THE ACCC MERGER GUIDELINES 2008: SOME CONCERNS AND RECOMMENDATIONS

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Abstract

Developments in the theory and practice of competition law necessitate making revisions to the Australian Competition and Consumer Commission's *Merger Guidelines 2008*. The aim of this paper is to identify and discuss some areas of concern, as well as make some recommendations for consideration when these Guidelines come up for revision.

I Introduction

Four years ago, on 21 November 2008, the Australian Competition and Consumer Commission ('ACCC') released the *Merger Guidelines 2008* ('the Guidelines' or 'the 2008 Guidelines').[1] The Guidelines outline the analytical and evaluative framework which the ACCC applies when reviewing mergers[2] under s 50 of the *Competition and Consumer Act 2010* (Cth) ('the Act'). Essentially, they provide guidance on the factors the ACCC considers relevant to its consideration of mergers.[3]

The Guidelines have no statutory effect. It appears that they have not once been referred to by a court considering a merger matter.[4]

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1 Australian Competition and Consumer Commission, *Merger Guidelines 2008 Public Release* (2008) <http://www.accc.gov.au/content/index.phtml/itemId/810047>.

2 For the purposes of this paper as nothing turns on the distinction between mergers and acquisitions, both will be referred to as 'mergers'. A merger is a transaction in which two previously distinct entities combine into a new entity; an acquisition is a transaction in which one previously existing entity acquires another.

3 Sections 50(1) and (2) *Competition and Consumer Act 2010* (Cth) prohibit mergers that would have the effect, or are likely to have the effect, of 'substantially lessening competition' in a market. Additionally, s 50(3) specifies a number of factors that the ACCC must take into account when determining whether a proposed merger violates s 50(1) or (2).

4 There are not many merger cases and none of them refer to the Guidelines. See, Duns and Arlen, below n 8. This may be contrasted with, for example, the situation in the United States, where courts frequently cite the merger review guidelines issued jointly by the US Department of Justice and the Federal Trade Commission. As the International Competition Network notes, Australia's system of merger review is most akin to the review process found in the United Kingdom: International Competition

Notwithstanding, the Guidelines are pivotal to merger law in Australia. Mergers represent a field of competition law in which the ACCC may be viewed as a 'tertiary legislator.'[5] The ACCC, rather than the courts, assess the competitive effects of almost all mergers.[6] If the ACCC opposes a merger, the merger parties are very unlikely to proceed given the prospect of injunctions being brought by the ACCC under s 80(1A) of the Act, and possible litigation. Moreover, 'the fast commercial pace of mergers and acquisitions is not conducive to lengthy litigation'.[7] Parties' preference for the administrative processes of the ACCC, the informal clearance and authorisation procedures, results in the ACCC applying the Guidelines largely free from judicial supervision.[8]

The Guidelines' pivotal role in the Australian commercial environment calls for a discussion of their strengths and weaknesses. This article contributes to the discussion by identifying and discussing some areas of concern as well as making some recommendations for future revision of the Guidelines.

II Keeping The Guidelines Relevant And Clear

Overall, the Guidelines appear to serve the interests of the Australian commercial community well. Rod Sims, Chairman of the ACCC, therefore asserted that 'any suggestion that there needs to be a root-and-branch review of mergers is not right'.[9] However, the inevitable passage of time has left the Guidelines in need of some review.

Network, 'Information Requirements for Merger Notification' (Paper presented at the 8th Annual Conference of the International Competition Network, Zurich, June 2009) 20-2.

5 See, eg, John Burrows QC, 'Legislation: Primary, Secondary and Tertiary' (Speech delivered at The Treasury, Wellington, 26 May 2009) < http://www.treasury.govt.nz/publications/media-speeches/guestlectures/pdfs/tgls-burrows.pdf>.

6 Stephen G. Corones, *Competition Law in Australia* (Lawbook Co, 3rd ed, 2004) 292; Dave Poddar and Kate Newman, 'Stormy Seas Make Skilful Sailors: Changes to the Australian Merger Control Regime' (2008) 16(3) *Trade Practices Law Journal* 191, 201.

7 Dave Poddar and Kate Newman, 'Stormy Seas Make Skilful Sailors: Changes to the Australian Merger Control Regime' (2008) 16 *Trade Practices Law Journal* 191, 192.

8 John Duns and Arlen Duke, *Competition Law: Cases & Materials* (LexisNexis Butterworths, 3rd ed, 2011) 110.

9 Patrick Durkin, 'ACCC Vows to Get Real on Corporate Deals', *The Australian Financial Review* (online), 16 January 2012 <http://afr.com/p/national/accc_vows_to_get_real_on_corporate_2QpfQiqae0VdwRR0YFndfI>.

A *Keeping the Guidelines Relevant*

The Guidelines should reflect the actual practices of the ACCC in conducting merger review. Judicial developments should also be taken into account when considering a revision of the Guidelines.

It is argued here that following the decision of the Full Court of the Federal Court of Australia in *Australian Competition and Consumer Commission v Metcash Trading Ltd* ('*Metcash*')[10] the ACCC should consider incorporating an empirical information framework into the Guidelines when it is next revised. This will serve to keep the Guidelines relevant.

On 1 July 2010, the independent grocery wholesaler Metcash entered into an agreement to acquire Franklins, a supermarket chain. The ACCC considered that the acquisition was likely to substantially lessen competition contrary to s 50 of the Act. On 8 December 2010, the ACCC commenced proceedings in the Federal Court, seeking an injunction to restrain Metcash from completing the acquisition.

The ACCC relied primarily on economic theories, namely the theory of coordinated effects,[11] in support of its preferred market definition. On appeal, the Full Court soundly rejected this theoretical approach,[12] in line with earlier decisions criticising arguments based primarily on economic theory.[13] The ACCC's failure in this case means that the ACCC will have to reconsider its approach to market definition in future merger reviews. More specifically, the natural inference is that the ACCC will have to adopt a more explicitly empirical approach when considering merger proposals. This may present particular difficulties for the ACCC in respect of some areas of the Guidelines. For example, assessing whether a merger is likely to result in the aforementioned coordinated effects is a largely theoretical process; as Cadd and Chubb

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10 (2011) 198 FCR 297.

11 A coordinated effect arises when, post-merger, it is easier for the remaining firms to enhance coordination and the collective exercise of market power, whether explicit or implicit. See generally Janusz A Ordover, 'Coordinated Effects in Merger Analysis: An Introduction' (2007) 2 *Columbia Business Law Review* 411.

12 See in particular, *Australian Competition and Consumer Commission v Metcash Trading Ltd* (2011) 198 FCR 297, 301 (Buchanan J); 358 (Yates J).

13 See, *Australian Gas Light Company v Australian Competition and Consumer Commission* (2003) 137 FCR 317, 416 (French J). See generally Justice Robert French, 'Expert testimony, opinion argument and the rules of evidence' (Speech delivered at the Law Council Case Management Workshop, Federal Court of Australia, 15 March 2008).

note 'it will be challenging to find "real world" evidence to put before a court to establish a coordinated effects theory of harm.'[14]

The Guidelines current provisions regarding the supply of information are contained in a series of shaded boxes that are included beneath the relevant section of the Guidelines. This approach lacks coherence and provides nothing more than rudimentary guidance concerning the type of information that the ACCC may seek from merger parties. As the International Competition Network notes, there is no minimum amount of information provision required of merger parties under the informal clearance process.[15] Furthermore, the specificity of the sparse information guidance given has decreased from the iteration of the previous Guidelines, the *Merger Guidelines 1999* ('the 1999 Guidelines'). For example, para 5.62 of the 1999 Guidelines provides that '[i]n establishing the relevant geographic dimension of the market the Commission *will* have regard to the following types of information'. In comparison, para 4.27 the 2008 Guidelines provides that '[t]he following are examples of the types of information the ACCC *may* require to identify close substitutes of the relevant geographic region'.[16] While this may seem like a minor change, the substitution of modal verbs, which persists throughout a comparison of the 1999 Guidelines and the 2008 Guidelines, provides merger parties with less guidance when seeking merger clearance.

Following *Metcash*, the ACCC should consider the incorporation of an empirical information framework into the next revision of the Guidelines.[17] Such a framework would give merging parties and their advisors clear indicia of the data that the ACCC will consider when conducting merger review. This would enable parties to focus their efforts and resources on the timely provision of relevant information to the ACCC. While the provision of this information will impose a burden upon some merger parties, many merger parties would have already gathered much of this information during merger negotiations. Further,

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14 Sarah Chubb and Caris Cadd, *Why the Metcash Case will Continue to Trouble the ACCC* (16 December 2011) Freehills http://www.lexology.com/library/detail.aspx?g=30157ce6-4d20-4de5-83bd-1dc89caa58de. For a discussion on the ACCC's recent approach to coordinated effects, see Emily McConnell, 'Coordinated Effects – The Emergence of a New Paradigm' (2011) 39 *Australian Business Law Review* 159.

15 International Competition Network, above n 4, 20.

16 (Emphasis added.)

17 *Australian Competition and Consumer Commission v Metcash Trading Ltd* (2011) 198 FCR 297. See Gregory Leonard and Lawrence Wu, 'Revising the Merger Guidelines: Second Request Screens and the Agencies' Empirical Approach to Competitive Effects' (2009) 12 *The CPI Antitrust Chronicle* 1: Leonard and Wu persuasively argue for a similar proposal in relation to the US merger guidelines, detailing many potential benefits that are equally applicable in the Australian context.

additional compliance costs must be balanced against the greater efficiencies in the broader merger review process that an empirical information framework would deliver.

Such frameworks have been incorporated in other jurisdictions. For example, regulators in Russia,[18] India[19] and China[20] require merger parties to submit, at the notification stage, information and analyses relating to market definitions and a proposed merger's competitive impact. Detailed information guidelines are provided to this effect.[21] The approaches taken by these jurisdictions are largely in accordance with those advocated by the International Competition Network[22] and are illustrative of the type of approach that could be adopted in Australia. While these countries are not traditional sources of Australian regulation policy, it would be worth considering if their economic and political weight can possibly rival or surpass that of Australia's traditional policy sources, namely the United Kingdom and the United States. Australia should not restrict itself to traditional policy sources as it may deprive itself of the new economic thinking emerging from these dynamic economies and the fresh eyes that have been turned to merger regulation by lawmakers in these countries.[23]

In light of *Metcash*,[24] and in line with international best practice, the adoption of an empirical information framework is recommended to ensure that the Guidelines remain of the utmost relevance to actual practice.

18 See, Regulations on the Law on the Defence of Competition (Russian Federation) Federal Antimonopoly Service, Order No. 135-FZ, 8 July 2006, reg 35.2. <http://www.fas.gov.ru/legislative-acts/legislative-acts_9498.html>.

19 See, Neeraj Tiwari, 'Merger under the Regime of Competition Law: A Comparative Study of Indian Legal Framework with EC And UK' (2011) 23 *Bond Law Review* 117, 131; Terry Calvani and Karan Alderman, 'BRIC in the International Merger Review Edifice' (2010) 43 *Cornell International Law Journal* 73, 109–10.

20 See, Antimonopoly Law (People's Republic of China) National People's Congress Standing Committee, Order No 6B, 30 August 2007, art 23. Translated at <http://www.china.org.cn/government/laws/2009-02/10/content_17254169.htm>.

21 See, Guidance for Notification Documents and Materials for Concentrations of Undertakings (People's Republic of China) Ministry of Commerce, 5 January 2009, <http://fldj.mofcom.gov.cn/aarticle/xgxz/200901/20090105993841. html?2343966839=3683028003>; Regulations on the Law on the Defence of Competition (Russian Federation) Federal Antimonopoly Service, Order No. 135-FZ, 8 July 2006, reg 35.2. <http://www.fas.gov.ru/legislative-acts/legislative-acts_9498.html>.

22 See generally, International Competition Network, above n 4.

23 Roche et al provide a recent overview of merger regulation in Russia, China and India: Emily Roche et al, 'BRIC Merger Control—The New Regulatory Frontier' (2012) 5(19) *International In-house Counsel Journal* 1.

24 (2011) 198 FCR 297.

B *Keeping the Guidelines Clear*

The success and relevance of a system of voluntary pre-merger notification, such as that found in Australia, depends on the availability of clear and comprehensive guidelines regarding the application of the relevant competition law. Unfortunately, the 2008 Guidelines are substantially more discretionary than the 1999 Guidelines. This is the result of two particular aspects of the current Guidelines, first the use of uncertain or imprecise language and second, the removal of safe harbours, which are discussed below. This combination leads to excessive discretion that may have a dissuasive effect on parties considering a merger.

1 *Uncertain or Imprecise Language*

The current Guidelines are substantially less discursive than the 1999 Guidelines.[25] For example, consider paragraphs 5.4–5.22 of the 1999 Guidelines which detail the ACCC's approach to determining the question at the heart of merger inquiries under s 50: what constitutes a 'substantial lessening of competition'? The 1999 Guidelines contain 18 paragraphs on this point, including references to and extracts from pertinent cases, such as *Re Queensland Co-operative Milling Association Ltd*[26] and *Queensland Wire Industries Pty Ltd v The Broken Hill Proprietary Company Ltd*.[27] Supplementary materials also feature in the 1999 Guidelines, including practice notes from foreign jurisdictions, and extracts from Explanatory Memorandums and Second Reading Speeches.

In contrast, the current Guidelines deal with this fundamental issue in just four paragraphs, paras 3.5-3.8. These paragraphs contain no extracts from case law or supplementary materials and have minimal references.[28] Nonetheless, the message at the crux of both sets of guidelines is the same:

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25 Ergas et al reach the same conclusion, although their criticisms are primarily based on economic arguments: Henry Ergas, Eric Kodjo Ralph, Alex Robson, 'The ACCC Merger Guidelines: A Reader's Manual' (2009) 17 *Competition & Consumer Law Journal* 192.

26 (1976) ATPR 40-012; (1976) ALR 481.

27 (1989) 167 CLR 177.

28 Competition lawyers, of course, do not need to be directed to the case law to know which cases are relevant to merger analysis. Nonetheless, decisions such as *Metcash* emphasise the importance of case law, particularly in light of the stringent counterfactual test posited in that case. Rather than attempt their own formulation of the *Metcash* test, the ACCC should consider extracting from the relevant part of the judgment for possible inclusion in the next revision of the Guidelines.

> The precise threshold between a lessening of competition and a substantial lessening of competition is a matter of judgement and will always depend on the particular facts of the merger under investigation. Generally, the ACCC takes the view that a lessening of competition is substantial if it confers an increase in market power on the merged firm that is significant and sustainable.[29]

The 1999 Guidelines, however, provide much more guidance than the current Guidelines on the 'particular facts' that will be relevant to an investigation. For example, consider the following extracts from the 1999 Guidelines:

> [5.20] In many industries the exercise of such market power may not be possible, even by a large buyer, because supply will be highly price elastic … Firms will rapidly remove resources from the (domestic) market in response to any attempt to depress price below its competitive level.
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> [5.21] However, there are significant exceptions to this. In particular, many primary industries … are characterised by less than perfectly elastic supply, reflecting diminishing returns from scarce resources. One of the few merger cases to reach the courts, *Australian Meat Holdings*[30] involved the creation of a dominant position in the acquisition of fat cattle in North Queensland. Similarly, labour intensive industries, particularly where workers have limited alternative employment opportunities, such as clothing manufacture, are often characterised by less than perfectly elastic supply ...

The current Guidelines contain no comparable statements concerning the particular facts that would be, or have been previously considered relevant to the determination of a substantial lessening of competition. The exclusion of detail and nuance leaves the current Guidelines, in comparison to the 1999 Guidelines, substantially less discursive. By failing to detail the mechanisms by which a particular factual scenario reduces competition, the ACCC's reasoning when considering merger proposals is thus less predictable.

The current Guidelines also contain numerous ambiguous provisions. For example:

> [7.41] The ACCC therefore considers the extent of product differentiation by assessing whether the merger parties differ from rivals in terms of … whether a substantial number of customers consider the products of the merger parties to be particularly close substitutes.

Para 7.41 leaves merger parties under informed with respect to fundamental questions, such as how many customers constitute a

29 The 2008 Guidelines [3.5]. The comparable statement is found in the Australian Competition and Consumer Commission, *Merger guidelines* 1999 (at 30 June 1999) [5.15].

30 *Australian Meat Holdings Pty Ltd v Trade Practices Commission* (1989) ATPR 40–932.

'substantial number'. Deane J's judgment in *Tillmanns Butcheries Pty Ltd v Australasian Meat Industry Employees' Union*, is apposite here: the 'word "substantial" is not only susceptible to ambiguity; it is a word calculated to conceal a lack of precision.'[31] Moreover, how are merger parties supposed to know their customers' 'substitutability perceptions'? Similar comments may be made regarding para 7.15:

> [7.15] A merger that falls below the HHI threshold may still raise competition concerns if any of the following are relevant … the target firm has shown a recent rapid increase in market share … or has tended to charge lower prices than its competitors in one or more markets (properly defined) in which the merged firm would operate.

This begs the question, over what time period and by how much of an increase is this 'recent rapid increase in market share' to be tested? Further, charging lower prices can mean many things, aside from demonstrating that the target is a keen competitor. For example, it may mean that the firm has chosen to target the lower end of the market.

Terms such as 'substantial' are, of course, common in legislative materials. However, given the aforementioned lack of judicial supervision over the application of the Guidelines, the presence of these ambiguous terms affords the ACCC the utmost discretion in its consideration of merger proposals. Furthermore, merger parties cannot rely on how words have previously been interpreted by the ACCC to guide their future conduct, given that the ACCC is not bound by its previous interpretation of the Guidelines. While a degree of discretion is necessary to enable the ACCC to assess mergers on a case by case basis, the use of imprecise language, combined with the departure from the 1999 Guideline's discursive style, results in the current Guidelines lacking the clarity that is necessary to provide effective guidance to merger parties. It is therefore recommended that the Guidelines be made clearer and less discretionary.

It is important to note, however, that this recommendation could be achieved in many different ways. For example, the Guidelines could be completely re-written so as to be largely exhaustive, or the discursive and case-heavy style of the 1999 Guidelines could be revived. Alternatively, the approach taken by United States' competition authorities in their *2010 Horizontal Merger Guidelines* may reach the same end. The *2010 Horizontal Merger Guidelines* contain 24

31 (1979) 42 FLR 331, 348. See, eg, John Duns and Arlen Duke, above n 8, 108-9; Cf *Australian Gas Light Co v Australian Competition and Consumer Commission* (2003) 137 FCR 317, 320 (French J).

examples that illustrate the policies, procedures and methods that the US authorities normally use to assess merger effects.[32]

2 *Safe Harbours*

The 2009 Guidelines have abandoned the market share safe harbours[33] that were included in the 1999 Guidelines. Under the 1999 Guidelines, the ACCC would closely examine mergers where the post-merger market share of the top four firms was 75 per cent or more and the merged firm would supply at least 15 per cent of the market; or, where the post-merger market share of the merged entity was equal to, or greater than 40 per cent.[34]

In place of safe harbours the 2008 Guidelines contain notification thresholds.[35] The expectation is that parties will inform the ACCC where the products of the merger parties are either substitutes or close complements, and the merged firm will have a post-merger market share of greater than 20 per cent in relevant markets.[36] An important caveat applies to these thresholds: 'a merger that does not meet the notification threshold may still raise competition concerns. The ACCC may therefore investigate such mergers, even if they have not been notified to it.'[37] This indicates the ACCC's adoption of a more flexible approach to mergers.

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32 See, the *2010 Horizontal Merger Guidelines* United States Department of Justice and Federal Trade Commission, *2010 Horizontal Merger Guidelines <http://www.justice.gov/atr/public/guidelines/hmg-2010.html>*. Overall, the *2010 Horizontal Merger Guidelines* represent a move toward a more discretionary and less rigid merger review process when compared to the preceding guidelines, the *1992 Horizontal Merger Guidelines*: Thomas J. Horton, 'The New United States Horizontal Merger Guidelines: Devolution, Evolution, or Counterrevolution?' (2011) 2(2) *Journal of European Competition Law & Practice* 158, 159-61. Indeed, the differences between the *2010 Horizontal Merger Guidelines* and the *1992 Horizontal Merger Guidelines* are akin to those found between Australia's Merger Guidelines 1999 and the current Guidelines. However, it is important to note that in the United States many merger parties have a statutory obligation to notify the Department of Justice and Federal Trade Commission of their intention to merge under the *Hart-Scott-Rodino Antitrust Improvements Act of 1976*, 15 USC § 18a. There is no such statutory obligation in Australia, regardless of the size of the merger.

33 While the phrase 'safe harbour' is used throughout the 1999 Guidelines, it was caveated in para 5.27: 'parties cannot conclude without reference to the Commission whether or not an acquisition will be opposed.' While the 1999 thresholds were not true safe harbours, in that they did not confer immunity, they appear to have been largely treated as true safe harbours by the ACCC.

34 The 1999 Guidelines, para 5.94. Note the caveat at [5.95].

35 The 2008 Guidelines, para 7.16. The notification thresholds are not to be confused with the Hirfindahl-Hirschman Index ('HHI') levels noted in [7.14]: 'The HHI levels are one of many factors that the ACCC will take into account when analysing a merger, and is not a substitute for the notification thresholds.'

36 The 2008 Guidelines, para 2.9.

37 The 2008 Guidelines para 2.8.

The move away from safe harbours may be defended on the grounds that merger analysis has become substantially more complex,[38] or that it may be inappropriate in differentiated markets.[39] However, the provision of safe harbours allows firms to pursue their commercial strategies on a sound legal footing by increasing the predictability of the merger control process.[40] The removal of the safe harbours, as Poddar and Newman note, creates 'difficulties for merger parties in predicting the level of scrutiny a proposed merger could receive from the ACCC.'[41] Safe harbours may encourage competition by providing small firms with a clear merger path that could lead to more effective competition with larger firms.[42] By acting as a screening mechanism, safe harbours would allow the ACCC to focus its limited resources on those mergers that are likely to substantially lessen competition. Furthermore, the empirical economic research demonstrates that safe harbours provisions are generally too restrictive, rather than too lenient.[43] Despite the inherent costs of rules, as opposed to standards,[44] safe harbours could be an effective tool in both providing guidance to merger parties, and in reducing the ACCC's workload and associated costs. This indicates that carefully calibrated safe harbours may result in greater certainty and efficiency in the merger review process, without fostering anti-competitive mergers. For these reasons, the next revision of the Guidelines should consider re-establishing the safe harbours found in the 1999 Guidelines, calibrated with reference to international best practice[45] and the latest economic research.[46]

3 *The Cost of Uncertainty*

The combination of uncertain language and the removal of safe harbours represent a substantial reduction in the ability of the 2008 Guidelines to

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38 See for eg, Dave Poddar, *Safe Harbours and First Ports of Call* (14 February 2008) <http://www.mallesons.com/publications/marketAlerts/2008/Documents/9310627w.htm>.

39 See, Henry Ergas, 'Are the ACCC's Merger Guidelines Too Strict? A Critical Review of the Industry Commission's Information Paper on Merger Regulation' (1996) 6 *Competition and Consumer Law Journal* 171, 177.

40 International Competition Network, 'Project on Merger Guidelines: Report of Merger Working Group, Analytical Framework Subgroup' (Paper presented at the 3rd International Competition Network Conference, Seoul, April 2004) 9.

41 Poddar and Newman, above n 7, 201.

42 Duns and Duke, above n 8, 102.

43 Qing Gong Yang and Michael Pickford, 'Safe Harbours in Merger Guidelines: What Should They Be?' (2011) 44 *Australian Economic Review* 1, 13.

44 The cost of a *rule* has two components: the costs of its formulation and the costs of its over- or under-inclusiveness. Conversely, a *standard* imposes costs in terms of the greater investment required to determine whether conditions which trigger the prohibition have been violated: Ergas, above n 39, 189.

45 See generally International Competition Network, above n 40.

46 See, eg, Yang and Pickford, above n 43, 30.

provide effective guidance to merger parties, and a substantial increase in the discretion afforded to the ACCC. The deterrent effect of overly discretionary policies should not be underestimated. As McHugh J notes in *Perre v Apand*:

> [if] legal practitioners are unable to predict the outcome of cases with a high degree of probability, the choice for litigants is to abandon or compromise their claims or … to expose themselves to the great expense and unpredictable risks of litigation.[47]

The same holds true in relation to merger parties. Without certainty, firms will not be able to effectively plan for the future and their lawyers will have difficulty advising them of the law. Moreover, the risks of litigation in relation to s 50 of the Act are significant. If the ACCC decides to intervene, there is the possibility of a divestiture order and penalties of up to $10 million, three times the gain, or 10 per cent of annual turnover, whichever is the greater.[48] In addition, there are often substantial costs associated with disrupting a merger process.

Ergas notes that '[t]he fact that competition law is economic law, and hence must evolve with our understanding of how the economy functions, makes it inevitable that some uncertainty will persist, even as the case law accumulates.'[49] As much as this is true, the Guidelines need not provide *certainty*; rather, it must provide *guidance*. In this respect, the 2008 Guidelines appear to be at risk of not providing the necessary level of guidance to avoid the substantial economic costs associated with uncertainty. These costs include excessive legal fees due to the increasing complexity of compliance. In addition, overly discretionary policies may have a dissuasive effect on mergers, resulting in the loss of some socially beneficial mergers. While certainty is not a 'free good',[50] neither is discretion.

III Other Concerns

In the following two sections I identify two areas of general concern within the 2008 Guidelines that warrant further critical attention.

A *The Predisposition toward Type I Errors*

Sims, the ACCC Chairman, has stated that the ACCC will not entertain 'theoretical points' in considering proposed mergers, as he claims that the ACCC will be making 'proper, commercial assessments' in its merger

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47 *Perre v Apand Pty Ltd* (1999) 198 CLR 180, 215.

48 *Competition and Consumer Act 2010* (Cth) s 76(1A).

49 Ergas, above n 39, 190.

50 Ibid 191.

review processes.[51] It is argued here that this attitude is not reflected in the 2008 Guidelines. Rather, the 2008 Guidelines are predisposed to committing Type I errors[52] because the Guidelines, as Ergas et al note, 'often take what are mere possibilities, identified in the theoretical literature, and suggest they are significant.'[53] This is most salient with regards to two areas that receive substantially more attention in the 2008 Guidelines than in the 1999 Guidelines: vertical mergers and conglomerate mergers.

1 *Vertical Mergers*

Vertical mergers involve combining firms that operate at different stages of a single supply chain, such as a merger between an upstream firm and a downstream firm whereby the upstream firm is an actual or potential supplier of an input into the downstream firm's production process.[54] The ACCC's key question regarding vertical mergers is 'whether the merger is likely to increase the risk of limiting the supply of inputs or access to distribution, such that downstream or upstream rivals face higher costs post-merger or risks of full or partial foreclosure of key inputs or distribution channels.'[55] Such an anti-competitive strategy is commonly referred to as foreclosure.[56]

The ability to discriminate is central to foreclosure: a vertically integrated firm may discriminate in favour of its own business and against those of businesses who seek to compete with it.[57] However, distinguishing between efficiencies and discrimination is often problematic.

Vertical integration can result in substantial efficiencies for the merger parties.[58] A vertically integrated firm is likely to use fewer resources in supplying itself as opposed to supplying others, such that the transaction costs faced by the vertically integrated company would

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51 Durkin, above n 9.

52 A Type I error is prohibiting a merger that should have been cleared. Conversely, a Type II error is clearing a merger that should have been opposed.

53 Ergas et al, above n 25, 193.

54 The 2008 Guidelines, para 5.19.

55 The 2008 Guidelines para 7.59.

56 The 2008 Guidelines contain extensive provisions concerning foreclosure: paras 5.22 - 5.43. See generally Russell Miller, *Miller's Australian Competition and Consumer Law Annotated* (Thomson Reuters, 34th ed, 2012) 675.

57 The Guidelines do not mention discrimination in relation to foreclosure. This is incongruous with the concerns the ACCC have publicly voiced in relation to vertical integration, given that since 2005 the ACCC has included specific warnings on the dangers of discrimination by vertically integrated firms in its submissions on various governmental policies. See, eg, Australian Competition and Consumer Commission, *Submission to the Proposed National Ports Strategy* (June 2010).

58 See, eg, the 2008 Guidelines para 5.20.

be minimal. This results in the vertically integrated firm being able to charge itself a lower downstream price than it charges others. In this case, for example, discerning between a refusal to deal and an efficient response to transaction costs is difficult. The Guidelines, unfortunately, provide no information on how to distinguish between efficiencies and foreclosure. More troubling is that they do not acknowledge the difficulties that may arise in making a determination between the two.

Ergas et al outline the numerous conditions that need to be met in order for a vertically integrated firm to profitably foreclose.[59] For example, the integrated firm's downstream products must not be differentiated from those supplied by rivals, in order to prevent diversion amongst the firms in the market. In addition, the market demand for the downstream products must be relatively inelastic in order to prevent any price increase resulting in a reduction in sales.[60] While some of these conditions are acknowledged in paragraphs 5.33–5.37 of the Guidelines, the extremely low likelihood of all the conditions being satisfied is not adequately represented by stating that 'in the majority of cases, [vertical] mergers will raise no competition concerns'.[61] The more accurate description would replace 'the majority of' with 'almost all'.

As Poddar and Newman note,

> the United States regulator appears to take a more benign approach to vertical mergers than the European regulator, on the basis that they are not as problematic as horizontal mergers which normally displace competition, whereas vertical mergers usually involve efficiencies.[62]

The US position is supported by the fact that there is a notable lack of empirical evidence that vertical integration has anti-competitive effects.[63] Indeed, Hortaçsu and Syverson found that vertical integration in US cement and concrete markets lead to lower prices and higher quantities, while entry rates remain unchanged.[64] This provides further

59 Profitable foreclosure occurs when the revenue gain downstream is greater than the revenue reduction arising from reduced sales to third parties.

60 Ergas et al, above n 25, 202.

61 The 2008 Guidelines para 5.21.

62 Poddar and Newman, above n 7, 201.

63 See generally Francine Lafontaine and Margaret Slade, 'Vertical Integration and Firm Boundaries: the Evidence' (2007) 45 *Journal of Economic Literature* 629. An exception should be noted here in relation to the media, where Chipty found that integrated media firms are likely to attempt to exclude rival program services by foreclosing rival program services from vertically integrated distribution systems; Tasneem Chipty, 'Vertical Integration, Market Foreclosure, and Consumer Welfare in the Cable Television Industry' (2001) 91 *American Economic Review* 3. Given the importance of a vibrant and independent media in Australian society, such findings may justify increased scrutiny by the ACCC regarding mergers in media markets.

64 Ali Hortaçsu and Chad Syverson, 'Cementing Relationships: Vertical Integration,

support for the proposition that vertical mergers are highly unlikely to pose anti-competitive concerns, despite the attention given to such mergers in the Guidelines.

2 *Conglomerate Mergers*

Conglomerate mergers involve combining firms that interact, or potentially interact, across several separate markets and supply goods or services that are in some way related to each other.[65]

Corrigan notes that 'conglomerate mergers raising competition issues of substance in Australia are rare.'[66] Yet the Guidelines focus on these mergers. Indeed, it is a key point of differentiation between the 1999 Guidelines and the 2008 Guidelines. The anti-competitive effects of conglomerate mergers are largely centred on fears that these mergers could facilitate price coordination, and may lead to increased product tying and bundling. However, 'there are no *a priori* reasons to believe that the tying or bundling of complements will reduce competition.'[67] Rather, as Motta notes, conglomerate mergers tend to increase efficiency by reducing distribution and transaction costs.[68]

One example of the predisposition toward Type I errors may be the ACCC's opposition to Coca-Cola Amatil's ('CCA') proposed acquisition of Berri in 2003.[69] The ACCC stated that after the acquisition, CCA would be able to leverage its market power in the soft drink market (derived primarily from the 'Coca-Cola' brand) to increase distribution of Berri's products, to the exclusion of rivals, in the fruit juice market.[70] The reality is that CCA's fruit juice brands Goulburn Valley and Fruitopia have failed to increase their market share from the combined one per cent they held in 2003.[71] CCA's inability to leverage its market power to promote

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Foreclosure, Productivity, and Prices' (2007) 115 *Journal of Political Economy* 250.

65 The 2008 Guidelines para 1.15.

66 David Corrigan, *New draft merger guidelines raise questions* (14 February 2008) <http://www.claytonutz.com/publications/news/200802/14/new_draft_merger_guidelines_raise_questions.page>.

67 Ergas et al, above n 25, 203.

68 Massimo Motta, *Competition Policy: Theory and Practice* (Cambridge University Press, 2004) [7.3.2.1].

69 Australian Competition and Consumer Commission, *Acquirer: Coca Cola Amatil Ltd; Target: Berri Ltd* (25 November 2003) <http://www.accc.gov.au/content/index.phtml/itemId/486557/fromItemId/751043>. Prima facie, a merger between two beverage companies may not be thought of as a conglomerate merger. The ACCC, however, saw it as such, and for the purposes of this argument it is sufficient that they did so.

70 This assessment was carried out under the 1999 Guidelines. Para 5.26 is the relevant paragraph in the 2008 Guidelines.

71 Australian Beverages, *Beverage Market Reports – A World of Variety* (December 2003) <http://www.australianbeverages.org/scripts/cgiip.exe/WService=ASP0002/

its own fruit juice brands, or exclude rival brands, indicates that the harm claimed by the ACCC was unlikely to materialise.

In making their assessment, the ACCC appears to have ignored many features of the market that would have indicated that the acquisition was unlikely to be anti-competitive, and that CCA was unlikely to be able to leverage its soft drink market power into the juice market. For example, in 2003 the juice market in Australia displayed significant dynamism as a result of the rapid expansion of 'Boost' juice bars.[72] Customers' growing preference for fresh fruit juices led to the creation of a new market segment in the ambient fruit juice market, the 'super-premium' segment, characterised by brands such as 'Nudie' and 'Emma & Tom's'.[73] Overall, this market was characterised by growth, innovation and product differentiation.

In such a market, the ability of CCA to push certain products and exclude competitors is severely limited due to the lack of homogeneity. Without homogenous products, CCA would have to discount Berri's products for leveraging to be successful. Moreover, given that the market was moving toward a more premium product, discounting would not make commercial sense and could even attract claims of predatory pricing. The scope for product differentiation means bundling or tying would be ineffectual in preventing any entry that would be attracted by the market growth. Despite these factors, the ACCC's analysis almost exclusively focused on the characteristics of CCA's products as 'must have' traffic-building products.[74]

Given the benefit of hindsight, it would be presumptuous to claim that CCA's acquisition of Berri would *not* have resulted in a substantial lessening of competition. Nonetheless, this example illustrates a merger proposal that may have fallen victim to the predisposition to view mergers as harmful.

The pessimistic view of vertical and conglomerate mergers has the potential to distort the reasoning process in the Guidelines. Ergas et al summarise the argument as follows:

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ccms.r?PageId=10063>; IBISWorld, *Fruit Juice Drink Manufacturing in Australia* (April 2012) <http://www.ibisworld.com.au/industry/default.aspx?indid=1861>.

72 See, eg, Australian Food & Retail News, *Boost Juice Enters NZ, Eyes USA* (14 May 2004) <http://www.muzink.com/afrn?articleid=31>.

73 Morris Kaplan, 'Competitive Juices Start to Flow', *The Australian* (online), 17 October 2009 <http://www.theaustralian.com.au/business/small-business/competitive-juices-start-to-flow-emma-toms/story-e6frg9hf-1225787735831>; Mark Russell, 'Pulp Friction', *The Age* (online), 16 April 2005 <http://www.theage.com.au/news/national/pulp-friction/2006/04/15/1144521546974.html>.

74 Australian Competition and Consumer Commission, above n 69.

> If one starts from the (erroneous) presumption that a relatively high proportion of vertical mergers are likely to be anti-competitive, and assumes that one is more likely to see certain characteristics (such as entry barriers and high market shares) where they are, then one will more readily infer a finding of likely harm to competition from the presence of those characteristics than one should.[75]

In favour of this predisposition, it may be argued that in the small, concentrated and isolated Australian economy, the dangers posed by Type II errors are too great to consider adopting a more permissive regime. While this is a legitimate concern, it is important to recognise, as Leonard and Wu note, that there are significant costs associated with the Type I errors. While these authors are writing from the perspective of the large and diverse US economy, the costs they identify as being associated with Type I remain relevant. Following a merger proposal rejection, merging parties face significant costs in the form of expenses, delays and frustrated business plans. Consumers are denied the benefits of efficient and pro-competitive mergers. The ACCC also faces costs in the form of allocating its limited resources to analysing mergers that are, in the overwhelming majority of cases, benign.

B *Overlooking Efficiencies*

Duke notes that 'improving efficiency has long been the stated aim of competition laws around the world and it is generally accepted that one of the most effective ways of achieving this aim is to foster competitive markets.'[76] Tension arises between efficiency and competition because 'the rationalisation and integration of merging entities can simultaneously bring about both a lessening of competition and substantial efficiency gains.'[77] The result is a narrow view of competition, which tends to overlook considerations of the efficiencies that mergers can deliver.[78] It is argued here that the Guidelines, as interpreted by the ACCC, represent a narrow view of competition.

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75 Ergas et al, above n 25, 193.

76 Arlen Duke, 'A More Efficient Use of Efficiencies in Merger Authorisation Determinations' (2007) 35 *Australian Business Law Review* 278.

77 Ibid.

78 The narrow view of competition is best expressed in early United States Supreme Court decisions where merger efficiencies were deemed to lessen competition on the basis that it would become more difficult to compete with the highly efficient merged firm: *Brown Shoe Co v United States*, 370 US 294 (1962). This position is, of course, no longer the law in the United States today: *Cargill Inc v Monfort of Colorado Inc*, 479 US 104 (1986).

1 *The ACCC's Approach to Competition and Efficiency*

The ACCC's approach to efficiencies is outlined in paras 7.63–7.66 of the 2008 Guidelines. These paragraphs outline a cautious approach to the consideration of efficiencies:

> [7.56] If efficiencies are likely to result in lower (or not significantly higher) prices, increased output and/or higher quality goods or services, the merger may not substantially lessen competition. The ACCC generally only considers merger-related efficiencies to be relevant to s 50 merger analyses when it involves a significant reduction in the marginal production cost of the merged firm and there is clear and compelling evidence that the resulting efficiencies directly affect the level of competition in a market and these efficiencies will not be dissipated post-merger.

Where the ACCC determines that the efficiencies are not sufficient to prevent a substantial lessening of competition, the merging parties have the option of authorisation by the Australian Competition Tribunal. The Tribunal will consider whether gains in efficiency constitute a public benefit that outweighs the public detriment from the substantial lessening of competition.[79]

Unfortunately, the practice of the ACCC regarding efficiencies does not appear to be as sophisticated as that stated in paragraph 7.65. Generally, the ACCC's statements regarding informal clearance applications contain no references to pro-competitive efficiencies. For example, efficiencies were not discussed in relation to Metcash's proposed acquisition of Foodland,[80] or in relation to the merging of two small cab companies,[81] despite the reasonable inference that there would be such pro-competitive efficiencies in both cases.[82] Duke further notes that '[i]n practice, efficiencies generally tend to be viewed almost solely through a public benefit lens…rather than as a fact that is relevant to determining whether the merger in fact substantially lessens competition.'[83] While Duke's comments were made prior to the 2008 revision of the Guidelines, the cautious approach to expanding the role

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79 The 2008 Guidelines para 7.66. This process can take up to six months, requires the submission of 'Form S' (and thus associated legal costs) and attracts a fee of $25,000. For obvious reasons, alongside the onus of proving that the efficiencies outweigh the competition concerns, merger authorisations are rarely sought.

80 Australian Competition and Consumer Commission, *Metcash Trading Limited - proposed acquisition of Foodland Australia Limited* (25 January 2005) <http://www.accc.gov.au/content/index.phtml/itemId/638097/fromItemId/751043>.

81 Australian Competition and Consumer Commission, *Acquirer: Black Cabs Combined Ltd; Target: North Suburban Taxis Ltd* (7 March 2002) <http://www.accc.gov.au/content/index.phtml/itemId/476456/fromItemId/751043>.

82 Duke, above n 76, 287.

83 Ibid 284-5.

of efficiencies in merger analysis, reflected in para 7.65, is insufficient to stem the dismissive attitude the ACCC displays toward treating efficiencies as potentially pro-competitive. Efficiencies are primarily seen as being a defence against a finding of substantial lessening of competition, as opposed to being a product of competitive markets.[84] Indeed, in Australian competition practice there exists a perception that efficiencies are created at the *expense* of competition.[85]

2 *A Broader View of Competition*

The courts have adopted and applied the following dictum given by the Trade Practices Tribunal concerning 'competition':

> Competition is such a very rich concept (containing within it a number of ideas) that we should not wish to attempt any final definition which might, in some market settings, prove misleading or which might, in respect of some future application, be unduly restrictive.[86]

It is clear that the courts do not intend a restrictive interpretation of competition. More importantly, the flexibility of the concept is emphasised. Yet, as discussed above, the ACCC's narrow view of competition overlooks efficiencies when determining the competitive impact of a proposed merger. The application of this narrow view can lead to outcomes that are detrimental from the consumer welfare point-of-view. For example, consider a market characterised by high price elasticity of demand. The vast majority of firms in this market propose to merge, so as to access a level of technology that no individual firm could have accessed. The merger would result in consumers paying lower prices and the post-merger monopoly firm making large profits due to large efficiencies resulting from the improved technology.[87]

The ACCC is likely to view the merger as substantially lessening competition, in violation of s 50. Yet both consumer and producer surpluses have increased. While this 'Williamson trade-off' is a somewhat fanciful example, it should not be forgotten that even small gains in efficiency have the potential to offset large gains in market power.[88] Thus, tension between the ACCC's narrow view of competition and potential gains in consumer surplus from efficiencies may arise in more merger proposals than first thought.

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84 Notably, the 1999 Guidelines specifically stated that this should not be the case: para 5.17. This guidance is not repeated in the 2008 Guidelines.

85 Duke, above n 76, 288.

86 *Re Queensland Independent Wholesalers Ltd* (1995)132 ALR 225.

87 This example is an adaptation of the famous Williamson trade-off: Williamson, 'Economies as an Antitrust Defence' (1968) 58 *American Economic Review* 18.

88 Ibid 22.

This tension may be resolved by taking a broader view of competition. In the scenario above, competition is only diminished if one disregards the rivalry between alternative market structures and focuses solely on the extent of rivalry within one particular structure. However, a broader view of competition would recognise this change in market structure as a valid form of competition for, as McGee notes, '[i]t is arbitrary to attribute to competition among firms using the same technology greater economic virtue than is attributed to competition among different methods of doing things.'[89] This broader view of competition encourages consideration of the efficiencies that may arise between different market structures, by allowing competition to be examined both as a process existing between firms, and between ways of organising an industry.

Explicitly recognising that efficiencies may be pro-competitive in future revisions of the Guidelines is likely to lead merger parties to claim a great variety of potential efficiencies in their submissions to the ACCC. In this respect, the aforementioned empirical information framework could provide the ACCC with the data necessary to determine which of these claims is supported by the available evidence.

The fact that efficiencies are, in practice, not considered part of the competition analysis may prevent some efficiency-increasing mergers from being cleared, or even deter some mergers from being proposed. By embracing a broader definition of competition that embraces efficiencies, the ACCC may be able to deliver outcomes in greater concordance with the Act's purpose: 'to enhance the welfare of Australians through the promotion of competition'.[90]

IV CONCLUSION

Myriad paths could be followed to address the general concerns raised in this article, ranging from mere tweaking of the Guidelines to the root-and-branch review of merger policy that Sims is anxious to avoid.[91] For example, the disposition toward Type I errors could possibly be ameliorated by the greater use of ex post facto assessments, while a more fundamental change aimed at curtailing discretion could involve replacing the informal process with the never-utilised formal process.[92] The specific recommendations made in this article, however, represent, in the author's opinion, the best or most appropriate approaches to the issues they purport to resolve.

89 John McGee, *In Defense of Industrial Concentration* (Praeger, 1971) 23.

90 *Competition and Consumer Act 2010* (Cth) s 2.

91 Durkin, above n 9.

92 Indeed, it is prima facie incongruous to have large, multi-million dollar mergers that can drastically change industry structures being assessed 'informally' by the ACCC.

It should be noted that there are many other pertinent issues that have not been raised in this article which are worthy of discussion. One prominent example is 'creeping acquisitions'.[93] Another issue which is more abstract but equally important relates to the rising economic power of the Asia-Pacific region. The rapid growth in our region is the way Australian firms do business. For example, the burgeoning number of low-cost airlines in the Asia-Pacific region will likely result in mass consolidation, due to the fundamentals of the modern airline business.[94] Given that one of the region's major airline groups, Jetstar, is Australian-based, a significant proportion of this future consolidation is likely to be subjected to ACCC scrutiny. The future revision of the 2008 Guidelines should occur in concert with the relevant authorities in other regional jurisdictions to ensure that competition in our region remains strong, and that rapid growth does not lead to rapid concentration or abuse of position.

Perhaps most importantly, however, is that the ACCC comes to recognise its position as a tertiary legislator, and revises the Guidelines in line with the Guidelines' effective role: as tertiary legislation. Indeed, the recommendations and concerns posited in this article are predicated on this observation. The recognition of this position would invite scrutiny of the Guidelines, and the ACCC's practices, by a wider variety of organisations and persons beyond the legal and business spheres. Such a development is laudable, given the fundamental role played by the ACCC in the Australian economy, and the far-reaching consequences of its decisions.

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93 See generally Alex Bruce, *Restrictive Trade Practices Law in Australia* (LexisNexis Butterworths, 2010) 193.

94 Bernie Lo, *Straight Talk* (Television Interview with Bruce Buchanan - Jetstar CEO), CNBC (9 April 2012).