Markets, Market Power and Competition

Market

[1] The ACCC will argue that the market is **[NARROW MARKET]**, whilst **[D]** will argue that the market is **[BROAD MARKET]**. The process of defining the market is 'inexact' and involves a 'question of degree' (***QLD Wire***).

The market will include other goods (or services) that are substitutable or competitive with **[G/S(1)]** **(s.4E CCA)**. To determine whether **[G/S(1)]** can be substituted with **[G/S(2)]**, the SNIPP test needs to be applied (***QCMA***).

Go through both (even if you dismiss one)

- Demand-side substitution
  - If the price of **[G/S(1)]** increased by 5% **(merger guidelines 4.21)** for a long period of time (ie 2 years), will consumers start purchasing **[G/S(2)]** instead? **FACTUAL ANALYSIS**.
- Supply-side substitution
  - **[D]** may argue that applying the SNIPP test to the supply-side of the market will also help determining the market. That is, if the price of **[G/S(1)]** increased by 5% for 2 years, will other companies start selling **[G/S(1)]** instead? **FACTUAL ANALYSIS**.
    - Also includes whether suppliers can adjust their production plans, substituting one product for another in their output mix, or substituting one geographic source of supply for another (***QCMA***)

Dimensions of the market

- Product (covered above)
- Functional level
  - Eg importer, manufacturer, distributor, wholesaler or retailer?
- Geographic
  - Ie is the market limited by geographic constraints?
  - Consider the cost of transpiration and the nature of the goods
- Time

Cellophane Case	• Du Pont used cellophane to wrap food products and cigarettes • They were in competition with companies that manufactured different packages (plastic bags, cling wrap, plan paper, etc) used for the same purpose
	• Flexible packaging material or cellophane market? • The main consumers of the cellophane provided by DP were supermarkets • DP had evidence that supermarkets would shift to other forms of packaging material if the price increased • Regarded as substitutable products; market was flexible packaging material
Tooth and Tooheys	• 2 brewers and distributors of beer supplied 90% of beer in NSW
	• Leisure facilities, alcoholic beverages market, beer or bulk beer market? • The court remarked on how substitutability changes due to changes in lifestyle

	• Post-war, wines and spirits have become relatively more popular beverages compared to beers. The increased popularity of wines and spirits operate to lessen beer's substantial market power. • Beer still plays a distinctive role in the Australian way of life. It still has its characteristic, times and places of consumption, and its devotees. In 1976, beer accounted for $3/4^{th}$ of the value of liquor purchases from suppliers and registered clubs. • The market was just beer (both bulk and packaged)
Singapore Airlines	• Taprobane Tours (TT) was a wholesale travel agent that would arrange packaged tours for retail travel agents to supply to consumers • It specialised in tours to the Maldives • Air travel for these tours was by Singapore Airlines • SA then restricted the operations of TT by confining it to flights departing from WA and charging prices higher than those charged to other wholesalers

	• SA had overwhelming dominance in supplying airline services to the Maldives. There were also no feasible or economical alternatives for travel by air to the Maldives by Australian tourists. Thus, SA could 'promote or retard' the business of a wholesaler (aka TT) when they offered Maldives tours to consumers without the fear that they would engage another airline supplier.
	  o However, the court didn't consider whether SA's ability to affect price at the wholesale or resale level was constrained by the ability of wholesalers and their customers to turn to other destinations.
	  o This would establish that they had substantial market power if the market was confined the holiday packages to the Maldives. However, the market (outlined below) is broader.
	• With regards to the regulation of landing rights and SA's enjoyment of such rights pursuant to a bilateral agreement between the governments of the Maldives and Singapore (barriers to entry) – other air service providers flying into the Maldives. There was no reason that arrangements couldn't be made by which other airlines could operate from Australia either directly to the Maldives or through some other nearby country (however, this was speculation).
	• The market was island holiday packages available at the retail and wholesale levels

Subaru	• Company in question was the supplier of genuine Subaru parts in the region/state
	• Car parts (in general) or Subaru car parts market? • A single brand market may exist where the evidence supports a finding that consumers purchase a product solely in reliance upon its brand name and not in reliance upon the physical qualities of the product. Spare parts not readily interchangeable for those of other machines may also lead to a finding of the existence of such a market. • Consumers would factor in maintenance and repair costs in the long term • The company's ability to raise the prices will be impaired, because consumers would buy non-Subaru cars • Market was Subaru car parts
United Brands	• Bananas or fruit market?

	• Empirical evidence was used (cyclone) to show that people would continue to buy bananas, especially for the elderly and children • Market was bananas

[2] *Market structure?*

The level of competition between firms depends on the 'structure of the market in which they operate', where the market structure comprises of 5 elements (***QCMA)***.

- Potential competition is important, not actual competition (***QLD Wire***)

Barriers to enter the market

- Types of barriers:
  - Legal or regulatory **(7.30 Merger Guidelines)**:
    - Licensing conditions
    - Exclusive government licenses
    - Tariffs
    - Patent or IP rights
    - Environmental regulations
  - Structural or technological **(7.31 Merger Guidelines)**:
    - Sunk costs (eg product development, advertising or promotion)
    - If economies of scale are disproportionate to the size of the market (***QLD Wire***)
    - Mature markets
    - Access to key production
    - Network effects
- Most important consideration because it's the "ease" and the "threat" of a new firm entering into the market that "operates as the ultimate regulatory of competitive conduct" (***QCMA***)

Number of companies

Vertical relationship

- Eg if they operate at 2 or more different functional levels (importer, manufacturer, distributor, wholesaler or retailer)

Product differentiation

Arrangement between the firms

- Eg parent and subsidiary relationship

Outboard Marines	• OM was a company that supplied 2 different brands of outboard motors for boats in NSW • They would only sell their motors to retailers if they didn't sell Suzuki motors • If the retailer didn't accept, they would stop supplying to them

	• The court considered the retail market of outboard marine engines within the geographic region of NSW (the court imposed this geographical limit)
	• Number of companies and market share
	    o There were many competing firms
	    o If you walked along the coastline, there would be several suppliers
	• Barriers to entry
	    o Low barriers to entry because any company could contract with OMA, Suzuki, etc to sell their engines
	• Thus, it was a highly competitive market

	• If conduct (here it’s to stop supplying to retailer) is to lessen competition, it has to change one of the market structure elements • Refusing to supply to one retailer didn’t significantly reduce competition in the market. It simply removed one retailer from selling one engine (because they could supply Suzuki engines). • In other words, it didn’t impact the market share of the other companies
QLD Wire	• BHP refused to sell its product, Y-bar, to QLD Wire • BHP was responsible for ~97% of Australia’s steel output and supplies and ~85% of the country’s demand for steel and steel products • Their only substantial domestic competitor in the supply of steel and steel products was Smorgon; supplying 3% to the market • BHP was the only manufacturer of Y-bar in Australia and no significant quantities had been imported • The Y-bar isn’t for general sale. However, BHP did send it to subsidiaries and companies in which they have an interest. • The Y-bar was used to manufacture star picket posts • Only 1% of star picket posts used in Australia is imported. The rest is made by BHP from its Y-bar. • BHP advertised that they could supply ‘every part of the fence – not just the wire’

	• Steel or Y-bars market?
	• Barriers for entry were significant: high cost of setting up a rolling mill, high capital costs in the steel industry, the presence of an established and overwhelmingly large producer in a protected market and large economies of scale
	• Even though BHP didn’t sell to anyone other than their wholly owned subsidiary, they were a potential seller to other purchasers in that market – hence they were prepared to sell the Y-bar albeit at an excessive price. A market existed for Y-bars.
	    o This existence or non-existence of sales of a product cannot conclude whether a market exists or not. It must be sufficient to constitute a market that there is a product for exchange, regardless of whether exchange or negotiation for exchange has actually taken place. (Dawson J)
	    o However, the market wasn’t Y-bars for this case
	• Steel market (market in which producers sell steel and steel products from the rolling mills); didn’t matter whether it was this or Y-bars because they had substantial market power in both markets

[3] Problems with defining the market

Surveys

Broderbund Software	• BS gave an Australian company a license to sell a game they produced • It was argued that this Australian company was a monopoly • BS tried conducting surveys to determine what the market was
	• Was the market: the game produced by BS, educational video games or games (in general)? • The questions didn’t have real prohibitive value

	• All the questions were hypothetical
	  o The problem with surveys is that the person answering them won't necessarily follow what they claimed in the future
	  o In other words, what you'll do in 2-5 years' time isn't reliable
	• The court said that the practicality of finding reliable results is difficult

Expert evidence

Arnott's	• Arnott's is a biscuit manufacturer that wanted to merge with another biscuit manufacturer • They called upon an economist (expert) to tell the court what he believed the market was
	• The court held that he couldn't decide what the market was because it was a legal question that was for the court to decide **unless** he established what his assumptions were

Industry experts

- This is different to experts stating what their opinion on the law is (see ***Arnott's***)
- In ***Broderbund***, an industry expert in computer software video games provided evidence on the market of video games in Australia (eg who BS' game target, who BS' competitors were or whether BS' game was educational)

Defendant's perception

- The court will consider who the D considers their competitors to be. This won't be determinative (***Arnott's***)

Mergers

The ACCC may contend that [CO. 1]'s acquisition of [SHARES/ASSETS] in [CO. 2] breaches **s.50 CCA**.

[1] A corporation must not directly or indirectly acquire shares in a body corporate (or assets of a person) if the acquisition would have the effect or likely effect of substantially lessening competition (SLC) in any market **(s.50(1) CCA)**.

- Acquire includes: alone, jointly, legal or equitable acquisition **(s.4(4) CCA)**

[2] [CO. 1] has [DIRECTLY/INDIRECTLY] acquired [CO. 2] [SHARES/ASSETS], resulting in a [TYPE] merger.

- Indirect acquisition occurs where Co. 1's subsidiary buys shares in Co. 2
  - Narrow view espoused by Lockhart J in ***Australian Iron & Steel*** – corporate veil can't be pierced. If the subsidiary acquires the company, the parent company won't be held as acquiring the company.
  - Broader view in ***Australian Meat Holdings*** where the holding company indirectly acquires the company if their wholly owned subsidiary acquires the company
- Merger types
  - Horizontal – same market
  - Vertical – different functional level
  - Conglomerate – different market

[3] Defining the market

Although a market includes a market for goods or services in [REGION] **(s.50(6)(…))**, the parties will need to delineate a more specific market.

- **(a)** Australia
- **(b)** State
- **(c)** Territory
- **(d)** Region of Australia

GO THROUGH [1] and [2] in 'Markets, Market Power and Competition' Template.

[4] The court will apply the 'future with and without' test to determine whether the merger will SLC (**3.16 Merger Guidelines**).

[5] *Future without the merger*

Although more information is required, the counterfactual generally assumes a continuation of the current state of the market (***Metcash***).

- **IF** the counterfactual is different from the status quo:
  - "[ACCC/CO.1] will need to prove that on a balance of probabilities, [COUNTER FACTUAL] will occur (Buchanan J in ***Metcash***). FACTUAL ANALYSIS."
- 'Likely' means 'a real chance or possibility' (***AGL***) or 'more probable than not' (***Ansett***)

[6] *Future with the merger*
With the merger, the market in the future will be **[CONSEQUENCE]** because **[FACTOR]**. Although the court will consider all **s.50(3)** factors, only the aforementioned factors are significant for current discussion.

Factors (s.50(3)(…)):

- **(a)** the actual and potential level of import competition in the market
  - **7.35 Merger Guidelines**
    Imports can provide competitive constraint in the following circs:
    - Independent imports represent at least 10% of total sales in each of the previous three years
    - No barriers to quantity of independent imports which would prevent imported product from competing
    - Actual or potential imported product is a strong substitute (quality, range, price, etc.)
    - Price of actual or potential imports (including tariffs or duties) is close to domestic price
    - Importers can readily increase supply volume
    - Merged firm and other major domestic suppliers do not have a direct interest with importers
- **(b)** the height of barriers to entry to the market
- **(c)** the level of concentration in the market
  - **7.6 Merger Guidelines**
    Changes in market concentration over time can reveal the frequency of new entry, providing insight into the ability of new entrants and smaller competitors to attract customers and expand
- **(d)** the degree of countervailing power in the market
  - **7.48 Merger Guidelines**
    Whether one or more buyers (ie customers) have sufficient countervailing power to constrain any attempted increase in market power by a supplier. This exists where buyers have special characteristics that enable them to credibly threaten to bypass the merged firm.
- **(e)** the likelihood that the acquisition would result in the acquirer being able to significantly and sustainably increase prices or profit margins
- **(f)** the extent to which substitute are available in the market or are likely to be available in the market
  - **7.41 Merger Guidelines**
    ACCC will consider the extent of product differentiation by assessing whether the merger parties differ from rivals in terms of:
    - Product features and function
    - Customer loyalty
    - Brand loyalty
    - Whether a substantial number of customers consider the products of the merger parties to be particular close substitutes
    - Production capacity
    - Breadth of product line and level of specialisation
    - Distribution channel coverage

        - Geographic presence
        - Cost structures
        - Level of vertical integration
- **(g)** the dynamic characteristics of the market, including growth, innovation and product differentiation (ie does dynamic features lessen competition?)
    - **7.52 Merger Guidelines**
      Examples
        - Market growth
        - Innovation
        - Product differentiation
        - Technological changes

      Changes will be considered from 2 perspectives:
        - Extent to which dynamic features of market affect the competitive impact of the merger
        - Whether the merger itself impacts on the dynamic features of the market
- **(h)** the likelihood that the acquisition would result in the removal from the market of a vigorous and effective competitor
    - **7.57 Merger Guidelines**
      Where a vigorous competitor drives significant aspects of competition: pricing, innovation or product development, even though their own market share may be modest
- **(i)** the nature and extent of vertical integration in the market.

Brisbane Gas	• One company purchased 20% of another company
	• A pragmatic approach needs to be adopted to determine whether acquiring a partial shareholding is anti-competitive (eg consider how many shareholders there are)
Arnott's	• Arnott's wanted to acquire Nabisco; horizontal merger • The Arnott's group carried on business in: manufacturing and distributing biscuits and snack foods through to flour milling and engineering • Nabisco manufactured biscuits and cereal products • Arnott's owned 65% of the biscuit market and Nabisco owned 15%.
	• Was the market 'sweet biscuits' or 'dry biscuits'? o Upon some occasions, some consumers select one product rather than another – this doesn't establish that the 2 products are substitutable (eg serving corn crisps with a savoury dip rather than dry biscuits) o Other manufacturers considered the market to only be 'biscuits'. o When they put it on the shelf, all the dry and sweet biscuits were blocked together on one shelf (eg Arnott's didn't have a sweet biscuits section in one aisle and then a dry biscuits section later down the aisle). This is at the behest of the manufacturers. o Arnott's slogan "there's no substitute for quality" commands strong brand loyalty – focus of the advertising is on the name Arnott's in connection with biscuits, rather than particular varieties of biscuits o The market was just biscuits ('national market for the supply of biscuits to wholesalers and retailers') • Market structure

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Barriers to entry

The costs to enter the market isn’t a definitive test because there will always be some disadvantage for a new entrant in the market
However, if there is an asymmetry between the amount that the incumbent (Arnott’s) had to spend on entering the market with how much a newcomer has to spend, it points to a barrier
Arnott’s has incurred costs over 140 years – substantial asymmetry

Brand loyalty

Arnott’s is known to generations of Australians

Economies of scale

Its volume provides flexibility in the use of factory ovens and warehouses and unit economics in advertising, with emphasis upon the name and tradition of Arnott’s
Its great product range minimises seasonal sales fluctuations, with resulting benefits to cashflow, the efficient use of manufacturing and distribution resources and retention of supermarket shelf space allocations

Distribution channels

The 3 biscuit manufacturers operated their own transport fleets to carry supplies directly from their plants or warehouses to the supermarkets
They don’t use central warehousing facilities offered by the supermarket chains because of the relatively short shelf life of biscuits
Other biscuit suppliers depend upon retailers to get their products to the stores (offering a discount to the wholesale price of biscuits)

After the merger, there will be less firms in the market

Merger SLC

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<tr><td>Metcash</td><td>

Coles/Woolworths

These companies get their groceries from the manufacturers/importers, distribute it to their wholesale suppliers and then sell to the retailers
Thus, they essentially control the supply chain of their goods

IGA/independent grocers

These companies get their groceries from wholesalers
Thus, they are only involved with the final link to the supply chain (from retailers → consumers)

Metcash supplied groceries to IGA and other companies. In other words, they were the wholesaler.
Franklins was a retailer that sold goods to consumers. They also have a wholesaler arm that sells goods to retailers. In other words, they had 2 functions (wholesaler and retailer).
In the market, there weren’t other wholesalers like Metcash and Franklins that supplied to independent retailers.
Metcash wanted to purchased Franklins’ wholesaler arm

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	- Was the market the wholesale supply of groceries (broad) or the wholesale supply of pre-wrapped groceries to supermarkets (narrow)? - What was the market? - If Metcash increases their wholesaling prices by 5%, what are the consequences? - The independent grocers/retailers will face a price rise and offset this by charging their consumers more - Coles and Woolworths aren't subject to the same pressure to increase their price - Consumers will see the retailers' relatively higher prices, and start shopping at Coles and Woolworths - Thus, Coles and Woolworths are considered to be substitutes - Market structure - Independent retailers are unable to increase their prices in response to increases in wholesale prices without losing significant volume to the major supermarket chains (eg Coles and Woolworths) - Volume is the key to success for major supermarket chains, independent retailers and Metcash. Metcash competes with the major supermarket chains for this volume. - Because there were tight margins in the industry, wholesale pricing directly affected retail competition and retail competition, likewise, affected wholesale pricing - The major supermarket chains constrained Metcash to raise its wholesale prices - The relevant market is the wholesale supply of groceries - Because the merger has an insubstantial effect on the concentration of the market (mainly because of the presence of Coles and Woolworths), the merger doesn't SLC - The acquisition would strengthen the capacity of independent retailers operating under the IGA banner to compete more vigorously with the major supermarket chains - In regard to the ACCC's argument that there was a consortium willing to buy Franklin if the merger was blocked: - On a balance of probabilities, it wasn't likely that KKKL would make a serious binding offer to purchase Franklins because: - No evidence that they had adequate funding to acquire Franklins' assets; they needed ~$110m - Franklins intended to sell their business store by store if it couldn't be acquired by Metcash; nor was there evidence as to who would buy, or take a franchise of, unwanted stores acquired by KKKL - Even if they did acquire Franklins' assets, they wouldn't be able to establish a viable and sustainable wholesale operation in competition with Metcash

[7] After comparing the market with and without the merger, it **[IS/ISN/T]** likely that the merger will SLC **(s.50)**.

[8] *Consequences*

- **[CO.1]** may apply:
    - For informal clearance with the ACCC **(s.88)**
        - The ACCC will provide them with the issues of the merger
        - Their decision will not be binding
    - For formal clearance **(Part VII Division 3 Subdivision B)**
        - Doesn't arise often in practice because of the onerous requirements
        - The decision will be based on **s.50**
    - For ACCC Authorisation **(Part VII Division 3 Subdivision C)**
        - If the company believes the outcome is unfavourable, they can go to the ACT for a merits review of the outcome
        - The company will need to prove to the ACT that the benefits that flow from the merger outweigh the detriments (see ***Tabcorp***)
        - The ACT will need to respond within 3 months of their application

<table>
<tr><td rowspan="2">Tabcorp</td><td>Tabcorp wanted to acquire Tatts
Tatts had several business arms: wagering, gaming services and lottery</td></tr>
<tr><td>Benefits of the merger
Totalisator pool would be more stable because Tabcorp would access to a greater pool of funds (more punters)
Flow through benefits to the racing industries
Detriments of the merger
Tabcorp would be to only exclusive retail and totalisator license holder in all states and territories (excluding WA)
The acquisition would result in vertical integration
This is because Tabcorp owns Sky Racing, a platform that airs horse racing
Thus, Tabcorp will air racing and offer markets on these races
The ACT didn't believe that the acquisition would eliminate the only credible bidder (Tatts) for exclusive wagering licenses due to the rise of corporate bookmakers
ACT held that it would lead to a net public benefit</td></tr>
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Overseas acquisition (‘rogue’ issue; unlikely to come up on the exam)

Because **[CO. 1]**, a company not incorporated or carrying on business in Australia, has acquired a controlling interest (ie ≥ 50%) in **[CO. 2]**, a company that also isn’t incorporated or carry on business in Australia, **s.50A** may apply because they both have subsidiaries in Australia.

- This wasn’t considered in ***Australian Iron and Steel*** because a 49% interest was acquired

Thus, the Tribunal must be satisfied that any SLC in the market would not outweigh the benefit to the public **(s.50A(8)(b))**.

- Follow the template above. We still use the **s.50(3)** factors **(s.50A(1A))**.

If a declaration to the affirmative is made, then the company must cease trading within 6 months of that declaration being made **(s.50A(6))**.