

TOPIC 1: MARKETS AND MARKET POWER

1. Defining the Market

- ✎ A market is the area of close competition between firms (*QCMA*). *Section 4E* sets out that the market must be a market in Australia and the crux of market definition is substitution. There will be substitution where there is cross-elasticity of demand and supply (*Cellophane*). Additional factors may be considered when determining market dimensions.
- A market can still exist even if there is no actual competition provided there is the potential for it
 - ❖ E.g. in *Queensland Wire*, the HC was prepared to accept that there was a market for Y-bar, even though BHP was the only source of Y-bar in Australia and none had ever been sold ^[1]_{SEP}.

A. DETERMINING MARKET DIMENSIONS

I. PRODUCT CROSS-ELASTICITY

- To determine product cross-elasticity, ask:
 - 1. Cross-elasticity of demand**
 - **SSNIP test:** What would be the consumer reaction to a small but significant non-transitory increase in price from the firm? If a substantial number of consumers would turn to another product, then the market includes that product (*Cellophane*)
 - **Rephrased test:** If the firm were to 'give less and charge more' would there be much of a reaction? If so, from whom? (*QCMA*)
 - **ACCC approach:** If the price increased by 5% what would happen? (not adopted by the courts)
 - 2. Cross-elasticity of supply**
 - **ASK:** What would be the reaction from suppliers to a small but significant non-transitory increase in price? That is, are there other firms with existing capacity to shift production? If so, they form part of the market.
 - ❖ E.g. a women's shoes company is a supply substitute for men's shoes, because if the price of men's shoes increases they could shift production

Case	Decision
<i>Tooheys</i>	Bulk beer and packaged beer belong within the one market (because they have close demand and supply substitutes), but beer and other alcoholic beverages are not in the same market
<i>Singapore Airlines</i>	The market was island holiday services, and not a separate Maldivian Island holiday services market because there were close substitute destinations (Bali, Fiji etc);
<i>Ansett</i>	Public transport and taxis are weak substitutes for rental cars, and hence not in the same market
<i>Arnotts</i>	Biscuits are not in the same market as other snack foods, because there is no high cross-elasticity of demand – occasional substitution is not enough. However, there are not individual biscuit markets for sweet and savoury b/c substitution
<i>Mark Lyons</i>	Market was found to be all types of ski boots. Sellemens ski boots were too small a market, and all sports equipment was not substitutable for ski boots.

II. FUNCTIONAL

- Competitors must operate at the same functional level
- Three levels: manufacturing, wholesale and retail
- ❖ E.g. in *Metcash*, the market was found to be the Aus-wide grocery distribution market. M was not simply a wholesaler but was closely involved in the retail process – IGA brand was a significant element in the rivalry between IGA retailers and the major supermarket chains. To separate wholesale and retail activities would ‘involve a significant degree of artificiality’

III. GEOGRAPHIC

- Need to look at whether close substitutes are limited to a geographic area.
- **ASK:** what the response would be if a small group of vendors raised their price. If, because of their geographic isolation there would be no response from neighbouring vendors, then the group occupies a separate geographic market.
- Look at factors:
 - Perishability of goods
 - Transport costs
 - Excess capacity of rival firms
 - Brand loyalty
 - Convenience
- ❖ E.g. in *AMH*, AMH was an abattoir that purchased cattle from farmers. The FFC confined the market to North Qld because abattoirs from southern areas were not substitutes, because of transport costs and the loss in condition of cattle during transport.

IV. TIME

- How long should we allow for substitution to occur?
- Focus on longer term effects (*QCMA*) e.g. ACCC uses a 2-year time frame

B. EVIDENCE OF SUBSTITUTION

- ✓ Evidence of past price increases;
- ✓ Experts in the industry (what other products are good substitutes?) (*Broderbund*)
- ✓ The opinions of the parties themselves (who do they see as their competitors?) (*Arnotts*)
- ✓ Surveys of consumers (be careful of questions – ask whether they would substitute) (*Broderbund*)
- ✗ Economist opinions (it is a question of law so not up to economist) (*Arnotts*)
- ❖ E.g. in *Mark Lyons*, the Court looked at the behaviour of the people in the trade – including figures relating to competitors and customer behaviour

2. Does the Firm Have Market Power?

- Market power is the absence of competition → it is the discretion to give less and charge more (QLD W)
- ✎ The level of competition is determined by the market structure. For one of the prohibitions to be made out, must show the conduct has changed the market structure. If conduct does not change the market structure, it cannot be said to impact competition.

A. DETERMINING MARKET STRUCTURE

- ✎ In order to determine whether a market is competitive, the court will consider 5 elements of the market structure: (QCMA) → remember to apply this analysis to your market determined above

1. Number and market share of firms (s 50(3)(c))

- ASK: how many firms are in the market and what is the market share of each firm?
- A competitive market has a large number of firms with a small market share (Outboard)
- If at the manufacturing level, look at the capacity of each firm
 - ❖ E.g. in AMH, AMH had nearly 64% of the capacity to slaughter cows in North Qld.

2. Barriers to entry (s 50(3b))

- ASK: how difficult is it for new firms to enter market and secure a viable market share?
- This is often regarded as the most important test b/c the threat of entry of a new firm into the market operates as the ultimate regulator of anticompetitive conduct
- What are barriers to entry?
 - a. Legal barriers (e.g. patent rights, exclusive government licences, or tariffs);
 - b. Restricted access to natural resources (e.g. entrants might only be able to access inferior natural resources, or it will cost them much more to access same resources as the incumbent);
 - c. Large economies of scale (this will be a barrier if the entrant cannot get those same economies of scale as the incumbent/s – e.g. because the market is too small);
 - d. Strategic barriers to entry (e.g. conduct engaged in by firms to make entry into the market more difficult, e.g. predatory pricing (Boral))
 - e. Surplus capacity (e.g. AMH had had closed plants that it could reopen to meet the competition of a new entrant)
 - f. Product differentiation (e.g. the strength of brand loyalty can be relevant (Arnotts))
 - g. High costs to commence production (if need to spend a massive sum at once compared to a long term company that has relayed costs over many years (Arnotts))
- Must be a disadvantage that a potential entrant would face that the incumbent does not (asymmetry disadvantage). Look for “sunk costs” – those costs that an entrant cannot recover

3. Product differentiation (s 50(3)(g))

- ASK: to what extent are the products in the market differentiated or homogenized?
- The more differentiated the product or sales promotion, the less competition in the market. The more homogenous, the stronger the competition (e.g. the concrete masonry products in Boral)

4. Vertical relationships (s 50(3)(i))

- ASK: what is the extent of vertical integration?
- The greater the vertical integration between firms (eg manufacturers own the wholesalers and retailers), the less competitive the market because there is less inter-trading.
- This is not a strong indicator

5. Arrangements among firms

- ASK: are the firms independent?
 - Look at the nature of any formal, stable and fundamental arrangements between firms, or common ownership between firms (e.g. *AMH*), which restrict their ability to compete.
- ❖ E.g. in *QLD Wire*, found that BHP had significant market share and there were no threats from imports. Were the only one with access to Y-bar. Therefore, market power.
- ❖ E.g. in *Outboard*, there was hundreds of retailers for machine engines with small market shares. Found highly competitive market.
- ✍ **CONCLUDE:** As there are high barriers to entry, market is not competitive, and X has a substantial degree of market power, in that it can raise its prices above the supply cost without rivals taking away its customers in time (*Queensland Wire*) → it has discretion over price and services.

TOPIC 2: MERGERS

1. Rationale

- Mergers can be both pro- and anti-competitive:
 - Pro-competitive: a merger can result in a more efficient firm (economies of scale and scope) or a more competitive firm (where two smaller firms merge to compete against a larger firm); and the threat of acquisition encourages management to run firms efficiently;
 - Anti-competitive: a merger can give market power (which can lead to inefficiencies)

2. Requirements

- (1) A corporation must not directly or indirectly: *(s50(1))*
 - 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 any market

(2) same terms but applies to a person acquiring shares/assets of a corporation

A. A CORPORATION

- A “**corporation**” is defined in *s 4(1)* to mean a body corporate that is:
 - a foreign corporation;
 - a trading or financial corporation formed within the limits of Australia;
 - incorporated in a Territory; or
 - the holding company of any of the above (a holding company means they own >50% of the shares)

B. ACQUIRE

- Acquisition = any legal or equitable acquisition of shares or assets, whether alone or jointly
- An acquisition of assets does not include by way of charge only, or where it is in the ordinary course of business (e.g. bank holding a security interest; super fund acquiring shares all the time) *(s 4(4)(b))*

C. DIRECT OR INDIRECT ACQUISITION


- **Direct acquisition** = where the corporation makes the acquisition itself
- **Indirect acquisition** = two interpretations
 1. Broad view: holding company ‘indirectly’ acquires shares/assets acquired by its subsidiary *(AMH)*
 - This ignores the corporation rule that they corporations are distinct legal entities
 2. Narrow view: an indirect acquisition only occurs where the subsidiary makes the acquisition *on behalf of* the holding company (i.e. agency arrangement) *(Australia Iron & Steel per Lockhart J)*
 - This renders the word ‘indirectly’ redundant as agency situations are direct acquisitions
- In *TPC v Gillette, Burchett J* held that it was at least arguable that the term ‘indirect’ acquisition in s 50 could bear the definition given by *Davies J* (broad view). Therefore, broad view is preferable as it better aligns with the Act and agency fits better under direct acquisition.
- Where subsidiary acquires – go through direct acquisition first and then indirect of holding company
- Where subsidiary is overseas → will pursue holding company *(BHP)*

D. CAUSAL LINK

- There must be a causal link between the acquisition and the substantial lessening of competition
- **ASK**: whether the acquirer achieves sufficient control of shares or assets to reduce competition
- What if there is a partial takeover (<50% of shares acquired)?

- **ASK:** Does the acquirer have practical control of the other company? (*Brisbane Gas*)
- For example, a 30% shareholding might be enough if the other shares are spread diffusely (everyone else has 5%)
- What if the acquisition was one in a series of creeping acquisitions?
 - E.g. $A \rightarrow B \rightarrow C \rightarrow X \rightarrow Y \rightarrow Z$, and only the final acquisition of Z substantially lessened competition;
 - $A \rightarrow Z$ = indirect; $Y \rightarrow Z$ = direct;
 - It is possible to attack the $A \rightarrow B$ direct acquisition, because it was part of a scheme for A to get indirect control of Z and therefore ultimately had the effect of SLC (*Australia Iron & Steel*)
 - Generally, will only do this if ACCC can't go after direct acquirer (outside jurisdiction)

D. SUBSTANTIALLY LESSENING COMPETITION

 The acquisition must have the effect or likely effect, of substantially lessening competition in a market

I. REQUIRED STEPS

1. Define the market

- 'Market' = market for goods or services in Australia, a State, a Territory or a region of Aus (*s 50(6)*)
- Follow steps outlined above (pp 5-6)

2. Apply with and without test

- To determine whether the acquisition SLC, apply the future with and without test – comparing the future with the acquisition and the future without the acquisition (counterfactual) (*AGL*)

➤ Step 1: Assess future market without the acquisition

- This is generally similar to the competition before the acquisition, but taking into account changes that would inevitably occur
- The burden of proof for the counterfactual will be on the balance of probabilities (*Metcash*)

➤ Step 2: Assess future market with the acquisition

- ASK: does the firm have more market power or is there substantially less competition
- Consider pro-competitive effect such as efficiencies and economic scale
- Where non-horizontal merger, will be SLC if allows foreclosure of markets (i.e. via bundling)

Factors to consider in determining if acquisition SLC: (*s 50(3)*)

- the actual and potential level of import competition in the market
- the height of barriers to entry to the market (see above)
- the level of concentration in the market
- the degree of countervailing power in the market
 - Refers to the extent to which market power held by a firm could be offset by customers or suppliers – are there strong buyers that can ensure firms do not abuse market power by threatening to stop purchasing unless the firm acts competitively
- the likelihood that the acquisition would result in the acquirer being able to significantly and sustainably increase prices or profit margins
- the extent to which substitutes are available in the market or are likely to be available
- the dynamic characteristics of the market, including growth, innovation and product differentiation
- the likelihood that acquisition would result in removing a vigorous/effective competitor from the market
- the nature and extent of vertical integration in the market

What does 'substantially' mean?

- 'Real or of substance' (*Arnotts*)
- 'Meaningful or relevant to the competitive process' (*Rural Press, concerning s 45*)

- 'Significant and sustainable' (*ACCC Guidelines*)
- The test does not require the acquisition to give the corporation "a large increase" in its position of MP (e.g. if the corporation is already in a dominant position) → it will be 'substantial' where likely outcome of acquisition would be a real or substantial **strengthening** of the MP (*Arnotts*)

Does the acquisition have the effect or likely effect of SLC?

- 'Would have the effect' = an actual lessening of competition to be proven by evidence
 - 'Likely to have the effect' = 'more probable than not' (>50%; *Ansett and Buchanan J in Metcash*) OR a 'real chance or possibility' (<50%, preferred by *French J in AGL and by the ACCC Guidelines*)
- ❖ E.g. in *Arnotts*, A had 65% share of biscuit market. Nabisco 8%. Weston 13%. A wanted to acquire Nabisco. Full Court said no b/c A already had significant power + barriers to entry such as capital costs, brand loyalty and difficulty of obtaining supermarket shelf space.
- ❖ E.g. in *QIW*, strong competition in overall grocery distribution market so no need to oppose merger. It may have benefit of creating 'fourth force' in the national market.
- ❖ E.g. in *Metcash*, Metcash (largest independent grocery wholesaler) wanted to buy Franklins. Court allowed it because Franklins had decided to close its wholesale operation because it was making a loss so without the merger the market would be weaker. Rejected idea that consortium would have bought Franklins on BoP if Metcash didn't.

OVERSEAS ACQUISITION

I. SECTION 50

- s 50 can apply to overseas acquisitions as "corporation" is defined to include foreign corps (*s 4(1)*)
- Two requirements:
 - Lessening of competition occurs in an Australian market (*ss 4E; 50(6)*); AND ^[1]_{SEP}
 - The acquirer has a relevant connection to Australia (*s 5(1)(g)-(i)*)
 - Incorporated or carrying on business within Australia
 - Australian citizen,
 - person ordinarily resident within Australia

II. SECTION 50A

- Introduced to cover situations where s 50 doesn't (*s 50 (7)*)
- When does it apply?
 - Where a person gets control of a body corp (any foreign or Aus corp) [first controlling interest] and by reason of this, the person gets control of another corporation [second controlling interest]
 - That is, A buys B which means it has control of B's subsidiaries (C and D)
- If the Tribunal is satisfied that the person obtaining the second controlling interest would substantially lessen competition in a market in Australia and it would not result in a public benefit, the Tribunal may make a declaration (*s 50A(1)*)
- The remedy is that the corporations [C and D] have to stop trading within 6 months (*s 50A(6)*)

✍ **CONCLUDE:** X firm has lessened competition by reducing or weakening the competitive constraints or reducing the incentives for competitive rivalry. The increased market power of the merged entity may enable it to profitably reduce prices or otherwise engage in behaviour that is detrimental to consumers.