant investment in response to a price increase.

4.25. For some products, only a proportion of total supply capacity could feasibly be switched quickly and at minimal cost (for example, because firms producing this product use different technologies). In these cases, the capacity that could be switched will be considered as potential new entry when conducting the competition analysis rather than included in the market definition.

4.26. While a distinction is made between supply-side substitution and new entry for market definition purposes, the relevant consideration in establishing a substantial lessening of competition is the degree of competitive constraint imposed on the merged firm by either firms in the market or new entrants.

Useful information in identifying demand-side and supply-side substitutes

4.27. The ACCC relies on information from the merger parties and third parties to identify and assess the strength of substitution possibilities.

Identifying products that may be close substitutes

The following are examples of the types of information the ACCC may require to identify close substitutes of the relevant product:

- the function or end use of the product
- physical and technical characteristics of the product

[23] *Seven Network Limited v News Limited* [2007] FCA 1062, at [1786].

- costs of switching purchases between the product and potential substitutes
- views and past behaviour of buyers regarding the likelihood of substitution between products
- evidence of buyers switching to other products in response to price increases in the recent past
- evidence of producers redeploying their production capacity in response to price increases in the recent past
- costs of switching production and distribution systems from another product line to a product that is closely substitutable with the relevant product
- views, business records and past behaviour of suppliers of the relevant products regarding the impact of price and marketing decisions by suppliers of potential substitute products on their own pricing and marketing decisions
- relative price levels and price movements of the product compared to potential substitutes.

In an informal merger review, providing a base level of information to the ACCC will, in non-controversial cases, usually be sufficient to satisfy the ACCC of whether or not a substantial lessening of competition is likely. Whether a wider range of information will be required by the ACCC will be assessed on a case-by-case basis and will depend on the complexity of the matter and the potential competition concerns raised.

Identifying geographic regions that may be close substitutes

The following are examples of the types of information the ACCC may require to identify close substitutes of the relevant geographic region:

- the portability of the relevant product as determined by its perishability, weight, etc.
- transportation costs to move the relevant product between regions (particularly the transportation costs as a proportion of total value of the product)
- the costs to customers of obtaining supply from alternative regions
- any limitations on the ability of customers to access alternative sources of supply in alternative regions
- the costs of extending or switching production and distribution systems to supply the customers in alternative regions
- any regulatory or other practical constraints on suppliers selling to alternative regions
- records relating to trade flows and the actual movement of customers and/or suppliers between geographic regions, especially related to changes in relative prices across regions in the recent past
- views and business records of buyers and suppliers regarding the likelihood of switching between geographic sources of supply
- the relative price levels and price movements of different geographic sources of supply.

In an informal merger review, providing a base level of information will, in non-controversial cases, usually be sufficient to satisfy the ACCC of whether or not a substantial lessening of competition is likely. Whether a wider range of information will be required by the ACCC will be assessed on a case-by-case basis and will depend on the complexity of the matter and the potential competition concerns raised.

Substantial market in Australia, a state, territory or region of Australia

4.28. Section 50(6) of the Act states that 'market' means a substantial market in Australia, or in a state, a territory or a region of Australia.

4.29. The ACCC's view is that the substantiality criteria could be satisfied in many ways including by reference to the size of the market in terms of number of customers, total sales or geographic size. A market that is 'small' in some sense may still be substantial.

4.30. In particular, substantiality of a market is not necessarily related to geographic size. A market may be small geographically (for example, a local market) but may also be substantial within the region in which it is located. Alternatively, a market for the supply of a product that is an essential but small ingredient in the production of one or more other products sold in large markets may be considered substantial.

4.31. Section 50(6) also states that 'market' means a market for goods or services in Australia, or in a state, a territory or region of Australia. In addition, s. 4E specifies that 'market' is a market in Australia. The ACCC's view is that this does not preclude it from analysing a merger proposal in the context of a geographically broader market — for example, a trans-Tasman market or even a global market — provided that at least some part of it is located in Australia.[24] In most cases the ACCC will define the relevant market to be Australia or a part of Australia, and take full account of any competitive constraint provided by suppliers located outside Australia when considering import competition (as required by the merger factors — see paragraphs 7.33 to 7.37).

Issues that may arise in market definition

Asymmetric substitution

4.32. Substitution possibilities are not necessarily symmetric. Asymmetric demand-side substitution occurs when substitution between two products only occurs in one direction. For example, buyers of luxury cars may substitute to more 'standard' cars in response to an increase in the price of luxury cars, but the opposite may not be the case. Asymmetric supply-side substitution may occur when one group of suppliers has the same production facilities as another group of suppliers, but also has additional facilities for supplying a slightly different good or service. For example, suppliers of scheduled travel services might be able to redeploy their facilities to provide charter travel services, but suppliers of charter travel services might face significant investment or obstacles to supply scheduled travel services (such as building terminal facilities).

Product differentiation

4.33. Market definition establishes the boundaries for competitive analysis but within those boundaries the degree of substitution can vary. Indeed it is extremely rare for a uniform level of substitution to exist across all products, services or regions within a relevant market. For example, products that serve similar functions may be differentiated rather than homogenous. Product differentiation often limits substitution at the margins because certain customers do not view differentiated products as comparable. For example, brand loyalty may limit the extent of both demand- and

[24] See, for example, *Riverstone Computer Services Pty Limited v IBM Global Financing Australia Limited* [2002] FCA 1608, at [21].

supply-side substitution. However, it is important to note that differentiated products may still be part of the same market.

4.34. The extent to which product differentiation affects the constraint provided by actual or potential competitors in the market is taken into account when assessing the competitive effects of a merger (often by reference to different 'segments' of the market). While a substantial lessening of competition must arise in a market to contravene s. 50, this does not imply that the lessening of competition must apply to the entire market or to all aspects of competition in the relevant market.[25]

Discrimination and captive customers

4.35. In certain cases where substitution possibilities are not uniform across consumer groups, it may be appropriate to define separate markets for different consumer groups. For example, some consumers may view two products to be highly substitutable while other consumers may consider the products to be, at best, weak substitutes. In such situations, the relative number and importance of each customer class and the ability of suppliers (including the merger parties) to discriminate between the customer classes will be important when determining the appropriate product and/or geographic dimension of the market.

4.36. The ability of suppliers to discriminate between customer classes will depend on their ability to:

- distinguish between those customers that have the option of substitution and those who lack that option
- prevent resale or arbitrage between the customer classes.

4.37. If suppliers can discriminate, a customer that has limited substitution possibilities receives different terms and conditions from suppliers to a customer that has strong substitution possibilities. In this situation it may be appropriate to consider two separate markets for merger analysis. One market would include the relevant product and the alternative product, and would focus on those consumers who have the option of substitution. The second market would not include the alternative product and would focus on those consumers who are 'captive' or do not have the option of substitution.

4.38. If suppliers are unable to discriminate between customer classes, they will provide similar, if not identical, prices and levels of service to each customer, regardless of their substitution possibilities. In this situation, there are unlikely to be multiple markets based on different customer classes. Customers that are unable to substitute to the alternative product would be protected to the extent that suppliers cannot distinguish them from customers that are able to switch.

Indirect substitution

4.39. In some limited circumstances, a relevant market may include products that are only indirect substitutes for a product of one of the merger parties (that is, a substitute for a substitute of the relevant product). Indirect substitution occurs when there is a 'chain' of products in the product dimension or a 'chain' of regions in the geographic dimension. There are at least three significant limitations on the extent to which an indirect substitute can provide an alternative to the product or region under investigation and thereby be included in the relevant market:

---

[25] *Dandy Power Equipment Pty Ltd v Mercury Marine Pty Ltd* (1982) ATPR 40–315, at 43,888.

- chains of substitution often have a break such that products on one side of the break are not close substitutes for those on the other side of the break (for example, breaks caused by obstacles to travel)
- as a chain of substitution expands, the proportion of customers that can switch to neighbouring links in the chain (marginal customers) will tend to decrease and at some point a hypothetical monopolist controlling the chain would find a SSNIP profitable regardless of those switching customers
- where price discrimination is possible, a market may be limited to the captive customers at the centre of a chain or circle of substitution.

4.40. While analysis depends on the particular circumstances under examination, in general, the further removed from the product or region under investigation, the less likely it is that an indirect substitute will be included in the relevant market. The ACCC draws on whatever quantitative and qualitative information is available to determine the boundary of a market where chains of substitution exist.

Integration and aggregation[26]

4.41. The purposive nature of market definition can require the product or geographic dimension of a market to be extended beyond what can be substituted for products of the merger parties to include other **functional** levels in the vertical supply chain or other products that are typically purchased or supplied together with those of the merger parties.

4.42. Where merger parties are vertically integrated or compete against vertically integrated firms, the ACCC must determine whether competition analysis is best conducted in the context of one relevant market encompassing the whole vertical supply chain or a series of separate markets each comprising one or more stages of the chain. This delineation depends on the economics of integration. Importantly, there need not be trade between the relevant stages of the vertical supply chain for there to be separate markets — the potential for exchange can be sufficient.[27] However, where there are overwhelming efficiencies of vertical integration between two or more stages in the vertical supply chain, the ACCC will define one market encompassing all those stages.

4.43. To define the relevant markets where vertical integration exists, the ACCC considers, among other things:

- the actual patterns of exchange between firms at different vertical levels
- the split between internal transfers of each relevant product and third party transactions
- the costs involved in trading the product between firms at different vertical levels
- any obstacles to trade between firms at different vertical levels
- any assets or specialisation required to supply each product within the vertical chain.

4.44. In some cases, a product that the merger parties supply is part of a package of several distinct products that are generally purchased or supplied together. Such

---

[26] This includes considerations that have hitherto been categorised as the 'functional dimension' of the market. In practice, issues relating to integration and aggregation tend to inform the appropriate product and geographic characterisation of the market.

[27] *Queensland Wire Industries Pty Ltd v The Broken Hill Proprietary Company Limited & Anor* [1989] HCA 6; (1989) 167 CLR 177 F.C 89/004; ATPR 40-925, Deane J at p. 50,013(ATPR).

products may belong to several separate disaggregated markets and/or one aggregated market consisting of a suite of goods and services generally supplied together (sometimes referred to as a 'cluster market'). To define the relevant markets in these cases, the ACCC considers, among other things:

- the split between products purchased or supplied separately, and products purchased or supplied together
- the costs involved in purchasing or supplying the product separately
- any obstacles to purchasing or supplying the product separately
- any assets or specialisation required to supply each product.

5. Unilateral effects

5.1. One of the main ways in which mergers can lessen competition is through unilateral effects. Mergers have unilateral effects when they remove or weaken competitive constraints in such a way that the merged firm's unilateral market power is increased. That is, as a result of the merger the merged firm finds it profitable to raise prices, reduce output or otherwise exercise market power it has gained, and can do so, even given the expected response of other market participants to the resulting change in market conditions.[28]

5.2. Where unilateral effects occur, other market participants' responses may vary. In some situations other market participants may respond in a pro-competitive way and (at least partially) attempt to offset the merged firm's behaviour. Alternatively, it may be more profitable for other market participants to simply support the merged firm's conduct — for example, if a merged firm exercises unilateral market power by raising the price of its products, other firms supplying substitutes may respond by also raising their prices, thereby exacerbating the competitive impact of the unilateral exercise of market power. As this example illustrates, a unilateral exercise of market power may make it profitable for both the merged firm and its competitors to raise prices.

5.3. In determining whether unilateral effects arise and whether they are likely to result in a substantial lessening of competition, the ACCC considers all of the merger factors contained in s. 50(3) of the Act and any other relevant factors. In particular, it considers whether the broader actual and potential competitive constraints — such as new entrants, imports or countervailing power — will limit any increase in the unilateral market power of each remaining market participant. These factors are discussed in more detail in chapter 7.

5.4. Although horizontal, vertical and conglomerate mergers can all potentially give rise to unilateral effects, it is recognised that vertical and conglomerate mergers are generally less likely than horizontal mergers to raise competition concerns. Since much of the general guidance on horizontal mergers is also relevant to vertical and conglomerate mergers, this section also identifies those competition issues that are specific to non-horizontal mergers that the ACCC will take into account. Mergers that involve both horizontal and non-horizontal effects will be assessed based on the combined horizontal and non-horizontal impact on competition.

Horizontal mergers

5.5. Horizontal mergers involve firms that operate in the same relevant market or markets. Horizontal mergers may give rise to unilateral effects by eliminating the actual or potential competitive constraint that the merger parties exerted on each other pre-merger. Two competing firms may constrain each other, including via the (actual or potential) transfer of sales from one to the other as customers switch, or threaten to switch, between them. If these two firms merge, the merger 'internalises' any such transfers within the merged firm, thereby removing this constraining effect. Where there are limited effective constraints from other sources, this unilateral effect can amount to a substantial lessening of competition.

5.6. Unilateral effects may arise in different ways depending on the characteristics of the market — some, but not all are outlined below. The most obvious way is when no

[28] This may be contrasted to coordinated effects arising from a merger where it may be profitable for the merged firm to raise prices, reduce output or otherwise exercise market power because it considers that the responses of its rivals will be directly influenced by its own actions. This may manifest as either tacit or explicit collusion (see chapter 6).

rivals[29] remain post-merger (i.e. merger to monopoly). In the absence of effective competitive constraints from other sources, such as future entrants, imports or countervailing power, a merger that leaves no rivals to the merged firm will likely result in unilateral effects amounting to a substantial lessening of competition.

5.7. Unilateral effects may also arise where a merger results in markets characterised by a single firm with market power and numerous other smaller competitors that can supply only a small portion of the total market demand because of factors limiting their ability to significantly expand output. In these circumstances, consideration will be given to whether the merged firm would have the ability and incentive to raise prices for the segment of the market that the smaller competitors are unable to supply — taking into account, amongst other factors, the ability and incentives of these smaller competitors to expand capacity.

5.8. In markets involving homogeneous products with no dominant firm, competition analysis will focus on the strategic interaction between rivals competing on output or capacity. Unilateral effects may arise where the merged firm sets its post-merger output level significantly below the level of output that would have prevailed absent the merger and, despite the response of competitors, brings about a higher price than would have prevailed absent the merger.

5.9. In contrast, in markets where competition between firms selling differentiated products is based on price, unilateral effects may arise where a merger between firms previously supplying close substitutes is able to increase the price of either or both of the close substitutes. In this case, consideration will be given to the proportion of substitution that would occur.

5.10. Outlined below are some of the relevant factors that the ACCC will take into account, in addition to those specified in s. 50(3) of the Act, to determine whether unilateral effects are likely to arise from a merger.

Significance of the merger parties to the competitive process

5.11. While some firms may be relatively small in terms of size and market share, they may nevertheless have a significant influence on the competitiveness of the market. Mergers involving such firms may result in unilateral effects by impeding or removing significant aspects of competition, such as innovation or product development.

Closeness of merger parties

5.12. The ACCC will take into consideration the extent of competitive constraint that the merger parties exert on each other pre-merger. Merger parties are more likely to be close competitors — and therefore provide each other with an effective constraint that may be lost post-merger — if they differ from rivals in respect of characteristics such as:

- product features and function
- customer loyalty
- production capacity
- breadth of product line and level of specialisation
- distribution channel coverage
- geographic presence

[29] In these guidelines, the term ‘rival’ includes both actual and potential rivals, unless the context otherwise specifies.

- cost structures
- level of vertical integration.

5.13. The degree of rivalry between the merger parties pre-merger can be an important factor in the analysis of mergers in differentiated product markets. Mergers between firms supplying competing differentiated products may result in unilateral effects when the merger parties are considered close competitors by a sufficient number of customers, which thereby alters the incentives of the merger parties. Merger parties are likely to have an incentive to increase the price of one or both products if the sales lost due to the price increase would be recaptured by an increase in sales of the other product. That is, the greater the number of customers that regard the merger parties as particularly close competitors (for example, their first and second choices), the greater the potential for the merger parties to impose a unilateral increase in price post-merger. Unilateral effects may arise even where the merger parties are not one another's 'closest' competitor pre-merger or would not be the dominant firm post-merger based on market shares.

5.14. Competitors supplying the relevant market with products that are less likely to be substituted for, or repositioned to compete with, the merger parties' products may only be able to offer a competitive alternative to marginal customers; the loss of such marginal customers would not prevent the merged firm's actions being profitable. Such competitors may also decide to simply follow the merged firm's price increase to profit from the less competitive environment.

Rivals' responses

5.15. Unilateral effects are unlikely if rivals have the incentive and ability to respond to a price increase by the merged firm such that they are able to capture sales and replace competition lost by the merger.

5.16. In some cases, rivals in differentiated product markets that are less direct competitors at the time of a merger may potentially overcome differences between themselves and the merged firm to become closer competitors. This may occur where rivals have the ability and incentive to reposition or extend their product range relatively easily and without significant cost in response to the merged firm increasing its prices. If the competition lost through the merger would likely be replaced by other rivals in the market or new entrants within a one- to two-year period, a merger is less likely to result in an increase in unilateral market power.

5.17. In non-differentiated product markets, other factors that may influence the abilities and incentives of rivals to constrain the merged firm from unilaterally increasing prices post-merger include whether:

- rival firms have sufficient capacity or are able to profitably expand capacity
- the merged firm is able to hinder entry or expansion by rivals through various means (for example, by controlling inputs, distribution channels and patents/other IP and access to, or pricing of, different platforms)
- the relevant products are sold under terms and conditions likely to limit or curtail the ability of rivals to compete effectively for the customers of the merged firm post-merger
- customers are constrained in their ability to switch to rival suppliers of the merged firm post-merger.

Non-horizontal mergers

5.18. Non-horizontal mergers include vertical mergers and conglomerate mergers.

5.19. Vertical mergers involve combining firms that operate at different stages of a single vertical supply chain — that is, a merger between an 'upstream' firm and a 'downstream' firm (for example, an upstream manufacturer and a downstream distributor) where the upstream firm is an actual or potential supplier of an input into the production process of the downstream firm. It is often the case that vertical mergers will promote efficiency by combining complementary assets/services which may benefit consumers.

5.20. Conglomerate mergers involve firms that interact across several separate markets and supply products that are typically in some way related to each other — for example, products that are in neighbouring markets or products that are complementary in either demand or supply, such as staples and staplers.[30] Often, conglomerate mergers will allow firms to achieve efficiencies and result in better integration, increased convenience and reduced transaction costs.

5.21. In the majority of cases, non-horizontal mergers will raise no competition concerns. However, where insufficient competitive constraints remain in the relevant market post-merger, some non-horizontal mergers will raise competition concerns when the merged firm is able to increase its unilateral market power. One way in which this can occur is through the merged firm 'foreclosing' rivals, but non-horizontal mergers can also increase unilateral market power in other ways. In some cases, a non-horizontal transaction, either alone or in conjunction with a horizontal transaction, may amount to a substantial lessening of competition in a market.

Foreclosure

5.22. Recognising that not all forms of foreclosure are anti-competitive, the ACCC is only concerned with non-horizontal mergers where the merged firm has the ability and incentive to use its position in one market to anti-competitively foreclose rivals in another market in a way that lessens competition.

5.23. In determining whether foreclosure is likely to increase the unilateral market power of the merged firm, the ACCC will consider the following three issues:

- the merged firm's ability to foreclose
- any incentive the merged firm may have to foreclose
- the likely effect of any such foreclosure.

Vertical mergers

5.24. The particular anti-competitive foreclosure strategies that a vertically integrated merged firm might adopt will depend on the circumstances of each case, but some examples include:

- charging a higher price for an important input into the production processes of downstream (non-integrated) rivals

[30] Conglomerate mergers may also arise in markets that are unrelated or independent of one another.

- limiting,[31] or denying access by, downstream (non-integrated) rivals to important inputs (thereby forcing them, for example, to use more expensive or inferior quality alternatives)
- limiting, or denying access by, upstream (non-integrated) rivals to a sufficient customer base
- raising the cost of access by upstream (non-integrated) rivals to a sufficient customer base.

Conglomerate mergers

5.25. Conglomerate mergers provide a merged firm with the opportunity to bundle or tie products in related or independent markets. The practice of bundling or tying product offerings is common and is undertaken by firms for a variety reasons, often with no anti-competitive consequences under s. 50.[32]

5.26. However, in some cases conglomerate mergers can raise competition concerns where they enable the merged firm to alter its operations or product offerings in a way that forecloses the merged firm's rivals and ultimately reduces the competitive constraint they provide. For example, the merged firm's rivals may be foreclosed if the merged firm chooses to bundle or tie complementary products, such that:

- no product can be purchased or used separately
- at least one product cannot be purchased or used separately, or
- customers receive additional benefits when they purchase or use the merged firm's products together (for example, due to discounts, rebates or design features).

5.27. The adoption of such strategies can limit or raise the cost of rival firms' access to a sufficient customer base and in some circumstances deny rival firms access to customers altogether.

Ability to foreclose

5.28. An integrated or conglomerate firm will generally only be able to engage in foreclosure if it has sufficient market power at one or more functional levels within the vertical supply chain, or in one or more of the related markets post-acquisition.

5.29. The ACCC will determine whether an integrated or conglomerate firm has market power in the relevant markets by assessing whether there are effective competitive constraints, such as those discussed in chapter 7.

Vertical mergers

5.30. An integrated merged firm would only be able to engage in foreclosure strategies against rival downstream firms if it had sufficient market power in the upstream market — that is, where its downstream rivals faced insufficient viable supply alternatives. This might occur for a variety of reasons including capacity constraints faced by rival upstream suppliers, barriers to entry or product differentiation between the products and/or services offered by the integrated firm and its rivals.

[31] Limiting access may involve reducing the quality of the good or service supplied.

[32] Tying or bundling may however raise competition concerns under other provisions of the Act.

5.31. Similarly, an integrated merged firm would only be able to engage in foreclosure strategies against rival upstream firms if it had sufficient market power in the downstream market — that is, where its upstream rivals lacked sufficient actual or potential economic alternatives in the downstream market to sell their output. The ability of upstream rivals to sell their output is especially likely to be prevented or impeded where the downstream division of the merged firm is an important customer in that market and where there are significant economies of scale or scope in the input market.

Conglomerate mergers

5.32. In the context of conglomerate mergers, market power may arise where products are considered by customers to be especially important or a 'must have' because of factors such as superior functionality (product differentiation) or brand loyalty. Where the merged firm supplies customers that on-sell its products to end customers, the market power of the merged firm may be reflected in its ability to influence the product-stocking decisions of its customers. This will depend on the specifics of the industry, but can include supplier involvement in category management and the supply of in-store distribution assets to retailers on condition of certain stocking requirements.

Incentive to foreclose

5.33. While possession of market power by the merged firm in one or more of the relevant markets is a necessary consideration, it is not determinative in itself. Even if a vertically integrated or conglomerate firm has the ability, it may not have the economic incentive to foreclose rivals. A firm is unlikely to exercise its ability to foreclose unless it is profitable to do so, which will depend on the nature of competition in each of the relevant markets and the particular means available to the firm to foreclose rivals.[33]

5.34. An integrated or conglomerate firm will only have an incentive to engage in foreclosure strategies with rivals if the benefit it receives from doing so outweighs potential lost sales resulting from the foreclosure. In assessing whether the merged firm has the incentive to engage in foreclosure, the ACCC will weigh likely short-term costs against likely gains and the relative size and importance of each market to the merged firm.

5.35. For example, in vertical mergers foreclosing independent downstream rivals may simply close off a good source of upstream revenue without providing any significant boost to the integrated merged firm's own downstream sales or other benefits. Similarly, an integrated firm will only have an incentive to limit the downstream sales of its non-integrated upstream rivals if it receives sufficient benefits to offset any increased costs or decreased custom associated with the foreclosure.

5.36. In conglomerate mergers, the merged firm may be able to take advantage of economies of scale in a market by increasing sales in that market and, where there is commonality in operations (such as in manufacturing, distribution and/or marketing), may also be able to gain economies in a related market.

5.37. In assessing the merged firm's likely incentives, the ACCC will take into account a range of quantitative and qualitative information.

---

[33] For example, a conglomerate firm implementing a tie may involve risking the loss of customers that are not interested in purchasing the bundle, depending on the closeness of the products in question. In addition, the profitability of discounting a bundle may depend on the relative value of the products being united and the value of the markets in which they are supplied.

Likely effect of foreclosure

5.38. The ability and incentive of the merged firm to foreclose rivals may not of itself increase the merged firm's unilateral market power to the extent that there is a substantial lessening of competition. Consideration must also be given to the effect of foreclosure on competition in the relevant market/s.

5.39. Foreclosure need not result in rivals being forced to exit the market to have a detrimental effect on competition. Actual rivals may simply be forced to use more expensive alternatives to those offered by the merged firm or may be discouraged from expanding their operations. Potential rivals may be discouraged from entering the market. Foreclosure lessens competition when the merged firm — and, in some cases, certain of its rivals — finds it profitable to increase the price charged to intermediate and end consumers or decrease the price paid to upstream suppliers below competitive levels.

5.40. In determining whether a merger is likely to result in a substantial lessening of competition, the ACCC considers all the merger factors contained in s. 50(3) of the Act and other relevant factors. In particular, the following factors inform the ACCC's assessment as to whether the merged firm's unilateral market power is likely to increase to the extent that there is a substantial lessening of competition:

- the proportion and significance of the firms that are foreclosed as a result of the merger
- the proportion and significance of other firms still able to provide a constraint over the merged firm
- the potential for the merger to raise barriers to entry by foreclosure or the threat of foreclosure to rivals in related markets.

5.41. Two further factors that may be relevant in the context of vertical mergers are:

- the significance of the input to the production process of downstream rivals
- the presence of countervailing power, particularly the ability of firms to integrate to avoid foreclosure.

5.42. An additional factor that may be relevant in the context of conglomerate mergers is the proportion of customers likely to purchase the relevant products from the merged firm. This must be sufficiently large to cause independent rivals to face a significant decline in sales, resulting in increased costs. The level of competitive constraint imposed by rivals may be detrimentally affected where economies of scale or network effects[34] are important features of the relevant markets, since foreclosure may prevent the merged firm's rivals from achieving minimum efficient scale.

5.43. However, where a significant proportion of customers continue to purchase products from independent rivals, a conglomerate firm is likely to continue to be constrained post-merger. For example, where rivals are able to replicate the merged firm's offering through assembly of their own competing bundle, and therefore reap similar cost savings and/or retain economies of scale or scope, they may be able to avoid or minimise foreclosure and thereby continue to constrain the merged firm. This may be through organic growth, counter-merger or joint supply arrangements with suppliers of the related product. Depending on the nature of the merged firm's market power, however, it may be difficult or impossible for rivals to replicate the merged firm's

[34] Network effects arise when a product becomes more valuable as the number of customers consuming it increases, thus providing an advantage to firms that have an existing customer base over rivals and prospective entrants that do not.

bundle. If rivals are able to avoid foreclosure by supplying a competitive bundle, a conglomerate merger is unlikely to substantially lessen competition.

Other unilateral effects

5.44. Other unilateral effects that may arise from vertical mergers and conglomerate mergers include raising structural and/or strategic barriers to entry and access to commercially sensitive information.

Barriers to entry

5.45. A vertical merger may raise barriers to entry if, as a result of the merger, new entrants would have to enter at multiple stages of the vertical supply chain instead of just one. In some cases, the increase in unilateral market power accruing to the merged firm as a result of increased barriers to entry constitutes a substantial lessening of competition.

5.46. By creating strategic links between related products, a conglomerate merger may result in formerly separate markets becoming part of one integrated market in which suppliers must offer the full range of complementary products to compete. Future entry may therefore require an offering of the full range of products, potentially increasing the sunk costs associated with entry or exit.

Access to commercially sensitive information

5.47. A vertical merger may also result in unilateral effects if the integrated merged firm would, through its supply of an input or distribution services to firms that are otherwise rivals, obtain competitively sensitive information such as costs or planned product launches. This may distort the dynamics of competition.

6. Coordinated effects

6.1. In addition to unilateral effects, mergers can lessen competition through coordinated effects. Mergers have coordinated effects when they assist firms in the market in implicitly or explicitly coordinating their pricing, output or related commercial decisions. A merger may do so simply by reducing the number of firms among which to coordinate, by removing or weakening competitive constraints or by altering certain market conditions that make coordination more likely. Coordinated effects may occur in addition to unilateral effects so that the merged firm is able to achieve even higher prices than it would on its own. In some cases, coordinated effects, either alone or in conjunction with unilateral effects, may amount to a substantial lessening of competition.

6.2. Horizontal, vertical and conglomerate mergers may give rise to coordinated effects in a number of different ways. Some of these are discussed below, but coordinated effects may also arise in ways that are not discussed here. Competitive constraints and other factors relevant to coordinated effects are discussed in chapter 7. Rather than presenting horizontal, vertical and conglomerate mergers separately, this section discusses the issues that the ACCC considers relevant across all three types of merger.

Coordinated conduct

6.3. Mergers have coordinated effects when they alter the nature of interdependence between rivals such that coordinated conduct is more likely, more complete or more sustainable. Interdependence arises when a market is characterised by a small number of firms (an oligopoly or a duopoly), with each firm anticipating the response of the other firms and devising their commercial strategies accordingly. If the oligopolistic structure of a market persists over time — for instance, because barriers to entry and expansion shield incumbents from new competitors — the repeated nature of the competitive interaction can result in a range of coordinated conduct, from muted competition through to tacit or explicit agreement between firms not to compete. Although firms may have the ability to engage in effective competition, they may not have the incentive if they recognise that any short-term benefits from competing will likely be eroded by lost sales once other firms respond. Coordinated conduct can in some cases involve contravention of other provisions of the Act.

6.4. In some cases, a change in the nature of the interdependence among competitors may lead to an implicit agreement among them to refrain from competing. This behaviour is sometimes referred to as tacit collusion, since it involves active coordination but no explicit agreement between firms. Firms may signal to each other that they will not compete on price, output, customer allocation or indeed any other parameter of competition. Where the products are relatively homogenous, coordinated terms are more likely to be based on price or output in markets, whereas differentiated products may be more conducive to division of a market by customer type or region. In certain circumstances, interdependence may result in explicit collusion between firms, whereby firms explicitly agree to refrain from competing.

Conditions facilitating coordinated conduct

6.5. When assessing whether a merger is likely to give rise to coordinated effects, the ACCC first assesses whether conditions in the relevant market are likely to be conducive to coordinated conduct. Generally, the potential for sustainable coordination is greatest where:

- firms have the ability and incentive to settle on terms[35] that are profitable for all
- firms can detect deviations from the consensus
- the threat of retaliation from other firms involved is sufficiently costly to act as a deterrent to deviation
- the consensus is not undermined by competitive constraints in the market (discussed further in chapter 7).

6.6. It is impossible to be prescriptive about the conditions in which coordinated conduct is likely to arise or the types of mergers that would increase the likelihood of coordinated conduct. However, settling on and maintaining a profitable consensus will often be easier where certain conditions exist post-merger. Some of these conditions are discussed below. The non-existence of one or more of these conditions may not necessarily make coordinated effects less likely and there may be other factors not discussed here which are relevant.

6.7. Importantly, a merger will only result in coordinated effects if it increases the likelihood of coordinated conduct, or it results in more complete or sustainable coordination post-merger. As noted above, a merger may do this by reducing the number of firms among which to coordinate (thereby reducing the likelihood of deviation from the consensus), by removing or weakening competitive constraints or by altering certain market conditions that make coordination more likely.

Observing other firms

6.8. Each firm must be aware of the behaviour of other firms for coordinated conduct to arise. This is easiest when the number of firms in the market is small (that is, concentration is high) and firms can quickly and readily observe other firms' activities and general market conditions. Information may be readily available if, for example, firms actively publish their prices to consumers, firms hold cross-shareholdings in each other, or trade associations collate and publish recent market information. Markets need not be fully transparent for coordinated conduct to arise, but firms must have some mechanism for detecting the behaviour of their competitors.

6.9. In addition, where product innovation or fluctuations in costs or demand are common, it may be difficult for firms to know whether a change in their rivals' pricing arises from such a fluctuation or constitutes a deviation from the settled terms. Market stability therefore facilitates coordination.

Retaliation and incentives

6.10. Coordinated effects are more likely when firms are likely to interact regularly post-merger, either in the relevant market where coordination could occur or in other separate markets, and for a considerable period. The sustainability of coordination rests upon repeated interaction, since the prospect of future retaliation discourages firms from pursuing more competitive strategies.

6.11. Firms in a market will have an incentive to deviate from the consensus unless they fear punishment that would outweigh the potential short-term gains from cheating on the terms of coordination. Punishment may simply involve a return to competitive conditions or, for example, a 'price war'. The incentive to cheat is increased if the imposition of punishment is likely to be significantly delayed (for example, because

[35] In these guidelines, 'settle on terms' and 'consensus' do not necessarily involve communication or active coordination but are intended to reflect muted competition, tacit collusion and explicit collusion.

market transactions are infrequent). The credible threat of effective punishment alone may be sufficient to deter cheating.

6.12. The ability of coordinating firms to punish deviations is often increased where:

- firms have similar cost structures — low-cost firms may not fear retaliation by higher cost firms
- firms compete against each other in more than one market — this provides additional markets in which to punish deviating firms
- some firms have excess capacity, which enables them to increase output and reduce prices in response to a deviation from the terms of coordination.

6.13. Interdependence and coordination may therefore be facilitated by a merger that creates firms with similar market shares, cost structures, production capacities and levels of vertical integration. Where there is firm asymmetry, smaller firms or firms with lower cost structures may have more to gain from competing rather than refraining from competition. In this regard, a vigorous and effective competitor may be instrumental in disrupting interdependence and ensuring effective competition (see paragraph 7.56).

Competitive constraints

6.14. Coordination is unlikely to be sustained if it induces new entry or expansion by firms in the relevant market that are not engaging in coordination. Such competitive constraints are discussed further in chapter 7.

6.15. Generally, assessing whether a merger is likely to give rise to coordinated effects requires a close examination of the conditions prevailing in the relevant market and the likely effect of the merger on these conditions. This generally requires a detailed qualitative assessment of a range of factors (including those noted above), some of which may suggest conflicting conclusions. For example, a merger may decrease the number of firms in a market, while increasing the level of asymmetry between firms (or it might increase the level of symmetry). Given the potential complexity of the assessment required, evidence of prior coordinated conduct between firms in the relevant market may be highly relevant, particularly if the merger is likely to reduce the number of participants without undermining the conditions that facilitate coordinated conduct.

7. Merger factors

7.1. Mergers result in unilateral and/or coordinated effects when they weaken or remove the competitive pressure on firms in a market. Where unilateral and/or coordinated effects amount to a significant and sustainable increase in the market power of the merged firm and/or other firms in a market, the merger is likely to substantially lessen competition in contravention of the Act.

7.2. In assessing whether a merger is likely to result in a significant and sustainable increase in market power, the ACCC must consider each of the merger factors set out in s. 50(3) as well as any other relevant factors (see paragraph 1.4). These merger factors provide insight about the likely competitive constraints that the merged firm will face post-merger. The merger factors cover a broad range of possible competitive constraints faced by the merged firm — some assist in identifying the presence of direct constraints,[36] while others provide insight into less direct forms of constraint relating to either the structure and characteristics of the market[37] or the behaviour of actual and potential participants in the market.[38]

7.3. The ACCC recognises that competitive constraints are not static and strategic behaviour by market participants can affect competition. The significance of the merger factors and the weight placed on them will depend on the actual matter under investigation.

7.4. The likely presence of effective competitive constraints post-merger is a key indicator that a merger is unlikely to result in a substantial lessening of competition. While all the merger factors must be taken into consideration, it may not be necessary for all factors to indicate that the merged firm would face effective competitive constraints. In some cases a single constraint can be sufficient to prevent a significant and sustainable increase in the market power of the merged firm while in other cases the collective effect of several constraints may be required. Conversely, the absence of a single particular constraint is unlikely to be indicative of an increase in market power as a result of the merger.

7.5. The order in which the merger factors and other sources of constraint are considered below reflects the order in which the ACCC generally undertakes its analysis and does not reflect the priority or weight given to any particular factor. Indeed, many of the factors are interrelated and the ACCC adopts an integrated approach, taking into account all potential competitive constraints.

Concentration and market shares[39]

7.6. Market concentration refers to the number and size of participants in the market. It provides a snapshot of market structure as well as an approximation of the size of the merger parties, which can assist when considering the other merger factors. Changes in market concentration over time can also reveal the frequency of new entry and provide insight into the ability of new entrants and smaller competitors to attract custom and expand.

---

[36] For example, the level of actual and potential imports, height of barriers to entry, degree of countervailing power and the availability of substitutes.

[37] For example, the dynamic characteristics of the market, level of concentration in the market and nature and extent of vertical integration.

[38] For example, the likelihood that the acquirer would be able to significantly and sustainably increase prices or profit margins, whether the acquisition will result in the removal of a vigorous and effective competitor and other relevant factors.

[39] Refers to the merger factor contained in s. 50(3)(c).

7.7. However, market concentration is not determinative in itself. For example, firms can gain a high market share by adopting more efficient technology, lowering costs and reducing prices. In such cases, high levels of market concentration are not necessarily reflective of a non-competitive market. Measures of concentration in markets characterised by product differentiation may also obscure the closeness of competitors.

7.8. Notwithstanding these limitations, market concentration can help to determine whether a merger is likely to result in unilateral and/or coordinated effects. It is the link between concentration and the strength of competition that is important for merger analysis and this ultimately requires consideration of all relevant factors before a final conclusion can be reached.

Measuring market concentration

7.9. The ACCC typically measures concentration with reference to market shares, concentration ratios and the Herfindahl-Hirschman Index (HHI).

Market shares

7.10. Market shares are a key input when determining concentration. The ACCC will generally calculate market shares according to sales, volume and capacity using information from a variety of sources, such as:

- the merger parties
- competitors
- customers
- suppliers
- trade associations
- market research reports.

7.11. Consistent with the forward-looking nature of the competition test, the ACCC considers the extent to which current market shares are likely to accurately reflect future market share patterns. For example, there may be evidence that substantial new capacity is due to come on- stream in a manufactured product market, new licences are about to be issued in a broadcasting market or some firms are running out of reserves in a primary product market. Where such evidence exists, the ACCC adapts current market shares accordingly.

Concentration and market shares

The ACCC will generally require information from the merger parties to calculate market shares based on the most appropriate measure from one of the following:

- sales by volume (for each competitor) in at least three recent annual periods
- sales by value (for each competitor) in those periods
- capacity (for each competitor) over the previous three years.

In some cases the ACCC may request additional information to calculate market shares based on an alternative measure to that provided by the merger parties. Whether a wider range of information will be required by the ACCC will be assessed on a case-by-case basis.

Market share information should be supported by details of how the data was compiled, the source of the estimates and any assumptions used. Where actual figures are not available, best estimates will be considered — for example, where there are a number of smaller firms in the market, an approximation may be appropriate.

In markets where actual or potential imports are relevant, these should be clearly identified (indicating whether these imports are independent of the merger parties) and included in the market share and concentration metric calculations. Similarly, supply-side substitutes should be included in these calculations.

Measures of concentration

7.12. In assessing market concentration, the ACCC takes into account the pre- and post-merger market shares of the merged firm and its rivals and the actual increase in concentration, as well as the level of symmetry between rival firms' market shares. Concentration metrics such as the HHI and the x-firm concentration ratio (CRx) may provide useful summary statistics by combining some or all of the market share data for individual firms. Different concentration metrics may highlight different aspects of the market share data.

7.13. The HHI is calculated by adding the sum of the squares of the post-merger market share of the merged firm and each rival firm in the relevant market, thereby giving greater weight to the market shares of the larger firms. The HHI therefore requires the market shares, or estimates of them, for all the participants in the relevant market. The HHI indicates the level of market concentration while the change in the HHI (or 'delta') reflects the change in market concentration as a result of the merger.

HHI threshold

7.14. As part of its overall assessment of a merger, the ACCC will take into account the HHI, as a preliminary indicator of the likelihood that the merger will raise competition concerns requiring more extensive analysis. The ACCC will generally be less likely to identify horizontal competition concerns when the post-merger HHI is:

- less than 2000, or
- greater than 2000 with a delta less than 100.

7.15. These HHI levels should not be taken to imply a presumption as to whether or not a merger will be likely to result in a substantial lessening of competition. Only by considering the merger factors can this assessment be made. To illustrate this point, a merger that falls below the HHI threshold may still raise competition concerns if any of the following are relevant:

- a substantial number of customers consider the products of the merger parties to be particularly close substitutes — for example, the merger parties represent their first and second choices
- the target firm has shown a recent rapid increase in market share, has driven innovation or has tended to charge lower prices than its competitors in one or more markets (properly defined) in which the merged firm would operate.

7.16. The HHI threshold is not interchangeable with, or a substitute for, the notification threshold (see chapter 2). Mergers that meet the notification threshold should be notified to the ACCC regardless of the specific HHI and delta.

Height of barriers to entry[40]

7.17. The entry of new firms into a market can provide an important source of competitive constraint on incumbents. If new entrants are able to offer customers an appropriate alternative source of supply at the right time, any attempt by incumbents to exercise market power will be unsustainable since their customers will simply switch to the new entrants. A credible threat of new entry alone may prevent any attempt to exercise market power in the first place.

7.18. If there is a high likelihood of timely and sufficient entry in all relevant markets post-merger, the merged firm is unlikely to have market power either pre- or post-merger and therefore the merger is unlikely to result in a substantial lessening of competition. In some markets, however, there are barriers to entry that either prevent firms from entering the market altogether or delay and impede entry to such a degree that the merged firm is sheltered from competitive constraint for a significant period.[41] A barrier to entry is any factor that prevents or hinders effective new entry that would otherwise be capable of defeating a price increase caused by a merger.[42]

7.19. The ACCC takes the view that new entry must be timely, likely and sufficient in scope and nature to be effective. This test will be based on an assessment of the height of barriers to entry taking into account whether actual or threatened entry post-merger is both possible and likely in response to an attempted exercise of market power by the merged firm — this will generally depend on the profitability of entering the market.

7.20. It is not necessary for a merger to increase barriers to entry for it to be anti-competitive — only that significant barriers exist and provide the merged firm with discretion over its pricing and other conduct. If the merger also increases barriers to entry, the effect on competition is likely to be more severe because new entry that may have been possible before the merger is likely to be prevented or impeded post-merger — that is, the gap between the future states with and without the merger will be widened.

Timeliness of entry

7.21. When considering the degree of competitive constraint provided by new entry, it is necessary to assess the time it would take a new firm to enter the relevant market and offer customers a competitive alternative to the merged firm. The evaluation of whether entry will be timely necessarily varies with each specific merger and the dynamics of the market.

7.22. Entry will generally provide an effective competitive constraint post-merger if actual or threatened entry would occur in an appropriate time to deter or defeat any non-transitory exercise of increased market power by the merged firm. While the ACCC's starting point for timely entry is entry within one to two years, the appropriate timeframe will depend on the particular market under consideration.

7.23. When determining whether potential entry is likely to be timely the ACCC considers the barriers outlined in paragraphs 7.30 to 7.32, as well as factors such as the frequency of transactions, the nature and duration of contracts between buyers and

[40] Refers to the merger factor contained in s. 50(3)(b).

[41] The analysis would apply in matters involving unilateral effects and also matters involving coordinated effects (in particular the possibility of new entry constraining the ability and incentive of a small group of firms to engage in coordinated conduct).

[42] Note that some barriers to entry may technically be barriers to **exit**. Nevertheless, the effect is the same if such barriers to exit increase the risk to prospective entrants and ultimately discourage entry.

sellers, lead times for production and the time required to achieve the necessary scale.

Likelihood of entry

7.24. The ACCC needs to be satisfied that actual or threatened entry post-merger is not just possible but likely in response to an attempted exercise of market power by the merged firm. The likelihood of entry generally depends on the profitability of entering the market. The ACCC will assess whether a new entrant could expect to make a commercial return on its investment taking into account the price effects the additional output may have on the market and the likely responses of the incumbent firms and other costs/risks associated with entry.

7.25. Factors likely to affect the profitability of entry include the examples of barriers outlined in paragraphs 7.30 to 7.32. Evidence of the past success or failure of new entrants in establishing themselves as effective competitors in the relevant market may also provide insight into the profitability of entry into particular markets but will not necessarily indicate ease of entry. To test the likelihood of entry where it is not possible to identify potential new entrants, the ACCC requires identification of the likely categories of entrants that could potentially enter.

Sufficiency of entry

7.26. Entry must be of sufficient scale with a sufficient range of products to provide an effective competitive constraint. In differentiated product markets, the sufficiency of entry will critically depend on the ability and incentive[43] of entrants to supply a sufficiently close substitute to that of the merged firm. Entry at the fringe of the market is unlikely to constrain any attempted exercise of market power by incumbents if incumbents are unlikely to lose significant sales to those fringe entrants. Therefore individual entry that is small-scale, localised or targeted at niche segments is unlikely to be an effective constraint post-merger.

7.27. Sufficiency does not require in all circumstances that one new entrant alone duplicates the scale and all the relevant activities of the merged firm. Timely entry by multiple firms may be sufficient if the combined effect of their entry would defeat or deter the exercise of increased market power by the merged firm.

7.28. The ACCC's assessment of the timeliness, likelihood and sufficiency of entry will depend on the circumstances of each particular merger under consideration. However, the underlying test is always whether the potential for entry provides an effective competitive constraint that would prevent a significant and sustainable increase in the market power of market participants post-merger.

Types of barriers to entry

7.29. In assessing the potential for entry to act as a competitive constraint, the ACCC considers the costs of entry and incumbency advantages under the following categories:

7.30. **Legal or regulatory barriers**, including but not limited to:

- licensing conditions, tariffs, explicit restrictions on the number of market participants and other government regulations

[43] The ACCC will take into account a range of factors including whether new entry that targets the products of the merged firm would be profitable.

- legally enforceable intellectual property rights
- environmental regulations that raise the costs of entry or limit the ability for customers to switch suppliers.

7.31. **Structural or technological barriers**, including but not limited to:

- the existence of sunk costs, which increase the risks of, and costs associated with, failed entry and include factors such as product development, advertising or promotion to establish a sufficient reputation in the market and construction of specialised facilities — the high risk and costs associated with failed entry may deter new entry
- substantial economies of scale, which may limit the viability of entry below a certain minimum efficient scale
- high customer switching costs, such as search costs, transaction costs and market specific behaviour (including customer inertia to switching suppliers)
- mature markets or markets with declining levels of demand growth
- access to key production or supply assets, important technologies or distribution channels
- the existence of significant network effects.

7.32. **Strategic barriers** that arise because of actions or threatened actions by incumbents to deter new entry, including but not limited to:

- risk of retaliatory action by incumbents against new entry, such as price wars or temporarily pricing below cost
- creation and maintenance of excess capacity by incumbents that can be deployed against new entry
- creation of strategic customer switching costs through contracting, such as exclusive long-term contracts and termination fees
- brand proliferation by incumbents, which may crowd out the product space leaving insufficient opportunities for new firms to recover any sunk entry costs.

Height of barriers to entry

The following are examples of the types of information the ACCC may require to assess the height of any barriers to entry:

- the ability of producers that are not current competitors to switch production to competing products or services
- the market conditions that may affect the ability of existing firms to expand
- the size and extent of any investment, particularly sunk investment, that producers would need to make to either enter the relevant market/s or to expand production significantly in these market/s
- the extent of brand loyalty in the relevant market/s
- the existence and nature of any long-term supply contracts in the relevant market/s
- any relevant ‘switching costs’ (such as product compatibility issues, product bundling, contract termination charges) that may prevent buyers in the relevant market/s from changing suppliers or sellers in the relevant market/s from changing buyers, in the short to medium term

- evidence of any growth or decline in the relevant market/s.

In an informal merger review, providing a base level of information to the ACCC will, in non-controversial cases, usually be sufficient to satisfy the ACCC of whether or not a substantial lessening of competition is likely. Whether a wider range of information will be required by the ACCC will be assessed on a case-by-case basis and will depend on the complexity of the matter and the potential competition concerns raised.

Actual and potential import competition[44]

7.33. Actual or potential direct competition from imported goods or services can provide an important competitive discipline on domestic firms. Where the ACCC can be satisfied that import competition — or the potential for import competition — provides an effective constraint on domestic suppliers, it is unlikely that a merger would result in a substantial lessening of competition.

7.34. While the current or historic levels of imports may indicate the competitive role of imports in the relevant market, the ACCC will consider the potential for imports to expand if the merged firm[45] attempted to exercise increased market power post-merger.

7.35. Imports are most likely to provide an effective and direct competitive constraint in circumstances where all of the following conditions are met:

- independent imports (that is, imports distributed by parties that are independent of the merger parties) represent at least 10 per cent of total sales in each of the previous three years
- there are no barriers to the quantity of independent imports rapidly increasing that would prevent suppliers of the imported product from competing effectively against the merged firm within a period of one to two years (for example, government regulations, the likelihood and impact of anti-dumping applications on imports, customer-switching costs or the need to establish or expand distribution networks)
- the (actual or potential) imported product is a strong substitute in all respects (that is, quality, range, price, etc.) for the relevant product of the merged firm, taking into account factors including the need to meet any relevant Australian or industry standards, any increase in the complexity of customers' logistical arrangements, increased transport times and costs, and the risk of adverse currency exchange rate fluctuations
- the price of actual or potential landed imports, including any tariffs or other import-specific taxes and charges, (that is, the import parity price) is close to the domestic price of the relevant product that would prevail in the absence of the merger
- importers are able to readily increase the supply volume of the product they import with minimal or no increase in the price paid
- the merged firm and other major domestic suppliers do not have a direct interest in, are not controlled by, and do not otherwise interact with, actual or potential import suppliers.

[44] Refers to the merger factor contained in s. 50(3)(a).

[45] The analysis would apply in matters involving unilateral effects and also matters involving coordinated effects (in particular the possibility of import competition constraining the ability and incentive of a small number of firms to engage in coordinated conduct).

Barriers to import expansion

7.36. The ability of imports to expand (import supply elasticity) will be a key consideration in the ACCC's competition analysis. If the supply of imports is either unable to respond, or only able to respond slowly, to an increase in demand by Australian consumers, imports are unlikely to effectively counteract any increased market power of the merged firm. For example, where there are production capacity or supply constraints, or where imports targeted to niche segments would not be profitable on a wider scale given their cost structures, import competition is unlikely to be sufficient to prevent a substantial lessening of competition.

7.37. The barriers to import expansion that the ACCC considers when assessing the supply elasticity of imports include:

- the existence of capacity constraints overseas and the resulting impact on the potential for expansion of imports into Australia
- the level and impact of transport costs and logistics (particularly the impact of transport costs as a percentage of the value of the good or service being imported)
- the cost and delay associated with the need to establish or expand effective distribution networks
- the cost and delay associated with any specialised facilities required by importers to supply domestic customers
- the level and effect of tariffs, quotas and other government regulations (both in Australia and the country of origin)
- the likelihood and impact of anti-dumping applications on imports
- the presence of exclusive licensing arrangements on imports
- the existence of impediments to customers choosing imports rather than the domestic product post-merger, such as switching costs, lock-in contracts, compatibility problems, importance of an Australian agent and local service and supply, or consistency and timeliness of supply.

Actual and potential import competition

The following are examples of the types of information the ACCC may require to determine the competitive constraint provided by imports:

- which products are imported into the relevant market/s
- who undertakes the importation and their relative share of the market/s
- estimates of the actual and potential level of import competition in the market/s
- historical importation figures
- details of any barriers to entry to importing, including access to distribution facilities, transport costs and customs restrictions
- details of the price of imports as opposed to domestic production in the relevant market/s and an explanation of any divergence in these prices
- the extent to which imports provide a constraint on domestic suppliers, including the merger parties, in the relevant market/s post-merger.

In an informal merger review, providing a base level of information to the ACCC will, in non-controversial cases, usually be sufficient to satisfy the ACCC of whether or not a substantial lessening of competition is likely. Whether a wider range of information will be required by the ACCC will be assessed on a case-by-case basis and will depend on the complexity of the matter and the potential competition concerns raised.

Availability of substitutes[46]

7.38. In assessing the competitive implications of a merger, the ACCC considers both the range of available or potentially available substitutes in each relevant market and the relative intensity of rivalry between different products within those markets. The existence of comparable alternatives to the merged firm that are available in plentiful supply to the entire market can, in the absence of coordinated effects, indicate that a merger is unlikely to substantially lessen competition.

7.39. The analysis of the likely competitive constraints provided by alternatives focuses on two issues:

- rivalry within the market, given the likely closeness of rivalry between the merger parties and
- between the merged firm and its rivals
- barriers to expansion (elasticity of supply).

Rivalry within the market

7.40. When analysing the competitive effects of a merger, the ACCC assesses the closeness of rivalry between the merger parties and between the merger parties and other market participants. This analysis goes beyond the process of defining the market based on whether products are close substitutes — it also considers the relative degree of substitution or rivalry between alternative suppliers of products in the relevant market and the merged firm.

7.41. As discussed in chapter 5, unilateral effects in differentiated product markets are more likely if the merger parties are relatively close competitors pre-merger and other market participants, while providing alternatives to consumers, are relatively more distant competitors for the products of the merged firm. The ACCC therefore considers the extent of product differentiation by assessing whether the merger parties differ from rivals in terms of:

- product features and function
- customer loyalty
- brand loyalty
- whether a substantial number of customers consider the products of the merger parties to be particularly close substitutes — for example, the merger parties represent their first and second choices
- production capacity
- breadth of product line and level of specialization
- distribution channel coverage
- geographic presence

[46] Refers to the merger factor contained in s. 50(3)(f).

- cost structures
- the level of vertical integration.

7.42. If, for a significant number of customers, the merger parties are each other's closest competitor and there would be no close competitors to the merged firm in one or more relevant markets, the ACCC then explores the ability and incentives of rivals in the relevant market/s to move into the merged firm's product or geographic space post-merger. This analysis involves considering any barriers to mobility across the product or geographic space within a market and taking into account relevant factors such as those listed below in the context of barriers to expansion. Impediments may include the costs of altering the mix of products, the costs of introducing a new type of product, brand loyalty to the relevant products, the profitability of entry targeting the products of the merged firm or the costs of establishing or expanding distribution channels for the relevant types of product.

7.43. Conversely, if the merger parties are relatively distant competitors in the relevant market pre-merger, and several of the merged firm's remaining rivals would be close competitors to the merged firm, the merger is less likely to result in a substantial lessening of competition in that market.

Barriers to expansion

7.44. The degree of competitive constraint provided by rivals to the merged firm also depends on their ability to profitably increase production in the event that the merged firm attempts to exercise market power (the elasticity of supply).[47] The ability of rivals to expand depends on the existence of any features of the market that either prevent firms from expanding altogether or delay or impede expansion to such a degree that rivals are unable to expand in an appropriate time to defer or defeat any non-transitory exercise of increased market power by the merged firm. While the ACCC's starting point for timely expansion is within one to two years, the appropriate timeframe will depend on the particular matter under consideration. For example, the appropriate timeframe may be longer than one to two years in industries where supply arrangements are subject to long-term contracts.

7.45. The abilities and incentives of the merged firm's rivals to increase output and sales if the merged firm attempts to exercise increased market power post-merger depend on, among other things:

- the level of excess capacity that non-merger parties could deploy to take sales away from the merged firm
- the cost to non-merger parties of expanding their output
- the ability of non-merger parties to source increased inputs and their ability to distribute increased output to customers
- the level of excess capacity held by the merged firm that could be deployed to prevent non-merger parties from capturing sales.

7.46. The ACCC will consider similar factors to those set out in paragraphs 7.30 to 7.32 in relation to new entry. For example, if non-merger parties face difficulties in distributing increased output because of logistical bottlenecks, the availability of substitutes may be limited post-merger. However, the costs of expansion can sometimes differ significantly from the costs of new entry.

[47] The analysis would apply in matters involving unilateral effects and also matters involving coordinated effects (in particular the possibility of smaller rivals expanding production in response to coordinated conduct).

7.47. If non-merger parties are capacity constrained post-merger, they will have a reduced ability to steal customers from the merged firm if it attempts to exercise market power. As a result, if non- merger parties in the relevant market are capacity constrained, the merger is more likely to result in a substantial lessening of competition.

The availability of substitutes

The following are examples of the types of information the ACCC may require to assess the relative degree of rivalry both between the merger parties themselves and between the merger parties and other market participants:

- internal company strategy, marketing and sales documents
- information about advertising campaigns and other information that highlights how firms in the market perceive the competitive constraint created by other market participants
- past history of customers switching between suppliers
- whether market features exist that prevent or hinder customers changing suppliers — for example, switching costs resulting from the use of exclusive long-term contracts and termination fees
- studies and information regarding consumer preferences
- estimates of cross elasticities of supply and demand[i]
- the diversion ratios between the merger parties[ii]
- estimates of the own-price elasticity of supply of non-merger parties[iii]
- the production capacity of firms in the market, including any capacity constraints or excess capacity
- the costs to rival firms of expanding their output
- impediments to firms altering or expanding their product mix to compete more closely with the products of the merged firm
- whether the merged firm controls inputs/distribution channels, patents/other IP and access to, or pricing of, different platforms
- the degree of homogeneity of products.

In an informal merger review, providing a base level of information to the ACCC will, in non-controversial cases, usually be sufficient to satisfy the ACCC of whether or not a substantial lessening of competition is likely. Whether a wider range of information will be required by the ACCC will be assessed on a case-by-case basis and will depend on the complexity of the matter and the potential competition concerns raised.

---

i The cross-elasticity of supply (demand) is the percentage change in the supply (demand) for one firm's output in response to a 1 per cent change in the price of the product sold by a second firm.

ii A diversion ratio measures the proportion of consumers that switch to another firm's product if a particular firm increases the price of its product.

iii The own-price elasticity of supply of a firm is the percentage change in the firm's output in response to a 1 per cent change in the price the firm sells its product for.

Countervailing power[48]

7.48. In addition to considering supply-side sources of competitive constraint, the ACCC also considers whether one or more buyers would have sufficient countervailing power to constrain any attempted increase in market power by a supplier.[49] Countervailing power exists when buyers have special characteristics that enable them to credibly threaten to bypass the merged firm,[50] such as by vertically integrating into the upstream market, establishing importing operations or sponsoring new entry.

7.49. Countervailing power is more than the ability of buyers to switch to alternative domestic or imported products. As discussed above, the availability of substitutes and import competition are important considerations in assessing whether a merger is likely to result in a substantial lessening of competition. The availability of effective alternatives to the merged firm provides all buyers with a means of bypassing the merged firm. Countervailing power, however, exists when the specific characteristics of a buyer — such as its size, its commercial significance to suppliers or the manner in which it purchases from suppliers — provide the buyer with additional negotiating leverage. In some cases, a buyer may have countervailing power because they have market power.[51]

7.50. Importantly, the size and commercial significance of customers (sometimes referred to as 'buyer power') is not sufficient to constitute countervailing power. A large buyer that accounts for a significant proportion of the merged firm's sales may be able to negotiate favourable terms and price relative to other buyers in the market. However, buyers need more than size to constrain the exercise of market power by a supplier. For example, if the supplier's product is an essential input for the buyer, the only way the buyer can defeat any attempted increase in market power is if it can credibly threaten to bypass the supplier.

7.51. In assessing whether countervailing power is likely to prevent a substantial lessening of competition by constraining any attempt by the merged firm to increase market power, the ACCC considers the following factors, among others:

- **Whether the threat to bypass is credible on commercial grounds** Evidence of this will often include the size of the buyer's purchases and the efficient scale of production of the product. For sponsored entry to be commercially viable, the entrant will have to operate at an efficient scale of production. If the purchases of the sponsoring firm are insufficient to underpin such a production scale, the ACCC needs to be convinced that the entrant could readily find other sales in the relevant market.

---

[48] Refers to the merger factor contained in s. 50(3)(d).

[49] In a merger between buyers, countervailing power may also be exerted by one or more suppliers if they are able to bypass the merged firm and establish alternative supply channels. In line with the approach adopted throughout these guidelines, consideration is directed towards the case where the merged firm is a seller in the relevant market under analysis. As previously noted, all guidance provided here needs to be appropriately adjusted when merger analysis involves a merger of competing purchasers.

[50] The analysis would apply in matters involving unilateral effects and also matters involving coordinated effects (in particular the possibility of countervailing power constraining the ability and incentive of a small number of firms to engage in coordinated conduct).

[51] The existence of buyer market power may offset the merged firm's market power on the supply side (see the Trade Practices Legislation Amendment Bill 1992, explanatory memorandum, paragraph 23). However, the ACCC notes that the outcomes of mergers that 'pit' market power against market power are difficult to determine. When firms in both markets have market power, a broad range of prices and price structures are possible and there is a risk that the merger will result in monopoly prices being charged for both the input (in the upstream market) and the final output (in the downstream market). Such a 'double-monopoly' can be particularly damaging to consumers.

- **Whether the buyer is likely to bypass the supplier** Evidence of this could include plans or other documents suggesting such a strategy is commercial, as well as instances and circumstances when the buyer or other buyers of the relevant input have previously sponsored entry or vertically integrated. The ACCC places greater weight on evidence that such strategies form part of the firm's business model. Also, if the relevant input does not account for a significant proportion of the buyer's total input costs, sponsored entry or backward integration may be less likely.
- **The proportion of the downstream market able to wield a credible threat** For the countervailing power to offset or limit any market power arising from a merger, it will usually not be sufficient if only one buyer or category of customers is able to bypass the merged firm post-merger. For example, the merged firm may be able to increase prices charged to smaller buyers that are unable to bypass the supplier while larger buyers with countervailing power are able to avoid the increase. A significant proportion of customers must be shielded from the effects of market power if countervailing power is to prevent a substantial lessening of competition in the relevant market/s.

Countervailing power

The following are examples of the types of information the ACCC may require to ascertain the degree of countervailing power in the relevant market/s:

- the relative strength of bargaining power possessed by customers of the products in the relevant market/s
- the extent to which it is possible for customers to bypass the merger parties by importing or producing the product themselves, vertically integrating, or using an alternative supplier.

In an informal merger review, providing a base level of information to the ACCC will, in non-controversial cases, usually be sufficient to satisfy the ACCC of whether or not a substantial lessening of competition is likely. Whether a wider range of information will be required by the ACCC will be assessed on a case-by-case basis and will depend on the complexity of the matter and the potential competition concerns raised.

Dynamic characteristics of the market[52]

7.52. The forward-looking nature of merger analysis means that the ACCC, when analysing the competitive effect of a merger, must take into account the changing nature of the market in the future. Dynamic changes may result from a range of factors including market growth, innovation, product differentiation and technological changes. The analysis of the effects of dynamic changes in the market is closely linked with analysis of the other merger factors discussed in this chapter. The changes in the market will be considered from two perspectives:

- the extent to which the dynamic features of the market affect the likely competitive impact of the merger
- whether the merger itself impacts on the dynamic features of the market.

7.53. Whether a market is growing or declining can have significant implications for the competitiveness of the market in the future. Markets that are growing rapidly may offer both greater scope for new entry and the erosion of market shares over time.

[52] Refers to the merger factor contained in s. 50(3)(g).

Similarly, markets that are characterised by rapid product innovation may be unstable so that any increased market power gained through a merger is transitory.

7.54. In general, a merger is less likely to substantially lessen competition in a market that is rapidly evolving.

7.55. When considering how a merger will influence future competition in a dynamic market, the ACCC places more weight on robust evidence about likely future developments in the relevant market. The ACCC will give significantly less weight to predictions about the future state of competition that are speculative or have little chance of developing for some considerable time in the future.

Dynamic characteristics of the market

The ACCC may require information on dynamic characteristics such as growth, innovation and product and/or service differentiation. In an informal merger review, providing a base level of information to the ACCC will, in non-controversial cases, usually be sufficient to satisfy the ACCC of whether or not a substantial lessening of competition is likely. Whether a wider range of information will be required by the ACCC will be assessed on a case-by-case basis and will depend on the complexity of the matter and the potential competition concerns raised.

Removal of a vigorous and effective competitor[53]

7.56. Mergers involving a vigorous and effective competitor (sometimes referred to as a maverick firm) are more likely to result in a significant and sustainable increase in the unilateral market power of the merged firm or increase the ability and incentive of a small number of firms to engage in coordinated conduct. Vigorous and effective competitors may drive significant aspects of competition, such as pricing, innovation or product development, even though their own market share may be modest. These firms tend to be less predictable in their behaviour and deliver benefits to consumers beyond their own immediate supply, by forcing other market participants to deliver better and cheaper products. They also tend to undermine attempts to coordinate the exercise of market power.

7.57. A merger that removes a vigorous and effective competitor may therefore remove one of the most effective competitive constraints on market participants and thereby result in a substantial lessening of competition.

Removal of a vigorous and effective competitor

The following are examples of the types of information the ACCC may require to ascertain the extent to which each party to the transaction would separately be considered as a vigorous and effective competitor in the relevant market/s:

- evidence of past competitive pricing behaviour, for example discounting and promotions
- levels of point-of-sale service (for example opening hours and store format) and after-sales service
- past and expected innovation, for example in design or production technology
- past evidence of leadership in non-price competition, for example product quality and loyalty programs.

[53] Refers to the merger factor contained in s. 50(3)(h).

In an informal merger review, providing a base level of information to the ACCC will, in non-controversial cases, usually be sufficient to satisfy the ACCC of whether or not a substantial lessening of competition is likely. Whether a wider range of information will be required by the ACCC will be assessed on a case-by-case basis and will depend on the complexity of the matter and the potential competition concerns raised.

Vertical integration[54]

7.58. It is recognised that some horizontal mergers can be affected by vertical integration or vertical relationships in the market — for example, horizontal competition issues may be exacerbated by vertical aspects of a merger and vice versa. Where a merger involves both horizontal and vertical competition issues, the ACCC will assess the merger based on the combined horizontal and vertical impact on competition.

7.59. The nature and extent of vertical relationships between firms in separate areas of activity along a vertical supply chain can affect the competitive implications of consolidation in any one of those areas. For example, a horizontal merger can increase the likelihood of coordination in cases where downstream integration increases the visibility of pricing. Generally, horizontal mergers involving a vertically integrated firm are unlikely to lessen competition provided effective competition remains at all levels of the vertical supply chain post-merger.

Vertical integration

The following are examples of the types of information the ACCC may require to ascertain whether vertical integration is likely to be relevant to the competition assessment:

- whether the merger will result in vertical integration between firms involved at different functional levels of the relevant market/s
- whether the merger is likely to increase the risk of limiting the supply of inputs or access to distribution, such that downstream or upstream rivals face higher costs post-merger or risks of full or partial foreclosure of key inputs or distribution channels
- the extent of existing vertical integration, noting in particular where either merger party currently operates as a customer or supplier to competitors in the relevant market/s.

In an informal merger review, providing a base level of information to the ACCC will, in non-controversial cases, usually be sufficient to satisfy the ACCC of whether or not a substantial lessening of competition is likely. Whether a wider range of information will be required by the ACCC will be assessed on a case-by-case basis and will depend on the complexity of the matter and the potential competition concerns raised.

Ability to increase prices or profit margins[55]

7.60. As discussed in paragraph 3.5, a merger that results in the merged firm[56] being able to significantly and sustainably increase prices (or exercise market power in other non-price ways) will substantially lessen competition. In general, an increase in price will result in a corresponding increase in profit margins. In some cases, the merged firm's ability to significantly and sustainably increase profit margins may also indicate a substantial lessening of competition. For example, following a vertical merger that achieves control over essential inputs, the merged firm may be able to raise the

[54] Refers to the merger factor contained in s. 50(3)(i).

[55] Refers to the merger factor contained in s. 50(3)(e).

[56] The analysis would apply in matters involving unilateral effects and also matters involving coordinated effects (in particular whether a small number of firms could significantly and sustainably increase prices post-merger.

prices at which it sells to competitors in intermediate markets, thereby increasing its revenue and accordingly its profit margins, while raising the input costs of its competitors above its own.[57] However, several factors influence profit margins and the ACCC recognises that increased profitability may not be a conclusive indicator of a substantial lessening of competition. Assessing the likelihood of a significant and sustainable increase in prices or profit margins requires an analysis of all sources of competitive constraint.

7.61. The ACCC considers both qualitative and quantitative evidence relating to the likelihood that the merger will lead to a significant and sustainable increase in prices or profit margins. Qualitative evidence may include relevant internal firm documents, industry studies and other information provided by market participants, including the merging parties.

Ability to increase prices or profit margins

The following are examples of the types of information the ACCC may require to determine the extent to which merger parties may be able to increase prices or profit margins:

- details of recent and current levels of pricing in the relevant market/s, including the use of rebates and discounts
- details of supply costs of goods and services supplied by the merger parties including manufacturing, marketing and distribution costs in the relevant market/s
- a description of any competitive constraints likely to prevent the merger parties from significantly and sustainably increasing the prices paid by their customers, or lowering the prices paid to their suppliers post-merger in the relevant market/s
- a description of the likely effect of the merger on the profit margins of the merger parties post-merger and the expected cause of any change.

In an informal merger review, providing a base level of information to the ACCC will, in non-controversial cases, usually be sufficient to satisfy the ACCC of whether or not a substantial lessening of competition is likely. Whether a wider range of information will be required by the ACCC will be assessed on a case-by-case basis and will depend on the complexity of the matter and the potential competition concerns raised.

Other factors

7.62. The list of merger factors contained in s. 50(3) is not exhaustive. Particular mergers may involve other factors that affect the likely competitive outcome of the merger. It is not possible in these guidelines to foresee every possible factor that may be relevant in a particular merger assessment, but other factors such as merger-related efficiencies, effect of export markets and government regulation may be relevant.

Efficiencies

7.63. The potential for improved efficiency is a common motivation for firms to merge. Merger-related efficiencies include greater economies of scale and scope from combining production, distribution and marketing activities, greater innovation yields from combining investment in research and development and reduced transaction

[57] Trade Practices Legislation Amendment Bill 1992, explanatory memorandum, paragraph 26.

costs.[58] The ACCC recognises that a reduction in marginal costs post-merger may increase competitive tension. However, the ACCC's focus in s. 50 merger analyses is the effect of the merger on competition, competitive constraints and the efficiency of markets, rather than the efficiency of individual firms. A merger that removes or weakens competitive constraints to the extent that a substantial lessening of competition results, will (unless authorised) contravene s. 50 — even if the merger results in a more efficient firm with a lower cost structure.

7.64. While competitive constraints are generally external to a firm, the likely internal cost structure of a firm (which, for a merged firm, is in part determined by the efficiencies it has gained through merging) is often relevant to competition. For instance, the cost structure of firms in a duopoly or oligopoly market is one of many factors relevant to the likelihood of coordinated conduct. Symmetry between firms may be conducive to coordinated conduct and strategic interdependence, whereas the presence of a firm with a lower cost structure than that of its rivals might cause coordination to break down. Similarly, changes in the level of excess capacity in a market may alter the intensity of competition. The competitive impact of a merged firm's likely cost structure depends on the circumstances of the merger.

7.65. If efficiencies are likely to result in lower (or not significantly higher) prices, increased output and/or higher quality goods or services, the merger may not substantially lessen competition. The ACCC generally only considers merger-related efficiencies to be relevant to s. 50 merger analyses when it involves a significant reduction in the marginal production cost of the merged firm and there is clear and compelling evidence that the resulting efficiencies directly affect the level of competition in a market and these efficiencies will not be dissipated post-merger.

7.66. In cases where a merger is likely to achieve significant efficiencies, but the efficiencies do not prevent a substantial lessening of competition, the merger may only proceed if the acquirer applies for, and the ACCC grants, authorisation for the proposed merger. As part of the statutory test, the ACCC may consider whether gains in efficiency constitute a public benefit that outweighs the public detriment from the substantial lessening of competition.

Potential effect of exports on domestic markets

7.67. While competition in overseas markets may prevent the merged firm from raising its export prices, the ACCC generally focuses on whether the merged firm[59] is able to significantly and sustainably raise prices in a market in Australia post-merger.[60] Generally, the merged firm's export operations do not limit its ability to exercise market power in a market in Australia. In some limited circumstances, however, exports can play a similar role in constraining the market power of domestic suppliers to the role played by imports in constraining the market power of domestic suppliers.

7.68. The merged firm may be constrained in its domestic activities by competition in export markets if:

---

[58] Larger firms also typically achieve lower input prices because of enhanced bargaining power and bulk discounts. Such cost reductions are pecuniary benefits, not efficiency gains. In some cases a merger of two significant acquirers of an input can substantially lessen competition for the acquisition of that input. The ACCC will explore such issues separately from the impact of efficiencies on competitive constraints in the relevant supply market.

[59] Either unilaterally or in conjunction with other suppliers.

[60] Exports may provide a competitive constraint when a merger involves firms that are buyers in the relevant market. In line with the approach adopted throughout these guidelines, consideration is directed towards the case where the merged firm is a seller in the relevant market under analysis. As previously noted, all guidance provided here needs to be appropriately adjusted when merger analysis involves a merger of competing purchasers.

- the merged firm’s foreign sales (exports) represent a significant proportion of the merged firm’s total sales and
- the merged firm is unable to discriminate in price (or other characteristics) between foreign and domestic sales.

7.69. Under these circumstances, the merged firm may be limited in its ability to exercise market power in the relevant market in Australia without losing export sales. Any increased profit from the domestic market may be offset by the fall in profits from export sales.

Government regulation

7.70. The ACCC considers the effect of any state or federal government regulation that affects competition. For example, firms may be restricted in the range or features of products they can supply, or a price cap might prevent increases in price. However, the ACCC does not regard speculation about future alterations to the regulatory environment, or the mere ability of government to regulate, as an effective competitive constraint.

Appendix 1: Relevant provisions of the Act

1. The merger and acquisition provisions are part of the competition provisions of Part IV of the Act. Some of the relevant provisions of the Act are summarised below for ease of reading. However, the Act is complex legislation and, while the ACCC believes such summaries are accurate, the nature of the Act requires the actual provisions to be consulted in specific cases.

The substantive mergers test (s. 50)

2. Section 50 of the Act prohibits acquisitions that would have the effect, or be likely to have the effect, of substantially lessening competition in a substantial market in Australia or a state, territory or region of Australia.
3. Section 50 of the Act provides that:

   1) A corporation must not directly or indirectly:

      (a) acquire shares in the capital of a body corporate, or

      (b) acquire 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.

   2) A person must not directly or indirectly:

      (a) acquire shares in the capital of a corporation, or

      (b) acquire any assets of a corporation

   if the acquisition would have the effect, or be likely to have the effect, of substantially lessening competition in a market.

   3) Without limiting the matters that may be taken into account for the purposes of subsections (1) and (2) in determining whether the acquisition would have the effect, or be likely to have the effect, of substantially lessening competition in a market, the following matters must be taken into account:

      (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

      (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

      (i) the nature and extent of vertical integration in the market.

4. Foreign acquisitions for which an acquirer is not considered to be carrying on a business within Australia may fall under s. 50A of the Act for consideration.

5. Section 4G provides:

> For the purposes of this Act, references to the lessening of competition shall be read as including references to preventing or hindering competition.

6. Section 4E of the Act provides:

> For the purposes of this Act, unless the contrary intention appears, market' means a market in Australia and, when used in relation to any goods or services, includes a market for those goods or services and other goods or services that are substitutable for, or otherwise competitive with, the first mentioned goods or services.

7. Sections 50 and 50A relate only to substantial markets for goods and services in Australia, a state, a territory or a region (ss. 50(6) and 50A(9)).
8. The terms 'substantial lessening of competition', 'market' and 'substantial market' are discussed in paragraphs 3.5, 4.6 and 4.28 respectively.

Clearance processes and authorisations provisions

9. The ACCC investigates and reviews those mergers it becomes aware of that have the potential to raise concerns under s. 50 of the Act. The ACCC's approach to informal merger reviews is contained in its *Informal Merger Review Process Guidelines* (available at www.accc.gov.au).
10. Alternatively, parties may seek legal protection from court action under s. 50 by applying to the ACCC for authorisation of a proposed merger. Sections 88 to 90 of the Act provide for the ACCC, upon application by the acquirer, to grant authorisation for a proposed merger if it is satisfied that:
    - the proposed acquisition would not be likely to substantially lessen competition or
    - the likely public benefit from the proposed acquisition outweighs the likely public detriment.

    Further detail about the merger authorisation process may be found in the ACCC's *Merger Authorisation Guidelines* (available at www.accc.gov.au).

Enforcement and undertakings provisions

11. Under s. 87B of the Act, the ACCC may accept a written undertaking in connection with a matter in relation to which it has a power or function under the Act, except Part X. If the undertaking is breached, the ACCC may seek orders from the court directing compliance with the undertaking, the giving up of any financial benefit gained from the breach, compensation for any other loss or damage as a result of the breach, or any other appropriate orders. Section 87B provides:

    1) The ACCC may accept a written undertaking given by a person for the purposes of this section in connection with a matter in relation to which the ACCC has a power or function under this Act (other than Part X).

    2) The person may withdraw or vary the undertaking at any time, but only with the consent of the ACCC.

    3) If the ACCC considers that the person who gave the undertaking has breached any of its terms, the ACCC may apply to the court for an order under subsection (4).

    4) If the court is satisfied that the person has breached a term of the undertaking, the court may make all or any of the following orders:

(a) an order directing the person to comply with that term of the undertaking;

(b) an order directing the person to pay to the Commonwealth an amount up to the amount of any financial benefit that the person has obtained directly or indirectly and that is reasonably attributable to the breach;

(c) any order that the court considers appropriate directing the person to compensate any other person who has suffered loss or damage as a result of the breach;

(d) any other order that the court considers appropriate.

12. Under s. 80 of the Act, only the ACCC may seek injunctive relief from the Federal Court to prevent a merger from proceeding (s. 80(1A)). Other persons may institute declaration proceedings in respect of an acquisition (s. 163A) but may not seek an injunction.

13. Under s. 81(1) of the Act, the court may, on the application of the ACCC or any other person, if it finds or has in another proceeding under the Act found that a person has contravened s. 50, give directions to secure disposal of all or any of the shares or assets acquired in contravention of s. 50. Under s. 81(1A) the court may declare such an acquisition void where it finds that the vendor was involved in the contravention. Section 81(1C) provides for the court to accept as an alternative an undertaking from the person to dispose of other shares or assets owned by the person. An application under s. 81(1) or 81(1A) may be made at any time within three years after the date on which the contravention occurred.

14. In certain circumstances, as provided for in ss. 76(1A) and 76(1B) of the Act, the court may impose a penalty for a contravention of s. 50 of up to $500,000 for an individual and, for a corporation, up to the greatest of:

- $10 million
- three times the value of the benefit to the corporation that is reasonably attributable to the contravention
- 10 per cent of the corporation’s annual turnover.

15. In summary, the provisions of the Act relevant to mergers include:

- mergers and acquisitions — s. 50
- extraterritorial operation — s. 5(1)
- overseas share acquisitions — s. 50A
- anti-competitive agreements — s. 45
- definition of acquisition of shares or assets — s. 4(4)
- market definition — s. 4E
- lessening of competition includes preventing or hindering — s. 4G
- injunctions — s. 80
- divestiture and setting aside acquisitions — s. 81
- pecuniary penalty — s. 76
- enforceable undertakings — s. 87B
- ability to grant authorisation – s. 88(1)
- ability to grant authorisation subject to conditions – s. 88(3)
- procedure for applications and the keeping of a register – s. 89
- determination of an application for authorisation – s. 90.

Appendix 2: Acquisitions subject to the Act

1. The following provides guidance about the types of transactions that are subject to the Act. Nevertheless, the Act is complex legislation, and parties should consult the actual provisions of the Act to determine whether a particular transaction falls within the scope of the Act.

Territorial jurisdiction

2. The Act applies to the following acquisitions:

   (a) acquisitions of property within Australia are covered by virtue of s. 50, including (but not limited to):

   - shares in Australian companies, wherever the transaction is entered into, as the shares are domestically situated
   - domestic businesses
   - local intellectual property such as trademarks
   - local plant and equipment.

   (b) acquisitions of property wherever situated are covered by virtue of ss. 50 and 5(1) if the acquirer is:

   - incorporated in Australia
   - carries on business in Australia
   - an Australian citizen, or
   - ordinarily resident in Australia.

   (c) if (a) and (b) above do not apply, acquisitions of a controlling interest (presumably shares in almost all cases) in a body corporate where that body corporate has a controlling interest in a corporation are covered by virtue of s. 50A.

Acquirers subject to the Act

3. Section 50 of the Act applies to corporations (s. 50(1)) and persons (s. 50(2)).
4. Acquisitions involving both incorporated and non-incorporated entities are subject to the Act through Part XIA (the Competition Code). Each Australian state and territory government has, under clause 5 of the Conduct Code Agreement between the Australian Government and state and territory governments, passed legislation implementing the Competition Code.
5. The merger provisions of the Act also apply to the Commonwealth and to the state and territory governments insofar as they are carrying on business (ss. 2A and 2B respectively). Pecuniary penalties do not, however, apply to activities of the Crown.

Types of acquisitions

6. The Act applies to both direct and indirect acquisitions. Section 4(1) of the Act makes it clear that ‘acquire’ is not limited to acquisition by way of purchase but also includes exchange, lease, hire or hire purchase.

7. Section 4(4) of the Act provides that joint acquisitions and acquisitions of equitable as well as legal interests are acquisitions subject to s. 50,[61] but that in the case of assets, an acquisition by way of a charge and an acquisition in the ordinary course of business are not acquisitions to which s. 50 applies.

Exceptions

8. Section 51(1) of the Act provides for exceptions from s. 50 and s. 50A for conduct that is specified in and specifically authorised by Commonwealth legislation. As with all exceptions under s. 51, the relevant Commonwealth law must specify the excepted acquisition and specifically authorize it (s. 51(1)(a)(i)). Acquisitions cannot be exempted from s. 50 and s. 50A by state or territory laws (s. 51(1C)(b)).

Partial shareholdings and minority interests

9. Mergers often involve one or more firms being completely subsumed by another firm. However, mergers and acquisitions may also involve parties acquiring a partial shareholding in another firm. There is no threshold shareholding for the purposes of s. 50 and all acquisitions are therefore subject to the Act.

10. For the purposes of competition analysis, acquisition by one company of a controlling interest in another company will be treated in the same way as an acquisition of all the shares of the target company. While a majority shareholding would in many cases ensure control, much lower shareholdings with or without other non-shareholding interests might also be sufficient. Factors that the ACCC takes into account when considering whether a shareholding and/or other interest is sufficient to deliver control of a company include, among other things:

    - the ownership distribution of the remaining shares and securities, including ordinary and preference shares and any special shares
    - the distribution of voting rights, including any special voting rights
    - whether other shareholders are active or passive participants at company meetings
    - any restrictive covenants or special benefits attaching to shares
    - any pre-emption rights in relation to the sale of shares or assets
    - any other contracts or arrangements between the parties
    - the rights and influence of any significant debt holders
    - the composition of the board of directors
    - the company's constitution.

11. In any event, a level of ownership less than a controlling interest that nevertheless alters the incentives of all parties may give rise to a contravention of s. 50 of the Act. The Act does not refer to control but rather to the effect on competition. The following are some of the potential anti-competitive effects of shareholdings below a level delivering control:

    - horizontal acquisitions may increase interdependence between rivals and lead to muted competition or coordinated conduct (see chapter 6)
    - joint acquisitions of assets by rivals may have coordinated effects

[61] In *Trade Practices Commission v Arnotts Ltd & Ors* (1990) ATPR 41–002, at 51,044, creation of an option over shares was found to create an equitable interest in those shares and therefore constituted an acquisition subject to s. 50.

- vertical or conglomerate acquisitions may increase the acquirer's incentive to foreclose rival suppliers
- acquisitions may provide access to commercially sensitive information in relation to competitors
- acquisitions may block potentially pro-competitive mergers and rationalisation.

Horizontal minority acquisitions

12. If a firm has a significant shareholding in a rival firm, it may be less inclined to compete head-to-head with that firm, since to do so would result in a transfer of revenue between commonly held assets and would likely reduce overall profitability. Refraining from competition to maximise joint profits becomes more attractive. Where the incentives lie in particular circumstances depends on the relative value of the assets as well as the percentage shareholding. Partial shareholdings and directorships may result in coordinated effects by reducing the incentives for 'cheating', making departures from the consensus harder to conceal and facilitating the exchange of information between firms.

Third party minority acquisitions

13. Two parties that compete in one market may acquire shares in a company or participate in a joint venture in another market. This may result in coordinated effects in the first market.
14. Minority interests may raise competition concerns when the same party has an interest in a number of otherwise independent competitors. For example, if a party acquires a minority interest in two competitors, that acquisition may substantially lessen competition if it results in coordinated effects. Such coordination need not be explicit but may simply reflect the mutual benefits to be gained by the relevant firms in limiting competition, together with the requirement for each competitor's directors to act in the interests of the company as a whole. In such circumstances, the ACCC may also consider whether overlapping directorships create opportunities to limit competition between rivals.

Vertical minority acquisitions

15. Minority interests may also raise competition concerns when the same party has an interest in vertically related firms or firms supplying complementary products. If an acquisition creates a relationship between a firm with significant market power in one market and another firm operating in a market upstream or downstream, the acquisition may create an incentive for the firm with market power to discriminate in favour of the related firm.
16. In addition to analysing the effect that the acquisition of the minority interest will have on the incentives of the relevant firms, the ACCC will take into consideration the legal responsibilities of company directors under the *Corporations Act 2001* and at common law.

Minority acquisitions and information flows

17. Firms could gain access to commercially sensitive information about their rivals through either horizontal or vertical acquisitions. Debt holders may also have access to significant information. Information such as costs, revenues, bids, contracts, forward supply estimates, marketing campaigns and new product plans may be available. The level of available information depends on the nature and level of the shareholding. If the shareholding is sufficient to secure a position on the board of directors, more information is likely to be available.

Blocking stakes

18. A shareholding of over 10 per cent in a company is sufficient to block the compulsory acquisition of all the shares by another party. This in turn may allow the minority shareholder to prevent rationalisation of two weak rivals and the creation of a more competitive firm, thereby hindering or preventing competition.

ACCC’s assessment

19. The framework for competition analysis set out in these guidelines is relevant for all share acquisitions, whether or not they deliver control of the target firm. Where share acquisitions do not deliver control, the ACCC will take into consideration inter-company relationships, director’s duties, and a range of other factors including:

    - the actual ownership share of the minority interest
    - the existence of any contractual or other arrangements that may enhance the influence of the minority interest
    - the size, concentration, dispersion and rights of the remaining ownership shares
    - the board representation and voting rights of the minority interests.

Appendix 3: Undertakings

1. During the course of its competition assessment, the ACCC may identify competition concerns that support the view that an acquisition is likely to substantially lessen competition in contravention of the Act. If these competition concerns cannot be resolved and the merger parties continue to pursue the acquisition, the ACCC will, along with other orders, seek an injunction in the Federal Court to stop the merger proceeding.
2. In some cases, however, merger parties can provide the ACCC with a court enforceable undertaking under s. 87B of the Act to implement structural, behavioural or other measures that assuage the competition concerns identified by the ACCC.[62] Undertakings of this type are also referred to as 'remedies.' If the ACCC is satisfied that the proposed measures will address the competition concerns identified, it may accept the undertaking and allow the merger to proceed. Merger parties therefore have strong incentives for proposing effective and enforceable remedies in the form of s. 87B undertakings to remedy identified competition concerns.
3. Undertakings that remedy a likely contravention of the Act prevent the detriment that would otherwise result from the transaction, while at the same time allowing any benefits arising from the transaction to be realised. In the merger context, undertakings can address the competition concerns while at the same time permitting the realisation of merger benefits, such as efficiencies or improvements in management. In this context, s. 87B undertakings are a flexible alternative to simply opposing an acquisition when the ACCC believes that a merger or acquisition is likely to substantially lessen competition.
4. The provision of undertakings is at the discretion of the party giving the undertaking. The structure and content of undertakings offered to the ACCC will therefore be a matter for the party offering the undertaking to determine. However, the ACCC will not accept undertakings if it is not satisfied they address its competition concerns. The ACCC encourages merger parties to carefully consider ACCC feedback on the form and content of proposed undertakings.

General principles

5. The ACCC's approach to the substance of s. 87B undertakings will depend on the merits and circumstances of each matter. However, it is possible to identify certain general principles that underpin effective undertakings.
6. In accepting an undertaking the ACCC does not seek to improve competition beyond the pre-merger level of competition, but the remedy needs to adequately address the potential harm identified. There will be instances when only an outright rejection of the merger can address the ACCC's competition concerns.
7. To determine whether the undertaking is acceptable, the ACCC will consider a range of factors — in particular the effectiveness of the remedy to address the ACCC's competition concerns, how difficult the proposal will be to administer, the ability of the merged firm to deliver the required outcomes, monitoring and compliance costs and any risk to competition associated with the implementation of the undertaking (or failure to do so).
8. Before accepting an undertaking, the ACCC will need to be satisfied that:
    - the proposed undertaking is customised to the particular nature of the relevant merger, the competition concerns raised, and the industry or industries involved

[62] In some circumstances, the ACCC may seek an undertaking from merger parties not to proceed until the ACCC has completed an informal merger review. This is distinct from the enforceable undertakings under discussion in this appendix 3.

- the core obligations in the proposed undertaking (for example, a divesture) specifically, comprehensively and effectively address the ACCC's competition concerns
- the proposed undertaking would impose clear and unambiguous obligations on the party giving the undertaking, including clear delineation of assets and businesses covered by the remedy, the terms under which the remedy is to be carried out, timeframes for actions to be completed, and the consequences of non-performance within those timeframes
- the party offering the undertaking is capable of meeting its obligations as set out in the undertaking, and the remedy cannot be frustrated by the actions (or inaction) of third parties (for example, there may be matters where minority shareholders remain following the acquisition of a firm, who may be able to prevent the acquirer from meeting its obligations under a proposed undertaking)
- for international mergers involving firms operating in jurisdictions other than Australia, any remedies provided to the ACCC are capable of being enforced by the ACCC and coordinated with any of the other relevant jurisdictions involved.

9. Importantly, the ACCC will be unlikely to accept an undertaking when, in its view:
    - there are risks that the undertaking will not be effective in preventing a substantial lessening of competition as a result of the merger, and/or
    - there are risks that the undertaking cannot be implemented in practice and (where necessary) properly monitored and/or enforced.

Types of undertakings

10. Undertaking remedies are conventionally classified as either structural or behavioural. Structural remedies generally change the structure of the merged firm and/or the market, typically through divestiture of part or all of a business, and, in satisfying the ACCC's competition concerns, are generally aimed at restoring or maintaining the level of competition prevailing before the acquisition. Behavioural remedies are normally ongoing remedies designed to modify or constrain the behaviour of the merged firms, by mandating the price, quality or output of the merged firm's goods or services, or otherwise modifying their dealings with other firms.
11. The ACCC has a strong preference for structural undertakings — that is, undertakings to divest part of the merged firm to address competition concerns. Structural undertakings provide an enduring remedy with relatively low monitoring and compliance costs.
12. On occasion, behavioural undertakings — that is, undertakings by the merged firm to do, or not do, certain acts (for example, meet specified service levels) — may be appropriate as an adjunct to a structural remedy. Behavioural remedies are rarely appropriate on their own to address competition concerns.

Structural undertakings — divestitures

13. Divestiture is generally the most common form of structural remedy accepted by the ACCC. In essence, a divestiture seeks to remedy the competitive detriments of a merger by either:
    - creating a new source of competition through the disposal of shares, interests, a business or a set of assets to a new, competitive market participant, or
    - strengthening an existing source of competition through disposal to an existing market participant independent of the merging parties.

14. As a general rule, divestiture undertakings aim to ensure that the ultimate purchaser of the divestiture assets will be a viable, long-term, independent and effective competitor to the merged firm, in a way that addresses the ACCC's competition concerns with the merger.

15. Key elements of a divestiture are the scope of the divestiture package, the purchaser selection and the disposal process. While merger parties will generally seek to offer divestiture remedies that satisfy the ACCC's requirements so that the merger is not opposed, they may have a conflicting incentive to undermine the future competitive effect of any divested assets and businesses where those divested assets or business will compete against the merged firm post-merger. Each of the key aspects of the divestiture may be susceptible to a number of risks such as:

    - composition risks — the scope of the divestiture package may not be appropriately configured (or sufficiently wide, say, in product range) to attract a suitable purchaser or allow a suitable purchaser to operate effectively
    - purchaser risks — a suitable purchaser may not be available or the merging firms may attempt to dispose of assets to a weak or otherwise inappropriate purchaser
    - asset risks — the competitive capability of a divestiture package may deteriorate significantly before completion of a divestment, for example through loss of customers or key members of staff, or there may be some impediment to sale such as third party approvals, or minority shareholder actions.

16. The ACCC closely examines the nature and extent of the undertakings offered against such risks in any individual case.

17. Generally, for a structural undertaking to be acceptable to the ACCC, all of the following requirements should be satisfied:

    - the divestiture remedy should be proportionate to the competition concerns or detriments and be effective in restoring or maintaining competition
    - the assets must be sold to a viable, effective and long-term competitor. That is, the part of the merged firm to be divested (for example, a subsidiary or a suite of assets) must facilitate the maintenance or creation of an independent and effective long-term competitor in the market. There should be no need for continuing supply or other arrangements between the merged firm and the purchaser of the divested business
    - there must be procedures for the purchaser to be approved by the ACCC. Generally, purchasers should be independent of the merged firm and possess the necessary expertise, experience and resources to be an effective long-term competitor in the market. The purchaser's acquisition of the divestiture business must not itself raise competition concerns in any market
    - the value and integrity of the divestiture package must be preserved and independently maintained and operated as a going concern, pending divestiture. Wherever practicable, divestiture should occur on or before the completion date of the merger, particularly in cases where there are risks in identifying a (suitable) purchaser or asset-deterioration risks. There will be some specific circumstances where, if the remedy cannot be implemented on or before completion of the main transaction to address the identified competition concerns, no remedy will be acceptable to the ACCC
    - appropriate provisions will apply, should firms fail in their core obligations. For example, an undertaking should provide for the merged firm to appoint an ACCC-approved sales agent to divest the business to an ACCC-approved purchaser if the firm fails to sell the divestiture business itself within the requisite period

- appropriate provisions will apply to enable the ACCC to monitor and investigate compliance with the undertakings and enforce the provisions if necessary. For example, an undertaking may require the appointment of an ACCC-approved independent auditor or other independent expert to monitor certain aspects of the undertakings, contain provisions that require periodic reporting by the undertaking parties or an auditor, and contain provisions to enable the ACCC to obtain information about compliance with the undertakings
- remedies will also be required to be implemented in a timely manner.

18. In each case the specific measures and provisions needed to achieve these requirements (and further requirements if appropriate) may differ, in accordance with the circumstances of each case. Examples of specific provisions found to be acceptable to the ACCC in previous matters and that may assist merger party/parties in developing undertakings proposals can be found on the ACCC website (www.accc.gov.au).

Behavioural undertakings

19. The nature of effective behavioural undertakings will depend on the particular competition concerns they seek to address and the likely future state of competition in the relevant markets. It is therefore difficult to provide clear guidance as to whether behavioural undertakings will be appropriate to remedy the competition issues in any given matter.
20. Generally, behavioural undertakings are only likely to address the ACCC's competition concerns if they foster the development or maintenance of enduring and effective competitive constraints within a short and pre-specified period of time. It is particularly rare for the ACCC to accept behavioural remedies that apply on a permanent basis due to the inherent risk to competition combined with the monitoring and enforcement burden such remedies create.
21. An effective behavioural undertaking must contain an effective mechanism for the on-going monitoring and compliance and investigation of suspected breaches of the undertaking by the merged firm. Commonly, behavioural undertakings provide for the appointment of an ACCC-approved auditor to monitor compliance and report back to the ACCC.

Process

22. The *Informal Merger Review Process Guidelines* and *Merger Authorisation Guidelines* explain the ACCC's processes when considering a proposed undertaking.
23. To the greatest extent possible, subject to the legitimate confidentiality concerns of the parties, the ACCC will seek to ensure that the reasons for accepting an undertaking are publicly available and that undertakings accepted for one merger are broadly consistent with the undertakings accepted in other merger cases.
24. A party to an undertaking may withdraw or vary their undertaking at any time but only with the consent of the ACCC.

Enforcement

25. The ACCC considers that s. 87B undertakings play a critical role in administering and enforcing s. 50 of the Act. Accordingly, the ACCC carefully monitors compliance with all undertakings it accepts and will investigate if it identifies any potential non-compliance. The ACCC will not hesitate to take enforcement action if it considers that an undertaking has been breached, and that court action is the appropriate response in the circumstances.

26. In the event of non-compliance with an undertaking the ACCC may make an application to the Federal Court for an order under s. 87B(4), and the court may, if it is satisfied that the party to the undertaking has contravened a term of the undertaking, make all or any of the following orders:

- an order directing the person to comply with that term of the undertaking
- an order directing the person to pay to the Commonwealth an amount up to the amount of any financial benefit that the person has obtained directly or indirectly and that is reasonably attributable to the breach
- any order that the court considers appropriate directing the person to compensate any other person who has suffered loss or damage as a result of the breach any other order that the court considers appropriate.

27. Further, the ACCC will generally not cede the legal right to take action in an undertaking. An undertaking accepted by the ACCC does not preclude the ACCC from taking legal action under s. 50, particularly if the undertaking is not properly implemented or the decision to accept the undertaking was based on inaccurate information.

Glossary and shortened forms

Note: in these guidelines, the term ‘product’ encompasses both goods and services.

ACCC	Australian Competition and Consumer Commission
Act (the)	*Competition and Consumer Act 2010* (Cth) formerly the *Trade Practices Act 1974*
behavioural undertakings	An undertaking that prescribes conduct to be carried out, directed or avoided by the merged firm on an ongoing basis to minimise its ability to exercise anti-competitive market power.
complementary products	Products are complementary in either demand or supply where a change in the demand for one generates demand for the other. If the price of one product rises, demand for both products may fall. Similarly, if the price of one product falls, demand for both products may increase.
conglomerate mergers	Mergers involving firms that interact or potentially interact across several separate markets and supply products that are in some way related to each other — for example, products that are complementary in either demand or supply.
court (the)	Federal Court of Australia
CRx	The x firm concentration ratio. This ratio is the fraction of market shares possessed by the ‘x’ largest firms in a given market. The higher the concentration ratio, the greater the level of concentration in that market.
differentiation	Differences in the features of a range of products that all serve the same function.
economies of scale	The economic principle whereby a firm’s long-run average total cost of production is decreased as the quantity of that firm’s output is increased.
economies of scope	The economic principle whereby a firm’s long-run average total cost of production is decreased as the quantity of different goods produced by that firm is increased.
failing firm	A firm that is likely to exit a particular market in the foreseeable future (generally within one to two years) with its productive capacity leaving the market — that is, not simply a change in ownership.
foreclosure	Refers to when a firm prevents or impedes a rival firm from competing.
guidelines (the)	*ACCC Merger Guidelines 2008*
HHI	Herfindahl-Hirschman Index — a metric used to estimate the post-merger level of concentration of markets, as well as changes in the concentration of markets as a result of a merger. The HHI is calculated by adding the sum of the squares of the market share of each firm in a particular market.
HMT	Hypothetical monopolist test — the HMT identifies the smallest area in product and geographic space within which a hypothetical current and future profit-maximising monopolist could effectively exercise market power.
horizontal mergers	The merging of firms operating in the same market or markets.
ICN	International Competition Network
market participant	A firm that operates in a particular market or markets, such as a supplier or customer.
maverick firm	A firm with a relatively small market share in a particular industry that is considered a vigorous and effective competitor and which generally drive

	significant aspects of competition, such as pricing, innovation and/or product development.
merger factors	The non-exhaustive list of factors set out in s. 50(3) of the Act that must be taken into account when assessing whether a merger will contravene the Act, as well as any other factors relevant to the effect of a merger on competition.
minimum efficient scale	The minimum size (typically in terms of output, capacity or customer base) that a firm requires to compete effectively with incumbent suppliers in a market.
niche segment	Refers to a portion of a differentiated market serviced by small, specialised suppliers and often involving products that are in some way distinct from the products of larger suppliers.
notification threshold	The threshold established by the ACCC to identify mergers that should be notified to it (see chapter 2 of these guidelines)
public competition assessment	This outlines the basis for the ACCC reaching its final conclusion on a merger when: the merger is rejected; the merger is subject to enforceable undertakings; the merger parties seek such disclosure; or the merger is approved but raises important issues that the ACCC considers should be made public (published at www.accc.gov.au).
section 87B undertaking	A court enforceable undertaking under s. 87B of the Act that may be accepted by the ACCC to assuage any competition concerns identified.
SSNIP	A small but significant and non-transitory increase in price.
statement of issues	This provides the ACCC's preliminary views on a merger which raises competition concerns requiring further investigation.
structural undertakings	An undertaking that provides for one-off actions that alter the entry conditions, or the vertical or the horizontal relationships in a particular industry. Structural undertakings will typically involve the divestment of part of a merged firm.
sunk costs	Costs that have already been committed by a firm to its business and cannot be recovered on exiting the market.
supply elasticity	This is a measure of how much the quantity of product supplied by a firm responds to specific changes in its particular market (for example, a change in the price of the product, a fall in input prices, or an improvement in production technology).
switching cost	Refers to the cost for customers to switch suppliers (for example, including search costs, transaction costs and market specific behaviour).
Tribunal (the)	Australian Competition Tribunal
undertaking	See section 87B undertaking.
vertical mergers	A merger involving firms operating or potentially operating at different functional levels of the same vertical supply chain.