UNITED ENERGY

Submission to the

REVIEW OF THE COMPETITION PROVISIONS OF THE TRADE PRACTICES ACT 1974

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REVIEW OF THE COMPETITION PROVISIONS OF THE TRADE PRACTICES ACT 1974[1]

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REVIEW OF THE COMPETITION PROVISIONS OF THE TRADE PRACTICES ACT 1974

1. Introduction and Summary

Since the birth of its predecessor, the Trade Practices Commission, the ACCC has been vested in progressively increased powers by Government. We are concerned that the powers of the ACCC may now be excessive and that its skills may not be fully consistent with those required to adequately fulfil the tasks set for it.

In this respect we are mindful of the far greater powers of the ACCC compared to its counterparts in comparable jurisdictions of the US and UK.

Concurrent with the present Inquiry, COAG is undertaking an inquiry into the energy industry. This may result in some rationalisation of the powers of the ACCC. UE has made a submission to the COAG review in which we drew attention to the overlap in regulation in the electricity and gas industries and called for rationalisation.

In this submission our focus is on the merger provisions of the Trade Practices Act (TPA) and associated competition policy laws.

A critical issue in assessing mergers is the definition of the proposed merged businesses' markets. This entails examining a wide variety of complex issues including the product, functional, time and geographic dimensions of the market. In addressing the time dimension the ACCC must consider complex issues such as technological and supply and demand changes. All this must be done rapidly in view of the urgency of merger proposals that have a time-limited banking dimension, and other constraints.

These matters call for economics expertise, which is outside the ACCC's core skills, and this has contributed to some poor merger decisions by the ACCC. Rather than seeking to graft a new economics layer onto the ACCC's legal skills, we recommend a divestment of some of the ACCC's present powers so that mergers are considered initially by an alternative body. The Commonwealth's prime adviser on micro-economic matters, the Productivity Commission, would seem to be best capable of taking on that role.

We also recommend the "substantial lessening of competition" test be shifted back to the "dominance" test. This would avoid resources being diverted into examining those mergers which pose little concern about market power being able to be exercised. It would also reduce the deterrence to firms pursuing the widest array of cost-reducing strategies and it may not lead to greater concentration in the economy compared to the implementation of the current test.

2. The ACCC's Powers

The ACCC has a range of powers that cross the whole spectrum of business behaviour including:

1. Mergers

- defining markets for the purpose of examining a proposal of firms to merge or to acquire rivals
- defining whether specific situations constitute an unacceptable diminution of competition
- setting conditions (including divestitures) and accepting firms' undertakings (under s 87B)) under which a merger may proceed
- an ability to grant immunity from prosecution for activity that diminishes competition to a business seeking to merge

    - s 50 of the Act has been amended to broaden its scope from applying only to mergers that result in "dominance" over markets to those that bring a "substantial lessening of competition".

- an exclusive right to seek injunctive relief to prevent an acquisition from proceeding (s. 80(1A))
- an ability to apply to the Federal Court (under s. 81) to force divestiture where an acquisition has in the view of the Commission and the Court substantially lessened competition in a substantial market.
- Competition principles agreements have increased the range of industries covered to those that are under the control of governments

2. Business Behaviour

- Assessing promotional and other claims of firms to determine whether these are in accord with truthfulness
- Administering the laws governing defective goods

3. Pricing

- Setting price ceilings on gas pipelines, electricity networks and on telecommunications.

4. Defining Access to Essential Facilities

- The ACCC is the regulator and determines the rules of the national electricity market; this includes setting the terms and conditions of access to services designated as essential services.
- The ACCC also monitors airport prices under recent Commonwealth government proposals.

Few other jurisdictions have concentrated such a vast array of powers under one body.

In the US some of the ACCC's functions are the responsibility of agencies other than the Department of Justice's Anti-Trust Division, including the Department of Commerce and specialised agencies like the Consumer Products Safety Commission.

In the UK, the Competition Commission shares powers with industry regulators like OFGEM. The formal review role is divided between the Office of Fair Trading (OFT) and the Competition Commission. The Director General of the OFT has a duty to monitor business transactions which may result (or may already have resulted) in the merger of two or more separate enterprises. The Director General advises the Secretary of State whether such mergers should be referred to the Competition Commission for further investigation and subsequently, if there has been a reference, on what action to take after the Competition Commission has reported. That advice will always be accepted except in exceptional circumstances.

The Director General may also be asked to advise whether restrictions in an agreement are ancillary to a merger and hence excluded from the prohibitions in the Competition Act 1998.

The Director General can, after consulting the Secretary of State, provide confidential guidance to the parties involved. In proposed or completed mergers, the Director General can, where so requested by the Secretary of State, negotiate undertakings in lieu of a reference to the Competition Commission. The Director General is assisted by administrative, legal, economics and accountancy staff within the OFT.

Recent decisions by the European Commission recommended giving enhanced responsibility for national competition authorities and national courts to apply Articles 81 and 82, which offer a procedure similar to the authorisation provisions under the Trade Practices Act. The EU is to retain a monopoly on such actions only where they affect more than three member states[2].

The current inquiry is an opportune time to consider the reduction of the powers of the ACCC and transfer of certain activities to other agencies where such agencies are more expert than the ACCC in the designated activities. We would certainly not support an augmentation of the ACCC's powers that would result it being able to infer ineligible activity by examining outcomes or by introducing criminal elements into the law governing corporate behaviour.

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[2] For a semi-official Competition Directorate view see Anna Papaioannou, Ulrich Diez, Stephen Ryan, and Dan Sjöblom, *Green Paper on the Review of the Merger Regulation,* Competition Policy Newsletter, Number 1 February2002. And speech by Mr. Mario Monti *European Competition Commissioner Review of the EC Merger Regulation - Roadmap for the reform project* Conference on Reform of European Merger Control British Chamber of Commerce - Brussels, June 4, 2002

3. Merger Responsibilities

ACCC's approach to mergers

The ACCC has both formal powers under the TPA and also administers a range of informal approaches to expedite merger clearances in view of the urgency of this to affected parties.

The criteria used to assess mergers are the ACCC "safe harbour" rules, which allow a merger to proceed if:

- the merged entity comprises less than 40% of the market; and
- the combined market power of the four largest firms is less than 75% of the market or where the four largest firms had more than 75% of the market, the merged firm had less than 15%
- adopting a Productivity Commission recommendation to the effect that it should also not oppose mergers where import competition exceeds 10% of the market, the ACCC has argued that it has not opposed any merger where such conditions prevail since 1993[3].

The ACCC stress that these rules are only guidelines and that a merger can breach these rules if the dynamic market considerations allow. This judgement of course further complicates the ACCC assessment under the existing merger test.

The Australian test of whether or not a merger proposal should be examined is, like that of the USA, based on a "substantial lessening of competition". That of the EU is based on "dominance" the criteria that prevailed in Australia prior to 1986. The EU is considering adopting the tighter US standard but there is considerable resistance to this from businesses who are already concerned about the extent of regulatory intrusion by the EU competition laws. We also contend that the outcome of the change will be little different from the current test but more certain to implement.

Current ACCC Approach to Addressing Merger Applications

The ACCC's merger evaluation process involves the following stages:

[3] *An Introduction to the Revised ACCC Merger Guidelines*, ACCC, July 1996

Figure 1 Merger Evaluation Stages

MARKET DEFINITION

The ACCC needs to first consider the following market dimensions:
- Product market;
- Geographic market;
- Functional market; and
- Time

ESTIMATE MARKET SHARES

The ACCC can then consider the market shares by customer numbers or by volume production or some other criteria.

EXAMINE IMPORT SHARES

This could include import penetration, whether imports were from independent companies and whether they would be likely to continue or re-occur in the foreseeable future

EXAMINE BARRIERS TO ENTRY

This involves considering the height of different barriers including the entry costs, the future technology and other dynamic market changes that impact on entry.

OTHER FACTORS

These might include the extent of other constraints on the "substantial lessening of competition" such as the state of substitutes, the level of technological change, the level of consumer switching for utility retailers, potential changes in demand or supply or changes in tastes.

The Merger Guidelines list a range of issues that the ACCC must consider in terms of a merger including the:
- actual height and potential level of import competition;
- height of barriers of entry to the market;
- level of concentration in the market;
- degree of countervailing power in the market;
- likelihood that the acquisition would result in the acquirer being able to significantly and sustainably increase prices or profit margins;
- extent to which substitutes are available in the market, or are likely to be available in the market; and the
- dynamic characteristics of the market, including growth, innovation and product innovation.

To judge the impact on competition of a particular merger proposal the ACCC must consider the impact on the market before and after the merger and judge the anti-competitive behaviour in terms of this difference.

As this clearly demonstrates the ACCC would find it extremely difficult to perform an adequate assessment of the issue in the timelines allowed for mergers.

Informal clearance of mergers

In addition to the formal merger authorisation procedures the ACCC also has an informal clearance process which it adopts when considering the vast majority of mergers and acquisitions which come before it. This process is not documented in the TPA but has evolved as a result of the tight timetables that mergers and acquisitions require.

Businesses require these tight timetables for merger approvals because:

- a merger may be highly profitable and there is an urgency to get it approved before competitors can act or to avoid customer/supplier uncertainty;
- banking syndicates approval timetable provide an endpoint that merger decisions must be completed because of the cost of reforming financial approvals;
- tight timetables may be required by the selling party for a range of reasons;
- parties may be uncertain of the ACCC position and would want a quick response to ensure that unnecessary costs were not incurred.

The flexibility inherent in the ACCC's informal clearance process is generally in tune with the commercial realities of a merger. This includes a capability by parties to get an understanding of any ACCC concerns prior to the merger proposal becoming public knowledge. Understanding the degree of the ACCC's concerns with a merger allows companies to appreciate the risk of proceeding with costly merger negotiations.

However, timing is a key issue for merging parties and this is one area the informal clearance process does not take into account[4]. Where merger negotiations are stalled for any reason (including awaiting a decision from the ACCC) companies may abandon merger plans. By simply delaying a decision on a merger the ACCC may be effectively blocking it from proceeding. The ACCC should therefore have some timing parameters set for its informal clearance process to ensure that merger plans, which may be good for industry, are not abandoned.

We also believe that the current ACCC informal clearance process can be improved to provide merging parties with greater certainty about the trade practices issues arising from their proposal. Moreover the process should be clearly set out in the TPA or an enforceable code in order to provide greater transparency.

The current informal clearance process

The informal clearance process generally consists of:

- ACCC is notified in writing of the merger by at least one of the merging entities.

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[4] We note that s.90(11)(a) of the TPA provides that the ACCC has just 30 days to consider a merger authorisation. This may be extended to 45 days for complex matters.

- ACCC begins its inquiries on either a confidential or public basis (depending on the requirements of the merging parties). Where public inquiries can be made the ACCC will discuss the proposed merger with interested parties.
- A decision regarding the merger is made by the ACCC and the parties are notified.
- Timeframes differ greatly depending on the acquisition and available ACCC resources. However, generally the ACCC would require at least 3-4 weeks to consider a merger. There is no maximum time limit imposed on the ACCC.
- A statement of reasons for the decision is not published. However, the ACCC will use its discretion to issue a press release from time to time outlining some of the reasons for the decision. In addition, a completed form is put on the public register about the merger. The form includes such fields as:
  - market definition (although the ACCC will often not commit to a single definition);
  - a brief competition analysis which will provide just a few reasons for the merger decision; and
  - whether imports were above 10%.

  The public register form cannot generally be relied on for precedent status or to understand the reasons for a decision.

4. Different Policy Approaches to Mergers

In the USA, anti-trust activity has undergone a transformation. In the past, the focus was on firms that dominated industries, although some decisions shifted from the targeting of firms that dominate industries to one that examines the likely impact on consumers. There have been many examples of merger proposals that have been disallowed have covered some very minor parts of an industry.

In general the US approach has focused on the degree of concentration in markets. A measure of market power, the Hirfindahl-Hirschman index, first applied by the United States Department of Justice following its 1986 report on gas pipelines (see Laine[5]) has been used. This takes as a proxy the existence of four similarly sized firms as providing a low risk of the exercise of market power. The ACCC's "safe harbour" approach mirrors this.

However, this approach was largely abandoned soon after its adoption. The US regulatory authorities took a relaxed view of all types of mergers following the growth in the influence of contestability theory, which emphasised that any market power was likely to be transitory because it would attract competitors. Such an approach is favoured in this paper–the experience in many industries is that structural market changes are constantly taking place and are accelerated where prices are attractive to new entrants, thereby setting in train a process which may alter market definitions and will usually reduce market power.

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[5] Laine, C., *The H-H Index: A Concentration Measure taking the Consumers Point of View*, Antitrust Bulletin, Summer 1995, p423-32.

The 1998 *Economic Report of the President* includes a major chapter on merger policy that indicates a more selective and possibly more interventionist approach. An article 'The Economics of Antitrust' in *The Economist* (2 May 1998) offers some insights into why this may be so. The article points out that markets such as that for soft drinks, dominated by just two firms, are intensely competitive, while firms in others where there is apparent high degrees of rivalry and few entry barriers can be interpreted to exhibit market power.

In line with the Economic Report of the President, the US Department of Justice has moved to a model that examines the case for blocking mergers on the basis of the likely effect on price. By examining scanner based price information in markets where two competitors are close substitutes, and comparing the outcomes in regions where they both compete with outcomes where that competition is absent, the likely immediate effects on consumers can be seen. In one case, concerning the merger of two firms that were market leaders in white bread, the merger was disallowed on these grounds. In another case, Bell Atlantic and NYNEX, a merger was permitted to proceed even though the combined firm would have a dominant share in a major market because an examination of the likely actions of rival firms indicated that the dominance would be subject to challenge.

The US approach has undergone a further change with the Bush Administration. Although not changing the "substantial lessening of competition" criteria, the new US administration has apparently adopted a position that is more akin to the "dominance" test by virtually dropping the case against Microsoft, a business with up to a 95% share of many of the markets in which it operates.

All this demonstrates that the definitions of a market, its geographical dimensions and alternative means of providing the equivalent goods and services are matters of considerable complexity. Determination of such matters is best left to an agency with specialist knowledge of them and with the capacity to determine many of the answers on market definition before mergers are considered.

5. Mergers and competition in a modern economy

The treatment of mergers and competition policy generally derives from two basic precepts:

- that competition brings dividends in terms of forcing increases in (allocative, productive and dynamic) efficiency; and
- that individual property rights protected by a stable legal system are essential if firms and individuals are to have the incentive to seek out gains from trade and innovation.

There are differences of view about the need for merger and competition commissions and the powers of those commissions. These stem from a divergent emphasis on the importance of, on the one hand, the capabilities of regulatory oversight to provide superior outcomes, and, on the other, the power of markets to automatically correct serious deviations from a stereotype of "perfect competition". This spontaneous correction is caused by the attraction of third parties to profitable opportunities.

Competition is not an end in itself: it is valued because economic experience tells us that, as a rule, competition is the best way to maximise the community's welfare through enhanced efficiency. Mergers allow economies to be made. They allow sharing of production and marketing overheads and the rationalisation of facilities. They therefore make possible improved efficiency.

Any merger, like any partnership of accountants, solicitors etc. will automatically reduce competition. Such combinations are designed to bring economies but must also attenuate – if not eliminate – the rivalry between those who have joined forces. These combinations or mergers are efficient in so far as they allow pooled resources. No competition authority would deny that the reduction of competition they entail leaves a net improvement in efficiency and welfare, including prices that are lower than they otherwise would have been.

Ginsberg put the case for mergers as follows

> ... the efficiency-enhancing character of many mergers goes beyond simple economies of scale to exploit financial economies, economies of scope, and the complementarity of the unique resources in the particular firms involved. A merger may involve firms with well developed distribution networks in different geographical areas or market segments, or firms with alternative research paths whose joint pursuit could lower risk. It may bring together firms with complementary product lines that could be manufactured, distributed, or marketed more efficiently in conjunction with one another. The internal growth of a single firm may never reproduce that configuration of resources, or it may take many years for a firm to accomplish unilaterally what it could have accomplished instantly by means of a merger[6]. (p. 27)

Thus, parties to the blocked merger may not grow separately to realise the scale economies and other efficiency benefits that the merger would have made possible much earlier.

On the other hand, some mergers allow prices to be increased. The merged entity may have the latitude to supply less than would have been supplied in a competitive situation and to benefit from the higher prices more than offsetting the increased revenues (less their associated costs) that would take place under fully competitive circumstances.

The case for regulating monopoly rests on the ability of the monopolist to raise price so that marginal revenue equals marginal cost. There is a social loss as a result because the net cost of the production foregone is less than the net value consumers place on it.

The difficulty in proceeding from this innocuous statement are manifold. Estimating marginal cost is one; the necessity to charge above it to cover fixed costs, and

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[6] Ginsberg, 'The Goals of Antitrust Revisited', *Journal of Institutional and Theoretical Economics*, Vol. 147, 1991, pp. 24-30.

accommodate joint costs comprise a raft of others. In addition, the actual market place is seldom in a static state, and major opportunities for profit are constantly presenting themselves. These opportunities drive entrepreneurial activity, and in themselves represent situations where prices are considerably above marginal costs.

A key issue is the benefits of preventing monopoly. Bollard[7] argues that in a private monopoly, prices may be 10 per cent higher than under competitive conditions but that under reasonable estimates of costs etc. the 10 per cent price reduction would bring a net benefit of only 3 per cent. As Bollard says, "A 3 per cent padding of costs is inconsequential compared with the welfare losses that can occur under intrusive regulation of monopoly."

Regulatory measures to forestall price increases in markets may detract from efficiency. Where two firms are engaged in cut-throat competition, the outcome will often be that one is driven out of business or exits the particular market segment.

A merger of two such firms can avoid this outcome and restore normal profits in a less socially wasteful manner. Accordingly, it is incorrect to oppose a rationalisation of two business entities on the grounds that this might bring increased prices. If lower prices are merely the result of a continued existence of surplus labour and capital forcibly retained within a production facility, improved resource allocation can be brought about by their shift to other activities. In this sense, preventing the industry rationalisation is akin to imposing a high tariff to arrest a domestic industry contraction. Although a tariff is designed to bring increased prices, and measures to prevent a rationalisation are designed to bring reduced prices, both can have the effect of establishing a larger industry than economic fundamentals would prescribe.

Hence, in effect actions to prevent rationalisations, especially where there are few entry barriers, are actions to force an enlarged industry and lower prices. With respect to the latter, it is generally recognised that imposing price reductions on competitive businesses (or foreclosing price increases) will detract from efficiency: for example, – rent control has been demonstrated to result in a reduction in rentable properties. Similarly, preventing a merger on the grounds that prices would subsequently rise will often lock firms into unsustainable positions, forcing them to treat their capital and marketing assets as sunk. This is, in short, a veiled form of price control.

There is a further reason why measures to prevent mergers may be unwise. This turns on "principal/agent" problems in modern firms where the owners are not the managers. Such a divorce can lead to conditions outlined by Berle and Means[8] 70 years ago (and accounts for Adam Smith's hostility to the joint stock company). Professional managers may prefer the quiet life or fail to pursue the opportunities for efficiency with the same zeal of those whose stake is the residual income of the firm, its profits. Under such circumstances, the firm becomes vulnerable to takeover, either because its share price falls or because rivals spot an opportunity to use the assets more efficiently. Takeovers are a major discipline on firms' managements, not least

[7] Alan Bollard, *The Economics of Competition Policy*, NZ Commerce Commission October 1997

[8] Berle, A., and Means, G., *The Modern Corporation and Private Property*, MacMillan, New York, 1932.

because they make the incumbents vulnerable to early dismissal. Hence, inhibiting takeovers can foster inefficiency.

“Dominance” versus the “substantial lessening of competition” test

Notwithstanding these matters, the scope for agency intervention to prevent mergers has increased over recent years in Australia, largely because the Trade Practices Act’s original focus on the more certain “dominance” was extended to the more contentious and uncertain “substantial lessening of competition” in a “substantial market” test.

The Review should also consider whether the test for examining mergers might better be returned to the pre-1986 standard. Waste stemming from what we regard as faulty analyses by the regulatory authority, as in the cases outlined below, is one reason for this. The arguments in favour of such a move include reduced tentativeness in firms adopting cost reducing strategies that may involve mergers when the merger itself may be subject to review. Such reviews retard the achievement of goals and deter the attempt to pursue some options.

In any case, the current ACCC position allowing mergers to proceed providing there are some 10 per cent of imports in a market, presumably would allow a merger where there is a 90 per cent market share, a position that many would regard as akin to “dominance”. This is similar to the USA position on “dominance” outlined above in regard to Microsoft. Hence a change in the test might not lead to markedly different decisions under the expert decision body we recommend. Such a change would however make market impacts and merger decisions easier to determine and to understand.

Behind the case for a shift to a tighter criteria for review is the fact that the weight of economic theory suggests that dominance and barriers to entry are essential if monopolistic exploitation involving sustained reduction in supply and consequent price increases were to take place. Mere substantive lessening of competition creates no market power. Moreover, it is a term that can be rendered meaningless–any merger, and partnership (of lawyers, accountants, etc.) will always lessen competition. The point is that it will also be expected to bring economies, which will accrue in the first instance to the merging partners but commercial rivalry will eventually shift these to the customer.

Casting a wide net under which the regulatory authorities have licence to review proposals can mean excessive resources, both of the regulator and the regulated businesses, allocated to the review. This would certainly appear to be the case in the current pursuit of possible oil company collusion in the supply of bitumen in north Queensland, a review that has resulted in many millions of dollars expenditure incurred in legal and consultancy services by the accused firms.

For the businesses in which UE is involved in Australia, we see some disadvantages in the current test. For example, electricity and gas retailing are highly contestable industries and there are presently some 30 firms with retailing licences in Australia. The ease of entry into the business means there should be few regulatory concerns from any level of merger. Yet such concerns are likely, especially if the wide criteria and complex analysis required of the “substantial lessening of competition” test were applied to particular regional markets, as it commonly is. Such an application may well trigger an inquiry into a market like Victoria where the ease of entry into retailing constitutes an adequate discipline on a firm with a large market share. Procedures that deter mergers in such cases could lead to the nation foregoing cost savings.

6. ACCC performance in addressing mergers

Although fewer than 10% of the 150 or so mergers examined each year are opposed in a formal sense, others “voluntarily” change the terms and conditions from those initially preferred. Still other possible acquisitions are not contemplated due to the known hostility of the ACCC[9]. In part these perceptions stem from some high-profile decisions of the ACCC that have indicated a strong ideological position regarding mergers.

The ACCC has tended to oppose some mergers even where strong efficiencies have been demonstrated. Rather than seeing mergers as opportunities to lower costs, the ACCC has tended to view proposals as means of providing rivals with greater competitive opportunities.

In part this may be due to the provisions of the Trade Practices Act. The Act allows efficiency may be considered only in a very limited way in addressing mergers under s50. There is greater scope for this under the alternative provisions of s88, but this is far more cumbersome, costly and time-consuming for firms proposing a merger. The importance of “efficiency” in improving economic performance of the Australian economy should be recognised more fully in Section 50 of the TPA.

A further issue with the ACCC performance has been its tendency to take public positions about regulatory issues that are not appropriate for an independent Commonwealth public service agency.[10].

[9] see Merger Regulation Information Paper Industry Commission, 1996:p.15

[10] It is questionable whether the ACCC has always conducted itself in a way that might be regarded as neutral. Thus in ESAA vs ACCC on the question of power surges, the Judge, Justice Finn made the following comments, “ There are two matters to which it is necessary to draw attention. Both relate to the manner in which the ACCC conducted itself in its dispute with ESAA and the electricity suppliers. The first is simply a matter for comment. In his evidence Professor Fels indicated on a number of occasions that, in light of the issues that have achieved prominence in this proceeding, he would have been more careful in what he said in press releases and comments to the media. He took the view that in a media release it has to be "really simple". I do not wish to question the use of the media made by the ACCC in publicising its views. I would merely suggest that, as the agency responsible for policing s52 of the TP Act, it properly can be expected to set the example of care in its own representations to the public.”

The Judge was also critical in saying that Professor Fels had “not been slow to raise the threat of civil and criminal proceedings under the Trade Practices Act against electricity suppliers who publicise or who might be minded to publicise views about the implied warranties that differ from the Commonwealth’s view”.

The ACCC's faulty decisions also stem from a poor analytical capability in determining what a market comprises. Three examples of this are discussed below.

Westpac/Bank of Melbourne Merger

The ACCC received a lengthy submission seeking clearance for a merger between the two banks on 15 April 1997, some twelve days after the merger proposal was announced. It announced its decision on 25 July 1997. During this time the customer uncertainty at the Bank of Melbourne (BML) resulted in a considerable loss of business and the two entities were pressed to agree to the Commission's requirements.

In its examination of the proposed merger, the ACCC addressed six features of the banking market: deposits, home loans, personal loans, small business banking, credit cards, and transaction accounts. Each of these market segments was addressed from the ACCC perspective of whether the segment was a state or national market.

In terms of overall matters, the existence of four major banks and a great number of smaller entities competing in the various segments should have been assurance enough of continued robust competitive conditions, as the Bank of Melbourne's market share was less than 2%. However in different segments, especially on a State basis, that share would be much more significant.

By considering the market as State based, ACCC managed to define two of the six segments as crossing its threshold. Thus, although the two entities each only had 9% of the Victorian deposit market, this was sufficient to cause "concern". Similarly, although the merged entity had only 20% of the Victorian transaction accounts, "concern" was again triggered.

Yet the markets for financial services were progressively being integrated. Banks, building societies, and other financial intermediaries were increasingly "poaching" on territory that was previously protected. These developments have continued with increased competition from food stores with EFTPOS and other financial services, the Post Office, and direct dealings in savings and deposits over the internet.

Ampol/Caltex Merger.

In December 1994, Ampol and Caltex proposed a merger of their Australian petroleum operations. The industry has considerable competition but, more importantly, it is highly contestable with the threat of new competition and hit-and-run competition constantly keeping suppliers' prices low. The industry has incurred very high financial losses over recent years illustrating its extremely rivalrous nature. The nature of these losses was one factor in promoting the merger.

In subsequent years, the industry has continued to exhibit very low costs and, according to the International Energy Agency[11], Australian prices net of taxes are among the lowest in the world. Much of this downward price pressure is due to

[11] http://www.iea.org/stats/files/prices.htm

imports from major Asian refineries that have an output balance with surpluses of the products in strongest demand in Australia.

Yet, in spite of this basic contestability of the industry, the ACCC adopted an approach to the application which was based on the industry being highly static and not subject to incipient competitive forces. The ACCC was concerned [12] about the high level of concentration in the industry but neglected the fact that Australian refineries are old and under-sized[13]. The ACCC also opposed refinery exchange agreements (swaps) and borrow and loan arrangements between the majors even though this allowed each a presence in States where they have no refinery capacity and added to competition in those states.

In its consideration of the merger, the ACCC forced the parties to offer undertakings, which the parties felt obliged to accept even though they found them onerous. These covered:

- sale of certain terminals in major cities; this provision was made even though there were already independently owned terminals in Sydney, Melbourne, Brisbane and Perth owned by major businesses and the cost of new terminal construction is only $10-20 million;
- to supply at least a billion litres of petrol per annum on reasonable commercial terms to independents; and
- to sell at least 35 metropolitan and 15 country sites.

These measures were in response to a market definition that was already outdated, as evidenced by the entry and substantial inroads of Woolworths into petrol retailing in competition with the existing businesses.

Australis/Foxtel Merger

On 14 October 1997, the ACCC announced that it would block the proposed merger between Foxtel and Australis Media. Australis Media had secured access to a key library of Hollywood movies but had done so at a high price. It had been attempting to merge with Foxtel (a joint Testra/Murdoch business) for the previous two years but the ACCC had prevented this.

The ACCC claimed the merger would have given the entity a high market share. However, as the outcome of the decision was to place Australis Media in bankruptcy, the loss of a significant market player occurred in any event. But the shareholders in the company and what the Chairman of the ACCC referred to as American junk bond holders (who had $US375 million at stake) sustained losses.

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[12] See Hearings of the HoR Standing Committee on Financial Institution and Public Administration with Professor Fels Hansard, 21 April 1997.

[13] Minimum efficient size is thought to be at least 200,000 barrels per day and may be closer to 300,000. The largest Australian refinery is 120,00 barrels per day and the total demand would accommodate little more than one world-scale refinery. In fact, the concentration in refining is clearly too low for an efficient industry.

The Chairman of the ACCC was reported as saying it was not the ACCC that caused Australis to have problems but the fact that it paid $184 million to acquire pay television licences and extremely high prices for their film material. Professor Fels was reported as saying that with a combined Foxtel/Australis “there was a real possibility that Optus (the main rival) would have disappeared from the scene”[14].

The upshot is that the ACCC made a determination that the structure of the market required it to take action to ensure that one player, Optus, was not swamped by another. Determining that specific firms should continue in business is a very bold decision for a regulator to make. Sacrificing the interests of one set of shareholders to those of another requires the wisdom of Solomon. Moreover, the market for pay-TV is one with a great deal of fluidity. The content competes with other outlets (free-to-air TV, video stores and the general entertainment industry) and is characterised by very rapid market and technological change (it is likely that means of fast downloading film material through the internet will provide meaningful competition before any of the present participants are operating profitably).

This issue also raises the need for mergers to be considered in terms of efficiencies and to reduce socially wasteful business failures. This is particularly pertinent in that it is probable that Foxtel got the majority of Australis’ customers without any additional expenditure.

7. Improvements to the current informal process

Market Definition

There is much in the analytical progression of merger assessment as set out in Figure 1 that might more appropriately be given to a body with a different range of expertise than the ACCC. In particular, the definition of what constitutes a market is not one in which the predominantly legal expertise housed within the ACCC is likely to be expert. The notion of what constitutes a market is one that is best determined by a body expert in economic analysis.

The problem of market definitions is best illustrated by some of the judgements that the ACCC has arrived at, which are not ones that would be shared by most other economists. The three cases discussed above are good examples of this.

Within Government, the premier agency involved with the sort of micro-economics that concerns itself with industry structure is the Productivity Commission. It would be helpful both in preventing too much power falling within a single agency and in ensuring the most capable analytical resources are available in the sifting process on what constitutes a market and whether a proposal might bring an unwanted increase in market power were to be given to the Productivity Commission (PC).

This would need some coordination between the agencies but no more so than is presently required within the ACCC between its initial filtering personnel and those

[14] Australian May 6 1998

that subsequently are required to develop legal approaches and liaise with legal advisers and officials in other agencies in order to actuate the initial advice.

There are several options as to the extent of the shift of responsibilities, the proposal would entail. The first is simply to allocate the determination of the market definition to the Productivity Commission. This would have the merits of providing to the Productivity Commission a range of work in which they are most expert. The resources of the PC would need to be augmented but there may not be a need for a net increase in the total staffing within the two agencies.

Giving the function to the PC would allow some dedicated personnel to be assembled and to develop real expertise on the matter. It would also be possible for the PC to define in advance certain markets, targeting those that are more likely to see takeover activity or where the notion of what constitutes a market is more controversial. All this would tend to improve the information base of business and give greater certainty in allowing firms to develop corporate strategies.

Estimating Market Shares and Other Firm-Specific Features

It is probably unwise to leave the definition of the market as a stand-alone task for the Productivity Commission. Market definition and whether or not a particular company is "dominant" or the merger would result in substantial lessening of competition, are closely linked. This was clearly understood by the High Court, which determined in the original *Queensland Wire* case:

In identifying the relevant market, it must be borne in mind that the object is to discover the degree of the defendant's market power. Defining the market and evaluating the degree of power in that market are part of the same process, and it is for the sake of simplicity of analysis that the two are separated. (Mason C.J. and Wilson J., *Queensland Wire* case at 50,008[15].

Similarly, Anne Bingaman as Assistant Attorney General under President Clinton expressed the position thus[16]:

"*In antitrust analysis every case is unique, every market is unique*".

It follows that it would be preferable to allocate all these market definition functions to the one agency, the Productivity Commission[17]. This would avoid the excessive concentration of power within the ACCC that is presently evident, while locating the function within the Commonwealth agency that has the greatest expertise on the matter.

The informal clearance process can also be greatly improved. The process should be formally documented in the TPA or an enforceable code with an outline of the steps of the process. The process should include clear timeframes that the PC must comply

[15] Quoted in *Merger Guidelines: Draft for Comment*, TPC 1992, p. 23.
[16] Janus A Ordover, *Bingaman's Antitrust Era*, Regulation, Cato Institute Spring 1998.
[17] While the Productivity Commission is primarily an advisory body, it does already have certain regulatory functions including a role in safeguards investigations under the WTO. and a unit that investigates competitive neutrality complaints.

with. This process would be relatively straightforward if the PC had already undertaken a detailed review of the relevant market as outlined above.

We recommend that the process and steps be:

1. Parties are to notify the PC in writing of the proposed merger and include information such as: background information on the parties, structure of the market, commercial rationale for the merger, a brief competition analysis of the merger proposal, and the timing of the merger and whether it is confidential.
2. The PC would be required to review the merger with consideration of the merger factors listed in section 50(3) of the TPA.
3. The PC must provide a written response to the merging entities within 4 weeks of being notified of the proposal (the PC may extend the time only where requests for information have been put to the parties and the PC is waiting on the response). The PC's written response does not need to be a final decision.
4. The PC must give a final decision to the merging parties with 12 weeks of their application to the PC. Again this time can only be extended where the PC has sought information from the parties and is awaiting a response (a final decision is only practical where the merger proposal becomes public during the timeframe).
5. The PC must publish a statement of reasons for the decision within 5 business days of the decision (the details of this proposal is outlined below).
6. Where a prima facie case of monopoly is raised in the analysis, the matter should be referred to the ACCC which should be required to move to a decision within 30 days. Liaison at an early stage between the ACCC and the PC would facilitate the meeting of this time framework.
7. The merging parties may appeal a PC final decision to a competition review body (not necessarily the current form of the Competition Tribunal). An appeal must be lodged within 14 business days of the release of the statement of reasons. Appeals may be merit, bias or factually based. A description and the merits of an appeals body is discussed below.
8. Appeals must be heard within 30 business days of the lodgement of an appeal by the merging parties. Third parties are prohibited from appealing merger decisions.

Statement of reasons

Currently the ACCC provides few reasons as to why a decision on a proposed merger has been made. This makes it very difficult for the merging parties to consider taking the matter to the Federal Court, as they may not fully appreciate the reasons for the ACCC's decision. In addition, companies considering similar proposals in the future are unable to understand the ACCC's thinking on particular markets and mergers and therefore can not rely on previous decisions as precedents.

Accordingly, we recommend that in taking over the ACCC's functions, the PC be required to publish a statement of reasons for each *substantial*[18] merger it considers. This includes a market definition and the results of the competition analysis based on the merger factors listed in s.50(3) of the TPA.

[18] Substantial could be defined in terms of the value added of the businesses involved (or another appropriate measure).

Similarly, if the ACCC makes a conditional determination, this should also be required to be explained in a Statement of Reasons.

A mergers appeals body

We recommend that an appeals body be formed to hear appeals of PC or ACCC merger decisions in a timely fashion. This would avoid companies abandoning merger plans where the ACCC indicates it will not clear the merger. An ability to lodge such an appeal would ensure that companies do not have to go through the lengthy, and therefore uncommercial, court process required to contest a PC or ACCC decision.

In order for the appeals body to be most effective, we recommend that it be made up from a panel of industry representatives as well as legal and economic experts. Three members of the panel would be drawn upon when particular mergers are appealed. The nature of the industry and the specifics of the market would determine the panel members for particular cases. For example, where an energy merger is appealed, panel members with energy expertise should be called upon. This would ensure the timely consideration of appeals. We do not believe that third parties should be allowed to appeal merger decisions as this creates too much uncertainty.

The existing Competition Tribunal appeals body may be appropriate providing it was expanded to include an industry expert in addition to the economic and legal expertise on the existing appeals body.

If the parties (including the PC and the ACCC) are not satisfied with the outcome of the decision of the appeals body the matter could then be heard by the Federal Court only on a matter of law.

8. Recommendations

1. That the responsibilities for merger approvals be shifted from the ACCC to the PC as set out above and that the previous informal merger steps be codified.

2. That the PC be required to consider efficiencies arising from mergers and acquisitions in Australia as part of the range of issues that need to be addressed.

3. That an appeals body be formed which may involve expansion of the Competition Tribunal to include industry experts for merger determinations.

4. The review should consider whether the dominance test is more appropriate for Australian markets.