> change. Rather, it would be expected that change would be marginal and targeted at the relatively small proportion of products which are affected by the cross-subsidisation issues.[73]

5.108 If this outcome were achieved, the Commission believes that there will be no anti-competitive detriment.

One existing full-line wholesaler adopts the short-line business model

5.109 The next most likely scenario is that one existing full-line wholesaler will slowly withdraw product lines and services and adopt a business model more akin to that of a short-line wholesaler. However, based on the arguments above, the Commission believes that this outcome is less likely, and may well be the result of business inefficiency, rather than market inefficiency or 'excessive competition'.

5.110 If one of the full-line wholesalers adopted a business model more akin to that of short-line wholesalers, the Commission believes that some anti-competitive detriment could result. However, it also believes that this scenario will result in significantly less anti-competitive detriment than if the merger were to proceed. First, the market will get a major short-line wholesaler, with the capacity to reasonably quickly re-establish itself as a full-line wholesaler. At present, there is no short-line wholesaler that comes close to the size and scale of the national full-line wholesalers. Second, it is likely that the market shares of the two remaining full-line wholesalers would be more equal – if the merger proceeds the merged entity's wholesaling business will be approximately twice the size of the remaining full line wholesaler's. The merged entity is more likely to become a price leader and there would be greater potential for tacit price collusion if the merger proceeded. In circumstances where two equal full-line wholesalers remain in the market, and there remains a national short-line wholesaler that poses a credible threat of re-entry, each market participant should be adequately constrained from engaging in anti-competitive conduct.

5.111 The Commission notes that, if one full-line wholesaler were to withdraw from certain geographic areas, the likelihood of the remaining players exploiting regional monopolies is small. In particular, the Commission considers that the threat of competition, both from the large short-line wholesaler and the other full-line wholesaler will be sufficient to ensure that competition remains in these markets should this outcome eventuate.

5.112 Therefore, should one existing full-line wholesaler scale down its operations in the event that the merger does not proceed the Commission is of the view that the anti-competitive detriment would be minimal, and would be significantly less than the anti-competitive detriment that is likely to result if the merger were to proceed.

Two existing full-line wholesalers adopt the short-line business model

5.113 The least likely outcome that the Commission envisages could occur if the merger were not to proceed would be that two full-line wholesalers would adopt a business model more akin to that of short-line wholesalers. The market would be left

[73] Mayne Group Limited Submission, 13 August 2002, Page 6.

with one full-line wholesaler. The Commission considers this highly unlikely for several reasons:

- presently, two full-line wholesalers appear to be making adequate returns on capital enabling them to continue with their existing business model on a sustainable basis; and
- if one full-line wholesaler were to exit the market and adopt a short-line business model, the remaining players would have access to potentially greater economies of scale, thereby assisting their financial viability, ensuring that at least 2 full-line wholesalers remain in the market.

5.114 The Commission also notes that the Commonwealth Government is currently undertaking the Joint Industry Government Review of Pharmaceutical Wholesaling Arrangements. This review is presently examining issues of wholesaler remuneration and will, if the Commonwealth considers it appropriate, modify wholesale margins.

5.115 In the unlikely event that two full-line wholesalers adopted business models more akin to short-line wholesalers, the Commission considers that anti-competitive detriment would possibly result. However, this detriment would be mitigated by the fact that the remaining full-line wholesaler should be constrained by the threat of re-entry into full-line wholesaling by two large short-line wholesalers. This threat would be credible given their relative scale vis-à-vis existing short-line wholesalers, whereas if the merger were to occur the Commission considers there is no credible threat of a new large wholesaler entering the market. Further, if there is only room in the market for one national full-line wholesaler, then, if the merger does not proceed, two existing full-line wholesalers will scale down their operations to adopt the short-line business model. If the merger were to proceed and one of the remaining two full-line wholesalers were forced to scale down their operations, the market would have only one large short-line wholesaler. In these scenarios, the market with two large short-line wholesalers remaining is likely to be more competitive than a market with only one large short-line wholesaler.

5.116 Therefore, the Commission is of the view that this outcome would also result in less anti-competitive detriment than would arise should the merger be allowed to proceed.

Conclusion

5.117 For the reasons outlined above, the Commission considers that:

- allowing the merger to proceed is likely to result in significant anti-competitive detriment;
- all of the likely scenarios if the Commission does not grant authorisation to the merger are likely to result in less anti-competitive detriment than allowing the merger to proceed; and
- the Commission believes that the most likely scenario if the merger does not proceed is that the status quo will be largely maintained, and that therefore no anti-competitive detriment will result.

6. Public Benefits

6.1 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 (s.90(9A)).

6.2 The Tribunal has suggested that the term 'public benefit' 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. [74]

6.3 Efficiency is a public benefit and has been recognised as such in numerous matters considered by the Commission and the Tribunal. The Tribunal has stated that:

> ... the encouragement of competition and competitive behaviour and the achievement of the economic goals of efficiency and progress will commonly be paramount.[75]

6.4 The Commission will consider public benefits in the form of savings from rationalisation and increased efficiency and better resource usage, resulting in lower unit costs. However, if rationalisation costs and efficiency gains are not passed through to the wider community, they may be given less weight than if such savings, or a proportion of the savings, were passed through in lower supply costs or increased service levels.[76] It is relevant, therefore, for the Commission to assess whether such savings, either in whole or in part, will be passed through.

6.5 The Tribunal has also noted that the concept of public benefit is not limited to a benefit to consumers. A private benefit can also be considered of value to the wider community.[77] However, the interests of the public are of primary importance in considering the public benefit.

6.6 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. 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. The Commission also considers it is critical to consider the likely durability of the claimed public benefits.

Community Access to Pharmaceuticals

6.7 The majority of submissions received by the Commission identify community access to pharmaceuticals as a benefit to the public. The Commission agrees.

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[74] *Re QCMA*, op cit, at 17,242.
[75] *Rural Traders Co-operative (Western Australia) Ltd & Ors.*, (1979), ATPR, 40-110, p.18,123.
[76] *Howard Smith Industries and Adelaide Steamship Industries*, (1977) ATPR, 40-023, p.17,334.
[77] *Re QCMA*, op cit, at 17, 242.

6.8 The Commission notes it is a central objective of the Commonwealth Government's National Medicines Policy that there is timely access to the medicines that Australians need, at a cost individuals and the community can afford.

6.9 The DHA submits that community access to pharmaceuticals is currently being achieved to a high standard and that includes access by consumers in regional and rural areas. The DHA acknowledges that wholesalers and direct distributors play a critical role in this respect and believe that competition between wholesalers and direct distributors has to date ensured that this objective is being achieved.

6.10 There are currently no concrete service standards requiring wholesalers to service particular regions or supply particular pharmaceuticals. Accordingly, under the PBS wholesalers are entitled to the same "notional" margin even if they elect to service only certain areas or supply certain pharmaceuticals.

6.11 The Applicants currently distribute pharmaceuticals for a flat percentage fee (less any discounts or rebates to individual pharmacies) to pharmacies regardless of geographic location (within a State) or actual cost of handling the particular item. This practice of uniform pricing means that full-line wholesalers achieve different returns on different products and different locations.

6.12 The Applicants claim that the current extent and level of their services is unsustainable. One reason given for this is the "cherry-picking" of the high volume/high profit segments by short-line wholesalers and manufacturers distributing direct to pharmacies reducing the Applicants' ability to support high cost services. As such the short-line wholesalers' operations are limiting the full-line wholesalers' ability to cross-subsidise their operations.

6.13 The Applicants claim that the economies of scale and efficiencies resulting from the merger will allow them to substantially increase the number of pharmacies that could sustainably be served and substantially increase the number of pharmaceutical products that could sustainably be supported thereby enhancing community access to pharmaceuticals. To this end the Applicants have provided an undertaking to maintain for five years benchmark service levels central to the merged entity's role as a full-line wholesaler.

6.14 A large number of pharmacists support the Applicants' claim that a merger is necessary for service levels to continue at their current level and that the maintenance of such service levels constitutes a benefit to the public. Likewise the South Australian and Tasmanian State branches of the Pharmacy Guild view the merger as necessary to maintain current service levels. The National Secretariat of the Pharmacy Guild of Australia submitted:

> The prevailing competitive pressures will inevitable [sic] lead to the downgrading of services offered by the full-line wholesalers in order to compete with the short-line and direct distributors. Such an outcome will be inimical to community pharmacy and ultimately to consumers. It would clearly jeopardise consumers' timely and equitable access to pharmaceutical products, particularly in rural and remote locations.

6.15 Without the merger the Applicants state they may need to remove some of their core services and move closer to the short-line wholesaling model reducing the current level of access to pharmaceuticals. The first services to be affected would be the higher-cost services such as distribution to pharmacies in remote areas and products requiring special handling. On 9 August 2002 the Commission requested estimates for both API and Sigma of the loss on their operations in each State from providing the following services for the last three years:

(1) Rural and remote deliveries
(2) Cold chain distribution
(3) Distribution of dangerous drugs

The Applicants were unable to account for any losses that may have been attributable to the provision of these services, although API identified some additional costs.

6.16 Mayne submits that it is inherently unlikely that Sigma and API will become short-line wholesalers if the merger does not proceed. Mayne states that the most likely response if the merger does not proceed is that all of the existing full-line distributors will make some modifications to the way in which they currently conduct their operations. However, such modifications are likely to be small.

6.17 The Commission accepts that the economies of scale resulting from the merger would assist the merged entity to continue to provide their existing services and notes the Applicants' undertaking in this regard. However, the Applicants have been unable to provide the Commission with evidence of the degree to which these services are currently unsustainable. In the Applicants' response to the Commission's request for further information, the Commission was advised that API and Sigma do not have complete information available in relation to the losses associated with these activities since they do not internally account for products on this basis. The Commission was informed that in API and Sigma's experience these activities contribute substantially to the Applicants' inadequate returns on capital, and on this basis they were unsustainable.

6.18 However, as noted in Chapter 4 the Commission considers that API currently in a sound financial position with ROCE exceeding WACC. Mayne is in a similar financial position. In relation to Sigma the Commission has formed the view that it is generally in a solid financial position and if it can achieve the internal efficiencies it has highlighted in its Annual Reports, then it will be in a position meet its cost of capital even if the merger does not proceed. In this context the Commission notes NECG's comments on page 9 of its Final Economic Report:

> Quality factors, particularly the ability to offer the full range of frequent deliveries, are so important that a full-line wholesaler who attempts to reduce costs by restricting the number of products carried or reducing the delivery frequency risks losing the pharmacy's primary business to another wholesaler who does offer these benefits.

Further at page 21:

> At some point, however, the prize of succeeding in the marketplace as a full line wholesaler may not be worth the sacrifice involved in carrying large volumes of uneconomic products. It

> seems plausible to assume that point will be reached when the overall return on capital employed fails to reach the cost of capital faced by a full liner.

Therefore, using this approach, API and Mayne will continue to offer the range of services they currently provide. Further, should Sigma achieve internal efficiencies, its operations are likely to be similarly sustainable.

6.19 As noted above, the Commission has not been provided with sufficient evidence to be able to satisfy itself of the degree to which these services are unsustainable. The Commission considers that the merger, of itself, does not guarantee the provision of these higher cost services. The Commission notes that the undertakings as to service levels offered by the Applicants are short-term, whereas the structural changes to the market following the merger are long term. Given the Commission's view of the competitive environment likely to prevail post-merger, it considers that the Applicants will be in an enhanced position to selectively withdraw these services or raise prices in that environment.

6.20 While the Commission accepts that over time that there may be some rationalisation in the market, as noted above, such rationalisation is likely to be small and at the fringe of the market. In addition, the Commission considers it likely that such rationalisation will be undertaken by individual businesses, and, rather than resulting in services not being provided, will result in the most efficient players providing those services.

Community Health Services

6.21 The Commission recognises the provision of community health services as a benefit to the public. The Applicants claim that they are instrumental in the provision of community health care both directly and through the support of the community pharmacy network.

6.22 It is clear from the Applicants' submission that they do provide a level of training to and sponsorship of pharmacy. The Applicants have provided the Commission with confidential information regarding their expenditure on the provision of community health services. *Confidential material see endnote xxvi.* The Applicants' claim that the merger would enable them to substantially increase the provision of community support services.

6.23 A number of pharmacists supported the Applicants' claim that the merger would allow API/Sigma to provide a greater level of training and distribution of health information. The Victorian Branch of the Pharmacy Guild of Victoria stated:

> Pharmacists currently provide a local primary healthcare role which is available in all communities – rural and metro – and we feel that the merger would continue to facilitate this core community service.

6.24 However, there were a substantial number of pharmacists who submitted that the wholesalers do not provide any significant assistance in relation to the provision of training or health information. One pharmacist commented that informing pharmacists could be achieved without the merger as Australia has one of the best health information distribution systems in the world. Further, a number of pharmacists submitted that they do not see the provision of health information as the role of the wholesaler and rely principally on other sources for this type of information and support.

6.25 CSL noted that pharmacists obtain and update their skills from sources other than wholesalers. Likewise, AstraZeneca stated that health information and training is available from the Pharmacy Guild, the Pharmaceutical Society and the Pharmaceutical Industry and they do not rely on wholesalers to distribute information about their products. GlaxoSmithKline submitted that if you consider what manufacturers and professional bodies do, the contribution of API and Sigma would be marginal, if not insignificant.

6.26 Medicines Australia stated that the services noted in the Application are marketing tools used by the wholesalers to engender loyalty. The provision of health information is primarily provided by professional bodies such as the Pharmacy Guild and by the manufacturers themselves.

6.27 The Commission notes that a range of industry participants, including the Pharmacy Guild and pharmaceutical manufacturers, principally provide these services. The Commission also considers that the Applicants offer these services partly to engender loyalty in their pharmacy customers and, accordingly, are likely to continue to provide these services even if the merger did not proceed.

6.28 Therefore, the Commission accepts the provision of community health services as a benefit to the public and that the Applicants contribute to this to a degree. The Commission is not satisfied that this benefit would be eroded without the merger, or that the merger will increase the extent of this benefit. The Commission further considers that the Applicants, as well as a range of other entities, are likely to continue to provide these benefits regardless of whether the merger proceeds.

Regional and Rural Support

6.29 The Applicants claim that the merger would substantially increase the range of pharmacies that API and Sigma can sustainably serve in rural and regional areas. The Applicants claim that whilst they currently service these areas it is not on a sustainable basis.

6.30 With respect to the pharmacists that commented specifically on this claim there was general consensus that the Applicants would continue to service regional and rural areas with or without the merger. Some pharmacists noted, however, that the merger may allow them to do this more efficiently and cost-effectively. One pharmacist noted that whilst the merger could result in increased support to regional areas these services could equally reduce because of warehouse closures.

6.31 CSL submitted that services to rural and regional areas are currently being provided and this is a result of competition. Likewise, Clifford Hallam submitted that the reason why the wholesalers do not charge more to deliver to rural pharmacies is because of competition. This point was further illustrated by National Pharmacies which submitted that Fauldings at one stage had a charge on deliveries in rural and regional areas in Western Australia but competition has resulted in these charges being dropped.

6.32 National Pharmacies submitted that rural and regional support would continue in the marketplace even without the merger because it is important for wholesalers to obtain volume and the accompanying economies of scale. National Pharmacies noted that the merger may in fact result in a lessening of this benefit because competition will reduce, meaning that the remaining full-line wholesalers may increase charges to the disadvantage of rural areas.

6.33 AstraZeneca submitted that the merged entity will not be able to serve any more pharmacies or products than they do currently. The Applicants' submission also acknowledged that they currently service all areas but not on a sustainable basis.

6.34 The Commission accepts that the economies of scale resulting from the merger are likely to assist the merged entity to service rural and remote areas on a more cost-effective basis. However the Applicants have provided only limited evidence that these services are currently unsustainable. The Commission accepts the submissions of the short-line wholesalers who state that competition between the three full-line wholesalers has resulted in these services being provided at their current level.

6.35 In light of:

(a) the submissions made by pharmacists and industry;

(b) the Commission's view on the sustainability of the Applicants' businesses; and

(c) the current level of competition in the wholesaling market;

the Commission is not satisfied that the merger is necessary to maintain continued access to pharmaceuticals in regional and rural areas. In addition, as discussed above in relation to community access to pharmaceuticals, the Commission does not accept that the merger will guarantee the provision of these services. Further it notes that the undertakings offered do not address the long term issues the Commission considers will emerge as a result of the merger.

Innovation in Access to Pharmaceuticals and Health Services

6.36 The Applicants claim that they provide a range of IT support systems and interfaces that promote innovation in access to pharmaceuticals and health services and will be critical in the development and implementation of new systems by the Government and the Pharmacy Guild. In the Applicants' response of 22 August 2002 to the Commission's request for further information on what IT support system provided by the Applicants promote innovation they responded:

> The merged company could use some of its economies to encourage web-based ordering programs on-line broadband [sic] in pharmacies. Computer ordering of stock by pharmacists with direct links from wholesaler to pharmacy point of sale system would allow pharmacists to become used to working on-line and used to having their business sales information open to the web and would allow pharmacists to feel secure working on the web, and in the security, integrity of information, stability of the IT system. ....Therefore the merged entity, by

promoting pharmacists' confidence in the security, integrity and stability of working on-line, would promote the BMMS, which will save lives and promote health outcomes.

6.37 The DHA has submitted in relation to innovation in access to pharmaceuticals and health services the wholesalers have a role in developing systems between themselves and pharmacists but the DHA is not aware of wholesalers playing a direct role in the Commonwealth Government initiatives listed in the Application. The DHA informed the Commission that to access these initiatives pharmacists will only require access to the Internet. The Victorian Branch of the Pharmacy Guild noted in this context however that the merger may provide the technological development and support for broadbanding.

6.38 A number of pharmacists also submitted that the merger will enable a greater level of investment in IT systems and support. Hospital Pharmacy Services submitted that sophisticated IT systems will help achieve savings in the industry and enable the PBS to survive.

6.39 Medicines Australia submitted that it was not clear from the Applicants' submission how wholesalers contribute to the government initiatives. It also noted that there has, in the past, been a lack of progress in relation to other IT initiatives between the wholesalers and manufacturers.

6.40 National Pharmacies submitted that while the merger may mean the Applicants can spend more on developing IT systems, this is not a public benefit. It is not critical to the government's commitment and is not critical generally to pharmacy. In fact, it is critical that the wholesaler does not control the software linking into the PBS rebate as this could force pharmacists to deal with particular wholesalers.

6.41 Clifford Hallam submitted that the provision of IT support systems forms part of the wholesalers business and if IT support systems were not provided the pharmacist customer would use the competition.

6.42 The Commission agrees that innovation in access to pharmaceuticals and health services is a public benefit. However, based on the submissions received the Commission notes that wholesalers are not considered critical to Government initiatives in this area.

6.43 The Commission considers that the provision of IT support systems to pharmacists is likely to create efficiencies in ordering pharmaceuticals. However, the Commission believes that it forms part of the full-line wholesalers' service offerings and that it is in the wholesalers' commercial interests to invest in these systems to encourage pharmacies to place orders through them and improve the overall efficiency of their business. Accordingly, the Commission is not satisfied that there will be a decline in these services should the merger not proceed, nor that the merger will lead to increased innovation. *Confidential material see endnote xxvii.* The Commission also strongly supports the view that innovation is more likely to occur in a highly competitive market.[78]

[78] "Innovation in the broad sense is driven by competition. While technological innovation is the result of a variety of factors, there is no doubt that healthy competition is an essential part." Professor Michael

Reductions in Commonwealth Government Expenditure

6.44 The Applicants claim that in order for the Commonwealth Government to maintain the public benefits described above whilst minimising increases in the PBS it will need to maximise the efficiency of the entire distribution system. The Applicants further claim that the improvements in manufacturing efficiency resulting from the merger will also contribute to a reduction in Commonwealth Government expenditure through the promotion of quality Australian pharmaceuticals including generic pharmaceuticals.

6.45 The responses to this claimed public benefit largely questioned the connection between the merger and any reduction (or minimisation of increases) in Commonwealth Government expenditure. National Pharmacies, CSL, Medicines Australia and AstraZeneca raised this point.

6.46 Macquarie Equities Limited submitted that the merger is likely to be a catalyst to the government reducing the current wholesale margin and that there are likely to be changes to the PBS regardless of whether the merger proceeds.

6.47 API and Sigma have stated in their Application that they have objected to the Commonwealth Government's proposal to reduce overall maximum wholesale margins by moving from a fixed 10% margin to an alternative structure which provides for a lower rate for higher value pharmaceuticals. Further, the Commission notes that all three full-line wholesalers are currently operating below the notional 10% wholesale margin allocated by the Commonwealth Government. This has not resulted in a reduction in expenditure for the Commonwealth Government but has been passed on to their pharmacy customers due to competitive pressures.

6.48 On 9 August 2002 the Commission requested further clarification on how efficiency gains in the distribution system will reduce (or at least minimise the increase in) Commonwealth Government expenditure on the health system. The Applicants responded:

> Efficiency gains detailed in the parties' submission will enable the merged entity to continue to fulfil its role in underpinning Commonwealth Government's policy that all Australians have timely access to all products listed on the PBS. Withdrawal of the current level of service due to financial pressures that both companies face as stand-alone entities will require the Commonwealth Government to put into place alternative distribution systems (particularly to ensure service to rural and regional pharmacy) that will be more costly than current arrangements.

6.49 The Applicants did not provide any evidence regarding the additional costs that they claim would be incurred in the event the Commonwealth was required to adopt alternative distribution systems.

6.50 The Commission accepts that the increased use of generic pharmaceuticals has contributed significantly to a reduction in Commonwealth Government expenditure.

Porter, Competition and Antitrust: Towards a Productivity-Based Approach to Evaluating Mergers and Joint Ventures, *Fundamental Theory Task Force Report*, American Bar Association 2001.

None of the submissions received by the Commission directly commented on this point.

6.51 The Commission accepts that there may be increased promotion of generic pharmaceuticals which may lead to their increased use resulting in a decrease in Commonwealth Government expenditure under the PBS. However, as discussed in greater detail below, the Commission considers that this benefit is offset to a degree by the anti-competitive detriment associated with the promotion of the merged entity's generic pharmaceuticals through its distribution network. Furthermore, the Commission notes that there are a number of successful generic pharmaceutical manufacturers currently operating in Australia.

6.52 A reduction in Commonwealth Government spending whilst maintaining high service levels is a benefit to the public. However, the Commission does not believe any efficiency gains achieved by the Applicants will result in a reduction in Commonwealth Government Expenditure within the current PBS framework. Further the Commission is not satisfied that the merger will minimise future government expenditure.

6.53 In respect to the promotion of generic pharmaceuticals, the Commission accepts that the merger may assist in the promotion of the merged entity's generic pharmaceuticals with resulting benefits to Commonwealth Government expenditure. However, the Commission notes that such benefit is likely to be achieved to a significant degree without the merger through generic manufacturers already present in the market, without the associated anti-competitive effect.

Small Business Support

6.54 The Applicants claim that the merger will enhance the parties' ability to provide this support. The Commission recognises the provision of small business support as a public benefit. This support includes marketing, financial and IT support.

6.55 Primarily small business support is provided by the full-line wholesalers through their banner groups. Members of the banner group pay a significant fee for their membership. Some business support, however, is available to pharmacies outside of the banner chains on a fee for service basis.

6.56 A number of pharmacists submitted that API and Sigma currently provide small business support. Mr Joe Cichello from Craigieburn Amcal Pharmacy submitted:

> We also rely on Sigma to provide us with marketing and small business support which, not only helps our pharmacy survive in the current cut-throat retail environment but also helps us to enhance our professional role in disseminating health information and advice to the local community. The important service that our wholesalers provide in this area would only be enhanced by a merger to a larger, more efficient entity.

6.57 Some pharmacists commented that the merger will allow the merged entity to increase this support. The various branches of the Pharmacy Guild also supported the claim that the merger would enhance small business support.

6.58 A smaller number of pharmacists, however, submitted that should the merger proceed they did not consider that there would be much benefit in the way of management, business or financial support or that the level of support would change. A number of pharmacists also commented that these services are available but only on a fee for service basis.

6.59 GlaxoSmithKline submitted that it is unclear how the merger will enhance small business support or how the failure of the merger to proceed would jeopardise existing support. GlaxoSmithKline noted that the provision of this support is not a function of scale of a wholesaler. AstraZeneca also noted that it was uncertain if there is a link between the merger and the provision of business services to pharmacists.

6.60 Clifford Hallam, Southern Hospital Supplies and National Pharmacies commented that this service forms part of the full-line wholesalers' overall service as it is part of their wider business strategy. National Pharmacies stated that the support that full-line wholesalers provide to small businesses is for the purpose of obtaining more customers and creating barriers to entry to the market. The full-line wholesalers would provide these services even if the merger did not take place as they are not costly to provide and further they receive a fee for banner group services.

6.61 In Sigma's 2001-2002 Annual Report it states:

> The banner groups are pivotal to the success of Sigma, with contributions through the purchase of Private Label products and Sigma branded products, utilisation of Sigma's wholesale distribution facilities and participation in Sigma's retail promotions.[79]

6.62 Further it claims:

> During the year, the Healthcare Division conducted a review of its retail services operations with PricewaterhouseCoopers. This review concluded that Amcal and Guardian contribute significantly to total group performance through wholesale sales, Private Label and Sigma brand products and the various promotional programs.[80]

6.63 *Confidential material see endnote xxviii.*

6.64 In relation to the provision of financial services, Macquarie Equities Ltd claimed that API is at the forefront of pharmacy loans and makes a real margin from that part of the business. *Confidential material see endnote xxix.* The Commission notes in this respect, however, the Applicants' further submissions of 22 August 2002 stating that Sigma does not make a profit in relation to the financial support services it provides.

6.65 *Confidential material see endnote xxx.*

6.66 Further, submissions from interested parties noted that the granting of a financial guarantee engendered loyalty from the pharmacist who would then purchase their goods through that wholesaler.

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[79] Sigma Annual Report 2001-02, Page 15.
[80] Sigma Annual Report 2001-02, Page 16

6.67 The Commission believes that full-line wholesalers provide these services for commercial reasons, primarily to encourage pharmacists' loyalty to the wholesaler. The Commission also considers, as noted in Chapter 5, that the creation of banner groups by the full-line wholesalers has created significant barriers to entry in the market.

6.68 The Commission considers that whilst the provision of small business support is a benefit to the public, it is already occurring. The Commission believes that the provision of these services is a point of competitive differentiation and is part of the full-line wholesalers' wider business strategy to ensure a retail distribution channel. On the information provided to the Commission, it appears that these services are a necessary part of the full-line business model, and accordingly will continue to be provided. Further, the Commission is not satisfied that the merger will enhance the provision of these services.

Export Enhancement and Import Replacement

6.69 Subsection 90(9A) of the Act 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.

6.70 Accordingly, the Commission regards a significant increase in the real value of exports and/or a significant substitution of domestic products for imported goods as a benefit to the public.

6.71 The Applicants claim that through the merger and increased scale of manufacturing operations, they have the potential to increase the real value of exports and promote import substitution in pharmaceutical manufacture. Sigma estimates that around $25 million in products currently imported by Sigma and its contract customers could be transferred to its Australian plants following the merger. The Application further states that the merged entity, with the advantages of lower capital costs (to attract investment to develop world-class manufacturing operations) and increased scale, would have a significantly enhanced ability to attract additional contract manufacturing activity, representing a further $25 to $30 million per year. However, the Commission notes that the Applicants did not substantiate these claims. For example, they did not provide evidence on how the merger would enable the local production of products currently imported by Sigma and why Sigma could not do this absent the merger.

6.72 In general pharmacists and the various branches of the Pharmacy Guild did not comment specifically on this claimed public benefit.

6.73 National Pharmacies stated that if the merged entity is able to invest more money in manufacturing then this is good for Australia. Arrow submitted that:

> Although Sigma's manufacturing business is still growing without the merger, the increased efficiencies would be unlikely to result without the merger.

6.74 Medicines Australia submitted that the merged entity would have the capacity to increase manufacturing and exports. However, given API has limited manufacturing operations Sigma is in a position to accomplish this in the absence of the merger. Deutsche Bank expressed similar sentiments, stating that given the size of API's current operations it did not expect the merger to assist manufacturing operations.

6.75 In this context the Commission notes that Sigma's Pharmaceutical Division has experienced significant sales growth with the Company's brand portfolio, contract manufacturing and in its export markets.[81] Further, in relation to attracting additional contract manufacturing activity the Commission notes the following statement on page 13 of Sigma's Annual Report 2001/2002:

> Further opportunities are currently being evaluated in both the acquisition and licensing of key brand opportunities to support our current portfolio. An increasing number of opportunities have been brought to Sigma for evaluation throughout the year, reflecting the image and success of the business in increasing the market share of the brands in our portfolio.

6.76 The Applicants claim that there are also significant economies of scope between the manufacture and distribution of certain products, particularly generic pharmaceuticals and OTC products, since manufacturers of these products can obtain information and marketing cost savings by integrating into distribution. API and Sigma as full-line wholesalers provide pharmacy-brand OTC products as part of the banner management and retail support package of services.

6.77 The Commission recognises that vertical relationships can reflect efficiency considerations, such as minimisation of transaction costs but it may also have implications for competition. 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.

6.78 As considered above in Chapter 5, the Commission believes that the increased level of vertical integration resulting from the merger is likely to increase barriers to entry into the wholesaling market. The Commission also notes the effect this degree of integration is likely to have on competing Australian manufacturers, particularly generic pharmaceutical and OTC manufacturers.

6.79 The Commission accepts that the merged entity may be in the position to attract further capital to expand its manufacturing operations and derive some benefits from economies of scope. However, the Applicants have not provided any information about potential export markets. Furthermore, the Applicants have not provided any information regarding the likely effect of the merger on their capital costs or scale, and therefore the extent of the claimed benefit remains unsubstantiated. In the

[81] Sigma Annual Report 2001-02, Page 7.

Commission's view the Applicants have not provided sufficient evidence that the claimed benefits are a result of the merger. Accordingly, while the Commission accepts that the merger may result in some benefit in relation to import replacement or export enhancement, on the information before it, only a small degree of benefit has been shown.

Efficiencies

Industry Efficiencies

6.80 The Applicants claim that the full-line wholesale model itself provides significant efficiencies to the community as it frees pharmacists from the requirement to separately and inefficiently maintain large stores of pharmaceutical products or order directly from each manufacturer.

6.81 Exel submitted:

> The current retail pharmaceutical supply channel is inefficient as [sic] has failed to achieve or match the significant supply chain improvement and efficiencies experienced in other industries (i.e. automotive, grocery etc) over the last 10 years.

6.82 Mayne in its submission stated:

> The central argument that is put forward by API and Sigma is that the merger should be allowed to proceed in order to preserve the current structure of the pharmaceutical distribution industry and specifically the role of full-line distributors in that industry. Mayne sees the present services being provided by pharmacists and full-time [sic] wholesalers as of significant value to the community. However, the payment structures which facilitate the provision of these services could be improved through greater transparency and more cost reflective approach. .... It is difficult to see how maintaining the current structure which involves a misallocation of resources demonstrated by the cross-subsidisation and free-riding which is evident can be said to be a 'public benefit' for these purposes.[82]

6.83 The Commission, however, acknowledges that there are efficiencies for pharmacists in not having to store large volumes of pharmaceuticals or having to order directly from each manufacturer. Each of these represent transaction efficiencies for pharmacists.

6.84 The Commission considers that the most likely outcome if the merger does not proceed is that API, Sigma and Mayne will remain in the market as full-line wholesalers. Further, as stated on page 10 of the NECG Final Economic Report, July 2002, it is unlikely that short liners or direct manufacturers could ever completely displace full liners. Accordingly, if the merger does not proceed, the Commission believes that the efficiencies inherent in the full-line wholesale model are likely to continue.

[82] Mayne Group Limited Submission, 13 August 2002, Page 6.

Capital Market Efficiencies

6.85 The Applicants claim that the merger would allow shares in the merged entity to be traded freely and would create a top-100 Australian company with a far greater ability to attract institutional investment. The resulting benefits available through rating and more accurate pricing through indexing would significantly lower the merged entity's cost of capital, allowing it to maintain the public benefits set out above on a more sustainable basis.

6.86 In response to this claim Deutsche Bank submitted that institutional investment would increase as a result of the merger. The merger would place the merged entity into the top 100 firms which would bring it into the range of interest for institutional investors. It was also submitted that the lack of liquidity in API stocks would also become less of a problem post merger. Likewise Macquarie Equities Ltd considered it very likely that the merger would result in increased trading and institutional investment in the merged entity.

6.87 A number of submissions noted however, that the shareholder base is unlikely to change with the merger as most shares will continue to be held by pharmacists. The Commission further notes in this regard that Sigma's constitution imposes a 10% shareholding limit (which would change if the merger proceeded).

6.88 In its 2001-02 Annual Report Sigma states:

> Elsewhere, the Company has continued to build on its relationship with the professional research analysts and institutional investors and can now boast research coverage by most major health and biotech analysts as well as many smaller broking houses. It is pleasing to note also that Sigma has strong institutional support on the Company's share register.[83]

6.89 The Commission acknowledges that the merger will create an entity of sufficient market capitalisation to be included in a various market indices and attract the attention of institutional investors. The Commission also accepts that there may be a reduction in the merged entity's weighted cost of capital as a result of this. However, neither the Commission nor the Applicants have been able to quantify the likely extent of this claimed benefit. Further, when questioned on this point in its meeting with the Commission, Deutsche Bank indicated that it was likely that the merged entity's WACC would fall somewhere between API and Sigma's individual WACCs, and probably closer to Sigma's WACC (which is higher than API's WACC).

6.90 The Commission therefore considers that this claimed benefit is not likely to be significant, and in addition notes that it is a benefit that will accrue to the merged entity and its shareholders.

Efficiency Gains through Merger

6.91 There is a general consensus among the interested parties that the merger will result in efficiency gains through rationalisation and consolidation. A number of

[83] Sigma Annual Report 2001-02, Page 5.

submissions stated that the merger will reduce duplication in the industry and should result in a more efficient use of society's resources.

6.92 The parties claimed efficiency gains in the order of approximately $20 million per annum with approximately $10 million in implementation costs incurred in the first year. *Confidential material see endnote xxxi.* Deutsche Bank commented that this estimate does not appear unreasonable given the size of the revenue base. Macquarie Equities Ltd however noted that these are aggressive estimates, but considered it likely that they will be realised over a 3 to 4 year period.

6.93 The Victorian Branch of the Pharmacy Guild submitted that the removal of duplication would enable wholesalers to become more efficient, with cost savings flowing to pharmacy. National Pharmacies however claimed that the efficiency gains are likely to benefit only the merged entity and its shareholders.

6.94 Public benefits in the form of increased efficiency and better resource usage, resulting in lower unit costs, are important in the consideration of applications for the authorisation of mergers. In *Davids* (1995) and *Davids* (1996), the Commission accepted that significant resource savings in grocery wholesaling from rationalisation (including warehousing and distribution facilities, advertising and generic product ranges) amounted to significant public benefits.[84]

6.95 The Commission considers that there are likely to be significant efficiency gains and resource savings resulting from the merger. However, the Commission considers that the anti-competitive effect of the merger will be such that these gains may not be maintained (ie in the absence of strong competition they may be wasted away):

> If a merger ...... gives rise to rationalization economies and high 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.[85]

6.96 In addition, the gains are unlikely to be passed through to the merged entity's pharmacy customers. In this regard, 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 dividend, this might be given less weight by the Tribunal, because the benefits are not being spread widely among the members of the community.[86]

6.97 The Commission recognises there will be substantial efficiency gains and resource savings but believes these are likely to benefit the merged entity's shareholders only.

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[84] *Davids Ltd* (1995), ATPR 50-185; *Davids Ltd* (1996), ATPR 50-224.
[85] Maureen Brunt, 'The Australian Antitrust Law After 20 Years – A Stocktake', *Review of Industrial Organisation*, Vol. 9, No. 5, 1994, p.508.
[86] *Re Howard Smith Industries Pty Ltd* (1977), ATPR 40-023, at 17,334.

6.98 With respect to the Benefit – Detriment calculation advanced on behalf of the Applicants by NECG on page 38 of its Final Economic Report the Commission notes that it largely overlooks qualitative issues associated with the proposed merger. While the Applicants submit that the market will remain highly competitive post merger, the Commission is of the view that the merger will change the competitive dynamic of the market (see Chapter 5).

6.99 The Benefit – Detriment analysis considers only allocative efficiency, fails to consider standards of service or quality and makes no allowance for the loss of productive efficiency as a result of increases in managerial slack and x-inefficiency due to a loss of competitive pressures. No consideration is given to the possibility of increased dependence or conscious parallelism leading to further allocative inefficiencies. The Applicants have built a static model that only considers possible improvements in allocative efficiency resulting from the merger. Such an approach is criticised by Scherer:

> X-efficiency is much more important quantitatively than allocative efficiency, and dynamic efficiency is almost surely more important.[87]

6.100 Further the expected loss of employment detracts from the anticipated efficiency gains from the merger. *Confidential material see endnote xxxii.*

6.101 On balance, given the magnitude of the claimed efficiency gains the Commission considers that the merger will result in a not insignificant public benefit in terms of resource savings which could not be achieved in the absence of the merger. In its Determination of 28 March 1996 concerning Davids Limited's proposed acquisition of QIW Limited, the Commission noted that to the extent that there is a risk of savings not being passed on, it may be said that the potential public benefits require discounting.

Wealth transfer

6.102 The Commission believes that the wealth transfer (or rent extraction) from pharmacists that would be likely to occur should the merged entity raise prices[88] has the potential to lessen some of the public benefits. As noted in Chapter 5, the Commission believes that the merger would significantly enhance the merged entity's ability to increase prices or decrease service levels.

6.103 In simple terms, API and Sigma have gross margin revenue of approximately \$240 million per annum (being 7/97$^{\text{ths}}$ of approximately \$3.33 billion in revenue they derive from pharmaceutical wholesaling). The table below considers the wealth transfer from pharmacists to the merged firm if the merged firm were to increase prices following the merger. The industry wide wealth transfer would be significantly higher if the merged entity acted as a price leader and the other industry participants also increased prices.

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[87] F.M Scherer, Antitrust, Efficiency, and Progress, New York Law Review Vol. 62:998, Page 56 at Page 76.

[88] Effective price increases to pharmacists could result from either a reduction in rebates offered to pharmacists or higher list prices.

TABLE 13: POTENTIAL WEALTH TRANSFER FROM PHARMACISTS TO API/SIGMA IF AVERAGE GROSS WHOLESALE MARGIN INCREASED

Wholesale gross margin	Wealth transfer from pharmacists to API and Sigma per year ($million)	Average cost per pharmacist per year ($)
7%	0	0
7.35%	12	2,436
7.7%	24	4,872
8.05%	36	7,308
8.4%	48	9,744
8.75%	60	12,180
9.1%	72	14,616
9.45%	84	17,052
9.8%	96	19,488
10%	103	20,913

(a) Assumes 4,925 approved pharmacies in Australia. As not all pharmacies are customers of API and Sigma, the increase per pharmacy affected would be greater than that listed in the table.
Source: Commission estimates

6.104 Such a wealth transfer would constitute a rent extracted by the merged entity as a result of the lessening of competition in the market. This rent extraction is, potentially, a detriment because the re-allocation of wealth away from pharmacists. This may force pharmacists to reduce services they provide to the public. This may occur because of the resultant reduction in the profitability of pharmacies.

6.105 In addition, it is possible that the merger could result in a wealth transfer from end consumers to wholesalers. In particular, the Commission notes that pharmacy only products are not subject to the same retail price regulation as PBS products, and therefore increases in prices at the wholesale level may flow through to consumers. This product segment is significant, accounting for approximately $500 million per year in sales for the Applicants.

6.106 The Applicants, through NECG, argue that wealth transfers are irrelevant as the appropriate test is a "total surplus test". That is, wealth redistribution should not be a factor in the Commission's assessment. The Commission disagrees to the extent that the redistribution impacts on the functioning of the market and the impact on services provided to consumers.

Deadweight loss

6.107 The Commission also notes that NECG has calculated the likely deadweight loss that would result from an increase in the gross wholesale margins following the merger. Should wholesale margins increase by 5% (from 7% to 7.35%) the associated deadweight loss would be approximately $1.8 million. Should wholesale margins increase by 25% (from 7% to 8.75%) the associated deadweight loss would be approximately $9.1 million. The Commission accepts that these are detriments that will flow should gross wholesale margins increase following the merger. However, the Commission considers that, because of the extent of anti-competitive detriment likely to result from the merger, an increase in the gross wholesale margin of 25% or more is not unlikely following the merger.

7. Conclusion on Application

Key detriments

7.1 In its examination of the Application for authorisation the Commission has identified a number structural changes to the market. In particular:

- the merger would significantly raise market concentration in each of the regional/state based markets for pharmaceutical wholesaling;
- the merger is likely to raise the height of certain barriers to entry or expansion in the market and this, combined with other existing barriers to entry in the market, would mean it is more difficult for any efficient new or existing entrant to enter or increase their scale in the market, and would make national entry or expansion difficult;
- the countervailing power possessed by pharmacists and small manufacturers is likely to be diminished following the merger;
- the merger would result in the loss of a vigorous and effective competitor from the market; and
- the merger is likely to increase the level of vertical integration in the market to the disadvantage of existing manufacturers of OTC and generic products.

7.2 The Commission believes that these factors would enhance the merged entity's ability to substantially and sustainably increase prices and/or decrease service levels. The extent of this likely detriment is significant. Further, such a detriment would impact not only on pharmacists, but on consumers generally.

7.3 In addition, the Commission notes that should price rises occur following the merger, the associated consumer and producer deadweight loss will also constitute a public detriment.

Key benefits

7.4 The Commission has also identified several public benefits that are likely to result following the merger:

- The merged entity will achieve rationalisation benefits through the closure of warehouses and other infrastructure. The merged entity will also achieve cost savings through reduction in unit expenditure because of improved route density and retrenchment of excess staff. The Applicants estimate these efficiency gains at approximately $20 million per year, with implementation costs in the first year of approximately $10 million. However, over time, these benefits are not likely to be passed onto customers in the form of lower prices. These benefits are likely to be retained by the merged entity for its benefit, and the benefit of its shareholders. Further the Commission considers that due to changes in the competitive dynamic of the market, it is possible that these gains will be eroded over time. The loss of employment from the merger also detracts from the overall public benefit;

- The merger may result in some import replacement as the merged entity will have increased access to economies of scope in relation to its manufacturing activities, and a vertically integrated distribution chain through which to distribute its manufactured products. Similarly the merger may also assist in export enhancement. However, the Applicants did not substantiate this claim fully, and accordingly the Commission is only able to satisfy itself that a small degree of benefit will result from the merger. The Commission is also concerned that the link between the merger and this benefit is tenuous because Sigma has been able to, and is likely to be able to, continue to grow its manufacturing operations substantially without the merger;
- The merger may result in some capital market efficiencies as a result of the merged entity attracting increased institutional attention, and perhaps a marginal decrease in the merged entity's cost of capital. However, in the Commission's view the extent of this benefit is likely to be small, and is likely to be retained by the merged entity for its benefit and the benefit of its shareholders; and
- The merger may assist in the promotion of generic drugs and this may result in a reduction in Commonwealth Government expenditure. However, the Commission considers the extent of the benefit attributable to the merger is likely to be small, especially as effective manufacturers of generic products exist at present and are likely to continue to increase their operations regardless of whether the merger proceeds.

7.5 API and Sigma argued that the following were also public benefits resulting from the merger:

- community access to pharmaceuticals;
- community health services;
- regional and rural support;
- innovation to access to pharmaceuticals and health services; and
- small business support.

7.6 The Commission accepts that each of these factors constitute public benefits. However, in relation to each of these claims, the information before the Commission has not satisfied it that these are benefits resulting from the merger. Similarly, the Commission is not satisfied that the merger will increase the extent of these benefits.[89] Further, the Commission considers on the information before it that the current full-line wholesalers are financially sustainable. In addition, as a result of the significant anti-competitive detriment that would be likely to result from the merger, the merged entity would have an enhanced ability through its increased market power to selectively withdraw these services.

7.7 The Applicants also submit that the merger will result in reductions in, or minimise the increase of, Commonwealth Government expenditure. The Commission does not consider that the Applicants have substantiated their claims in this regard.

[89] There is the possibility that unforeseeable factors could impact on the pharmaceutical wholesaling industry and result in some rationalisation. However, these should not be as a result of the merger not occurring.

7.8 Finally, the Applicants submitted that the full-line wholesale model itself provides significant efficiencies to the community. The Commission accepts that this is the case. However, the Commission believes that this model is sustainable in the absence of the merger.

Without the merger

7.9 The Commission considers that if the merger does not proceed it is likely there will be no, or very little, anti-competitive detriment. The Commission believes that prices and service levels should remain relatively constant, and in the long term further efficiency gains should be realised through vigorous and effective competition in the marketplace.

7.10 Further, based on the information available to the Commission, should the merger not proceed it is likely that:

- community access to pharmaceuticals will be maintained at approximately their present level in the long term;
- community health services will be maintained in the long term;
- rural and regional support will be maintained at approximately its present level in the long term;
- innovation in access to pharmaceuticals and health services will be maintained and possibly enhanced in the long term; and
- small business support will remain in the long term.

Nevertheless, should unforeseeable events occur, any changes to the levels of service and support currently provided would take place in a competitive market.

Conclusion

7.11 The public detriments that would be likely to result if the merger proceeds are significant. Further, they would be likely to have an adverse impact on pharmacists, pharmacists' customers, pharmaceutical and OTC product manufacturers and competitors of the merged entity. Conversely, the public benefits that would be likely to be realised by the merger, while not insignificant, are considerably smaller than the detriment that would be likely to result from the merger. In addition, the Commission notes that the benefits realised by the merger may not be sustained over time and that they accrue mainly to the merged entity and its shareholders.

On balance, the Commission is of the view that the public benefits flowing from the merger are not likely to outweigh the detriments. The Commission is not satisfied, in all the circumstances, that the proposed merger of API and Sigma would result, or be likely to result, in such a benefit to the public that it should be allowed to take place.

8. Consideration of Undertakings

8.1 Section 87B of the Act 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).

8.2 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.

8.3 The Commission favours undertakings which are able to address structural issues in the relevant market. This will often involve the divestiture of specific assets in order to maintain the competitive structure in those markets where the proposed acquisition raises competition concerns. However where structural undertakings are not feasible the Commission may consider proposals for behavioural undertakings, taking account of the regulatory costs in balancing the likely public benefit and detriment. The regulatory costs associated with behavioural undertakings includes the costs to the Commission of compliance and enforcement.

Proposed Undertakings

8.4 The Applicants have offered the Commission undertakings in relation to service and price. The principles proposed to be incorporated in the undertakings are:

(a) Undertakings to preserve specific price and service conditions prevailing at the time of the merger.

For two years, Sigma/API would:

i) not increase the average gross margin for PBS/ethical products through any reduction of rebates or discounts or the introduction of new charges or penalties;

ii) not materially adversely alter the standard payment terms offered to pharmacists;

iii) maintain the number of deliveries made to customers such that there is no reduction in the number of deliveries made to those customers by Sigma or API immediately before the Commencement Date (whichever is the greater);

iv) maintain deliveries to all geographic locations to which deliveries are made at the date of these Undertakings by Sigma and API;

v) not materially increase turnaround times for deliveries as applicable at the date of these Undertakings by Sigma and API; and

vi) maintain services to pharmacists at the levels applying immediately before the commencement date of the Undertakings.

(b) Undertakings to maintain benchmark service levels central to the merged entity's role as a full-line wholesaler.

For five years, Sigma/API would:

i) maintain the range of PBS and ethical products held by Sigma and API at the date of the undertakings, including those requiring cold-chain secure delivery;

ii) maintain delivery to non-metropolitan areas to the extent currently provided by either of the parties; and

iii) maintain a rebate structure that provides discounts for prompt payment and efficient ordering.

(c) Undertakings relating to fair dealings with pharmacist.

For the term of the undertakings, Sigma/API would:

i) not require the use of any information technology systems which would have the effect or likely effect of hindering or preventing pharmacists from acquiring pharmaceutical products or pharmaceutical services from other suppliers;

ii) not take advantage of market power to increase prices beyond those that would apply in a competitive market;

iii) not engage in unfair conduct in dealing with pharmacists; and

iv) not take action which is detrimental to the role of pharmacists as healthcare professionals or in relation to the obligation of pharmacists under the Guild/Government agreement.

(d) Undertakings to contribute $1 million per annum for three years as cost savings are realised from the authorised merger to community health initiatives such as supporting rural pharmacy or funding e-business or community health IT infrastructure.

(e) Market events and competition consequences that would trigger a good faith review of certain or all of the undertakings.

(f) Incorporate the Guild in monitoring the undertakings and consulting in relation to compliance.

Public Benefit/Public Detriment Balance

Public Benefits

8.5 The Undertakings guarantee, to a degree, the delivery of a number of the public benefits which the Applicants have claimed will result as a consequence of the merger, namely:

- community access to pharmaceuticals;
- community health services;
- regional and rural support;
- innovation in access to pharmaceuticals and health services; and
- small business support.

8.6 As these public benefits do not arise directly from the merger but are dependent upon the Applicants choosing to provide them the undertakings give the Commission comfort in their delivery.

8.7 These undertakings however, fail to address the longer-term structural issues that the Commission believes will arise as a result of the merger. The Commission notes that there is no guarantee that these benefits will continue past the period of the undertakings. Furthermore, the Commission considers given the anti-competitive effect of the merger the merged entity will be in a far stronger position to reduce services and raise prices once the undertakings cease to be in effect.

Public Detriment

8.8 Whilst the undertakings preserve price and service conditions which the Commission considers likely to be adversely affected by the merger, they are only a short-term solution. The undertakings do not resolve any of the longer term structural issues such as changes to barriers to entry, countervailing power and vertical integration which the Commission has identified as contributing to the anti-competitive detriment resulting from the merger.

Cost of Compliance

8.9 The Commission considers that the regulatory cost of ensuring compliance with the proposed undertakings would be substantial. It would involve monitoring prices over approximately 2,000 product lines throughout thousands of pharmacies. This is further complicated given that the level of rebates and discounts on various items vary between pharmacy. In relation to the undertakings as to service levels, the regulatory burden would also be extremely high. Service levels are extremely difficult to define and equally difficult to monitor given the range of service provided and the number of recipients.

8.10 The Applicants' submission of 22 August 2002 states that any material change to rebates and rebate structures, payment terms, and delivery arrangements, service levels or product range will be immediately apparent to pharmacies. The Applicants envisage that individual complaints would be referred to an independent ombudsman established and funded by the parties and that the parties would commission an annual independent audit of compliance with the undertakings.

8.11 The Commission accepts that the system proposed by the Applicants would go a significant way in reducing the large regulatory burden associated with monitoring the undertakings. However, the Commission would necessarily be involved in the monitoring of these undertakings, and as noted by the Applicants would be responsible for any enforcement action. Accordingly, the undertakings would involve a significant regulatory burden.

Balance

8.12 On balance the Commission does not consider that the proposed undertakings significantly alter the balance between the public benefits and public detriments in the longer term which the Commission considers arise from the merger.

Alternative Undertakings

8.13 Given the nature of the merger and the Commission's concerns about the anti-competitive effect of the merger it considers there are no possible undertakings, structural or behavioural, which would shift the public benefit/public detriment balance in favour of granting the Application for Authorisation.

9. Determination

9.1 For the reasons contained herein, the Commission denies Authorisation to Application A30215 made under s.88(9) of the Act.

9.2 This Determination is made on 11 September 2002. If no application for review is made to the Australian Competition Tribunal in accordance with s.101 of the Act, this Determination will come into force on 3 October 2002.[90]

9.3 If an application for review is made to the Tribunal, the Determination will come into force:

(a) on the day on which the Tribunal makes a Determination on the review; or

(b) where the application for review is withdrawn – on the day on which the application is withdrawn.

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[90] Trade Practices Act 1974 (Cth), and Regulation 20(1) which specifies that an application for review of a Commission Determination must be made within a period of 21 days after the date of the Determination.

Attachment A

Table of Submissions

1.	3M Pharmaceuticals Pty Ltd
2.	A Beaumont Hall Pharmacies
3.	A John - The Compounding Chemist
4.	Allens Pharmacy, Goondiwindi
5.	Allergan Australia Pty Ltd
6.	Amcal Beenleigh
7.	Andrew Milani - Pharmacist
8.	Andrew Neil - Pharmacist
9.	Anne Manley - Pharmacist
10.	Arrow Pharmaceuticals
11.	AstraZeneca
12.	Australian Consumers' Association
13.	Australian Medical Association
14.	Banovich Guardian Pharmacy
15.	Bristol-Myers Squibb Pharmaceuticals
16.	Bundanoon Pharmacy
17.	C & G Gellie, D Gordon, J & B Arnold
18.	Calamvale Day & Night Pharmacy Virginia Qld
19.	Capalaba Park Amcal Chemist
20.	Capital Chemist Kambah
21.	Carnegie Wylie
22.	Chemplus Hindmarsh SA
23.	Clifford Hallam
24.	Coles Myer Ltd
25.	Craigieburn Amcal Pharmacy
26.	CSL Limited
27.	Day & Night Chemist Ashfield
28.	Department of Health and Ageing
29.	Department of Health and Human Services Tasmania
30.	Department of Human Services
31.	Dept. Innovation Industry and Regional Development
32.	Deutsche Bank
33.	Donald Stewart - Pharmacist
34.	East Victoria Park Soul Pattinson
35.	Ego Pharmaceuticals Pty Ltd
36.	Eli Lilly Australia Pty Ltd
37.	Exel Logistics Australia and New Zealand
38.	Fourways Pharmacy Devonport TAS
39.	Gerard Purumian - Pharmacist
40.	GlaxoSmithKline
41.	Greg Da Rui - Pharmacist
42.	Greg Symons - Symons Amcal Pharmacy

43.	Gympie Village Pharmacy
44.	Hans and Rowena Kasch Pharmacist Ulladulla
45.	Holst - Portfolio Watch Monthly
46.	Hospital Pharmacy Services
47.	Independent Pharmacy 777 Mandurah Forum
48.	Jerry Hampton Pharmacies
49.	Jim Gow Burrendah Pharmacy WA
50.	John Anderson Guardian Pharmacy Shepparton Vic
51.	John Skyllas - Southgate Pharmacy Sylvania NSW
52.	John's Chemworld Chemist Orange NSW
53.	Lennon Marshall Group
54.	Lincoln Dispensary West Perth
55.	Macquarie Equities Limited
56.	Maidens Brush Pharmacy
57.	Marc Segler Noranda Feelgood Pharmacy Noranda WA
58.	Mayne Group Limited
59.	Meadow Mews Pharmacy Kings Meadow Tas
60.	Medical Benefits Fund of Australia Limited
61.	Medical Industry Association of Australia
62.	Medicines Australia Inc
63.	Meredith Baker
64.	Metcash Trading Limited
65.	Midnight Pharmacy
66.	Morgos Mari Mina Amcal Pharmacy
67.	National Pharmacies
68.	New Clicks Australia
69.	Night & Day Rozelle NSW
70.	Peter Madden - Pharmacist Paddington NSW
71.	Pfizer Pty Limited
72.	Pharmaceutical Society of Australia
73.	Pharmacy Guild of Australia National Secretariat
74.	Pharmacy Guild of Australia Victorian Branch
75.	Pharmacy Practice Foundation University of Sydney
76.	Pharmacy Workshops Pty Ltd
77.	Queensland Health
78.	Reckitt Benckiser
79.	Richard Turner Guardian Jesmond Pharmacy
80.	Rode Pharmacy Stafford Qld
81.	Ronald Lee - Pharmacist
82.	Ronald Rowland AM
83.	Rural Pharmacy, Queensland, greater than 10 years experience
84.	Simon Yu Pharmacy Amcal
85.	Small Manufacturer
86.	Small Manufacturer
87.	Society of Hospital Pharmacists of Australia
88.	Soul Pattinson Chemist Castle Hill
89.	Southern Hospital Supplies
90.	St Vincents and Mercy Private Hospital

91.	Steve Cohen Illawarra Pharmacy Marrickville
92.	Technipro Marketing Pty Ltd
93.	Terrace Pharmacy, Katherine, NT
94.	Terry White Chemists Level E Myer Centre, Brisbane
95.	Terry White Chemists North Perth
96.	Terry White Chemists, Stockland Shopping Centre, Townsville
97.	Terry White Chemists, Waverly Gardens
98.	The Pharmacy Guild of Australia South Australian Branch
99.	The Pharmacy Guild of Australia Tasmanian Branch
100.	The Pharmacy Guild of Australia Victorian Branch
101.	Tom Silvan SWAPS
102.	Tony Brangan - Pharmacist
103.	Tony Bugeja - Pharmacist
104.	Urban Pharmacy, South Australia with fewer than 10 years experience
105.	Urban Pharmacy, Victoria with greater than 10 years experience
106.	Urban Pharmacy, Victoria with greater than 10 years experience
107.	Urban Pharmacy, Queensland, fewer than 10 years experience
108.	Urban Pharmacy, South Australia, greater than 10 years experience
109.	Urban Pharmacy, Northern Territory, greater than 10 years experience
110.	Urban Pharmacy, South Australia, greater than 10 years experience
111.	Urban Pharmacy, South Australia, greater than 10 years experience
112.	Urban Pharmacy, South Australia, greater than 10 years experience
113.	Urban Pharmacy, Tasmania, greater than 10 years experience
114.	Urban Pharmacy, Tasmania, greater than 10 years experience
115.	Urban Pharmacy, Tasmania, greater than 10 years experience
116.	Urban Pharmacy, Victoria, greater than 10 years experience
117.	Urban Pharmacy, Victoria, greater than 10 years experience
118.	Victorian Pharmacy
119.	Wade's Pharmacy
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121.	Western Australia Department of Health
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Attachment B

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