Merger guidelines

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Important notice

Please note that these guidelines are a summary designed to give you the basic information you need. They do not cover the whole of the Trade Practices Act and are not a substitute for professional advice.

Moreover, because they avoid legal language wherever possible there may be some generalisations about the application of the Act. Some of the provisions referred to have exceptions or important qualifications. In most cases the particular circumstances of the conduct need to be taken into account when determining the application of the Act to that conduct.

Contents

1. Introduction

This publication updates the Australian Competition and Consumer Commission's 1996 guidelines and outlines its administration and enforcement policy for dealing with mergers under the *Trade Practices Act 1974.* It includes the factors the Commission considers relevant to its consideration of mergers, including issues relevant to authorisation (exemption) and enforceable undertakings. The guidelines do not have any legal force in determining breaches of the Act — final determination of the issues is a matter for the courts.

It is not possible to set out a prescriptive response to particular mergers — this requires analysis of the specific market characteristics and their interaction. The purpose of these guidelines is to show the Commission's approach when considering mergers and acquisitions and the types of information which are relevant. They provide guidance for the business community, their advisers and the public generally.

Mergers perform an important role in the efficient functioning of the economy. They allow firms to achieve efficiencies such as economies of scale, synergies and risk spreading. Furthermore, they facilitate an active 'market for corporate control' in which underperforming firms and managers are replaced by better ones.

However, in some cases mergers may also have anti-competitive effects by altering the structure of markets and hence the incentives for firms to behave in a competitive manner. This is the concern of the Act and the Commission.

The merger and acquisition provisions of the Act fall within the competition provisions of Part IV. Section 50 prohibits acquisitions which would have the effect, or be likely to have the effect, of substantially lessening competition in a substantial market in Australia, in a State or Territory.

The authorisation provisions in Part VII allow the Commission, or the Australian Competition Tribunal on review, to exempt mergers from the application of Part IV where they would result, or be likely to result, in such a benefit to the public that they should be allowed to take place.

The majority of mergers do not raise competition concerns. The Commission has objected to only a very small number of the hundreds formally investigated since the current test was introduced. Some were resolved by divestiture and/or undertakings which addressed the competition concerns.[1] Only five proceeded to litigation.[2] There have been 10 applications for authorisation: four were denied, three granted and one withdrawn, while two others were being considered at the time of going to print.[3] One decision was confirmed on review by the Tribunal and one application for review was withdrawn before the Tribunal heard the matter.[4]

If the Commission considers that an acquisition contravenes s. 50 of the Act and the parties do not agree to modify or abandon the acquisition, the Commission can apply to the Federal Court for an injunction, divestiture or penalties. Only the Commission can apply for an injunction in relation to merger matters. Other persons can apply for a declaration and divestiture (including setting aside the acquisition in certain cases). Any person suffering loss or damages as a result of a merger which breaches s. 50 can apply for damages.

If the Commission considers that an acquisition (of a relevant controlling interest) outside Australia would have the effect, or be likely to have the effect, of substantially lessening competition in a substantial market in Australia and that the acquisition would not in all the circumstances result or be likely to result in such a benefit to the public that it should be disregarded, it can apply to the Tribunal for a declaration to that effect (s. 50A). The Minister or any other person can also make such an application. If the Tribunal makes such a declaration the relevant corporation must cease to carry on business in the relevant market.

The Commission has the power to make determinations in relation to applications for authorisation of acquisitions which would otherwise be subject to s. 50 or s. 50A. The Tribunal has the power to review determinations made by the Commission where an application for review is made by an interested party.

2. Relevant provisions of the Act

2.1 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;
- power to grant authorisations — s. 88;
- determination of an application for authorisation — s. 90;
- application to the Australian Competition Tribunal for review — s. 101;
- injunctions — s. 80;
- divestiture and setting aside acquisitions — s. 81;
- pecuniary penalty — s. 76; and
- enforceable undertakings — s. 87B.

2.2 In some cases the relevant provisions of the Act are summarised below for ease of reading. However, the Act is complex legislation and, while the Commission believes such summaries are accurate, the nature of the Act requires the actual provisions to be consulted in cases that are not straightforward.

2.3 As from 21 January 1993 s. 50(1)–(2) of the Act provides:

> (1) A corporation must not directly or indirectly:
>
> (a) acquire shares in the capital of a body corporate; or
>
> (b) acquire any 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.

2.4 As from 21 January 1993 s. 50A(1) of the Act provides:

> (1) Where a person acquires, outside Australia, otherwise than by reason of the application of paragraph (8)(b), a controlling interest (the 'first controlling interest') in any body corporate and, by reason, but not necessarily by reason only, of the application of paragraph (8)(b) in relation to the first controlling interest, obtains a controlling interest ('the second controlling interest') in a corporation or each of two or more corporations, the Tribunal may, on the application of the Minister, the Commission or any other person, if the Tribunal is satisfied that -
>
> (a) the person's obtaining of the second controlling interest would have the effect, or be likely to have the effect, of substantially lessening competition in a market; and
>
> (b) the person's obtaining of the second controlling interest would not, in all the circumstances, result, or be likely to result, in such a benefit to the public that the obtaining should be disregarded for the purposes of this section, make a declaration accordingly.

Section 50A(8)(b) deals with the definition of 'controlling interest' (see paragraph 3.30).

2.5 Section 45(7) removes the application of s. 45 to a contract, arrangement or understanding insofar as it provides, directly or indirectly, for the acquisition of any shares in a body corporate or any assets of a person.

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

2.7 Section 4(4) makes it clear that joint acquisitions and acquisitions of equitable as well as legal interests are acquisitions subject to s. 50;[5] 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.

2.8 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.

2.9 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.

2.10 Sections 50 and 50A relate only to substantial markets for goods and services in Australia, a State or Territory (ss 50(6) and 50A(9)).

2.11 The terms ‘substantial lessening of competition’, ‘market’ and ‘substantial market’ are discussed in Section 5.

2.12 Under s. 88(9) of the Act the Commission may, upon application, grant authorisation to acquire shares in the capital of a body corporate or assets of a person and while such authorisation remains in force s. 50 does not prevent the person from making such an acquisition in accordance with the authorisation. The Commission may also, upon application, grant an authorisation to acquire a controlling interest in a body corporate within the meaning of s. 50A and while such an authorisation remains in force s. 50A does not, to the extent specified in the authorisation, apply in relation to the acquisition of that controlling interest.

2.13 Under s. 90(9) the Commission shall not make a determination granting an authorisation in respect of a proposed acquisition unless:

> It is satisfied in all the circumstances that the proposed acquisition would result, or be likely to result, in such a benefit to the public that the acquisition should be allowed to take place.

2.14 Under s. 101(1) the applicant for authorisation or any other person dissatisfied with the Commission’s determination, whom the Tribunal is satisfied has sufficient interest, can apply to the Tribunal for a review of the Commission’s determination.

2.15 Authorisation is discussed in Section 6.

2.16 Under s. 87B the Commission 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 Commission 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.

2.17 The Commission has a guideline on its general administration of s. 87B and, although it does not specifically deal with the use of enforceable undertakings in relation to mergers, many of the general principles apply.[6] The use of enforceable undertakings in relation to mergers is discussed in Section 7.

2.18 Under s. 80 only the Commission may seek injunctive relief from the Federal Court to prevent an acquisition from proceeding. Other persons may institute declaration proceedings in respect of an acquisition (s. 163A) but the right to seek an injunction has been expressly limited by Parliament to the Commission (s. 80(1A)).

2.19 Under s. 80(2) where in the opinion of the Court it is desirable to do so, the Court may grant an interim injunction pending determination of an application. Where the Commission makes an application seeking an injunction the Court shall not require the applicant, or any other person, to give an undertaking as to damages as a condition of granting an interim injunction.

2.20 Under s. 81 (1) the Court may, on the application of the Commission or any other person if it finds or has in another proceeding under the Act found that a person has contravened s. 50 of the Act, 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. Section 81(1B) deals with the divestiture of controlling interests acquired in contravention of s. 50A. An application under s. 81(1), (1A) or (1B) may be made at any time within three years after the date on which the contravention occurred.

2.21 In certain circumstances, as provided for in ss 76(1A) and (1B) of the Act, the Court may impose a penalty for a breach of s. 50 of up to $500 000 for an individual and $10 million for a corporation.

3. Acquisitions subject to the Act

Crown carrying on business and unincorporated organisations

3.1 Prior to the *Competition Policy Reform Act 1995* (CPR Act), by virtue of the limitations imposed by Australia's Commonwealth Constitution, the Trade Practices Act was limited in its application. Conduct that amounted to primary contraventions was basically limited to conduct by corporations. However, some sections extended liability for primary contraventions to non corporate persons. Section 50(2) prohibited an individual from acquiring shares or assets of a corporation where such an acquisition was likely to result in a substantial lessening of competition in a substantial market.

3.2 The CPR Act, in conjunction with corresponding legislation passed by each State Government, extends the reach of the Trade Practices Act to certain areas or types of conduct that were previously outside its reach. The CPR Act came into operation on 6 November 1995.

3.3 The practical results of the amendments in relation to the administration of mergers are as follows.

- The shield of the Crown in the right of the States and Territories has been abolished insofar as the States or Territories are carrying on business (s. 2B); but pecuniary penalties do not apply to activities of the Crown.

- Section 51(1), which provides for exceptions from Part IV for conduct that is excepted by laws of the Commonwealth, States or Territories is amended, inter alia, so that exceptions from s. 50 and s. 50A may only be made by laws of the Commonwealth. As with all 'new' exceptions under s. 51, the Commonwealth law must specify the excepted acquisition and specifically authorise it (s. 51(1C)(b)).

- Acquisitions by non corporate persons will be subject to the Act whether or not the target of the acquisition is incorporated. This is pursuant to the insertion of Part XIA, 'The Competition Code', into the Act. Each Australian State and Territory Government has, pursuant to Clause 5 of the Conduct Code Agreement between the Commonwealth, States and Territories, passed legislation implementing 'The Competition Code'.

3.4 In any situations discussed in paragraph 3.3, where the Commission must make inquiries into an acquisition or proposed acquisition, the process will be the same as that referred to in Section 4.

Deregulating industries

3.5 In recent years State, Territory and Commonwealth governments have initiated various pro-competitive reforms, involving horizontal and vertical disaggregation of government owned monopolies, corporatisation or privatisation and the removal of various restrictions on the operation of free markets, e.g. compulsory acquisition of crops by agricultural marketing boards and restrictions on the geographic distribution of dairy products. These initiatives have been given further impetus by the Competition Principles Agreement, whereby all governments agreed to a systematic review of all legislation restricting competition. These initiatives have a number of implications for merger policy administration.

3.6 Deregulation may have a significant impact on market boundaries. For example, the removal of restrictions on the geographic movement of products will result in market boundaries being determined by fundamental conditions of supply and demand rather than artificial regulatory restrictions. Similarly, changes in the licensing arrangements for financial institutions may result in greater supply side substitution and broader product markets.

3.7 Deregulation may also have a significant impact on barriers to import competition or new entry. Import quotas and tariffs restrict the supply elasticity of imports and the import parity price at which import competition constrains domestic prices. Government licensing often directly limits the number of potential participants in a market, e.g. broadcasting markets. Liberalisation or abolition of these requirements can ease or remove barriers to entry and any competition concerns relating to acquisitions in these markets.

3.8 Privatisation of government assets will generally be subject to the Act. The Commission will scrutinise proposed acquisitions by private sector competitors, suppliers or customers which could potentially result in a substantial lessening of competition in a substantial market. Where assets are being disaggregated to promote competitive markets, the Commission will want to ensure that this intent is not undermined through acquisition by horizontally or vertically related parties where this would have the effect of substantially lessening competition in a relevant market.

3.9 Subsequent to the privatisation and disaggregation of assets, both horizontal and vertical, the Commission will scrutinise any proposed mergers and acquisitions to ensure that the pro-competitive effects of disaggregation are not undone. Where statutory monopolies are removed in vertically related markets, e.g. grain storage and trading, the Commission will be concerned to ensure that any proposed vertical mergers between incumbents do not have the effect of preventing or hindering the development of competition in relevant markets (s. 4G, see paragraph 2.8).

3.10 Where governments are planning to remove restrictions on the supply of particular products, the Commission will scrutinise proposed acquisitions which might seek to pre-empt the competitive effects of such deregulation. For example, the merger of two dairy product manufacturers which do not currently compete in the same geographic market may nevertheless have the effect of preventing or hindering competition in broader geographic markets post deregulation.

Overseas acquisitions

3.11 Increasingly the Commission must deal with acquisitions in a global context. This may involve consideration of global competition, or even global markets, and the role of mergers in enhancing efficiency and international competitiveness. These issues are discussed in paragraphs 5.16–5.17, 5.63, 5.171–5.174 and Section 6. In addition, the mergers themselves may occur on a global scale, often involving multinational companies. Where these mergers impact on a market in Australia they will generally be subject to the Act, as discussed in the following paragraphs. Firms involved in these mergers will often have to deal with multiple competition agencies around the world. The Commission is increasingly involved in discourse and cooperation with these agencies and the OECD Committee on Competition Law and Policy recently approved a report reviewing and synthesising member countries' merger notification practices into a ‘Framework for a Notification and Report Form for Concentrations’.[7] While Australia does not have any formal pre-merger notification, there is benefit for both the Commission and the parties in streamlining the process of informal consideration. The Commission expects to be given the same notice of mergers as overseas agencies. As discussed in paragraphs 4.13–4.15, the Commission requires adequate time to make market inquiries before it will be able to provide a clear response to any proposed acquisitions. It also expects to be given all relevant information relating to the international transaction including, for example, full details of international agreements relating to any Australian aspects of the transaction.

3.12 To the extent that an acquisition occurs in Australia, the Act applies without any extraterritorial scope. To the extent that an acquisition occurs outside Australia, the Act may apply depending on its extraterritorial scope. The Commission has taken the view that the acquisition occurs (as opposed to the agreement or transaction) where the property is situated. This is an unsettled area of the law.

3.13 Section 5(1) of the Act extends Parts IV, IVA and V to the engaging in conduct outside Australia by corporations incorporated in, or carrying on business within, Australia or by Australian citizens or persons ordinarily resident within Australia. Accordingly, if a foreign corporation carries on business within Australia, or an individual who is not an Australian citizen carries on business in

Australia or is resident in Australia, their acquisition activities inside or outside of Australia are subject to the Act where they are likely to substantially lessen competition in a substantial market in Australia. Similarly, an acquisition of an unincorporated business by an Australian corporation, foreign corporation or an individual or an unincorporated business trading within Australia (these latter two by virtue of the enactment of the CPR Act) will be within the jurisdiction of s. 50 of the Act.

3.14 There have been a number of Court decisions about the term 'carrying on business within Australia'. It may apply to a foreign corporation that carries on business in Australia by way of an agent or a wholly owned Australian subsidiary. This is particularly the case where the degree of involvement by the foreign corporation in the direction of the business of the subsidiary is such as to go beyond a passive shareholding or, for example, where the Australian subsidiary has been set up to run its business as part of the worldwide organisation of the foreign corporation. It has also been held that the acquisition of, and licensing of, intellectual property rights within Australia by a foreign corporation is likely to constitute carrying on business in Australia.[8]

3.15 There are also foreign acquisitions in which the acquirer may not be considered as carrying on business within Australia. Prior to 1986 the Act did not extend to regulating this conduct. The 1986 amendments to the Act that led to the enactment of s. 50A extend the Act's jurisdiction to apply to these acquisitions.

3.16 Paragraph 2.4 sets out the elements of s. 50A. The main differences between s. 50A and s. 50 are as follows.

- Section 50A applies to the overseas acquisition by a person of a controlling interest (defined in s. 50A(8) – see paragraph 3.30) in a body corporate, which by reason of that acquisition obtains a controlling interest in a corporation (e.g. a domestic trading company or foreign company registered in Australia). Section 50 may not apply as the acquisition has occurred overseas and s. 5(1) may not operate as the acquirer may not be a body corporate incorporated or carrying on business in Australia or be an Australian citizen or be a person ordinarily resident here.

- Section 50A and s. 50 are procedurally different. Section 50A requires an application by the Minister, the Commission or a person to the Tribunal for a declaration (on grounds discussed below) with a statutory sanction (s. 50A(6)). Breaches of s. 50 are determined in and by the Federal Court.

- The factors for assessing acquisitions or proposed acquisitions under ss 50 and 50A are different. In an application to the Tribunal pursuant to s. 50A, the Tribunal shall assess whether the obtaining of the controlling interest will substantially lessen competition in a substantial market. It will also assess whether it will not result in such a benefit to the public that it should be disregarded for the purposes of the section. In effect, the Tribunal refers to the test in s. 50 as well as that set out in ss 88 and 90 of the Act (by way of sub-s. 50A (1A) and (1B)). Under s. 50 the Commission and the Federal Court do not consider the issue of benefit to the public unless the parties to the acquisition apply to the Commission for authorisation.

3.17 The effect of a declaration is that, by the end of six months from the date of the declaration, the corporation or corporations in which the person has the controlling interest shall not carry on business in Australia. Contravention of the declaration opens the corporation or corporations to all the remedies available under the Act.

3.18 In summary, the Act applies to the following acquisitions:

(a) acquisitions of property within Australia including:

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

(These are covered by virtue of s. 50)

(b) Acquisitions of property wherever situated if the acquirer is:

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

(These are covered by virtue of s. 50 and s. 5(1)); and

(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.

(These are covered by virtue of s. 50A)

Partial shareholdings

3.19 There is no threshold shareholding for the purposes of s. 50. Section 50 applies to any acquisition of shares which would have the effect, or be likely to have the effect, of substantially lessening competition in a substantial market. While questions of control or influence will be important, anti-competitive effects may arise from shareholdings which do not necessarily confer such control or even influence.

3.20 The following are some of the potential anti-competitive effects of shareholdings below a level delivering control:[9]

- horizontal acquisitions may reduce competitive zeal between rivals and increase the motivation and capacity to coordinate firm conduct;
- acquisitions in one market by parties which are rivals in another market may facilitate coordinated conduct in the second (or third) market;
- vertical acquisitions may result in foreclosure of rival suppliers;
- horizontal and vertical acquisitions may provide access to commercially sensitive information in relation to competitors; and
- horizontal and vertical acquisitions may block potentially pro-competitive mergers and rationalisation.

3.21 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. Coordinated conduct, 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. The extent to which coordination can succeed depends on features of the product market (see paragraph 5.168) and the degree of influence which one firm has on the conduct of the other. Partial shareholdings and directorships may encourage coordination by reducing the incentives for ‘cheating’, making departures from agreed behaviour harder to conceal and facilitating the exchange of information between firms.

3.22 Two parties which compete in one market may acquire shares in a company or participate in a joint venture in another market. This may facilitate coordinated conduct in the first market. Furthermore, while the third party might not compete in the first market, it is possible that all three might compete in a third market, for example in the acquisition of inputs, for example free-to-air television channels jointly participating in the provision of subscription television (which may or may not be in the same market), but which do compete for the acquisition of programming.

3.23 Acquisition of shares in a supplier may provide an incentive to favour that supplier over others, boosting the profitability of that shareholding, which may in turn foreclose rivals’ opportunities to sell to the acquirer. Acquisition of shares in a customer might induce that customer to buy from the acquirer, whose votes might be used against management, foreclosing sales opportunities from rival suppliers.

3.24 Firms may be able to 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 etc. may be available. The level of information available will depend 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.

3.25 A shareholding of over 10 per cent in a company is sufficient to block 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.

3.26 Acquisition by one company of a controlling interest in another company may permit two firms to effectively operate as a single entity, with the ability to maximise joint profits. While a majority shareholding would ensure control, much lower shareholdings might also be sufficient.

3.27 It is not possible to proscribe a level of shareholdings which would or could deliver control over a company. However, when considering any particular acquisition, factors which need to be taken into account when considering whether a shareholding is sufficient to deliver control of a company include:

- 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; and
- the company’s Articles of Association.

3.28 The framework for competition analysis set out in Section 5 is relevant for all share acquisitions, whether or not they deliver control of the target firm. Unless the parties compete in the same market or in vertically related markets, competition concerns are unlikely to arise. Similarly, if the combined market share of the companies is small, or if there is strong import competition or low entry barriers, competition concerns are unlikely to arise. However, where share acquisitions do not deliver control, additional consideration must be given to inter-company relationships and the types of competition concerns discussed above.

3.29 Section 50A, which deals with acquisitions outside Australia (see paragraphs 2.4 and 3.16–3.18), applies only to acquisitions which deliver a controlling interest in a body corporate and thereby result in the acquirer obtaining a controlling interest in a corporation (e.g. a domestic trading company or the holding company of such a company).

3.30 Section 50A(8) in essence defines a ‘controlling interest’ to require that a corporation becomes, directly or indirectly, a subsidiary of the acquirer. Section 4A in turn provides that a corporation will be a subsidiary of another body corporate where it:

- controls the composition of its board of directors;
- is in a position to cast more than 50 per cent of the maximum number of votes that can be cast at a general meeting; or
- holds more than 50 per cent of the issued share capital (excluding limited participation shares).

3.31 The Commission may, under s. 50, also consider the collective effect of shareholdings that are acquired incrementally over a period. In particular, the Corporations Law permits acquisitions beyond 20 per cent (the normal takeover threshold), of up to 3 per cent every six months without triggering the requirement for a full takeover offer. The initial acquisition may not raise substantial competition concerns, and each incremental acquisition may not give rise to a substantial lessening of competition in its own right. However, collectively the acquisitions may give rise to competition concerns and may eventually deliver control of the target company. The Commission considers that the Act may apply to such creeping acquisitions.

3.32 Partial share acquisitions may also occur through one party buying out another party in a joint venture arrangement. The framework for analysis of the competitive effects of mergers in general is equally applicable to joint venture buy-outs. However, additional factors need to be taken into account — in particular, the structure of the joint venture and the changes to that structure brought about by the acquisition. For example, if a joint venture is set up by downstream market participants as a monopoly supplier of inputs (the parties to the joint venture continuing to compete in the downstream market), it may be organised simply on a cost sharing basis in order to benefit from economies of scale; or it may be established as a profit maximising public company. In the first case a buyout by one party of the other parties may result in monopoly pricing; but in the second case the company is already likely to be exploiting any monopoly power.

4. Notification and Commission consideration of proposed mergers

4.1 There is no formal requirement that parties to a proposed acquisition advise the Commission prior to entering into an agreement to effect an acquisition (unless the parties seek to formally apply to the Commission for authorisation — this is discussed in Section 6). However, the Commission is commonly advised of such proposals.

4.2 In addition to parties to a proposed acquisition approaching the Commission, the Commission is, on occasions, advised by other regulators of proposed acquisitions. Regulators such as the Foreign Investment Review Board, The Australian Stock Exchange, The Australian Securities and Insurance Commission and the Australian Broadcasting Authority all provide the Commission with invaluable information and assistance with its inquiries. (The Commission also, from time to time, receives complaints by market participants about an acquisition).

4.3 Similarly, subject to restrictions to which various regulators are subject about the exchange of information, the Commission also liaises with and seeks assistance from overseas regulators such as the Commerce Commission in New Zealand, the Department of Justice and the Federal Trade Commission in the United States, the Bureau of Competition Policy in Canada and the Competition Commission in the UK. In particular, due to Australia's close economic relations with New Zealand the Commission often liaises with the Commerce Commission.

Informal consideration of mergers

4.4 The Commission encourages parties to approach it, on an informal basis, as soon as there is a real likelihood that a proposed acquisition may proceed, and certainly well before the completion of an acquisition.

4.5 Parties may approach the Commission either on a confidential basis or on the basis that the proposed acquisition is in the public domain.

4.6 If the requirements of the parties are that the proposed acquisition is confidential, the Commission is unlikely to be in a position to provide the parties with its finalised view about the acquisition. The Commission's position is that it requires the views of market participants prior to providing a final response to parties whether it considers that a proposed acquisition of shares or assets may or may not contravene the Act.

4.7 The range of responses to a confidential proposal that parties can expect from the Commission include the following:

- the Commission considers that the proposed acquisition would substantially lessen competition and requests the parties not to proceed;
- the Commission has some concerns in relation to the proposed acquisition (which will be set out), but does not propose to oppose the acquisition prior to making market inquiries; or
- in the absence of market inquiries the Commission does not propose to express an opinion, but does not intend to oppose the acquisition at that point in time.

4.8 The Commission is concerned to ensure that it does not give inappropriate comfort to the parties and then, upon undertaking market inquiries, come to the view that the merger would be likely to substantially lessen competition. This will be of particular concern to the Commission for proposals which affect markets in which it has little, or little recent, experience.

4.9 Whether or not parties approach the Commission on a confidential basis it encourages them to lodge written submissions setting out the following:

- background information about the parties;
- the structure of the market, including any relevant information about other major market participants;
- the commercial rationale for the merger; and
- an analysis of the proposed acquisition in terms of the factors referred to in s. 50 (3) of the Act.

Section 5 discusses in more detail the factors and information relevant to the Commission's consideration of a proposed acquisition.

4.10 Where acquisitions appear likely to breach the Act, the Commission will require firms to provide relevant internal company documents. If they are not provided cooperatively the Commission is prepared to use its powers under s. 155 of the Act. It will also be important for the Commission to talk directly to the chief executive officer(s) of the firm(s) involved in contentious mergers.

4.11 As stated in paragraph 4.6 the Commission will not give its finalised view to parties to a proposed acquisition without making market inquiries. The type of market inquiries the Commission may wish to undertake include consulting with:

- competitors;
- suppliers;
- customers;

- industry associations;
- government agencies and departments;
- overseas agencies;
- consumer groups; and
- trade unions.

Section 5 sets out the type of information that may be sought by the Commission in order to delineate the boundaries of the market and to consider the factors under s. 50(3) which determine whether the acquisition has the effect, or is likely to have the effect, of substantially lessening competition.

4.12 In 1996 the ACCC streamlined its process for considering mergers and acquisitions. Now only the more complex matters are considered by the full Commission. Most matters are considered by a Mergers Review Committee, comprising the Chairman and nominated Commissioners, with the Committee's decisions being reported to the Commission. Matters which raise concerns are referred to the full Commission for further consideration.

4.13 The length of time it will take the Commission to provide its response following an informal approach will vary depending on the particular circumstances of a matter. Parties are encouraged to approach the Commission at the earliest opportunity, to enable it to carry out its inquiries as expeditiously as possible. The Commission will be responsive to the commercial time frame of the parties. However, they should advise the Commission of their plans at least three to four weeks before entering into an agreement or before they plan to close the acquisition where it is conditional on the Commission's approval, and earlier wherever possible. As noted in paragraph 3.11, in the case of global mergers the Commission expects to receive the same notice and relevant documentation as overseas competition authorities. If the Commission is not given sufficient notice of a proposed merger or sufficient information, parties should not necessarily expect a quick response.

4.14 At the confidential stage of a proposal, that is where the Commission is unable to make market inquiries, an informal response should be available within two to three weeks. In those cases where it is appropriate to undertake market inquiries, a general guide to the time frame for a Commission decision is:

- in matters that the Commission is satisfied do not breach the merger thresholds, the Commission may inform the parties within 10 to 15 days that it does not propose to take any action at that time;

- in matters which do appear to breach the merger thresholds, the Commission will usually require about a month to make market inquiries and consider the matter; and

- in those few major cases which raise very substantial issues and with which the Commission is likely to have a problem, the Commission may take six to eight weeks to fully consider the matter.

However, it is the Commission's experience that some parties fail to provide timely information, in which case these time frames may be extended. Similarly, where there are delays in conducting market inquiries until the proposal becomes public, the Commission's time frame will be correspondingly extended.

4.15 There are certain circumstances in which particular issues of timing arise in relation to the operation of the Corporations Law and the Commission's consideration of proposed mergers and acquisitions.

(a) Where a person proposes an acquisition by way of a takeover announcement (and Part C Statement), advising the Commission prior to the announcement gives the Commission the opportunity to prepare itself to undertake market inquiries immediately upon the announcement. Further, if there may be an issue under s. 50, the parties may wish to approach the Commission with appropriate undertakings aimed at allaying any likely Commission concern.

An example of such a situation was Davids Ltd's Part C takeover offer for Independent Holdings Ltd (IHL), where IHL held more than 30 per cent in Davids' only competitor, Composite Buyers Ltd (CBL), in the Victorian and New South Wales grocery wholesaling market. Davids agreed to divest the shares if the Commission formed the view that the interest which it would acquire in CBL would be anti-competitive. In that way Davids was free to proceed with its offer for IHL without the threat of Commission intervention (the issue of undertakings is referred to further in section 7). The Commission ultimately did not oppose that acquisition.

(b) Similarly, where a person proposes an acquisition by way of a takeover scheme (and Part A Statement), the Commission is of the view that being advised prior to the registration of the offer and Part A Statement is more likely to facilitate the Commission's inquiries in such a way as to have least impact on the offer process.

One issue the Commission suggests should be considered, and on which it would encourage consultation, is the question of whether the offer should be conditional on the Commission's indicating that it would not oppose the proposed acquisition. In appropriate cases the Commission may seek an undertaking from the offeror that such a condition not be waived without reasonable notice to the Commission.

4.16 If the Commission concludes that a proposed acquisition would, or would be likely to have, the effect of substantially lessening competition, the Commission will advise the parties of its view. The parties may then take the following action:

- abandon the proposal;
- modify the proposal to address any of the likely anti-competitive consequences, either informally or formally by way of undertakings pursuant to s. 87B of the Act (s. 87B is discussed in Section 7);
- apply for authorisation if the acquirer considers it may be able to establish that the proposal would result in a net public benefit (see Section 6);
- take their own risk and seek to complete the acquisition; or
- seek a declaration that the proposed acquisition does not contravene the Act.

The Commission's responses to anti-competitive acquisitions

Injunctions

4.17 As stated in paragraph 2.18 the Commission, pursuant to s. 80 of the Act, is able to seek a permanent injunction to restrain an anti-competitive merger. A private litigant cannot seek an injunction to restrain a proposed acquisition.

4.18 The Commission will, when it is of the view that a proposed acquisition is likely to substantially lessen competition, seek an informal undertaking, or an undertaking pursuant to s. 87B of the Act, from the parties not to proceed (the issue of undertakings will be discussed further in section 7). If the parties do not give that undertaking the Commission will seek to stop the acquisition proceeding. The Commission does not consider that it is normally appropriate for it, in carrying out its statutory functions, to allow the acquisition to proceed and later seek divestiture. The Commission considers its responsibility is to protect the public interest in competition and the interest of consumers generally by seeking to prevent acquisitions which, in its view, will substantially lessen competition. Ultimately, the question of whether an acquisition will in fact substantially lessen competition or not is a matter for the Court.

4.19 The Commission can, if it believes that a proposed acquisition would substantially lessen competition, seek an interim injunction from the Federal Court to stop the proposed acquisition going ahead, prior to a final hearing. The Commission sometimes seeks an urgent ex-parte injunction, to hold the status quo for a few days, prior to a full interim injunction hearing.

4.20 Where the Commission has sought an interim injunction the matter proceeds to a final hearing in the usual way. If the Commission is successful at the final hearing the Court may grant a permanent injunction.

4.21 At the interlocutory stage the Court must assess whether there is a serious issue to be tried and, if so, whether the balance of convenience lies in favour of stopping the acquisition pending the final hearing. There is rarely little real debate that there is a serious issue for the Court to determine.

4.22 The Commission recognises that determining where the balance of convenience lies in a particular case will be a difficult matter for the Court to determine, and it will often be further complicated by the proffering of undertakings by the potential acquirer designed to address specific competition concerns.

4.23 The Commission considers that the public interest and the interests of consumers in the protection of competition reflected in s. 50 (and s. 80, the injunction power) should rank ahead of the private interests of the parties. In the *Rank* case, the Full Court stated:

> There is, however, a public interest in preventing an impairment of FAL's [the target company] competitiveness if such an impairment is seen to be a possible consequence of an acquisition of shares, undertaken in anticipation of a further proposed acquisition, where there is a serious question to be tried about the lawfulness of both acquisitions. [10]

4.24 In some cases it may be appropriate for the Commission to seek an ex-parte (i.e. without notice to the other party) interim injunction. The Commission will do so where it considers that:

- notice to the parties may enable them to take some step to defeat the effectiveness of any injunction granted; or
- where the urgency of the situation requires it.

4.25 An ex-parte injunction is usually sought by the Commission after it has requested the parties to provide an undertaking not to proceed with the proposed acquisition and that undertaking has not been given. In these circumstances the Commission will seek an ex-parte injunction if it considers that notice to the parties will give them an opportunity to proceed with, or put in train, their proposal prior to an injunction being granted or where formal notice is not feasible (in such cases informal notice may be given).

4.26 Typically, once an ex-parte injunction is granted a full interim injunction hearing at which all parties are represented will be scheduled within days or weeks.

Pecuniary penalties

4.27 Where an acquisition occurs without notice to the Commission and it considers there to have been a breach of the Act, the Commission will, in accordance with s. 76(1) consider pursuing penalties against all those involved in the acquisition, including directors, lawyers, banks and other advisers, as well as the corporations themselves. It will also consider, pursuant to s. 80(1), seeking injunctions against the same persons to prevent similar unlawful activity in future.

4.28 As stated in paragraph 2.21, ss 76(1A) and (1B) of the Act state that the Court may impose a penalty for a breach of s. 50 of up to $500 000 for an individual and $10 million for a corporation. For example, in 1996 the Court imposed penalties of $4.8 million on Pioneer for contravention of s. 50 when it acquired the assets of A Class Blocks (following an agreement with A Class that it should close down).

Divestiture

4.29 If the Commission is of the view that a completed acquisition has substantially lessened competition in a substantial market it may also apply to the Federal Court for an order pursuant to s. 81 of the Act that the acquirer dispose of the shares or assets acquired in contravention of the Act or it may apply for a declaration that the acquisition is void (resulting in the vendor refunding the consideration for the acquisition).

The Public Register

4.30 Following a recommendation of the Griffiths Committee, the Commission has established a public register of all mergers considered by it.[11]

4.31 That register does not include confidential or other sensitive information, but would otherwise include brief details of a proposed merger (including the names of the acquirer and target), a product description and brief reasons for the Commission's response to that acquisition.

5. Assessing the competitive effects of a merger

5.1 The role of ss 50 and 50A is to contribute to the maintenance of competitive markets in Australia. A breach of s. 50 occurs or relief under s. 50A is available where a merger would have the effect, or be likely to have the effect, of substantially lessening competition in a substantial market for goods or services in Australia, in a State or Territory.

5.2 This section explains the approach the Commission proposes to adopt in assessing the likely competitive effects of a merger.[12]

5.3 To determine whether any particular acquisition breaches s. 50 or is eligible for relief under s. 50A requires an assessment of the following matters:

- what is the relevant market;
- is that market substantial; and
- will the acquisition be likely to substantially lessen competition?

The three elements are interrelated. Identification of the relevant market is an integral part of the evaluation of the competitive effects of a merger; and only when the relevant market has been delineated, can its substantiality be determined.

Substantial lessening of competition

5.4 Competition is a process of rivalry between firms, where each market participant is constrained in its price and output decisions by the activity of other market participants. In *QCMA* the Tribunal quoted with approval the report of the US Attorney-General's National Committee to Study the Antitrust Laws:

> The basic characteristic of effective competition in the economic sense is that no one seller, and no group of sellers acting in concert, has the power to choose its level of profits by giving less and charging more. Where there is workable competition, rival sellers, whether existing competitors or new or potential entrants in the field, would keep this power in check by offering or threatening to offer effective inducements ...[13]

5.5 The Tribunal went on to state:

> In our view effective competition requires both that prices should be flexible, reflecting the forces of demand and supply, and that there should be independent rivalry in all dimensions of the price-product-service packages offered to consumers and customers.

> Competition is a process rather than a situation. Nevertheless, whether firms compete is very much a matter of the structure of the markets in which they operate. The elements of market structure which we would stress as needing to be scanned in any case are these:
>
> (i) the number and size distribution of independent sellers, especially the degree of market concentration;
>
> (ii) the height of barriers to entry, that is the ease with which new firms may enter and secure a viable market;
>
> (iii) the extent to which the products of the industry are characterised by extreme product differentiation and sales promotion;
>
> (iv) the character of 'vertical relationships' with customers and with suppliers and the extent of vertical integration; and
>
> (v) the nature of any formal, stable and fundamental arrangements between firms which restrict their ability to function as independent entities. [14]

5.6 Competition is inhibited where the structure of the market gives rise to market power. Market power is the ability of a firm or firms profitably to divert prices, quality, variety, service or innovation from their competitive levels for a significant period of time.[15] Dawson J in *QWI* quoted approvingly the Kaysen and Turner definition of market power:

> A firm possesses market power when it can behave persistently in a manner different from the behaviour that a competitive market would enforce on a firm facing otherwise similar cost and demand conditions. [16]

Firms with market power have discretion over their price and output decisions; competitive firms are compelled to perform by the discipline of the market.

5.7 Section 50 differs from the other prohibitions contained in Part IV of the Act, because it regulates market structure, to prevent the creation of or an increase in market power and consequent anti-competitive conduct, rather than directly regulating that conduct. Such conduct, sometimes termed 'strategic behaviour', may be directed at altering the market structure itself, particularly barriers to entry. [17]

5.8 The conduct which is prevented by s. 50 may be unlawful, involving breaches of other sections of Part IV, or it may be lawful conduct which would nevertheless be anti-competitive, resulting in less efficient markets and consumer detriment. The first category would include conduct such as price fixing and predatory pricing; the latter would include conduct such as tacit price coordination or unilateral price rises.

5.9 The Cooney Committee in its 1991 report on *Mergers, Monopolies and Acquisitions* took the view that the best way to protect against misuse of market power is to prevent it being created in the first place. It quoted Treasury's submission that:

> The potential anti-competitive effects, which may be difficult and costly to detect and act against under current arrangements, may better be avoided by preventing mergers than by applying other sections of the TPA (and other legislation).[18]

5.10 The Attorney-General's second reading speech, when introducing the current threshold test under s. 50, reiterated the preventive nature of merger regulation:

> Merger regulation is an important element of any law aiming to preserve levels of competition. Mergers can lessen competition, potentially providing increased scope for price rises or collusive behaviour and lessening dynamic factors such as the rate of innovation. These possible detriments provide the rationale for government intervention in the area of mergers.[19]

5.11 Market power may be exercised either unilaterally by a single firm, or coordinated among firms. The unilateral exercise of market power does not depend on the cooperation of other market participants. A firm with unilateral market power can assume that its rivals will behave competitively in response to market prices, but nevertheless their capacity to defeat a price rise is limited. In contrast, the coordinated exercise of market power depends on the cooperative or accommodating actions of other market participants.

5.12 The primary reason for being concerned about mergers, especially between competitors, is that they increase the likelihood that the merged firm would have greater scope to set prices above the competitive level, or otherwise distort competitive outcomes, either alone or in coordination with other firms selling the same product. However, it is well recognised that mergers can also yield significant benefits. These sometimes take a traditional form — internal efficiencies such as economies of scale or scope or transactions savings through vertical integration — but it is also recognised that mergers are an important aspect of the overall 'market for corporate control', in which outsiders who believe they are able to improve the efficiency of a firm are prepared to bid above current market values. Hence, a blanket prohibition of mergers, even mergers between competitors, would be inappropriate. Only those mergers which would have the effect, or be likely to have the effect, of **substantially** lessening competition are prohibited.

5.13 The word substantial has been the subject of differing interpretations in different contexts and in relation to other sections of the Act. It has sometimes been interpreted as meaning 'real or of substance' and sometimes as 'large or weighty'. In relation to s. 47, Smithers J stated in *Dandy Power*:

> To apply the concept of substantially lessening competition in a market, it is necessary to assess the nature and extent of the market, the probable nature and extent of competition which would exist therein but for the conduct in question, the way the market operates and the nature and extent of the contemplated lessening. To my mind one must look at the relevant significant portion of the market, ask oneself how and to what extent there would have been competition therein but for the conduct, assess what is left and determine whether what has been lost in relation to what would have been, is seen to be a substantial lessening of competition. I prefer not to substitute other adverbs for 'substantially'. 'Substantially' is a word the meaning of which in the circumstances in which it is applied must, to some extent, be of uncertain incidence and a matter of judgement. There is no precise scale by which to measure what is substantial. I think in the context, particularly the penalty and other remedies for contraventions of the Act, and the nature of trade which is the subject of the Act, the word is used in a sense importing a greater rather than a less degree of lessening. Accordingly in my opinion competition in a market is substantially lessened if the extent of competition in the market which has been lost, is seen by those competent to judge to be a substantial lessening of competition. Has competitive trading in the market been substantially interfered with? It is then that the public as such will suffer ...
>
> Although the words 'substantially lessened in a market' refer generally to a market, it is the degree to which competition has been lessened which is critical, not the proportion of that lessening to the whole of the competition which exists in the total market. Thus a lessening in a significant section of the market, if a substantial lessening of otherwise active competition may, according to the circumstances, be a substantial lessening of competition in a market.[20]

5.14 The Explanatory Memorandum to the Trade Practices Legislation Amendment Bill 1992 states that:

> The term 'substantial lessening of competition' is used widely through the Principal Act. It is here intended to mean an effect on competition which is real or of substance, not one which must be large or weighty.[21]

This was clarified by the government during the Bill's passage through the Senate:

> In signifying its intention that that word as now proposed to be used in s. 50 should bear the meaning 'real or of substance', the Government intends that the test should apply to effects on competition which are not merely discernible but which are material in a relative sense in the impact they may have upon effective competition in the market place.[22]

5.15 Hence, the threshold in s. 50 would appear to be a relative one, either qualitative or quantitative. Where there is a reasonable likelihood that prices in the relevant product market will be maintained at a significantly greater level than they would be in the absence of the merger, or where competitive outcomes would be otherwise distorted, the Commission will consider there to be a substantial lessening of competition.

5.16 Increased exposure to global markets is placing pressure on domestic firms to reduce costs, improve quality and service and innovate in order to become more competitive. Mergers may be one means of achieving such efficiencies. Section 50 is concerned with the lessening of competition in a market, not with the competitiveness of individual firms. However, an acquisition which increases the competitiveness of the merged firm may also increase (or not substantially lessen) competition in a market.[23] While efficiencies generally arise as a question of public benefit, which falls for consideration under authorisation (see Section 6), they are relevant in a s. 50 context to the extent that they impact on the level of competition in a market.

5.17 The analysis of efficiencies in a s. 50 context must be integrated within the framework of competition analysis, rather than being considered as a 'trade-off' with competition effects, as might be done in an authorisation context (see Section 6). The relevant question is the effect or likely effect of the merger on firms' abilities and incentives to compete in the relevant market, including any effect flowing from efficiencies:

> The weight and significance accorded to different types of efficiencies should be a function of their magnitude and probability, the degree to which they likely will enable the merged firm not only to be a better competitor but to enhance (or not lessen) competition and thus benefit consumers, and the delay with which these consumer benefits are to be realized.[24]

5.18 In considering whether a merger is likely to substantially lessen competition, the Commission will not simply compare the pre- and post-merger scenarios. Section 4G defines a lessening of competition to include preventing or hindering competition. In some circumstances it may be that without the merger, competition would be likely to increase in the relevant market and that the merger will prevent or reduce the potential increase in competition. Hence, for example, in a market where entry is difficult, a merger which forestalls entry to the market may be considered to substantially lessen competition. Alternatively, a merger may replace an unstable oligopolistic coordination of prices with a single firm's market power. Although prices may be no higher after the merger than before, there is no longer the possibility that price coordination will break down and competition break out between the merged firms. This too could be considered a substantial lessening of competition.

5.19 The preceding discussion has centred on the exercise of market power and potential lessening of competition on the supply side of the market. However, it is also possible for market power to be exercised in an analogous way on the demand side. Where firms have market power on the demand side of the market they may be in a position to impose a significant price decrease, or other deterioration in terms, on sellers, depressing output below its competitive level.

5.20 In many industries the exercise of such market power may not be possible, even by a large buyer, because supply will be highly price elastic; either because unit costs are constant or declining over a large output range and/or because the product is traded internationally and domestic supply can be readily diverted to export markets. Firms will rapidly remove resources from the (domestic) market in response to any attempt to depress price below its competitive level.

5.21 However, there are significant exceptions to this. In particular, many primary industries which utilise scarce resources are characterised by less than perfectly elastic supply, reflecting diminishing returns from scarce resources. One of the few merger cases to reach the courts, *Australian Meat Holdings*, involved the creation of a dominant position in the acquisition of fat cattle in North Queensland.[25] Similarly, labour intensive industries, particularly where workers have limited alternative employment opportunities, such as clothing manufacture, are often characterised by less than perfectly elastic supply. In some industries, while long run supply may be highly price elastic, short run supply is often not; and if long run adjustments take an extended period, there may be the opportunity and incentive for considerable competitive damage to occur.

5.22 Furthermore, large buyers may be able to exert market power in other ways, e.g. influencing the terms and conditions of supply to their smaller rivals. Such strategic behaviour may in turn enhance their market power as suppliers in the downstream market.

The analysis of substantial lessening of competition

5.23 In evaluating whether a merger is likely to have the effect of substantially lessening competition in a substantial market, s. 50(3) requires regard to be had to a non-exhaustive list of ‘merger factors:

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.

5.24 The Explanatory Memorandum to the Trade Practices Legislation Amendment Bill 1992 makes it clear that the list of factors in s. 50(3) is non-exhaustive and that some are interrelated:

> This is not an exhaustive list, and some of the factors are interrelated ... In considering a proposed acquisition, regard is to be had to the factors specified in the list, but of course there may be other factors that would need to be taken into account in any particular case, and the weight to be given to any factor, whether included in the list or otherwise found to be relevant, has to be determined in the context of the facts of the case. [26]

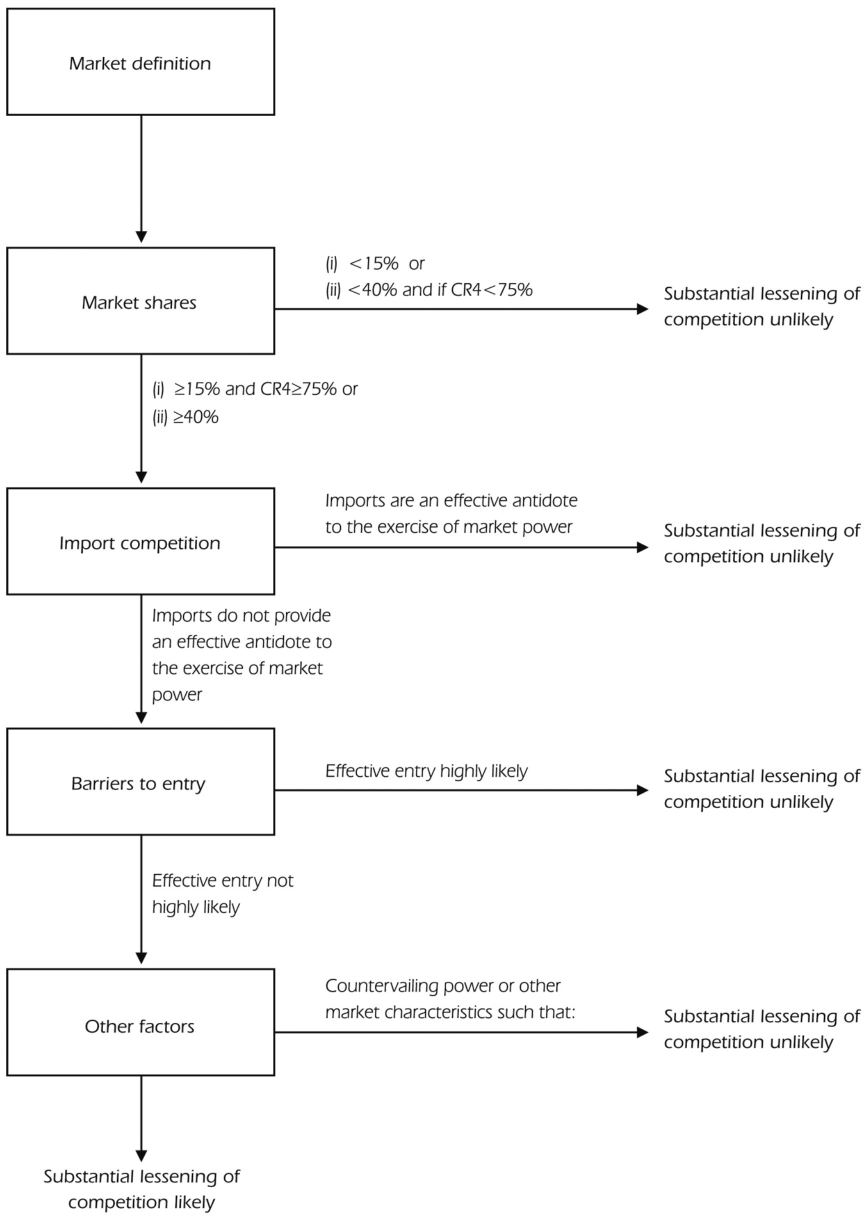
5.25 In analysing the likely effect of a merger or acquisition, the Commission has organised the statutory factors into a five stage evaluation process. The process is designed to give clear signals to the business community, wherever possible, as to the Commission's likely attitude to potential mergers; and to minimise the costs of compliance, data collection and analysis for both the parties to a merger and the Commission. This process is represented diagrammatically in Figure 1 (over page).

5.26 The first step is to define the relevant market, in its product, functional, geographic and time dimensions. This is a necessary prerequisite for the calculation of market shares and identification of other market characteristics, such as the height of barriers to entry. The Commission's approach to market definition and substantiality is discussed in paragraphs 5.34-5.86. If the market is not considered to be substantial, the Commission will take no further action.

5.27 Subsequent stages require the collection and analysis of increasingly complex data. At each stage, 'safe harbours' indicate mergers and acquisitions which are unlikely to be of concern to the Commission. However, parties cannot conclude without reference to the Commission whether or not an acquisition will be opposed. For example, the calculation of market shares hinges on the identification of the relevant market, which is often an issue of contention and the Commission will not necessarily accept the parties' market definition. Where mergers exceed the concentration thresholds the Commission will undertake its own analysis of the effectiveness of import competition and the height of barriers to entry, and this may not accord with submissions put forward by the parties.

5.28 If the market is considered to be substantial, the Commission will next consider market concentration. Concentration measures are used as a screening device to eliminate the need for detailed market studies where a merger is unlikely to give rise to any competitive concerns. The Commission has established concentration thresholds below which it is considered unlikely that a merger would give rise to a substantial lessening of competition. The basis for these thresholds is discussed in paragraphs 5.87-5.103. However, acquisitions resulting in concentration levels above the thresholds are not considered to give rise automatically to a substantial lessening of competition. Rather, the thresholds establish the need for further qualitative evaluation of market conditions.

Figure 1 The assessment of substantial lessening of competition



5.29 If the merger is not within the 'safe harbour' established by the concentration thresholds, the Commission will first consider the level and nature of import competition. The Commission's concern will be to establish whether imports provide or are likely to provide a competitive discipline on the merged firm which is greater than would be indicated by their market share; and in particular whether import competition will be adequate to prevent the exercise of domestic market power. The Commission's approach to this evaluation is discussed in paragraphs 5.104–5.114.

5.30 If import competition is not considered to impose an effective competitive discipline on the merged firm, the Commission will then go on to consider whether it is likely that new entrants will establish themselves in the market on a sufficient scale within a reasonable period of time to inhibit the exercise of market power by the merging firm. Barriers to entry are discussed further in paragraphs 5.115–5.128.

5.31 If effective entry is not considered a likely outcome the Commission will then consider other indicators of market structure and conduct which impinge on the likely competitive impact of a merger. These factors are discussed in paragraphs 5.129–5.179. They may have a positive or negative impact on the likely competitive effect of a merger. The Commission will consider the interaction of all relevant factors in reaching a conclusion on whether a merger is likely to substantially lessen competition.

5.32 The Commission will conclude that a merger or acquisition will result, or be likely to result, in a substantial lessening of competition in a substantial market only after consideration of all the statutory merger factors and any other relevant issues.

5.33 If the Commission concludes that a merger or acquisition is likely to substantially lessen competition, it will consider any actions which might be taken to alleviate the expected impact of the merger, and whether such actions can be covered by effective enforceable undertakings. Where parties consider there may be significant public benefits arising from the merger they may wish to apply for authorisation. Sections 6 and 7 discuss authorisation and enforceable undertakings in greater detail.

Market definition

5.34 The Act requires that the assessment of substantial lessening of competition be related to a market. Delineation of the relevant market also serves the purpose of focusing the analysis of competition effects.

5.35 Market definition is an integral part of competition analysis. It identifies the sellers and buyers who effectively constrain the price and output decisions of the merged firm. It identifies the relevant arena of competition. An appropriate definition of the market is the critical underpinning for the evaluation of 'substantial lessening of competition', the calculation of concentration ratios and the evaluation of import competition and barriers to entry.

5.36 In *QWI*, Mason C J and Wilson J said:

> In identifying the relevant market, it must be borne in mind that the object is to discover the degree of the defendant's market power. Defining the market and evaluating the degree of power in that market are part of the same process, and it is for the sake of simplicity of analysis that the two are separated. [27]

This approach was adopted by the Full Federal Court in *AMH*, where Pincus J stated:

> ... the process of identification of the relevant market must be carried out keeping in mind the object of doing so; in the instant case that is to determine whether the appellant was at the relevant time in a position to dominate the market, or was by the acquisition placed in such a position.
>
> The linking together of the process of definition of the market and its object implies some flexibility in the former. [28]

5.37 Section 4E provides that the term market 'includes a market for those goods and services and other goods and services that are substitutable for, or otherwise competitive with, the first-mentioned goods or services'. Merger factor (f) also requires the Commission to consider the extent to which substitutes are available in the market or are likely to be available in the market.

5.38 Section 4E was introduced following a recommendation of the Swanson Committee that the definition of market should:

> ... require that, in the determination of a 'market' for particular purposes, regard shall be had to substitute products which have a reasonable interchangeability of use and which have high cross-elasticity of demand, i.e. where a small decrease in the price of a particular product would cause a significant quantum of demand for a similar product to switch to the product in question. [29]

5.39 In addition to demand side substitutability, the Tribunal and the courts have established the need to consider supply side substitutability, where the same production and distribution facilities can be used to produce and sell two or more products. In *AMH*, Wilcox J stated:

> A market is the field of activity in which buyers and sellers interact and the identification of market boundaries requires consideration of both the demand and supply side. The ideal definition of the market must take into account substitution possibilities in both consumption and production. [30]

In *QWI*, Dawson J stated in the High Court:

> In setting the limits of a market the emphasis has historically been placed upon what is referred to as the 'demand side', but more recently the 'supply side' has also come to be regarded as significant. The basic test involves the ascertainment of the cross-elasticities of both supply and demand, that is to say, the extent to which the supply of or the demand for a product may be substituted for another, an important consideration in any definition of the market. [31]

5.40 A market involves four dimensions:

- product;
- geographic;
- functional; and
- time.

5.41 The merged firm is the starting point for delineating the relevant market. In this way the market which is identified is that which assists in the analysis of the likely competitive effects of the merger.[32] Market definition has a purposive tradition in Australian trade practices law.[33] A different market may be relevant for the analysis of a different merger or different conduct. For example, in the *Ansett* merger case the relevant market was found to be an Australian car rental market; whereas in the *Budget* case, concerning exclusive contracts for rental booths, the relevant market was found to be a market for rental car services at Auckland Airport.[34]

5.42 Substitutability may be thought of in terms of a price elevation test: what would be the response on the demand side and the supply side to a relatively small percentage increase in the price of the merged firm's product? As the Tribunal commented in *QCMA*:

> A market is the area of close competition between firms or, putting it a little differently, the field of rivalry between them.... Within the bounds of a market there is substitution - substitution between one product and another, and between one source of supply and another, in response to changing prices....
>
> It is the possibilities of such substitution which set the limits upon a firm's ability to 'give less and charge more'. Accordingly, in determining the outer boundaries of the market we ask a quite simple but fundamental question: if

> the firm were to 'give less and charge more' would there be, to put the matter colloquially, much of a reaction?[35]

5.43 Where the relevant market should be delineated is a question of degree. The Tribunal stated in *Tooth & Tooheys*:

> ... all competition or substitution does not cease at the outer boundaries of the market; the economy as a whole is a network of substitution possibilities in consumption and production; competition is a matter of degree. [36]

5.44 The process of market definition can be viewed as establishing the smallest area of product, functional and geographic space within which a hypothetical current and future[37] profit maximising monopolist would impose a small but significant and non-transitory increase in price (SSNIP) above the level that would prevail absent the merger.[38] More generally, the market can be defined as the smallest area over which a hypothetical monopolist (or monopsonist) could exercise a significant degree of market power. This would be possible only if all sources and potential sources[39] of close substitutes for the merged firm's products have been included in the definition of the market.

5.45 The process of establishing the market boundaries starts with the product, geographic and functional areas of supply covered by the merged firm. These are then extended in product, geographic and functional space to include all those sources, and potential sources, of close substitutes which would otherwise make it non profit-maximising for the hypothetical monopolist to impose a SSNIP or otherwise exercise a significant degree of market power. If consumers would switch their demand to close substitutes and/or firms would switch their production to supply the customers of the merged firm, it would not be profit maximising for the hypothetical monopolist to impose a SSNIP and the relevant market would need to be expanded to include these sources of substitute products.

5.46 Of course, history is unlikely to have provided us with such an experiment, and data is unlikely to be available on all the relevant elasticities, to establish precise market boundaries according to the above definition of the relevant market. However, the Commission considers this to be the appropriate analytical framework within which to make the necessary judgments in analysing the qualitative data and information it will necessarily have to rely on.

5.47 Note that it is the collective effect of substitution which determines what is in or out of the relevant market. A number of substitution possibilities, each of which is insufficient alone to defeat a SSNIP, may collectively have that effect.

5.48 The price elevation test does not require that all products included in the market should have the same price. Within a market there can be product differentiation. The relevant question is the degree of constraint imposed on the price and output decisions of the merged firm. As Wilcox J stated in *AMH*:

> The existence of price differentials between different products, reflecting differences in quality or other characteristics of the products, does not by itself place the products in different markets. The test of whether or not there are different markets is based on what happens (or would happen) on either the demand or the supply side in response to a change in relative price. [40]

5.49 Generally the question of price competition will be critical; if a product or supplier does not place any effective constraint on the price which the merged firm could charge for its product, the two products or suppliers will not be considered to be in the same market. However, there may be instances where 'commercial reality' makes it appropriate to include products in the same market despite limited price competition, e.g. between 'core' and 'fringe' suppliers.[41]

5.50 In order to establish the relevant market for a proposed merger the Commission is concerned to establish the potential sources of competitive, that is close, substitutes for the product(s) of the merging parties. Following the practice of the Tribunal and the Australian courts, the Commission will consider substitution possibilities on both the demand and supply side when identifying the competitive constraints which delineate the relevant market.

5.51 On the demand side the Commission will examine which goods or services consumers consider to be close substitutes for the merged firm's product and which geographic sources of supply they consider to be substitutable. If, in the event of a significant price rise or equivalent exercise of market power by the merged firm, consumers would switch to purchasing these alternatives to the extent of defeating such a price rise, these products and sources of supply will be included in the relevant market.

5.52 On the supply side the Commission will consider which suppliers could, without significant investment, switch their production and/or distribution facilities to supply a substitute product to that supplied by the merged firm, or switch from supplying another geographic area to that supplied by the merged firm. If, in the event of a significant price rise or equivalent exercise of market power by the merged firm, these suppliers would switch their supply to the extent of defeating the price rise, these suppliers will be included in the relevant market.

5.53 Market entry is distinguished from supply side substitution by the requirement for significant investment in production, distribution or promotion. For example, producers of T-shirts and shoes may be able to readily switch production and distribution facilities from supplying one size of garment or shoe to supplying another size. On the other hand, while a cannery could physically switch from the production of dog food to the production of canned peaches, the firm may need to make a significant investment in promoting the product for it to gain market acceptance.

5.54 In some cases it will be appropriate to define separate markets for different groups of customers. This will principally occur where a supplier with market power can effectively price discriminate between groups of customers characterised by different demand elasticities and/or competitive constraints, where arbitrage is ineffective. If competitive sources of supply were available and/or arbitrage were possible, price discrimination would not be possible and a single market would be defined.

5.55 When considering substitution possibilities it is sometimes necessary to consider a chain of substitution creating a 'ripple effect', or the 'linking principle'.[42] If A and B are substitutable and B and C are substitutable, should A and C be considered to be part of the same market? This question arises most frequently in relation to geographic market definition, but may also arise in relation to product market definition, particularly markets for differentiated goods and services. The argument has received a mixed reception from the courts. It was rejected in *TNT* but found favour in *Ansett*.[43, 44]

5.56 The Commission considers that the relevance of ripple effects depends on whether they constrain the price and output decisions of the merged firm. This in turn will depend on the degree of substitutability between different products or locations. For example, many retail markets are characterised by a continuum of geographic substitution across metropolitan areas, although stores at either extremity of the market are not in direct competition. If a significant price increase in one suburb would be defeated by customers shopping in neighbouring suburbs, where prices are in turn constrained by prices in the next suburbs, and this effect continues across the metropolitan area, the latter will be the relevant geographic market. By contrast, many wholesale markets are characterised by distribution over broadly State-based regions, with limited overlapping substitution at the edges. Such a limited overlap will not generally be sufficient to expand the relevant geographic market, since transport costs mean that substitution would be insufficient to render unprofitable a significant price increase in one State.

5.57 Market definition and/or the effect of a merger in such a product or geographic spectrum will also depend on the relative location of the parties in that spectrum. Where firms are adjacently located in the spectrum, the relevant market may be a narrow one and competition concerns are more likely to arise. Identification of sub-markets may also be a useful tool of competition analysis in this context (see paragraphs 5.77–5.78).

5.58 Delineation of the relevant **product** market (or markets) requires identification of the goods and/or services supplied by the merged firm and sources, or potential sources, of substitute products. Starting with the product (or products) supplied by the merged firm, each product market is gradually expanded to incorporate those firms which supply, or would supply, a closely substitutable product in the event of a significant price rise, or equivalent exercise of market power, by the merged firm.

5.59 In establishing the relevant product dimension of the market the Commission will have regard to the following types of information:

- end use of the product and potential substitutes;
- physical and technical characteristics of the product and potential substitutes;
- costs of switching purchases between the product and potential substitutes;
- views and past behaviour of buyers regarding the likelihood of substitution between products;
- costs of switching production and distribution systems from another product line to a product which is closely substitutable with the relevant product;
- views, business records and past behaviour of suppliers regarding the impact of price and marketing decisions by the suppliers of potential substitute products on their own pricing and marketing decisions; and
- relative price levels and price movements of the product compared to potential substitutes.[45]

5.60 In some cases it may be appropriate to define 'cluster' markets, comprising a bundle of related products, where the costs of unbundling mean that suppliers of the component products are unable to defeat a SSNIP by a hypothetical monopolist supplying the whole bundle of products.[46] These unbundling costs could be costs incurred directly by the consumer of unbundled products, e.g. additional transaction costs, or additional costs incurred by the suppliers of single products, e.g. diseconomies of scope, which are then reflected in the relative prices of bundled and unbundled products. However, these unbundling costs, like other determinants of the relevant market, may change over time. For example, when the Commission considered the Westpac/Challenge merger in 1995, it took the view that there was a cluster market for banking services. The subsequent development of effective competition from single product suppliers resulted in a different approach in 1997 when it considered the Westpac/Bank of Melbourne merger. In that case a number of separate product markets were identified for home loans, personal loans, transaction accounts and credit cards, but a smaller 'cluster' market for small business banking services was identified, based on the credit risk and information advantages of supplying a full range of services to small business.

5.61 Delineation of the relevant **geographic** market (or markets) involves the identification of the area or areas over which the merged firm and its rivals currently supply, or could supply, the relevant product and to which consumers can practically turn. Starting with the geographic area (or areas) supplied by the merged firm, each geographic market is gradually expanded to incorporate sources of supply to which consumers would turn and firms which supply, or would supply, the relevant product into that area in the event of a significant price rise, or equivalent exercise of market power, by the merged firm.

5.62 In establishing the relevant geographic dimension of the market the Commission will have regard to the following types of information:

- the convenience to customers of accessing alternative sources of supply;
- the costs of switching to alternative sources of supply;
- views and past behaviour of buyers regarding the likelihood of switching between geographic sources of supply;
- the costs of transportation or access to the alternative sources of supply;
- the perishability of the product;
- any regulatory or other practical constraints on suppliers selling to the customers of the merging firms;
- the costs of extending or switching production and distribution systems to supply the customers of the merging firms;
- views, business records and past behaviour of suppliers regarding the impact of price and marketing decisions in one geographic area on supply from another geographic area; and
- the relative price levels and price movements of different geographic sources of supply.[47]

5.63 Section 4E defines a market to be a market 'in Australia', while s. 50(6) defines a market to be a market 'in Australia, in a State or in a Territory'. Arguably, the Act does not require that the relevant market be defined as wholly within Australia, only that at least some part of it be in Australia. For practical purposes there will generally be significant discontinuities in substitution between domestic and imported supply. In most cases the Commission will define the relevant market to be Australia or a part of Australia (but including imports). However, in some circumstances it may be relevant to define the market as broader than Australia, e.g. trans-Tasman, or even a world market. For example, in its examination of the 1996 RGC/Cudgen RZ merger and the 1998 RGC/Westralian Sands merger the Commission accepted that there were world markets for the supply of feedstock for chlorine-route pigment production and for the supply of zircon. However, the international constraint must operate at the relevant functional stage; e.g. in *AMH* the Court defined a North Queensland fat cattle market despite the fact that beef is internationally traded. The international market price for beef might impose an upper limit on the price that could be charged for fat cattle by sellers, but it would not impose a lower limit on the price which could be extracted by buyers of those cattle, because fat cattle were not internationally traded.

5.64 Delineation of the relevant **functional** market requires identification of the vertical stages of production and/or distribution which comprise the relevant arena of competition. This involves consideration of both the efficiencies of vertical integration, commercial reality and substitution possibilities at adjacent vertical stages.

5.65 Where there are overwhelming efficiencies of vertical integration between two (or more) stages, it is inappropriate to define separate functional markets. Brunt made the following observation in relation to *QWI*:

> The market is the network of actual and potential transactions between buyers and sellers of goods or services which are, or could be, close substitutes. Under what circumstances, we may ask, would the potential for transactions not exist? Answer: when there are such efficiencies of vertical integration, as between y-bar and star pickets, that market coordination between buyers and sellers is superseded by in house coordination. There would, in such a case, be no functional split to create market transactions between stages of production. [48]

5.66 The current vertical structure of an industry may not be indicative of the relative efficiency of inter or intra firm coordination, as indeed was the case in *QWI*. However, for the purposes of merger evaluation the 'commercial reality' of current industry practice may mean that defining a single functional market most accurately reflects the arena of competition, even if the vertical efficiencies do not appear to dictate it. For example, when considering the proposed merger of the Bristile and Pioneer roof tile businesses in Western Australia the Commission defined a market for the 'manufacture, supply and fix' of roof tiles.[49] For newly deregulated utilities, where the industry has traditionally been organised as a vertically integrated government monopoly unresponsive to the relative efficiency of such a structure, the Commission will need to consider the likely evolution of vertical relations and the scope for market transactions at various vertical stages.

5.67 However, where vertical integration or vertical relationships are incomplete, or even non existent, vertical stages adjacent to the merged firm may still be relevantly included in the same functional market if close substitution possibilities, either product and/or geographic, at the adjacent level (and occasionally between levels) would constrain the merged firm from imposing a significant increase in price, or equivalent exercise of market power. For example, in *QIW* the Tribunal defined a single functional market for the distribution of groceries to the public, including wholesale and retail stages, reflecting the constraint imposed on the conduct of independent wholesalers by downstream competition between their independent retail customers and the vertically integrated chains.[50]

5.68 Product substitution primarily requires consideration of the extent to which vertically integrated suppliers constrain the price and output decisions of non-integrated suppliers. If the merged firm supplies an input A to downstream producers of B, and competition between those producers of B and integrated producers of A and B is sufficient to constrain the price and output decisions of the merged firm in relation to product A, the integrated suppliers will be included in the relevant market; either by defining the market to include both A and B, or by including the output of both integrated and non-integrated firms in a market for A. Either approach will incorporate all relevant substitution possibilities. Which approach is preferred will depend on what most accurately describes the arena of competition. For example, in the groceries example above the Tribunal's approach reflected the retail focus of competition between the independent wholesalers and retailers and the vertically integrated chains. However, when considering a number of mergers between vertically integrated miller-bakers, who compete with both independent millers and bakers, the Commission has defined separate functional markets for flour and bread, reflecting the two distinct arenas of competition (the former including other users of flour), but included internal sales in the flour market to reflect the constraint they impose through downstream competition in the bread market.

5.69 In relation to geographic substitution it is also necessary to consider whether the geographic markets in which the customers of the merged firm supply their output are broader than the geographic area in which the merged firm operates; and the extent to which downstream suppliers from different geographic areas constrain the upstream pricing of the merged firm. If the merged firm supplies an input A to downstream producers of B over a geographic area C, and competition between producers of B in area C and producers of B in area D is sufficient to constrain the price and output decisions of the merged firm in relation to the supply of product A in area C, the suppliers of A and B in area D will be included in the relevant market.

5.70 In establishing the relevant functional market the Commission will have regard to the types of information listed in paragraphs 5.59 and 5.62, to establish the relevant product and geographic market in which the customers of the merged firm operate. Where that product or geographic market incorporates sources of substitution and competitive restraint which have not already been incorporated in the product and geographic market identified in relation to the merged firm, the Commission will consider the following types of information to determine whether those constraints are sufficient to prevent the merged firm significantly increasing price, or an equivalent exercise of market power:

- the proportion of customers' costs represented by the merged firm's product;
- the gross margin of the merged firm in proportion to the total price charged to its customers;
- views, business records and past behaviour of suppliers regarding the impact of prices and marketing decisions by the downstream rivals of its customers on their own pricing and marketing decisions; and

- the relative price levels and price movements of the merged firm and the downstream rivals of its customers.[51]

5.71 The **time** dimension of the market refers to the period over which substitution possibilities should be considered.[52] In *Tooth & Tooheys* the Tribunal stated:

> It is plain that the longer the period allowed for likely customer and supplier adjustments to economic incentives, the wider the market delineated. In our judgement, given the policy objectives of the legislation, it serves no useful purpose to focus attention upon a short-run transitory situation. We consider we should be basically concerned with substitution possibilities in the longer run.[53]

The Commission will consider substitution possibilities over the longer term, but still in the foreseeable future, that will effectively constrain the exercise of significant market power by the merged firm.

5.72 The Commission recognises that competition and substitution are dynamic processes:

> ... effective competition is fully compatible with the existence of strictly 'limited monopolies' resting upon some short run advantage or upon distinctive characteristics of product (including location). Where there is effective competition, it is the ongoing substitution process that ensures that any achievement of market power will be transitory.[54]

5.73 Thus, for example, the New Zealand Court of Appeal confirmed a New Zealand High Court decision that there was a New Zealand album market rather than a separate market for each album.[55] Richardson J stated:

> Viewed in relation to product and time the single album definition of market ignores commercial realities. It focuses on short run phenomena. It presents a snapshot rather than a moving picture of continuing commercial activity. ... The emphasis on product differentiation arises precisely because there is a range of products competing for the consumer's attention. And the movement of albums in and out of the charts and their constantly shifting positions are clear evidence of the manner in which, and the extent to which substitution takes place.[56]

5.74 Planned deregulation may change the relevant product and geographic market boundaries in some industries (see paragraph 3.6). Whether or not the Commission defines the relevant market according to current substitution possibilities will depend on the timing and certainty of deregulation, the extent to which current price and output decisions are constrained by future substitution possibilities, and the extent of anti-competitive detriment that is likely to occur prior to deregulation. In *AGL* (concerning the gas industry), the Tribunal referred to 'a market expanding over time', in both its geographic and product dimensions.[57]

5.75 Where substitution requires significant new investment by producers or consumers these sources of competition will not be included in the relevant market, but will be considered under market entry.

5.76 Significant excess capacity in an industry may result in geographic movements of product that would not be sustainable in an equilibrium situation. Where such effects are likely to be transitory the Commission does not consider them to be a relevant basis to determine the geographic market.

5.77 In some cases it may be useful to identify sub-markets. In Australia sub-markets are used to refer to segments of markets which are characterised by some discontinuity in substitution possibilities or special characteristics. In *Tooth* & *Tooheys*, the Tribunal stated:

> Within the bounds of the market, substitution possibilities may be more or less intense, and more or less immediate: the field of substitution is not necessarily homogeneous but may contain within it sub-markets wherein competition is especially close or especially immediate. There may be, too, certain key sub-markets such that their competitive relationships have a wider effect upon the functioning of the market as a whole. In these matters we have found that the identification of sub-markets may be rather helpful in clarifying how competition works.[58]

5.78 Sub-markets are used as a tool to analyse the functioning of the market as a whole, but not as a legal standard of liability.[59] In *Tooth* & *Tooheys*, licensing restrictions within the Sydney and Newcastle areas had a significant impact on competition in the broader NSW market. For a merger to breach s. 50 there must be a substantial lessening of competition in the market as a whole; although its effects may be primarily or entirely felt in particular sub-market(s).

5.79 The identification of the precise market boundaries may be difficult on the basis of available evidence regarding substitution possibilities. It is critical to delineate the market precisely only to the extent that is necessary to determine the competitive effect of a merger.

5.80 While most mergers will involve the identification of markets where there is actual trade in goods or services, this is not necessarily the case. In *QWI* Deane J stated:

> The most that can be said is that ‘market’ should, in the context of the Act be understood in the sense of an area of potential close competition in particular goods and/or services and their substitutes.[60]

and:

> ... a market can exist if there be the potential for close competition even though none in fact exists. A market will continue to exist even though dealings in it be temporarily dormant or suspended. Indeed, for the purposes of the Act, a market may exist for existing goods at a particular level if there exists a demand for (and a potential for competition between traders in) such

goods at that level, notwithstanding that there is no supplier of, nor trade in, those goods at a given time — because, for example, one party is unwilling to enter any transaction at the price or on the conditions set by the other.[61]

Dawson J stated:

> ... the existence or non-existence of sales of a product cannot conclude whether a market exists or not. It must be sufficient to constitute a market that there is a product for exchange, regardless of whether exchange or negotiation for exchange has actually taken place.[62]

For example, a proposed acquisition may involve the prevention of trade and competition in an intermediate product by forestalling entry. This is likely to be particularly important in delineating functional market boundaries (see paragraphs 5.64–70).

5.81 In some cases mergers may occur between firms which are involved in the development or production of new products where no trade currently exists. Such a merger may have a substantial effect on potential competition.

Substantial market

5.82 Section 50 applies only to acquisitions in a substantial market. This qualification was introduced into the Act to remove *de minimus* matters from scrutiny.

5.83 The courts have not considered the meaning of the word ‘substantial’ in relation to market. In other contexts the courts have sometimes interpreted ‘substantial’ to mean real or of substance and sometimes to mean large, weighty or big. Thus, it can be used in either a relative or absolute sense.

5.84 In any particular case, it will be a matter of judgment whether a market is considered to be substantial. The Commission will take account of both quantitative and qualitative issues.

5.85 While a market may be small relative to the national economy, it may be substantial in the context of a State or regional economy.

5.86 Furthermore, whether or not a market is considered substantial will depend on the pervasiveness of the prices and outputs determined in that market. Thus, for example, a product which is an essential but small ingredient in the production of one or more other products with large markets, may be considered to be substantial in this sense.

Market concentration

5.87 Merger factor (c) requires the Commission to consider the level of concentration in the market. Market concentration refers to the number and size of participants in the market. A concentrated market is a necessary but not sufficient condition to enable the exercise of market power. If the relevant market is properly defined, a firm or firms will not normally be able to exercise market power in the absence of a significant market share.

5.88 A merger which increases the level of concentration in a market may reduce competition by increasing the unilateral market power of the merged firm and/or increasing the scope for coordinated conduct among remaining competitors.

5.89 The unilateral exercise of market power requires that a firm has sufficient control of a market, such that it can profitably 'give less and charge more' without being threatened by competing suppliers. For undifferentiated products this normally requires that a firm controls a substantial portion of capacity. The larger the percentage of total market supply which a firm accounts for, the less severely it must restrict its own output in order to procure a given price increase and the more likely such conduct is to be profitable. For differentiated products, brand loyalty and related factors may further inhibit smaller rivals from successfully preventing the unilateral exercise of market power. Market shares will generally be a good indicator of consumer preferences and brand loyalty for the firms' products; hence the greater the market share of the merged firm, the more potential switching between differentiated products will have been internalised within the firm.[63]

5.90 Firms with unilateral market power can also undertake 'strategic behaviour', such as predation, which may in turn affect market structure and market power. In its consideration of the proposed merger of Bristile and Pioneer's West Australian roof tile operations, the Commission was concerned that the creation of a clear market leader could result in price leadership and/or predation.

5.91 A reduction in the number of firms operating in a market increases the scope for coordinated conduct, including both overt and tacit collusion. It becomes easier to reach agreement on the terms of coordination, to signal intentions to other market participants and to monitor behaviour. More even market shares may increase the commonality of interest between market participants in some circumstances. In other situations the creation of one firm with a large market share may increase the likelihood of price leadership.

5.92 Furthermore, where market structure has been highly concentrated and market shares have been stable for a long period, this will tend to suggest that there are barriers to the entry of new market participants which might otherwise undermine and constrain the exercise of market power.

5.93 Since market shares are often more readily available than other information, they are a relatively low cost means of screening out many mergers which are not likely to result in a substantial lessening of competition. The Commission has adopted concentration thresholds below which it is unlikely to intervene in a proposed merger. The thresholds have been established on the basis of the Commission's historical experience of mergers and knowledge of current market structures.

5.94 The thresholds have been reviewed following a recommendation from the Industry Commission (now the Productivity Commission) to raise them. However, significant competition issues were found to arise in mergers which only just breached the thresholds, including one merger which the Commission considered breached the Act. The Commission has therefore decided to retain the existing thresholds.[64]

5.95 If the merger will result in a post-merger combined market share of the four (or fewer) largest firms (CR4) of 75 per cent or more and the merged firm will supply at least 15 per cent of the relevant market, the Commission will want to give further consideration to a merger proposal before being satisfied that it will not result in a substantial lessening of competition.[65] In any event, if the merged firm will supply 40 per cent or more of the market the Commission will want to give the merger further consideration. The twofold thresholds reflect concerns with the potential exercise of both coordinated market power and unilateral market power.[66]

5.96 Below these thresholds the Commission is unlikely to take any further interest in a merger. However, it must be emphasised that the calculation of market shares is critically dependent on market definition. Parties should be aware that the Commission will not necessarily accept their identification of the relevant market.

5.97 Occasionally an acquisition which falls below the thresholds may provide the merged firm with such a strategic advantage in the market that it could have the effect of substantially lessening competition. This is possible in auction type situations, where two small suppliers of (product or spatially) differentiated products provide the closest substitute to each other, or where an incumbent acquires a small innovative new entrant.[67]

5.98 The Commission will also want to consider the vertical independence of remaining rivals in a market before determining that a merger is unlikely to lessen competition (see paragraph 5.152).

5.99 A further relevant consideration is the extent of the increase in concentration. In many situations the acquisition of a small market player, resulting in a small increase in concentration, will have little effect on competition. However, in some instances a small increase in concentration may involve the removal of a market participant which played a significant role in maintaining a competitive market, e.g. by undermining attempts to coordinate market conduct. In other circumstances a small acquisition may form part of a pattern of creeping acquisitions, which have a significant cumulative effect on competition. Vertical mergers may involve no increase in concentration, but may enable the extension of market power into a vertically related market (see paragraph 5.153).

5.100 Market shares may be calculated with reference to capacity, sales volumes or sales values. Each conveys different information regarding the likely impact of a merger on competition. The Commission will place greatest weight on data which best reflects firms' future competitive significance. Capacity figures may be particularly useful as an indicator of market power in markets for undifferentiated products.[68] However, sales figures provide a better indication of firms' actual position in the market, which may reflect their access to distribution networks or the value of brand loyalty. The dollar value of sales is a particularly useful indicator of competitive strength in markets characterised by product differentiation and brand loyalty.

5.101 Imports should be included in the calculation of market shares and concentration ratios. Where a company is both an importer and a local manufacturer, the two types of supply should be treated as a single market share.

5.102 Post-merger market shares and concentration can generally be computed only on the basis of historic sales patterns, which may not reflect likely future patterns after the merger. There may be, for example, substantial new capacity coming on stream in a manufactured product market, there may be new licences about to be issued in a broadcasting market, or some firms may be running out of reserves in a primary product market. More generally, business customers are often reluctant to become dependent on a single supplier and may shift their custom if two suppliers merge. The Commission will consider any arguments which suggest that future market shares are likely to be significantly different from historic shares.

5.103 If the proposed merger does not fall within the 'safe harbours' established by the concentration criteria, the Commission will need to give close consideration to other merger factors to determine whether or not the merger is likely to result in a substantial lessening of competition.

Import competition

5.104 Merger factor (a) requires the Commission to consider the actual and potential level of import competition in the market. In an open economy such as Australia the importance of giving special consideration to the role of actual and potential import competition in considering the likely effect of a merger on competition is widely recognised.

5.105 Import tariffs and quotas have now been removed from most industries. However, industry standards may act as non-tariff barriers to trade, e.g. in plastics and steel products. If import competition, or the potential for import competition, is an effective check on the exercise of domestic market power, it is unlikely that the Commission will intervene in a merger. However, the assessment of actual and potential import competition needs to be undertaken with care.

5.106 As discussed at paragraph 5.63, the Commission will generally define the relevant geographic market to be Australia or a part of Australia and initially treat the market share of imports as indicative of their competitive role in that market. The Commission will then take account of arguments that the market share of imports is not indicative of their competitive role.

5.107 The Commission recognises that in some markets, market shares may understate the competitive constraint provided by imports, because of the potential to expand the supply of imports rapidly in response to higher prices. This will often be true in commodity markets.

5.108 However, it is also relevant to consider the price at which import supply becomes elastic. If that price is significantly higher than a competitive market price, there will still be scope for the merged firm to exercise market power by limit pricing to the import parity price. For example, the import parity price may be inflated by tariffs or transport costs; or a competitive domestic price may be the export parity price. In 1993 the Commission objected to a joint venture proposal between CSR and Mackay sugar because import tariffs and high freight costs raised the import parity price to a level which did not provide an effective constraint on refined sugar prices in Australia. However, in 1997 the Commission did not object to a similar proposal following reductions in freight rates and the imminent removal of import tariffs, reducing the import parity price to a level which would provide an effective constraint on Australian refined sugar prices. In some markets imports may even constrain domestic prices at levels below those which would deliver a normal rate of return.

5.109 In other cases market shares will overstate the likely role of imports in constraining the conduct of the merged firm. The fact that imports have established a small market share does not necessarily imply that they could expand in response to the exercise of market power by the merged firm. For example, imports may occupy a particular market niche, while the costs of importing may prohibit ‘mass market’ competition. In some markets, ‘buy Australian’ policies may reserve a significant percentage of sales for domestic suppliers. In other instances, imports may be sporadic to overcome shortages in domestic supply but would be considered a poor substitute for domestic supply on a regular basis. In some markets there is limited importing by wholesalers or retailers, but expansion may require significant investment in distribution facilities. As noted in paragraph 5.105, domestic industry standards may also create non-tariff barriers to effective import competition.

5.110 The Commission will also take account of licensing arrangements in relation to imports. For example, if domestic suppliers control the bulk of imports through exclusive licences, there will be little scope for independent import competition. Alternatively, if exclusive rights are held by independent importers, it will be necessary to consider whether rights to competitive products are held by a range of importers or aggregated by a few, and hence their likely behaviour post-merger.

5.111 The Commission has not objected to any merger where comparable and competitive imports have held a sustained market share of 10 per cent or more for at least three years, and — as an indicative guideline — is unlikely to do so. However, it should be emphasised that it is not the historical share of imports that is significant, but their potential to constrain the price and output decisions of the merged firm. Recent examples of mergers which the Commission has not opposed in concentrated markets on the basis of effective or potentially effective import competition are KAAL/Comalco (aluminium sheet and foil), Alcan/Comalco (aluminium extrusions), Consolidated Alloys/Radiant (lead sheeting), GNB/Australian Battery Company (automotive and industrial batteries), Dow Chemical/Huntsman Chemical (polystyrene), ICI/Auseon (PVC), ANI/National Castings (steel and alloy iron castings), Allied Colloids/Imdex (synthetic flocculants), Caroma/Fowler (vitreous china toilet bowls and hand basins), UCB/Orica (oriented polypropelene). However, it would still be prudent in such cases for the merging parties to advise the Commission of their plans given the necessarily qualitative nature of any assessment of import competition.

5.112 In considering the role of imports the Commission may require the following types of information:

- information that domestic suppliers are consistently inhibited in their pricing by the pricing of actual or potential import supplies;
- the extent to which imports are independent of domestic suppliers or the extent to which they are brought in under the licence of the merging firms and/or other domestic suppliers;
- whether existing import supply routes could accommodate a significant expansion of supply, without the need to invest in sunk costs of distribution, advertising and promotion;
- the extent to which imports are closely substitutable for the products of the merging firms from the perspective of their customers, without the need for supply substitution by the overseas producers;
- tariff levels and non-tariff barriers to trade, including industry standards;

- changes to tariff levels and other forms of protection which are likely to occur over the next two or three years;
- information that overseas corporations have concrete plans to enter the Australian market;
- data on the impact of exchange rate changes on the viability and market share of imports;
- information about the availability and potential availability and influence of imports in different parts of Australia; and
- practical difficulties in importing versus local supply in relation to the nature of the product and its demand, e.g. perishability (both physical and fashion related), the importance of rapid supply response and the costs of holding inventories.

5.113 In some markets import competition may impose a constraint on the merged firm via a downstream market. This is a parallel issue to part of the question of functional market definition discussed in paragraphs 5.67–5.70. If the merged firms' customers are closely constrained in their ability to pass on input price increases by effective import competition, the merged firm may not be able to significantly increase its prices. Similar information will be relevant here to that listed in paragraph 5.70 in relation to functional market definition.

5.114 Where a merger raises competition concerns on the demand side of a market, exports can play a similar role in constraining the market power of buyers to the role played by imports in constraining the market power of suppliers. That is, if the merged firm buys from producers in an export industry it will not be able to depress domestic prices below competitive levels because this would result in supply switching to export markets. Hence the merger would be unlikely to substantially lessen competition.

Barriers to entry

5.115 Merger factor (b) requires the Commission to consider the height of barriers to entry to the market. Even where a merger breaches the concentration thresholds and import competition is not effective, if the market is characterised by low barriers to new entry incumbent firms are likely to be constrained by the threat of potential competition to behave in a manner consistent with competitive market outcomes. However, if there are significant barriers to the entry of new suppliers, an increase in concentration to levels above the Commission's thresholds, in the absence of significant import competition, is likely to give rise to a substantial lessening of competition.

5.116 Barriers to entry can be any feature of a market that places an efficient prospective entrant at a significant disadvantage compared with incumbent firms. They may consist of sunk costs; legal or regulatory barriers; access to scarce resources enjoyed by incumbent firms; economies of scale and scope; product differentiation and brand loyalty; and the threat of retaliatory action by incumbents.

5.117 Sunk costs are costs which are unrecoverable on exit, creating a risk from entry. Their extent depends on factors such as capital specificity, whether there are developed markets in rental of equipment and requirements for investment in advertising and promotion.

5.118 Legal and regulatory barriers such as licensing requirements, planning or environmental controls or industry standards, may directly limit the number of competitors in a market, or may add to the sunk costs of entry through specific capital requirements.

5.119 Scarce resources may consist of physical resources such as mineral deposits or intellectual resources such as patents.

5.120 Economies of scale and scope, both plant and multi-plant, may inhibit entry depending on expected post-entry prices, which in turn will depend on factors such as the minimum efficient scale of entry, cost penalties associated with sub-optimal plant utilisation, price elasticity of demand and market growth.

5.121 Product differentiation and brand loyalty may affect both the level and elasticity of demand faced by a new entrant compared to an incumbent firm and add to the sunk cost requirements of entry in the form of advertising and promotion costs.

5.122 The threat of retaliatory action by incumbents may also create a barrier to new entry. Potential entrants may anticipate predatory behaviour by incumbent firms on the basis of past behaviour in this or other markets. Such threats may pose an effective deterrent, even in markets which may otherwise appear to have relatively low barriers to entry.

5.123 The 'height' of barriers to entry indicates the extent to which incumbents can raise the market price above its competitive level without attracting entry. It is not necessary for a merger to increase barriers to entry for it to be anti-competitive; only that significant barriers exist, providing incumbents with discretion in pricing and other conduct. If the merger also increases barriers to entry, the anti-competitive effects are likely to be more severe.

5.124 In considering the height of barriers to entry, the Commission will have regard to the following types of information:

- sunk costs in both production capacity, accessing shelf space, advertising and promotion;
- any regulatory restrictions on entry, such as licensing requirements and industry standards;
- any requirements for scarce inputs;
- the extent of brand loyalty enjoyed by incumbents;
- minimum efficient scale of operation;
- cost penalties for operating at sub-optimal capacity;
- price elasticity of demand;
- market growth or decline; and
- potential response of incumbents to new entry.

5.125 Dr Brunt has provided the following useful test of what constitutes a significant barrier to entry for trade practices purposes:

> The essential test for whether or not there is a significant barrier to entry can be expressed simply enough: it is whether the threat of entry of whatever kind will constrain incumbents to behave competitively. It follows that neither initial entry nor eventual established supply must necessarily be of the full-line variety. Leading firms can be constrained by a collection of more specialised rivals. Firms may enter at one scale or one product-range and grow to another. However we cannot speak of easy entry if the only viable entry is that which occurs at the fringe of the market in competition with that fraction of the incumbents' business that has high marginal costs; or if the only viable entry is of the fringe products that fail to attack the incumbents' core business. There must be, in Richard Schmalensee's phrase, 'real pressure on established firms' profits'. [69]

5.126 The Commission considers that effective entry is that which is likely to have a market impact within a two year period, either by deterring or defeating the attempted exercise of significant market power by the merged firm. In some markets the threat of entry is sufficient to constrain firm conduct. In others, actual entry will be required. The latter would require entry on a sufficient scale and which offered a product sufficiently attractive to consumers to be effective.

5.127 When the market impact of actual or potential entry on the merged firm's conduct occurs is likely to vary with the nature of the goods or services supplied. For example, where purchases are one-off, such as building services, actual entry may be required before there is any impact on current conduct, since high prices today are unlikely to deter tomorrow's customers. However, for goods which are subject to repeat purchases and significant consumer loyalty, potential entry is more likely to have an impact on current conduct, which has the potential to lose customers in the future. Product life can also be important. Consumers may choose to extend the life of their existing durable goods rather than buy new ones if the price is too high. In such markets, entry need not occur as swiftly to be effective. In markets characterised by bidding for large scale contracts, a potential entrant may be able to exert pressure on incumbent firms' conduct by submitting bids in advance of physical entry. If successful, those contracts could then provide the springboard for entry, e.g. an international firm considering entry into the Australian market or a firm operating in one State considering the extension of its operations inter-state.

5.128 The Commission will have particular regard to evidence of the past success or failure of new entrants in establishing themselves as mainstream competitors in the relevant market. Historical evidence of high prices and profits being maintained for long periods without encouraging new corporations to enter the market, or historical evidence of firms entering, failing and leaving the market, will suggest there are barriers to successful effective entry to the relevant market. Also relevant will be evidence of concrete plans by major corporations, either domestic or overseas, to launch a major entry into the market. However, if the historical record is one of failed entry, the Commission will need to be convinced that these plans are likely to meet with more success than those of past entrants.

Countervailing power

5.129 Merger factor (d) requires the Commission to consider the degree of countervailing power in the market. Countervailing power exists where a supplier (buyer) faces a buyer (supplier) with market power or a credible threat of vertical integration (or other form of bypass) or direct importing. In such cases, the ability of the merged firm to increase (decrease) prices may be constrained and the likelihood of a substantial lessening of competition diminished.

5.130 The Commission does not consider that countervailing power is synonymous with small numbers of buyers (suppliers). As discussed in paragraph 5.87, market concentration is a necessary but not sufficient condition for market power. Furthermore, as discussed in paragraph 5.20, the ability of buyers to depress prices below competitive levels tends to be inhibited by elastic supply conditions in many markets. However, as noted in paragraph 5.168, large infrequent purchases, such as long term contracts with major customers, may tend to undermine attempts at coordinated conduct.

5.131 If pre-merger prices are distorted from competitive levels by market power on the opposite side of the market, a merger may actually move prices closer to competitive levels and increase market efficiency. For example, a merger of buyers in a market may create countervailing power which can push prices down closer to competitive levels. If those firms face broader competition in their downstream market(s), the benefits are likely to be passed through to final consumers. Even if the buyers have downstream market power, moving input costs closer to competitive prices may result in profits being maximised at somewhat lower downstream prices.

5.132 Alternatively, if, for example, market power on the demand side of a market had simply kept pre-merger prices at competitive levels because of supply elasticity, a merger on the supply side of the market may or may not be able to increase prices. If both customers and the merged firm have market power post-merger, prices will be determined under conditions of bilateral monopoly, in which the relative bargaining power of each side will determine the outcome. If there are fewer suppliers than buyers post-merger, no significant restraint from imports and high barriers to entry, it is likely that post-merger prices will be higher than pre-merger prices. If, on the other hand, customers have a credible threat of vertical integration, could facilitate entry by long term vertical contracts or could directly import competitive supplies, post-merger prices may still be maintained at competitive levels.

5.133 If there are customers (suppliers) of the merged firm who possess effective countervailing power, the Commission will consider what proportion of the merged firm's total customer (supplier) base, in both numbers and revenue terms, has such countervailing power; the likely effect of the merger on prices for different groups of customers (suppliers); and whether any likely increase (decrease) in prices is sufficient to constitute a substantial lessening of competition.

Availability of substitutes

5.134 Merger factor (f) requires the Commission to consider the extent to which substitutes are available in the market or are likely to be available in the market. Demand and supply side substitution underpins the identification of the relevant market, which was discussed in paragraphs 5.34–5.86.

5.135 However, when considering the extent to which substitutes are available, it is also relevant to consider their own-price elasticity of supply. This is essentially a function of the relative capacity of market participants post-merger, the shape of firms' cost curves and the costs of capacity expansion.

5.136 For example, many distribution services tend to be characterised by high fixed costs and low variable costs over a large range of output, which can promote intense rivalry even between a small number of players. In other industries, costs rise sharply when full capacity is approached. If the merged firm has the majority of capacity, the ability of remaining firms to inhibit price increases is likely to be limited. However, the costs of capacity expansion also need to be considered, which can sometimes differ markedly from the costs of new entry.

5.137 Mergers often occur in industries with excess capacity. While excess capacity may be promoting competitive pricing pre-merger, the Commission will wish to consider the longer term effects of the merger on prices. This will depend on demand trends and planned post-merger rationalisation. Excess capacity may be a short lived phenomenon, either because demand is increasing or because the merged firm will retire excess capacity. If, on the other hand, the merged firm retains significant excess capacity, this in turn may inhibit competitive pricing by remaining rivals, expansion or new entry. Arguments regarding the efficiency benefits of rationalisation are primarily relevant in the context of applications for authorisation (see Section 6).

Vigorous and effective competitor

5.138 Merger factor (h) requires the Commission to consider the likelihood that the merger would result in the removal from the market of a vigorous and effective competitor. This factor focuses on the actual conduct of the target firm pre-merger and likely future conduct with and without the merger. The more significant the conduct of the target firm for the level of competition in the market, the greater the likely competitive effect of the acquisition.

5.139 If the target firm has been a particularly competitive or innovative influence in the market, the Commission will have particular concerns regarding the likely competitive effect of the merger. In some markets the 'maverick' behaviour of particular firms, even small firms, serves to undermine attempts to coordinate the exercise of market power. These firms tend to deliver benefits to consumers beyond their own immediate supply, by forcing other market participants to deliver better and cheaper products. Alternatively a small firm may be an innovative new entrant with a new product or process capable of upsetting established market shares. The Commission would be particularly concerned if such firms were the target of mergers.

5.140 In some instances a merger which breaches the concentration thresholds may create a more vigorous competitor in the market place. For example, a merger between two smaller companies may create a more efficient combined firm which is then able to compete more effectively with larger rivals. The Commission would need to be satisfied that such a merger would either increase, or not substantially lessen, competition in the market and that this effect would be sustained and not just a temporary struggle to establish future market dominance and/or one which is likely to be replaced by oligopolistic coordination, higher prices and potentially the erosion of efficiencies.

5.141 In other circumstances it may be argued that the target firm's assets would exit the industry absent the acquisition. The former Trade Practices Commission has discussed its approach to 'failing firms' in greater detail in a discussion paper issued jointly with the New Zealand Commerce Commission.[70] Briefly, the Commission will need to be convinced that the firm cannot be successfully reorganised and there is no other viable buyer whose acquisition of the firm would not raise competition concerns, and no likelihood of such a buyer emerging, such that the firm's resources are likely to exit the market absent the merger and so cease to represent an actual or potential constraint on the market.

5.142 In most instances the acquisition of a failing firm does not even raise competition issues because there are sufficient competitive constraints on the merged firm remaining in the market. Where competition concerns do arise, Australia does not have a US style 'failing firm defence'. However, failure may be relevant to the evaluation of a merger under both s. 50 and the authorisation provisions.

5.143 It is part of the competitive process that firms will fail, either because of internal problems or due to external changes in market demand and resultant excess capacity. In such circumstances mergers can be an effective means of putting resources to alternative uses and/or improving efficiency through rationalisation. These are issues which can be considered under the authorisation process. The question for s. 50 is how the acquisition of a failing firm will affect competition.

5.144 If the target firm is considered to be failing, the Commission will consider the likely effect of the acquisition on competition compared to the effect of the target's assets exiting the market. Under the latter circumstances the distribution of the target's customer base among the remaining market participants would be determined by market forces, whereas an acquisition would tend to deliver those customers to the acquiring firm.

5.145 If the acquirer is the only other participant in the market, the two scenarios give the same result and the acquisition is unlikely to have any effect on the level of competition. Only where the acquiring firm is able to get some strategic advantage from the acquisition, deterring further entry, might there be a substantial lessening of competition.

5.146 In oligopolistic markets the effect on competition is likely to be less straightforward. With a merger the market share of the acquiring firm will increase by more than if the failing firm exits the market and the failing firm's share is picked up by all the remaining firms. However, whether this amounts to a substantial lessening of competition will require a full assessment of the two scenarios, taking into account all the usual merger factors, including an assessment of possible strategic motives for the acquisition of the failing firm. In its consideration of Bristile's proposed acquisition of Pioneer's concrete roof tile business in Western Australia, which was claimed to be failing, the Commission took the view that the acquisition would give Bristile such strategic advantages as to make effective competition with the two remaining roof tile manufacturers or new entry unlikely.

5.147 Arguments regarding any claimed public benefits that may arise from the acquisition of a failing firm can be considered in the context of an application for authorisation (see Section 6). The claimed benefits may include retention of technical or productive assets, avoidance of social dislocation and unemployment or the achievement of resource savings through rationalisation and economies of scale. (To the extent that these impact on the likely competitive outcomes they may also be relevant to s. 50 considerations.)[71]

Vertical integration

5.148 Merger factor (i) requires the Commission to consider the nature and extent of vertical integration in the market. Vertical relations between firms can range from spot transactions, through long term contracts and licensing arrangements, to common vertical ownership. References to vertical integration in this section cover all forms of vertical relationships.

5.149 The form of vertical relationships can reflect efficiency considerations, such as minimisation of transactions costs or prevention of free riding, but may also have implications for competition. In *Queensland Wire Industries*, Mason CJ and Wilson J said:

> It is true enough that vertical integration sometimes accompanies a substantial degree of market power, but its presence does not necessarily mean that a substantial degree of power exists. [72]

5.150 Vertical relationships may affect the likely competitive impact of a horizontal merger; and vertical mergers may affect the degree of horizontal competition. The Commission will be concerned to examine both of these effects.

5.151 Vertical relationships and vertical mergers will raise concerns only if there is a concentrated industrial structure at one or more of the related or integrated stages of production or distribution. If all stages fall within the ‘safe harbours’ established for horizontal mergers, the Commission is unlikely to take any further interest in the merger. Only if the merged firm breaches the concentration thresholds, and there is an absence of effective import competition and there are high barriers to entry, will any of the detrimental effects to competition discussed below be likely to occur.

5.152 However, when considering the level of concentration it is also necessary to consider whether rivals are vertically independent of the merged firm. For example, in the *Rank* case the Commission considered that the acquisition of Foodland, the only independent grocery wholesaler in Western Australia, by Coles Myer Ltd (CML), a vertically integrated grocery retailer, under a Deed of Cooperation between Rank and CML, would have the effect of substantially lessening competition in retail grocery markets in which CML competed with the subsidiary retailers and customers of Foodland.[73] In other circumstances a horizontal merger may apparently not breach the concentration thresholds, but if the remaining rivals in the market must obtain essential inputs from a market in which the merged party has market power, the merger may still substantially lessen competition.

5.153 In certain circumstances vertical integration by a firm with market power at one stage of production or distribution can enable an extension of market power and reduction of competition to occur in a vertically related market. This may involve foreclosure of supply or customers to rivals in the vertically related market. Alternatively, vertical integration may pre-empt the development of competition at one vertical level where a vertically integrated incumbent can effect discriminatory access to an essential input; or where the vertically integrated owner of the essential input gains access to commercially sensitive information regarding the downstream activities of its rivals.

5.154 Vertical acquisitions may also target potential entrants into upstream or downstream markets, forestalling the development of competition.

5.155 Where vertical integration closes off independent sources of supply or outlets for distribution, barriers to entry and/or expansion may be raised and new entrants may be required to enter at all stages of production and/or distribution. In its consideration of Wattyl's proposed acquisition of Taubmans paints, the Commission considered that exclusive vertical trade dealership and associated retail relationships impeded the entry and expansion of new rivals in the architectural and decorative paints market, by restricting access to retail shelf space.[74]

5.156 Vertical integration may also enable a firm with market power to increase monopoly profits through price discrimination. As Mason CJ and Wilson J observed in *Queensland Wire Industries*:

> ... vertical integration may help a monopolist distinguish between customers whose demand is less and more elastic. Where consumers are able to trade amongst themselves, the monopolist cannot discriminate. By integrating vertically it may be possible for a monopolist to prevent this inter-trading. For example, power companies usually own distribution systems. This enables them to discriminate in pricing between residential and commercial users. Therefore, although vertical integration does not by itself mean that a firm has a substantial degree of market power, it may well be the means by which the firm capitalises on that market power.[75]

5.157 Where all firms are vertically integrated this may facilitate greater coordination of their activities. For example, ownership of retail outlets or retail price maintenance may enable better coordination and enforcement of upstream prices through the greater visibility of downstream prices.

5.158 Where a firm with market power is subject to downstream price regulation, upstream vertical integration may enable the circumvention of price controls through transfer pricing of inputs.

5.159 In summary, when considering the competition effects of vertical relationships and vertical mergers, the Commission will consider the following types of information:

- whether the merged firm has market power in any market which could be leveraged into a vertically related market;
- whether the target firm would have been a likely entrant to a vertically related market;
- whether the merged firm will control access to an essential input;
- whether vertical integration raises barriers to new entry;
- whether vertical integration is likely to facilitate the evasion of access or downstream price regulation;
- whether vertical integration is likely to facilitate price discrimination;
- whether vertical integration is likely to facilitate price coordination; and
- the extent to which horizontal rivals are vertically independent.

5.160 Potential efficiency gains from vertical mergers can be considered in the context of authorisation (see Section 6).

Dynamic characteristics of the market

5.161 Merger factor (g) requires the Commission to consider the dynamic characteristics of the market, including growth, innovation and product differentiation. This factor cuts across most of the other merger factors and has already been discussed to some extent.

5.162 Whether a market is growing or declining can have significant implications for the potential erosion of market power over time. Markets which are growing rapidly are more likely to see new entry and the erosion of market shares over time. Markets which are characterised by rapid product innovation may see market leaders rapidly replaced. However, in some differentiated product markets, first mover advantages and brand loyalty can resist such advances. Historical information on changing market shares will be informative here.

5.163 Regulatory or technological changes may change market boundaries or lower barriers to imports or new entry in the foreseeable future (see paragraphs 3.6 and 3.7). For example, deregulation may remove geographic restrictions on distribution, remove import quotas or reduce tariffs, or increase the number of potential entrants through the removal of restrictive licensing requirements. New technology may increase supply side substitution between products, facilitate global distribution of services, or facilitate new small scale entry into a market.

5.164 A merger may involve the acquisition of technology, intellectual and industrial property and/or research and development facilities, which may in turn affect the competitive dynamics of the relevant market. For example, the acquisition of a fledgling entrant with a new product and/or technology by an incumbent firm may prevent or hinder the injection of new competition into the market. By contrast a merger may combine complementary technologies in such a way as to create a stronger competitor and enhance competition in the market. Whether or not competition is enhanced there may still be efficiency gains which could be considered in the context of an application for authorisation (see Section 6).

5.165 Sometimes when there is one merger or joint venture in a market, the consequent realignment of competitive positions may result in further mergers and/or joint ventures. In these circumstances the Commission will consider the flow on effects of the original merger when evaluating its competitive impact on the market.

Other factors

5.166 The list of merger factors in s. 50(3) is not exclusive and particular mergers may involve other factors which impinge on the likely competitive outcome of the merger. It is not possible in this guideline to foresee every possible factor which may be of relevance in particular market circumstances.

Coordinated conduct

5.167 One factor which is of general relevance is the extent to which the market is characterised by conditions conducive to coordinated conduct. While the exercise of unilateral market power does not require accommodating action by remaining firms in a market, the exercise of coordinated market power does. This does not necessarily involve collusion of the kind covered by s. 45 but may simply involve signalling or conscious parallelism. Features of the market which impinge on the likely rewards from coordination, the likelihood of reaching an agreement, and the ability of the parties to detect and punish deviations from the agreement, are all relevant to the likelihood of such conduct occurring and being successful in the future.

5.168 Some of the factors affecting the likelihood of coordinated conduct are:

- a small number of firms increases the likelihood that firms will recognise mutual benefits from cooperation, and makes it easier to reach an agreement and detect cheating;

- the absence of potential entrants or fringe competitors makes it less likely that coordinated conduct will be undermined;
- inelastic demand increases firms' returns from coordination versus competition;
- product homogeneity makes it easier to reach an agreement and easier to detect deviations;
- firm homogeneity, similarity of cost and other conditions, e.g. vertical integration, product lines or production capacity, affecting the interests of rivals makes it easier to reach an agreement;
- posted prices or open bids, i.e. transparency of prices, make monitoring an agreement easier;
- vertical relationships may enable price signalling or price monitoring downstream;
- size and frequency of purchases affects firms' incentives to cooperate or compete; and
- industry associations and fora may facilitate the flow of information on prices and outputs between market participants and/or may facilitate them reaching an agreement.

5.169 If a merger increases the likelihood of coordination it is likely to substantially lessen competition. Both horizontal and vertical mergers may have this effect. For example, mergers can increase the level of concentration in a market, they may remove a maverick competitor which has destabilised past attempts at market coordination, they may create rivals with a greater commonality of interest, or they may increase the visibility of pricing through downstream integration. In other circumstances a merger which disrupts market conditions, e.g. by reducing the costs of the merged firm or eliminating a technology disadvantage, may disturb the terms of coordination and may make such coordination less likely.

5.170 When considering the likelihood of future coordination the Commission will also consider any existing relationships between firms and the past history of market conduct, whether it has been characterised by price fixing, parallel pricing or vigorous price competition and how such conduct is likely to be affected by the merger.

Efficiencies

5.171 As discussed in paragraphs 5.16-5.17, although s. 50 is concerned with the level of competition in markets and not the competitiveness of individual firms, and while efficiencies are more generally relevant in the context of authorisation, the extent to which any efficiency enhancing aspects of a merger may impact on the competitiveness of markets is relevant in the context of s. 50.

5.172 Where a merger enhances the efficiency of the merged firm, for example by achieving economies of scale or effectively combining research and development facilities, it may have the effect of creating a new or enhanced competitive constraint on the unilateral conduct of other firms in the market, or it may undermine the conditions for coordinated conduct. Pecuniary benefits, such as lower input prices due to enhanced bargaining power, may also be relevant in a s. 50 context.

5.173 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.

5.174 While recognising that precise quantification of such efficiencies is not generally possible, the Commission will require strong and credible evidence that such efficiencies are likely to accrue and that the claimed benefits for competition are likely to follow.

Prices and profit margins

5.175 Merger factor (e) requires the Commission to consider the likelihood that the acquisition would result in the acquirer being able to significantly and sustainably increase prices or profit margins. This factor brings together all the other factors discussed above to determine whether the merger will have the effect, or be likely to have the effect, of substantially lessening competition in a market. If the merger facilitates sustained increases in prices or profit margins above competitive levels, this will be indicative of an increase in market power and a reduction in competition. However, it is not necessary for the merged firm to take advantage of its pricing discretion for competition to be damaged; it may simply opt for a quiet life or may use its pricing discretion to protect inefficient operations rather than to accrue excess profits.

5.176 Sustained price increases above competitive levels are the most obvious and visible manifestation of market power and a substantial lessening of competition. In some instances a merger may not increase prices but rather prevent prices falling to competitive levels by, for example, forestalling entry. Market power can also be exercised in other ways, e.g. conditions of access to an essential facility or reductions in product quality. Alternatively the merger may result in cost reductions which accrue as increased profits rather than being passed through to consumers in lower prices. The merged firm sends out no price signals to rivals or potential rivals, which might otherwise increase production in response to price increases by the merged firm; while the merged firm increases its resources to discipline maverick pricing or attempts at market entry.

5.177 Where an acquisition involves a joint venture buyout it will be necessary to consider the price and other incentives operating on the joint venture before and after the buyout. For example, if the joint venture was previously operating on a profit maximising basis there may be no effect on prices from the buyout. However, if it was previously operating on a cost sharing basis, the buyout may significantly change incentives. A joint venture buyout by a vertically related firm may also create the potential to leverage market power from one stage to another (see paragraphs 5.153-5.156).

5.178 Where the merged firm's prices are regulated, the Commission will give particular attention to non-price aspects of competition. For example, if a vertically integrated firm owns an essential facility for its downstream rivals, but conditions of access are regulated, the Commission will consider whether the access regime is fully capable of insulating downstream rivals from the effects of upstream market power. Where final outputs are price regulated the Commission will consider the potential for reductions in non-price competition, such as quality and product innovation. Furthermore, access regimes and price regulation may not be a permanent feature of the market and it will be appropriate to consider the likelihood of future changes to the regulatory environment and the impact of the proposed merger in the absence of such regulation.

5.179 There may be circumstances where pre-merger profits are depressed below sustainable levels, for example due to excess capacity, and the merger provides a vehicle for rationalisation, resulting in price and/or profit increases. Provided there are sufficient constraints remaining in the market to prevent price increases above competitive levels, the Commission would be unlikely to object to such a merger. However, any such claims will be subject to careful scrutiny.

6. Authorisation

6.1 Authorisation is the process of granting immunity, on public benefit grounds, for mergers and acquisitions which would or might otherwise contravene ss 50 or 50A of the Act.[76]

6.2 Once authorisation is granted in relation to an acquisition neither the Commission, the Minister, nor third parties can take action under the Act to overturn the acquisition. The immunity only runs, however, once authorisation is granted and for the period authorisation is granted.

6.3 Applications for authorisation are considered initially by the Commission. Its determinations can be reviewed by the Tribunal on application by an interested party.

6.4 Authorisation may be granted conditionally and/or may be granted subject to statutory undertakings provided by the applicant.

6.5 Parties proposing a merger should be aware that they can not seek authorisation for an acquisition which has already occurred and, except in certain circumstances, this may also apply from the date upon which they enter into a contract for the acquisition. Sub-sections 50(4) and (5) provide that where a contract has been entered into for the acquisition of shares or assets, providing that the contract is subject to the granting of authorisation and the person applied for the granting of authorisation within a period of 14 days after the contract was entered into, the acquisition shall not be regarded as having taken place until the application is disposed of or the contract ceases to be subject to the condition.

6.6 The Commission cannot initiate the process. The acquirer must lodge the application. While the Commission may suggest an authorisation application should be lodged, the decision on whether or not to do so lies ultimately with the parties.

6.7 The Commission has a period of 30 days to consider an application (s. 90(11)(a)). This may be extended to 45 days for complex matters (s. 90(11A)). It may also be extended by Commission requests for information from the applicant (s. 90(11)(b)) or with the agreement of the applicant (s. 90(12)). The Commission endeavours to deal with applications for authorisation as expeditiously as possible, subject to meeting its statutory obligations. If the Commission has not made a determination in the relevant period the authorisation is deemed to have been granted.

6.8 The authorisation process is a public process in which any interested party may make a submission, submissions are open for inspection on a public register, and there may be provision for a conference of interested parties. There is, however, provision for maintaining confidentiality of commercially sensitive information or otherwise where it appears desirable to the Commission to grant confidentiality.

The statutory test

6.9 Section 90(9) provides that the Commission shall not grant authorisation:

> unless it is satisfied in all the circumstances that the proposed acquisition would result, or be likely to result, in such a benefit to the public that the acquisition should be allowed to take place.

6.10 Section 90(9A) provides that in determining what amounts to a benefit to the public:

> (a) the Commission must regard the following as benefits to the public (in addition to any other benefits to the public that may exist apart from this paragraph):
>
> (i) a significant increase in the real value of exports;
>
> (ii) a significant substitution of domestic products for imported goods; and
>
> (b) without limiting the matters that may be taken into account, the Commission must take into account all other relevant matters that relate to the international competitiveness of any Australian industry.

6.11 The onus is on the applicant to satisfy the test.[77]

Application for authorisation

6.12 An application must be lodged on the appropriate statutory form at an office of the Commission during business hours, accompanied by the relevant application fee(s).

6.13 The application should set out in detail particulars of the proposed acquisition. It should be accompanied by a comprehensive submission setting out the benefit to the public expected to flow from the acquisition and commenting on any possible anti-competitive or other detriments that may result.

6.14 A copy of the application and submissions will be placed on the public register. Section 89(5A) provides that confidential information may be excluded from the register. Any claim for confidentiality should be clearly marked. If the Commission refuses a claim for confidentiality the relevant submission or document, or part of a submission or document, will be returned to the applicant.

6.15 Section 90(11) provides for the Commission to issue a notice requesting additional information relevant to its consideration of the application. Such a notice has the effect of extending the 30 day period (or 45 days in complex matters) during which the Commission must make a determination, by the number of days the applicant takes to provide the information. This response, and any further submissions, will be placed on the public register, subject to confidentiality claims.

6.16 Whether the Commission issues a formal request for information or not will depend on the circumstances of the particular case. For example, if the Commission feels that it needs additional information to test some aspect of an application it may request additional information. In other cases where the Commission feels that an application is not particularly well supported in some respect, rather than issue a formal request for information it may simply advise the applicants of that assessment and then leave it up to the applicants (who bear the onus of making their case) to address that aspect if they wish. In other cases the Commission may receive submissions from interested parties challenging some aspect of an application. Rather than issue a formal request for information the Commission may simply bring the interested parties' submissions to the attention of the applicants and leave it to them to decide how or whether they address the issues raised.

6.17 In complex matters the Commission encourages parties to give it some advance notice on a confidential basis of a pending application for authorisation. This may obviate or minimise the need for additional information requests and extensions of the 30 day period.

Consideration of the application

6.18 In considering an application for authorisation the Commission seeks the views of a wide range of parties which may have an interest in the matter including:

- suppliers;
- customers;
- importers;
- competitors; and
- other potential acquirers.

6.19 Parties are invited to make written submissions which will be placed on the public register, subject to confidentiality claims. The Commission may also undertake market inquiries to gain a better understanding of the relevant market(s) and the likely effect of the proposed acquisition.

6.20 The Commission will also seek the views of government departments and others who may have expertise in the matter. Such parties may be asked for written comments and/or may be interviewed by the Commission. The Commission may also engage relevant experts to provide consultant reports on particular aspects of the application.

6.21 Because of the limited time frame in which the Commission must consider an authorisation application it is generally able to give interested parties only minimal time for comment — normally a week. However, subject to statutory time constraints interested parties are also welcome to comment on supplementary submissions which may be received after the initial application.

6.22 All non-confidential submissions and reports will be placed on the public register. The public register is located in Canberra but, depending on the likely interest in a matter, additional copies of the applications and submissions may also be located in appropriate regional offices.

Conferences

6.23 There is no statutory requirement to hold a pre-determination conference in relation to merger authorisation applications. However, in some cases the Commission receives an application for authorisation of an acquisition in conjunction with another application for authorisation, e.g. of a contract, arrangement or understanding. The Commission is required to call a pre-determination conference in relation to the latter at the request of interested parties. If the two (or more) applications both relate to the same joint venture proposal, the Commission is required to consider the two proposals together in the same time frame (s. 90(15)). The Commission will issue a single draft determination, hold a pre-determination conference if required and issue a single final determination.

6.24 In relation to other merger authorisations the Commission will not generally issue a draft determination. Although the time frame for consideration of merger applications is very short, in appropriate cases the Commission may hold an informal discussion with relevant interested parties. The Commission may find such meetings helpful in its exploration of the issues. A set of meeting procedures will be provided to those invited to attend.

6.25 If such a meeting is held the Commission will be represented by the Commissioner(s) primarily responsible for consideration of the application. Also attending would be the applicant, normally the target, and parties the Commission wishes to hear on the particular matter. A record of the meeting will be placed on the public register.

6.26 Prior to any such meeting the Commission may prepare a set of issues that it wishes to be addressed at the meeting. These would be sent to invited parties and the applicant a few days before the meeting.

6.27 Again because of the time constraints with such applications, meetings and other discussions may need to be conducted at a fairly early stage. If the application provides sufficient information and where a meeting of interested parties is considered desirable, it may be called at the end of the second week or the beginning of the third week from when the application was lodged.

The evaluation of public benefit/detriment

6.28 The Commission shall grant authorisation only if it is satisfied in all the circumstances that the acquisition would result, or be likely to result, in such a benefit to the public that the acquisition should be allowed to take place.

6.29 In making its evaluation the Commission adopts the approach set out by the former Trade Practices Tribunal (now the Australian Competition Tribunal) of comparing the position that would apply in the future were the proposed acquisition not given effect, with the position in the future which would arise if the proposed acquisition were given effect.[78] This requires an integrated analysis of both public benefit and public detriment.[79]

6.30 Public benefit is not defined by the Act, except to the extent that it requires that significant increases in exports or import replacement be considered as public benefits and that the Commission take account of all relevant matters relating to international competitiveness (see paragraph 6.10). However, the Tribunal has suggested in *QCMA* that the term should be given its widest possible meaning:

> ... anything of value to the community generally, any contribution to the aims pursued by society including as one of its principle elements ... the achievement of the economic goals of efficiency and progress.[80]

6.31 The Tribunal also stated in *QCMA* that the relevant public benefit is a net or overall benefit after any detriment to the public resulting or likely to result from the proposed acquisition:

> We accept that the statute calls upon us to adopt a balance-sheet approach: we must balance the likely benefits and detriments flowing from the acquisition.[81]

6.32 The notion of public detriment falling for consideration under 'all the circumstances' is wider than the notion of anti-competitive effect, but the latter will be a primary consideration. The Tribunal stated in *QCMA*:

> We accept that the notion of detriment falling for consideration under 'all the circumstances' is wider than the notion of anti-competitive effect. But at the same time, given the policy of the Act and the subject-matter under

> consideration, the most important of those potential detriments will normally be the anti-competitive effects.[82]

6.33 In assessing the benefit to the public of the proposed acquisition it is appropriate to start with an assessment of the competitive impact of the proposed acquisition. In *QCMA* the Tribunal gave the following reasons:

> (1) A merger may positively enhance the competitive process and thus give rise to a substantial benefit. ...
>
> (2) But the benefits claimed may not mention competition. ... Nevertheless, our appraisal of all the listed claims must depend upon our appreciation of the competitive functioning of the industry, with and without merger. ...
>
> (3) A claimed benefit may in fact be judged to be a detriment when viewed in terms of its contribution to a socially useful competitive process. ...
>
> (4) ... the substantiality of benefits needs to be measured against likely anti-competitive effects (and other detriments).
>
> (5) Quite generally, the Tribunal's role is seen as forming one of the means of achieving the policy objective of the Act, namely the preservation and promotion of useful competition.[83]

In *BHP/Koppers,* the Tribunal made the following statement:

> ... the delineation of the relevant markets is but a first and preliminary step to enable the identification of relevant elements of market structure and associated processes of competition. Such analysis of competition enables not only the identification of any anti-competitive detriment as required by the test imposed by the Act, it also facilitates the exploration of the role that is played by the relevant conduct, the subject of the Koppers' application, in achieving the claimed benefits to the public ...[84]

6.34 It is not necessary or appropriate to express a view as to whether the proposed acquisition would breach s. 50 of the Act in the absence of authorisation.[85] However, the framework of analysis used for s. 50 is still an appropriate one for the evaluation of competitive effects in relation to applications for authorisation.

6.35 Applicants should refer to Section 5 of these guidelines for a description of how the Commission applies that framework and the types of information which are required. However, applications for authorisation should include at least the following information:

- the volume and value of Australian sales supplied by the merging entities for each of the major goods and services supplied;
- details of the merged firm's major competitors, both domestic and importers, including the nature of the goods and services in which they compete;
- estimates of market shares, preferably on the basis of both sales volumes and values as well as capacity — imports should be included in the calculation of market shares; where a firm supplies both imports and local production, these should be treated as a single market share;

- information on the extent and nature of import competition in the market — this should include information on the nature of import distribution systems and the capacity for significant expansion;
- information on the problems facing new market entrants, the history of market entry and exit and any known plans for future entry;
- details of the merging firms major input suppliers and customers — including details of long term contracts and any countervailing power;
- details of the parties' cost structures and ability to increase output and how these will be affected by the proposed merger;
- information on competitive behaviour and price determination in the relevant market(s), including how the merging firms set their prices;
- information on the extent of vertical integration in the market;
- information on market growth, innovation, regulatory changes and product differentiation; and
- any other information likely to be relevant to the Commission's deliberations.

6.36 In considering applications for authorisation it is relevant for the Commission to consider how any reduction in competition may affect ultimate consumers. In *Rural Traders*, the Tribunal considered it relevant in assessing the public benefit of a proposal for Wesfarmers (a distributor of farm fertiliser) to acquire control of CSBP (a manufacturer of fertiliser) that notwithstanding the impact on competition at the distributor level there was likely to be no detrimental impact on fertiliser prices to farmers.[86]

6.37 The phrase 'not otherwise available' previously formed part of the public benefit test. This is no longer an absolute requirement. Nevertheless, there must be a nexus between the claimed public benefits and the proposed merger. Furthermore, the Commission considers that it is still relevant to consider whether the benefit may be available otherwise than by the proposed merger when comparing the situation which is likely to prevail with and without the merger. If a benefit may be otherwise available it is likely to receive less weight in the Commission's analysis.

6.38 Following the broad interpretation of potential public benefits adopted by the Tribunal the Commission has generally identified the following matters which could constitute public benefits:

- economic development, e.g. in natural resources, through encouragement of exploration, research and capital investment;
- fostering business efficiency, especially where this results in improved international competitiveness;

- industrial rationalisation resulting in more efficient allocation of resources and in lower or contained unit production costs;
- expansion of employment or prevention of unemployment in efficient industries and employment growth in particular regions;
- industrial harmony;
- assistance to efficient small businesses, such as guidance on costing and pricing or marketing initiatives which promote competitiveness;
- improvement in the quality and safety of goods and services and expansion of consumer choice;
- supply of better information to consumers and businesses to permit informed choices in their dealings;
- promotion of equitable dealings in the market;
- promotion of industry cost savings resulting in contained or lower prices at all levels in the supply chain;
- development of import replacements;
- growth in export markets;
- steps to protect the environment.[87]

6.39 However, as emphasised by the Tribunal, public benefits in the form of increased efficiency and better resource usage, resulting in lower unit costs, are most important in the consideration of applications for the authorisation of mergers. Efficiencies may take many forms, e.g. economies of scale and scope, more efficient technology resulting in reduced input and/or energy costs or the combining of complementary research and development facilities. In *Davids* (1995) and *Davids* (1996), the Commission accepted that significant resource savings from rationalisation, including warehousing and distribution facilities, advertising and generic product ranges, in grocery wholesaling amounted to significant public benefits.[88]

6.40 Pecuniary savings from increased bargaining power which merely result in a transfer of wealth rather than any real resource savings for the community may not be considered by the Commission to constitute substantial public benefits in themselves.[89] For example, in *Wattyl* the Commission considered that some of the claimed efficiencies relating to raw material and advertising costs constituted pecuniary benefits and were therefore not considered to be substantial public benefits in their own right.[90] However, where such cost savings arise from the creation of countervailing power they may move the market outcome closer to a competitive one, a relevant consideration under both s. 50 (see paragraph 5.131) and authorisation.

6.41 However, other types of public benefit may also be relevant in considering the authorisation of mergers. In *DuPont* the Commission accepted that significant environmental benefits, in the form of reduced carbon, nitrous oxide and greenhouse gas emissions, were likely to flow from the joint venture's upgrading of the Gladstone sodium cyanide plant.[91]

6.42 The concept of a benefit to the public is not limited to a benefit to consumers, a benefit to a private party which is of value to the community generally is a public benefit. The Tribunal stated in *Rural Traders*:

> Before a benefit (or detriment) can properly be regarded as a benefit (or detriment) to the public for the purposes of the assessment of public benefit required by sec. 90(9), it must be seen as a benefit (or detriment) to the community generally. This does not mean that private benefit or private detriment are necessarily irrelevant. Injury to an individual can itself, in many circumstances, constitute a detriment to the community generally. Injustice to an individual will commonly do so. The encouragement or enabling of an individual to pursue legitimate ends or to attain legitimate rewards may well be beneficial to the community generally. When a benefit or a detriment to a particular individual or segment of the public is pressed as a relevant benefit or detriment to the public for the purposes of sec. 90(9), the Tribunal must assess whether the benefit or detriment to the individual or group can properly be so categorised. That assessment will ordinarily involve the consideration of whether the community generally has an interest in the individual or group being so benefited or disadvantaged and whether the benefit or detriment involves detriment or benefit to other individuals or groups.[92]

In *QCMA* the Tribunal stated:

> ... it is clear that it could be possible to argue in some cases that a benefit to the members or employees of the corporations involved served some acknowledged end of public policy even though no immediate or direct benefit to others was demonstrable.[93]

6.43 For example, a merger may result in economies of scale or other resource savings which may not be immediately available to consumers in lower prices. However, the community at large has an interest in resource savings, releasing those resources for use elsewhere. In *DuPont* the Commission accepted that improvements in the efficiency of sodium cyanide production resulting in resource savings, such as electricity and capital, constituted a public benefit, although consumers were unlikely to benefit from lower prices.[94]

6.44 However, the interests of the public as purchasers, consumers or users are relevant.[95] Lower prices for consumers and lower input costs for business, with potential ramifications for international competitiveness, are considered by the Commission to constitute public benefits. In *Howard Smith* the Tribunal stated:

> If a merger is likely to result in the achievement of economies and a considerable cost saving in the cost of supplying a good or service this might well constitute a substantial benefit to the public, even though the cost saving is not passed on to the consumers in the form of lower prices. Nevertheless, if such a merger benefited only a small number of shareholders of the applicant

> corporations through higher profits and dividends, this might be given less weight by the Tribunal, because the benefits are not being spread widely among the members of the community.[96]

6.45 Furthermore, when comparing the situation that is likely to prevail with and without the proposed merger, it is critical to consider the likely durability of the claimed public benefits:

> The present writer would agree with the proposition that there must be public benefit in saving resources but would advance a third view, that it is not the immediate distribution of benefits that is important but their durability. If a merger, for example, gives rise to rationalization economies and higher profits that are not 'passed on to the consumer', one needs to ask why this is so. It may well reflect enhanced market power which would need to enter the benefit-cost equation; and there may well be a question of whether the lack of competitive pressure will allow productivity gains to be lost — 'benefit' to be dissipated — in slackness and rent-seeking activities.[97]

6.46 The Act specifically requires the Commission to consider export enhancement and import replacement as public benefits and to take account of international competitiveness (see paragraph 6.10). The Explanatory Memorandum to the 1992 amendments states:

> 63. The value of exports is the value of goods and services which are produced in Australia and sold overseas, and the real value is the dollar value of those goods and services, discounted to account for changes in the level of Australian prices. The word 'significant' is not intended to be interpreted in a relative sense. The effect on exports of any single merger is likely to be insignificant when assessed against the value of all Australian exports. Rather, the word 'significant' should be interpreted in an absolute sense, and is intended to mean increases which, when viewed in isolation, are not insignificant or ephemeral.
>
> 64. A substitution of domestic products for imported goods occurs when consumers alter their consumption to choose goods produced in Australia, where previously they had chosen goods produced outside Australia. This factor looks at the overall balance of choices made by individual consumers. If the total level of consumption of an Australian product rises at the expense of consumption of foreign-produced goods, and this change is attributable to the merger, the merger may be said to have produced a substitution of domestic products for imported goods. As with the real value of exports, the word 'significant' should be interpreted in an absolute sense to mean not insignificant or not ephemeral.
>
> 65. In determining public benefit for the purposes of s. 90(9A) the Commission must take into account all other relevant matters that relate to the international competitiveness of any Australian industry. Changes in international competitiveness may be attributed to a wide range of matters, which it is impossible to list exhaustively, but could include matters such as changes in the quality of inputs, improvements in technology, or better work practices. The range is qualified by the requirement that the matters looked at be 'relevant', which indicates that they should be attributable to the merger in question. It is not required that the improvement in international competitiveness be in the industry in which the merger occurs.

6.47 In *DuPont* the Commission accepted that increasing the capacity of the Gladstone sodium cyanide plant would result in either increased exports, import replacement or both, which would constitute a benefit to the public.[98]

6.48 In *QCMA* the Tribunal stated that:

> We are to be concerned with probable effects rather than with possible or speculative effects. Yet we accept the view that the probabilities with which we are concerned are commercial or economic likelihoods which may not be susceptible of formal proof. We are required to look into the future but we can be concerned only with the foreseeable future as it appears on the basis of evidence and argument relating to the particular application. [99]

6.49 Applications for authorisation should clearly set out the claimed public benefits, how they relate to the proposed merger, their likely magnitude and timing. It is often difficult to measure public benefits in precise quantitative terms. Nevertheless, general statements about possible or likely benefits will not be given much weight unless supported by factual material.[100]

Decision of the Commission

6.50 Normally in making a decision the Commission issues a determination setting out the full particulars of the application and submissions thereon, and providing a comprehensive evaluation of the arguments for and against authorisation. However, with the time constraints on merger applications the Commission may give reasons for reaching its decision without such a comprehensive evaluation of all submissions received.

6.51 The Commission can grant authorisation subject to conditions (s. 91(3)). The Commission may consider it appropriate in particular cases to grant authorisation subject to conditions which ensure that the claimed public benefit is likely to eventuate or to lessen any detriment that might result from the acquisition. Conditions may include a requirement that the applicant provide relevant undertakings. Such undertakings are now enforceable at law (see Section 7).

6.52 The Commission and the Tribunal have made determinations subject to conditions and accepted undertakings in relation to numerous applications for authorisation of a proposed acquisition. For example, in the application by Davids to acquire CBL, in which the Tribunal confirmed the Commission’s authorisation of Davids to acquire the only other major independent wholesaler in Victoria and NSW, authorisation was conditional on Davids being able to cast at least 50 per cent of votes at a general meeting of CBL.[101] The Commission imposed this condition in order to ensure that the claimed public benefits would be reasonably likely to accrue.

6.53 If the Commission grants authorisation for an acquisition, the authorisation comes into effect on a date specified by the Commission, not being a date before the expiry of the period for review by the Tribunal (see below). If an application for review is made, the authorisation will not come into effect before the Tribunal has granted authorisation or the application for review has been withdrawn.

6.54 If the Commission is not satisfied in all the circumstances that the acquisition would result, or be likely to result, in such a benefit to the public that it should be allowed to take place, the Commission may refuse authorisation or alternatively, in refusing authorisation, indicate to the applicant how the application could be constructed to change the balance of detriment and public benefit so that authorisation may be granted.

Australian Competition Tribunal

6.55 An application for review of the Commission's decision may be made to the Tribunal (the reviewing body).

6.56 An application for review may be made by the applicant for authorisation or by any person the Tribunal is satisfied has a sufficient interest in the matter.

6.57 The application for review must be lodged within 21 days of the Commission's determination or within such shorter time as the Tribunal directs.

6.58 A review by the Tribunal is a rehearing of the application for authorisation on the basis of the material placed before it, which may include new material not presented to the Commission.[102] It is not a review of the Commission's decision in the sense of ruling on alleged errors in the Commission's findings or procedures. The Tribunal will reach its own conclusions on whether authorisation should be granted and if so subject to what conditions.

6.59 The Tribunal has a period of 60 days to conduct a review, which may be extended if the Tribunal considers that the matter cannot be dealt with properly in that period because of the complexity of the matter or other special circumstances (s. 102).

Date of effect

6.60 If the Commission grants authorisation and no application for review of the Commission's determination has been made within the period allowed (see paragraph 6.57), the Commission's authorisation will come into effect at the end of that period (s. 91(1A)(a)).

6.61 If an application for review is made to the Tribunal, authorisation will come into effect:

- on the day on which the Tribunal makes a determination on the review and grants authorisation; or
- where the application for review is withdrawn, on the day on which the application is withdrawn (s. 91(1A)(b) and (c)).

7. Enforceable undertakings

7.1 As stated in paragraph 2.16, s. 87B allows the Commission to accept written undertakings in connection with matters where it has a power or function under the Act (other than Part X).

7.2 Undertakings pursuant to s. 87B are one of the tools available under the Act to further its goals of improved competition and efficiency in markets. Undertakings pursuant to s. 87B are a flexible alternative to simply opposing an acquisition where the Commission believes that the acquisition is likely to substantially lessen competition.

7.3 To date the Commission has accepted undertakings pursuant to s. 87B of the Act from parties to an acquisition for either of two purposes:

- to ensure that an acquisition is not completed until the Commission has had the opportunity to conduct the appropriate market inquiries; or
- to resolve matters where the proposed acquisition is, in the Commission's view, likely to contravene the Act.

7.4 Where, following its inquiries into a proposed acquisition, the Commission forms the view that it is likely to substantially lessen competition in breach of s. 50, it will provide the parties with reasons for that view. If the parties consider that undertakings could be offered to reduce or eliminate the stated concerns, they may choose to offer to the Commission undertakings aimed at restructuring the proposal in such a way as to address the competition concerns.

7.5 In these circumstances the offer of such an undertaking designed to address the competition concerns is a matter for strategic decision by the parties to the acquisition, and presumably will be considered along with other options open to the parties, for example challenging the Commission in court, seeking authorisation, revising the proposal without undertakings, or even abandoning the proposal. It is not the policy or practice of the Commission to demand such undertakings.

7.6 The Commission is likely to look most favourably on proposed undertakings which are able to address structural issues in the relevant market(s). Structural solutions provide an ongoing basis for the operation of competitive markets. The regulatory costs are one-off rather than a permanent burden. For example, divestiture of particular divisions of the merged company may remove competitive concerns from the merger, while leaving the merger an attractive proposition for the parties. The Commission accepted undertakings in the Village/Austereo merger which resulted in the divestiture of certain capital city radio stations, in order to maintain competition in those markets. In the

Sigma/QDL acquisition, the Commission accepted an undertaking from Sigma that if it obtained control of QDL it would move to sell QDL's business in Victoria, in order to maintain competition in that State. In the acquisition of Smiths Snackfoods by Frito-Lay the Commission accepted undertakings resulting in the divestiture of a package of brands, manufacturing facilities and staff comprising 'Snack Brands Australia'.

7.7 Another example is the Ampol/Caltex merger. After examining the proposed merger of Caltex and Ampol the Commission reached the conclusion that it would have the effect of substantially lessening competition in various petroleum markets. The increase in concentration and elimination of vertical imbalance between the parties, in addition to other market factors conducive to coordinated conduct, at a time when the industry was approaching full capacity utilisation, and in an industry with substantial barriers to importing and entry, would be likely to have the effect of squeezing independent distributors and retailers out of the industry, reducing competition and increasing prices and profits. The parties to the proposed merger offered, and the Commission accepted, undertakings which provided a structural underpinning for independent operators to continue to play a competitive role in petrol markets, undermining any attempts to coordinate pricing between the majors. The undertakings provided for the sale of import, storage and retail sites which were surplus following the merger to independent distributors and retailers, with guaranteed supply of petrol at a competitive price during a transition phase.

7.8 Where divestiture is an appropriate remedy the Commission will be concerned to ensure that the assets are sold to an effective competitor. It will also wish to ensure that the process is undertaken within a realistic time frame and that appropriate sanctions by way of speedy compulsory divestiture of assets can apply, should firms fail in their obligations under the undertakings.

7.9 The Commission is not likely to favour behavioural undertakings such as price, output, quality and/or service guarantees and obligations. Such undertakings may well interfere with the ongoing competitive process through their inflexibility and unresponsiveness to market changes. The duration of such undertakings is also highly problematic.

7.10 In addition, such undertakings have substantial regulatory difficulties. They are extremely difficult to make certain and workable in detail, particularly in the short time frames in which mergers are considered, they require continuing monitoring, and where breaches are detected they are often dependent on enforcement after the event. There is also likely to be substantial associated costs to the Commission of compliance and enforcement.

7.11 A vertical merger may involve the integration of a party in a competitive market with a party which has a natural monopoly, for example a gas pipeline. This will usually raise concerns about access, access pricing and protection of confidential information. In some cases the Commission's concerns may be able to be addressed by way of quasi-structural undertakings like ring fencing and access undertakings.[103] For example, in considering a number of port privatisations the Commission has accepted undertakings regarding non-discriminatory access. In other cases there may be existing regulation designed to address vertical integration concerns with respect to essential facilities.[104] However, it should be well understood that the Commission will view any such option sceptically as a set of undertakings are never capable of replacing the operation of a competitive market. The Hilmer Report recommended vertical separation of natural monopolies from competitive or potentially competitive activities in conjunction with an access regime.[105]

7.12 For example, in 1995 the Commission rejected undertakings proposed by GrainCorp and the Australian Wheat Board in relation to a proposal to enter into a joint venture to buy and sell NSW grain in the domestic market. The Commission considered that the proposal would be likely to substantially lessen competition in the NSW markets for the storage and handling of grain and for grain trading. Following widespread industry consultation the Commission concluded that the proposed undertakings did not address issues of access including internal transfer pricing, availability of capacity, preferential reservation of capacity and priority of access. They did not provide a satisfactory framework for preventing the flow of commercially sensitive information between the parties. There was no mechanism for monitoring, arbitrating and enforcing the undertakings. The Commission concluded that there was little real prospect that the structural concerns could be satisfactorily resolved by behavioural undertakings.

7.13 When considering applications for authorisation of a proposed merger the Commission may consider proposed undertakings which address the balance between public benefit and detriment, particularly the anti-competitive detriment. Again the Commission prefers structural remedies, but where these are not feasible it may consider proposals for behavioural undertakings, taking account of the regulatory costs in balancing the likely public benefit and detriment.

7.14 In one authorisation case, *Davids* (1995), the applicant sought to support its application by the provision of certain behavioural undertakings. In that case the Commission did accept certain undertakings from Davids in the course of its consideration of the authorisation application. Davids, in its application, had undertaken to pass on a proportion of the cost savings to its customers and to provide other guarantees, including dispute resolution facilities, to its customers. The Commission accepted these undertakings.[106] On review[107](the application for review was lodged by QIW) Davids withdrew its offer of undertakings and the then Trade Practices Tribunal granted authorisation without such undertakings.[108]

7.15 The Commission has also issued separate general guidelines on s. 87B, which are relevant to s. 87B undertakings in the mergers context. For example, those guidelines note that the Commission will not accept such an undertaking where the parties in the undertaking seek:

- to deny liability;
- to impose any terms or obligations on the Commission;
- a specific requirement that the Commission will not in future institute proceedings in the particular matter;
- a statement that the undertaking is not an admission in relation to action by third parties such as employees; or
- terms purporting to set up defences for possible non-compliance.

Procedural issues[109]

Scope

7.16 The scope of a s. 87B undertaking is potentially wider and the terms more flexible than a court imposed remedy. For example, the court may be reluctant to make other orders requiring ongoing monitoring and supervision by the court, whereas the Commission does have the resources and functions of an administrative agency and may be prepared to accept undertakings with an ongoing obligation.

7.17 The scope of s. 87B undertakings that the Commission is likely to accept in the mergers context will be determined by the Commission's assessment of the anti-competitive effects of the merger. The test will be whether the arrangements envisaged by the proposed undertakings will address the reduction in competition. The focus is not necessarily on the assets to be acquired and this may mean that the Commission may accept an undertaking which is not directly related to the assets to be acquired where that is considered necessary to address the reduction to competition.

Parties

7.18 The question of which bodies corporate, or persons, should be parties to a proposed s. 87B undertaking is an important one. The Commission will need to be satisfied that the parties to the undertakings are the relevant legal entities capable of performing the specified obligations. However, it may not be necessary to have all relevant legal entities sign the undertaking, particularly where a relevant parent company undertakes to cause or procure its relevant subsidiaries to do what is required. In some mergers all principal parties to the merger may be prepared to give undertakings, and therefore few issues will arise as to the power of particular companies to deliver on their undertakings. This will not be the case in all mergers. For example, where there is a hostile takeover the target will presumably not agree to providing undertakings to the Commission, while the acquirer may be agreeable. This will be a significant issue if the assets that are proposed to be divested are those of the target. In the event that the acquirer in a takeover is not completely successful (that is, it does not acquire all the shares) the anti-competitive consequences may arise, but the acquirer may have limitations on its ability to divest certain assets of the target because of minority shareholder interests. Ultimately, the parties proposing the undertakings will need to satisfy the Commission that they are able to perform their relevant obligations.

Confidentiality, consultation and publication

7.19 The Commission will insist that the general terms of any s. 87B undertaking accepted are made public as soon as possible. In almost all cases this would mean the publication of the actual provisions of the s. 87B undertaking by placing a copy of the undertaking on a public register.

7.20 However, the Commission is prepared to consider requests for confidentiality of certain information, for example the timing of any divestiture arrangement, or the arrangements in the event of the failure to divest, particularly where the disclosure of that information would undermine the effectiveness of the undertakings.

7.21 In most, if not all, cases the Commission will want to consult with relevant market participants before accepting a substantive s. 87B undertaking. While the Commission will usually have already undertaken extensive consultation through its market inquiries process, this consultation may not be sufficient to address all issues relevant to a decision to accept a proposed undertaking or not. Once having formed the view that an acquisition would be or is likely to be anti-competitive, and having received the offer of undertakings, the Commission will need to undertake a separate assessment of the impact of the proposed undertakings. This will almost always require further consultation with market place participants.

7.22 The Commission will need to assess the competitive significance of the undertakings, and at the same time inform itself as to the necessary requirements to make the undertakings practical and workable. The Commission will also want to assess the impact of the proposal on third parties, which is discussed further below.

7.23 To undertake this process of consultation, the substance of the undertaking proposal, if not all the mechanics of its timing and implementation, may need to be disclosed.

7.24 Where advance public disclosure is not possible the Commission will accept confidential undertakings. This may be necessary, for example, prior to a takeover bid. However, firms must accept that the Commission, if unable to conduct market inquiries as a result, will wish to maintain maximum flexibility in developing mechanisms within the undertaking to overcome its competition concerns.

Third party interests

7.25 The Commission may also need to assess the impact of third party rights and interests. Any merger will achieve some measure of structural change in a market and, therefore, any merger will be likely to impact on firms and consumers not party to the transaction. In its simplest terms, if a merger is anti-competitive it will have a direct impact on those parties dealing with the merged firm, whether in terms of increased prices or reduced service or quality. If a merger reduces competition in a market it may benefit rivals through lower competitive pressure and higher prices.

7.26 Just as any anti-competitive merger will have an impact on third parties, so too will any undertaking designed to address the anti-competitive consequences. Where the merger is likely to be anti-competitive the provision of undertakings to address that is likely to favour customers, but may remove the benefits that rival firms may have anticipated through the reduction in competition.

7.27 An assessment of these 'third party' interests is in effect subsumed within the general assessment of the competition effects of a merger and the capacity of the proposed undertakings to address those effects.

7.28 However, there may be other more specialised third party interests which need to be considered by the Commission and the merger parties. For example, merger parties which are proposing s. 87B undertakings will need to consider their own obligations to third parties, for example whether the undertakings are consistent with existing contractual obligations with another party or whether the performance of the undertakings may give rise to some claim against the merger parties.

7.29 Generally it would not be appropriate for the Commission to conduct this assessment of the rights and obligations as between the merger parties and other third parties. Generally that will be a matter for the merger parties. However, in some cases where the presence of third party rights may give rise to a challenge to the s. 87B undertakings or the undertakings being rendered impossible to comply with, it may be necessary for the proposed s. 87B undertakings to make specific provision for those rights, for example by way of indemnification of the affected third party. This is likely to arise only in rare cases.

Certainty

7.30 It is important to note that the resolution of a merger matter through s. 87B undertakings is not like a contractual bargain which is based on a mutual ongoing business relationship between the parties. In the event of a subsequent dispute over the effect of the undertakings, particularly where there is some deficiency from the Commission's point of view, there may be little scope or incentive for renegotiation. Therefore the terms of the undertakings need to be sufficiently detailed to ensure certainty and enforceability, and also be capable of dealing with changing circumstances. Accordingly, it may take some time to resolve all points of detail, and merger parties must be prepared (in appropriate cases) to allow time for this.

Monitoring and Commission information requirements

7.31 In order to ensure that s. 87B undertakings are complied with and to assist the Commission in monitoring that compliance, the Commission has as a standard practice sought the inclusion of provisions in undertakings which require relevant information to be made available to it:

- periodically: for example, a periodic audit of compliance with the undertaking;
- in specified circumstances: for example, where there is an event of default, information relating to that default, such as the reasons for it; or,
- upon the Commission's request.

Variation and review of Commission decisions

7.32 A party to a s. 87B undertaking may seek to have it varied with the Commission's consent: s. 87B(2). If the Commission does not consent it may be open to the party requesting the variation to seek judicial review of the Commission's decision.[110] The Commission's refusal to consent may also be a matter the Court may take into account in the exercise of its discretion to grant remedies for failure to comply with an undertaking in any action taken by the Commission to enforce the undertakings: s. 87B(4).

7.33 To avoid such disputes it is preferable to include an express mechanism for consultation and review in the undertakings in the event that there are any relevant changes in market circumstances. Such circumstances should be specified by agreement. The Commission is unlikely to accept any automatic variation of an undertaking without its prior approval or bind itself to a pre-agreed variation.

7.34 As noted above, there is implicit in the legislation a general mechanism for overview of s. 87B undertakings as the Court retains the ultimate discretion as to whether to grant any remedy sought by the Commission in the event of non-compliance with the undertakings.

Section 87B undertakings and authorisation

7.35 The Commission is able to accept undertakings in connection with an application for authorisation of a merger. The Commission is also able to grant authorisation subject to certain conditions. However, where those conditions are of an ongoing nature, or are to be performed after the date of the merger, it is not clear what remedy, if any, there would be available to the Commission in the event of non-compliance.[111] In these circumstances any condition the compliance with which falls due after the merger is effected should be reflected in a s. 87B undertaking.

7.36 At the same time, where there is an application to the Australian Competition Tribunal for review of a Commission determination, it is important that the Tribunal be seized of the entire matter. There is some doubt as to the position of s. 87B undertakings accepted by the Commission on a review by the Tribunal. In the *Davids/CBL* matter,[112] the Tribunal held that undertakings given in the authorisation context did not have any separate operation from the Commission's determination, and that on review only so much of the undertakings as the Tribunal considered to be appropriate would have any effect.[113] However, to avoid any doubt the Commission will as a standard practice ensure that the provision of any s. 87B undertakings as are considered appropriate in the authorisation context will form part of the conditions of the authorisation and be expressly subject to the outcome of any Tribunal review.

Enforcement

7.37 In the event of non-compliance with a s. 87B undertaking the Commission may make an application to the Court for an order under sub-s. (4), and the Court may, if it is satisfied that the party to the undertaking has breached 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; and
- any other order that the Court considers appropriate.

Endnotes

1 For further details see *the ACCC's approach to MERGERS: A statistical summary*, January 1998.

2 *Trade Practices Commission v Rank Commercial Limited & Ors.* (1994), ATPR, 41–331: the Court granted an interim injunction to restrain the acquisition and the merger parties subsequently abandoned the proposal. *Australian Competition and Consumer Commission v The Adelaide Steamship Company Limited & Ors* (1996) ATPR 41–462: the Court rejected an application for an interim injunction to restrain the acquisition of the Sydney port tugboat operations of Brambles by Adsteam and Howard Smith; the Commission subsequently discontinued the proceedings as divestiture was unlikely to be a satisfactory remedy. *Australian Competition and Consumer Commission v Pioneer Building Products (Qld) Pty Ltd* (1996) unreported: the Court ordered Pioneer and a subsidiary to pay $4.8 million in pecuniary penalties for contravention of s. 50 when it acquired the assets of A Class Blocks. In 1996 the Commission sought an interim injunction to restrain the acquisition by Wattyl of the Courtaulds architectural and decorative paint business, Taubmans; the merger parties gave undertakings to the Court not to proceed with the proposal prior to the determination of the matter; the parties subsequently sought authorisation, which was denied by the Commission, then applied for review of that decision by the Australian Competition Tribunal, but withdrew when Taubmans was sold to an alternative buyer. In 1997 the Commission sought an interim injunction to restrain the merger of Foxtel and Australis Media; the action was withdrawn when the merger proposal was terminated.

3 *CSR Ltd, Mackay Sugar Co-operative Association Ltd, E D & F Man Australia Pty Ltd & Newco* (1993), ATPR 50–138; *Davids Ltd* (1995), ATPR 50–185; *Silver Top Taxi Service Ltd* (1995), ATPR 50–209; *Davids Ltd* (1996), ATPR 50–224; *DuPont (Australia) & Ors* (1996), ATPR 50–231; *Wattyl (Australia) Pty Ltd, Courtaulds (Australia) Pty Ltd & Ors*. (1996), ATPR 50–232; *Bristile Holdings Ltd.* (1997), ATPR 50–250. An application by Foodland Associated Ltd in 1993 was withdrawn. Two applications by ABL to acquire Cockburn Cement and ABCL were being considered at the time of going to print.

4 *Re Queensland Independent Wholesalers Ltd* (1995) ATPR 41–438. Wattyl's application for review of the Commission's decision in relation to its proposed acquisition of Taubmans was withdrawn when Taubmans was sold to an alternative buyer.

5 In *Trade Practices Commission v Arnotts Ltd* (1990), ATPR 41–002, 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.

6 Trade Practices Commission, *Section 87B of the Trade Practices Act: A guideline on the Trade Practices Commission's use of enforceable undertakings*, August 1995.

7 OECD, *Report on Notification of Transnational Mergers*, Note by the Secretariat, 1999.

8 *Amalgamated Wireless (Australia) Ltd. v McDonnell Douglas Corporation* (1987), 77 ALR 537; and *Tycoon Holdings Ltd. v Tencor Jetco Inc* (1992), ATPR 41–183. See also *TPC v The Gillette Company (No.1)* (1993) 45 FCR 366 and *TPC v The Gillette Company* (1993) ATPR 41–278.

9 See Areeda and Turner, *Anti-Trust Law*, Volume 5, at pp. 318–319.

10 *Rank* op. cit., at 42,391.

11 House of Representatives Standing Committee on Legal and Constitutional Affairs, *Mergers, takeovers and monopolies: Profiting from Competition?*, AGPS, Canberra, 1989.

12 All references to the 'merged firm' should be read as applying equally to the acquiring firm and the target firm in cases of partial share acquisitions.

13 United States Attorney-General's National Committee to Study the Antitrust Laws (1955), *Report*, p. 320; quoted in *Re Queensland Co-operative Milling Association Ltd and Defiance Holdings Ltd* (1976), ATPR 40–012, at 17,245.

14 *QCMA*, op. cit., at 17,246.

15 Or any other aspect of the competitive process or its performance outcomes.

16 Kaysen and Turner *Antitrust Policy*, 1959, p. 75; *Queensland Wire Industries Pty. Ltd. v The Broken Hill Proprietary Company Limited & Anor* (1989) ATPR 40–925, at 50,015.

17 See Rhonda L Smith and David K Round, 'A Strategic Behaviour Approach to Evaluating Competitive Conduct', *Agenda*, Vol. 5, No. 1, 1998, pp. 25–36.

18 Report of the Senate Standing Committee on Legal and Constitutional Affairs, *Mergers, Monopolies and Acquisitions*, AGPS, 1991, p. 39.

19 *Hansard*, Tuesday 3 November 1992, p. 2406.

20 *Dandy Power Equipment Pty Ltd v Mercury Marine Pty. Ltd.* (1982), ATPR 40–315, at 43,887–43,888.

21 *Trade Practices Legislation Amendment Bill 1992: Explanatory Memorandum,* para.12, p. 4.

22 *Hansard*, 10 December 1992, p. 4776.

23 Alternatively, an acquisition may increase the competitiveness of the acquiring firm but diminish the level of competition in the market.

24 *Anticipating the 21st Century: Competition Policy in the New High-Tech, Global Marketplace* Volume 1, A Report by the Federal Trade Commission Staff, *Antitrust & Trade Regulation Report*, Vol. 70 No.1765, Special Supplement, 6 June 1996, p. S-36.

25 *Trade Practices Commission v. Australian Meat Holdings* (1988), ATPR 40–876; and *Australian Meat Holdings Pty Ltd v. Trade Practices Commission* (1989), ATPR 40–932.

26 Explanatory Memorandum, op. cit., para.15, p. 5.

27 *QWI*, op. cit., at 50,008.

28 *AMH* (1989), op. cit., at 50,104.

29 Trade Practices Act Review Committee, *Report to the Minister for Business and Consumer Affairs*, 1976, p. 17, para. 4.22.

30 *AMH* (1988), op. cit., at 49,480.

31 *QWI*, op. cit., at 50,014.

32 Neville R Norman and Philip L Williams, ‘The Analysis of Market and Competition under the Trade Practices Act’, *Australian Business Law Review,* December 1983, pp. 396–420.

33 See Maureen Brunt, ‘Market Definition Issues in Australian and New Zealand Trade Practices Litigation’, *Australian Business Law Review*, April 1990; and *Singapore Airlines Ltd v Taprobane Tours WA Pty Ltd* (1992) ATPR 41–159.

34 *Trade Practices Commission v. Ansett Transport Industries (Operations) Pty. Ltd.* (1978), ATPR 40–071; *Auckland Regional Authority v Mutual Rental Cars (Auckland Airport) Ltd.* (1988), 2 NZBLC 99–110; Brunt (1990), op. cit., p. 125.

35 *QCMA*, op. cit., at 17,247.

36 *Re Tooth & Co. Ltd.; in re Tooheys Ltd.* (1979), ATPR 40–113, at 18,196–18,197.

37 That is, not subject to the threat of entry.

38 This is the standard used in the US and Canadian merger guidelines, except that the latter only refers to a present monopolist, which would appear to incorporate potential entrants into the market. The appropriate base price for such a test has been the subject of some debate. The *Cellophane* case (*United States v E.I. DuPont De Nemours & Co.*, 351 U.S. 377, 76 S.Ct. 994,100 L.Ed. 1264 (1956)) indicated the dangers of using current prices as the base price for market definition where that price reflects limit pricing by a monopolist to the point where cross elasticities are relatively high. Where current prices reflect market power which would be likely to be undermined by new entry or the breakdown of coordinated pricing absent a proposed merger between the incumbent and the entrant or between the two coordinating firms, using current prices to define a broad market could result in the conclusion that the merger would not substantially lessen competition. However, in other merger cases such an approach could result in excluding a firm's closest rival and takeover target from the market. By using the likely future price absent the merger as the relevant base price, the market is defined in a way which is relevant to the conduct at issue, by identifying and including the closest substitutes to the merging firms product(s).

39 Including production and distribution capacity which could rapidly switch to supplying the relevant product, but not including new entrants.

40 *AMH* (1988), op. cit, at 49,480.

41 Rhonda L Smith and Jill E Walker, 'The Role of Commercial Reality versus Substitution in Market Definition', *Competition and Consumer Law Journal*, Vol. 5, No. 1, August 1997, pp. 1–21.

42 Brunt, op. cit., 1990 pp. 104–105; SG Corones and Neville Norman (1994), 'Markets, Competition and Market Power', ATPR 2–555.

43 *Trade Practices Commission v TNT Management Pty Ltd* (1985), ATPR 40–512.

44 *Ansett* (1978), op. cit.

45 Note that proportional price movements do not necessarily indicate that two products are in the same market; price movements may be correlated due to the use of a common input, which may bear no relation to the degree of substitutability between the products. However, a lack of correlation will generally indicate that two products are poor substitutes and should not be

included in the same market. See Prices Surveillance Authority, *Using Econometrics in Market Definition and Market Power Assessment,* Discussion Paper No. 7, 1995. Evidence regarding the pass-through of unique cost increases and their effect on demand will provide a useful indication of a firm or firms' ability to impose a SSNIP.

46 Cluster markets were first identified in *United States v Philadelphia National Bank*, 374 US 321 (1963), and have since been extensively applied in the United States, particularly in relation to financial services and health care. The concept has not been extensively used in Australia, but see Deena Shiff, Henry Ergas and Mitchell G Landrigan (1998), 'Telecommunications Issues in Market Definition', *Competition and Consumer Law Journal*, Vol. 6, No. 1, pp. 32–51, for a recent analysis.

47 See footnote 45 and *AMH* (1988), op. cit., at 49,492–49,493.

48 Brunt, op. cit., 1990, p. 122.

49 *Bristile Holdings Ltd* (1997), ATPR 50–250, at 57,295.

50 *Re QIW* (1995), op. cit.

51 See footnote 45.

52 Some overseas agencies have used the time dimension of a market to consider issues such as peak versus off-peak or seasonal variations in supply and demand conditions. See, for example, the New Zealand Commerce Commission, *Business Acquisitions Guidelines*, 1996, p. 14; and UK Office of Fair Trading, *Competition Act 1998: Market Definition*, formal consultation draft, 1998, p. 22. This is not the sense in which the time dimension of the market has generally been used in Australia. However, these issues would be relevant to defining narrower product markets, where the product is specified in terms of time of delivery, where appropriate.

53 *Tooth & Tooheys* (1979), op. cit., at 18,196.

54 Brunt, op. cit., 1990, p. 96.

55 *Tru Tone Ltd v Festival Records Retail Marketing Ltd.* (1988), 2 NZBLC 99–113 and 99–135.

56 *Tru Tone Ltd.*, op. cit., 99–135 at 103,293.

57 *Re: AGL Cooper Basin Natural Gas Supply Arrangements* (1997) ATPR 41–593, at 44,210.

58 *Tooth & Tooheys*, op. cit., at 18,197.

59 Brunt, op. cit., 1990, p. 117; *Singapore Airlines Ltd*, op.cit.

60 *QWI*, op. cit., at 50,012.

61 *QWI*, op. cit., at 50,013.

62 *QWI*, op. cit., at 50,015.

63 See RD Willig, 'Merger Analysis, Industrial Organization Theory, and Merger Guidelines', *Brookings Papers: Microeconomics,* 1991.

64 For further information see ACCC, op. cit., 1998, pp. 24–25.

65 Note that the 'four firm concentration ratio' is applied to the relevant market, not the industry as traditionally calculated by the Australian Bureau of Statistics.

66 These thresholds have been set at a more generous level than those in other jurisdictions with a similar merger law. For example, the Canadian Director of Investigation and Research, Competition Act, *Merger Enforcement Guidelines* (1991) employ a CR4 threshold of 65 per cent, with the merged firm's market share at 10 per cent, and a single firm market share of 35 per cent. The United States Department of Justice and Federal Trade Commission's *Horizontal Merger Guidelines* (1992) employ the Herfindahl-Hirschman Index (HHI) instead of the CR4, but would examine mergers where the post-merger CR4 was below 75 per cent; and the single firm market share threshold is 35 per cent. The New Zealand Commerce Commission's Guidelines, op.cit., employ a 40 per cent market share threshold under a dominance test.

67 See Jonathon B Baker, 'Unilateral Competitive Effects Theories in Merger Analysis', *Antitrust*, Vol. 11, No. 2, 1997, pp.21–26.

68 Capacity can also be a useful measure of concentration in some markets for differentiated products. The Commission has indicated that in considering the acquisition of radio stations, it will attach particular significance to the number of licences held by the merged firm in relation to the total number of licences available in the market, because of the volatility of individual audience and revenue shares. See Trade Practices Commission, *Market definition and competition issues in commercial broadcast radio,* June, 1994.

69 Professor Maureen Brunt, 'Australian & New Zealand Competition Law and Policy', *19th Fordham Conference on International Antitrust Law and Policy*, 1992.

70 *Acquisitions and the failing firm argument,* A joint discussion paper by the Australian Trade Practices Commission and the New Zealand Commerce Commission, October 1993.

71 For further discussion of the failing firm issue generally, see Martin Howe, 'The failing firm and the Trade Practices Act', *ACCC Journal*, No. 14, 1998, pp. 1–7.

72 *QWI*, op. cit., at 50,009.

73 *Rank*, op. cit.

74 *Wattyl*, op. cit.

75 *QWI*, op. cit., at 50,009–50,010.

76 Note that for acquisitions subject to s. 50A, the Tribunal considers both competition and public benefit issues, regardless of whether they are considering an application for a declaration or an application for review of a Commission determination (see paragraphs 2.4 and 3.16).

77 *QCMA*, op. cit., at 17,244; and *Re John Dee (Export) Pty Ltd & Ors.* (1989), ATPR 40–938, at 50,206.

78 *Tooth & Tooheys*, op. cit., at 18,186-18,187; *Re Media Council of Australia (No.2)* (1987), ATPR 40–774, at 48,419; *John Dee,* op. cit., at 50,206.

79 In *QCMA* the Tribunal rejected the alternative approach of first evaluating public benefit and only considering detriments if the former was established. As discussed in paragraph 6.33, the Tribunal considered it was not possible to evaluate public benefit without also considering competitive effects.

80 *QCMA*, op. cit., at 17,242.

81 *QCMA*, op. cit., at 17,243.

82 *QCMA*, op. cit., at 17,243.

83 *QCMA*, op. cit., at 17,244–17,245.

84 *Review of TPC notice: BHP/Koppers purchasing agreement* (1981), ATPR 40–203, at 42,828.

85 *QCMA*, op. cit., at 17, 241.

86 *Re Rural Traders Co-operative (WA) Ltd. & Ors.* (1979), ATPR 40–110.

87 *ACI Operations Pty Ltd* (1991), ATPR, 50–108, at 56,067.

88 *Davids* (1995) op. cit.; *Davids* (1996), op. cit.

89 Federal Trade Commission, op. cit., p. s-36.

90 *Wattyl*, op. cit.

91 *DuPont,* op. cit.

92 *Rural Traders*, op. cit., at 18,123.

93 *QCMA*, op. cit., at 17,242.

94 *DuPont,* op. cit.

95 *QCMA*, op. cit., at 17,242.

96 *Re Howard Smith Industries Pty Ltd* (1977), ATPR 40–023, at 17,334.

97 Maureen Brunt, 'The Australian Antitrust Law After 20 Years — A Stocktake', *Review of Industrial Organisation*, Vol. 9, No. 5, 1994, p. 508.

98 *DuPont*, op. cit., p. 49.

99 *QCMA*, op. cit., at 17,243.

100 *Howard Smith* (1977), op. cit.

101 *Davids* (1995) op. cit.; *QIW* (1995) op.cit.

102 *QCMA*, op. cit., at 17,226-17,227; *Tooth & Tooheys*, op. cit., at 18,183; *Rural Traders*, op. cit., at 18,122-18,123.

103 There has recently been a greater use of the consent decrees or undertakings approach to vertical mergers in the United States. See *United States v AT & T Corp* 59 Fed. Reg. 44,158; *United States v MCI Communications* 59 Fed. Reg. 33,009; *United States v Tele-Communications, Inc* 59 Fed. Reg. 24,723; *Martin Marietta Corp*. 59 Fed. Reg. 17,379.

104 The ACCC has published guidelines on the new access regime: *Access Regime — a guide to Part IIIA of the Trade Practices Act*, November 1995.

105 Report by the Independent Committee of Inquiry, *National Competition Policy*, AGPS, Canberra, 1993.

106 *Davids* (1995), op. cit.

107 *QIW* (1995), op. cit.

108 Davids subsequently acquired QIW (which had by then acquired CBL) and unilaterally entered into undertakings in substantively the same terms as those previously offered to the Commission, with the exception of the guaranteed pass through of a proportion of the cost savings.

109 Much of the following discussion on procedural issues relevant to s. 87B undertakings draws on the article by I Tonking and L Castle 'Mergers: The Use and Utility of Undertakings', 1TPLJ 37, 1993, and the article by J Walker and L Woodward, 'The Ampol/Caltex Australia Merger: Trade Practices Issues', 4TPLJ 21, 1996.

110 See Tonking and Castle, op. cit., 1993, p. 46.

111 See *Broken Hill Pty Ltd v Trade Practices Tribunal* (1980), 31 ALR 401.

112 *QIW* (1995), op. cit., at 40,914.

113 ibid., at 40,929.

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