# "SONS OF UNCLE SAM: HAVE THEY GROWN UP IN HIS IMAGE?"

# A COMPARATIVE ANALYSIS OF THE MERGER LAWS AND POLICIES OF AUSTRALIA AND THE EUROPEAN UNION IN THE CONTEXT OF US ANTITRUST THEORY

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## I. INTRODUCTION

Merger regulation in Australia and the European Union (EU) has been constructed on the building blocks of United States (US) antitrust theory. With more than a hundred years of US antitrust learning, Australian and EU regulators have drawn on this body of knowledge to provide a starting point from which to develop their own regimes.

Shaping these building blocks into useful merger regulation has required the integration of local economic and socio-political conditions. Determining the extent to which these building blocks have been moulded from their original form will also indicate the degree to which the two regulations may overlap.

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'Environmental' conditions rather than 'inherited' US characteristics have prevailed in the shaping of each of the regulations. Until 1993, although different environmental factors shaped the need for merger regulation in Australia and the EU, similar merger policies and regulations emerged. The drive for common market integration in the EU coincided with the desire for 'bigness' in Australia. In each case, these imperatives were translated into relatively non-interventionist and largely 'hospitable' merger policies.

Since that time, Australian merger policy has switched tracks. The desire for increased international competitiveness in Australian industry has been interpreted as requiring stricter merger laws to enhance competition.

Two main points are developed in this article. First, while US antitrust thinking may have provided the starting point for each of the regulations, only elements of this learning still exist in each regulation.

Secondly, while a textual comparison of the regulations indicates divergence between the merger regulations of Australia and the EU, the underlying theme of each regulation relates to the assessment of market power. As the basic assessment of market power is similarly approached, the actual degree of overlap between the two jurisdictions in relation to merger regulation is not inconsiderable.

It is acknowledged that there is considerable divergence within the United States as to the best theoretical approach to the regulation of competition. Since the '70s, the "Chicago School" has dominated the approach of US antitrust enforcement agencies. Accordingly, as each of the Australian and EU merger regimes has been drafted or modified since the ascendancy of the Chicago School, this body of thought has been taken to be the common starting point. The arguments of the "Harvard/Traditionalist School" have still been presented as they are not only relevant, but continue to be recognised by enforcers within the United States today.[1]

## II. THE ANTITRUST DEBATE - US

Antitrust debate in the United States has exhibited as much competitive rivalry as the markets it sought to describe. During its hundred year evolution, several competing theories have emerged to provide *the* theoretical approach to antitrust policy making.

In attempting to define an optimal approach to market regulation, the debate has spanned the full spectrum of political and economic opinion. From theories which support notions of "economic Darwinism"[2] and "laissez faire-ism" to others which

1 The judiciary of the United States has been slower to adopt the "Chicago School" learnings than the enforcement agencies.

2 See HB Thorelli, *The Federal Antitrust Policy: Organization of an American Tradition*, John Hopkins Press (1955) for a discussion of early antitrust thought in the US as cited in DB Audretsch, "Divergent Views in Antitrust Economics" (1988) 33 *Antitrust Bulletin* 135 at 137.

call for the need for close market regulation, antitrust thinking has taken very divergent paths.

The progression in thought has more often been cyclical than lineal. Depending on the prevailing social and political climate, economic and antitrust theory has often developed to meet those changes.

The most current debate with respect to the theory of merger regulation[3] has been dominated largely by two schools of thought. Broadly, these schools have been labelled the "Chicago School"[4] and the "Neo-Harvard" or "Realist/Traditionalist School".[5]

The two schools are sharply divided both in the way they perceive the need for merger regulation and the scope of its terms.

## A. Objectives of Merger Regulation

The foundational issue in any discussion of merger policy turns on the question: why regulate for merger? The implications of this question were crystallised by one of the leading proponents of the Chicago School, Professor Bork,[6] in the wider context of general antitrust regulation:

> Antitrust policy cannot be made rational until we are able to give a firm answer to one question: What is the point of the law - what are its goals? Everything else follows from the answer we give. Is the antitrust judge to be guided by one value or several? If by several, how is he to decide cases where a conflict in values arises? Only when the issue of goals has been settled is it possible to frame a coherent body of substantive rules.[7]

Bork answers this question simply. The antitrust judge (or enforcement agency) is to be guided by only one value: the maximisation of consumer welfare through economic efficiency. In the context of Chicago School thinking, 'consumer welfare'is defined solely by reference to 'Pareto' efficient criteria as described by neo-classical economic theory. These criteria provide a measuring tool for assessing whether the consequences of a particular change will increase or decrease consumer welfare. For a change to be 'potentially Pareto efficient' (the standard of efficiency adopted by the Chicago School), "the gains experienced by those who

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3 The theory of "strategic behaviour" has also assumed importance in the general debates on antitrust, but has less direct relevance in the context of determining appropriate forms of merger regulation. Hence, its study is beyond the scope of this article. For a discussion see eg, S Salop, "Strategic Entry Deterrence" (1979) *Am Econ Rev* 335; OJ Williamson, "Antitrust Enforcement: Where It's Been, Where It's Going" (1983) 27 *St Louis U LJ* 289; OJ Williamson, "Predatory Pricing: A Strategic and Welfare Analysis" (1977) 87 *Yale LJ* 284.

4 Much of the original debate was spearheaded by A Director, R Bork and R Posner, each of whom were once Professors of Law at Chicago University.

5 The latter label has been referred to by E Fox in several articles, including in particular her article written with LA Sullivan, "Antitrust-Retrospective and Prospective: Where Are We Coming From? Where Are We Going?" (1987) 62 *NYULR* 936.

6 R Bork, *The Antitrust Paradox: A Policy at War with Itself*, Basic Books Inc (1978).

7 *Ibid*, p 50.

gain from the change [must be] larger than the losses experienced by those who lose due to the change".[8]

The distributional consequences of any change in resource allocation are considered irrelevant as 'efficiency' is judged by reference to the aggregate maximisation of wealth. Whether or not 'wealth maximisation' benefits producers, shareholders or consumers, the only objective of the Chicago School is to ensure that a change will achieve *net* allocative efficiency.[9] This approach is justified on the basis that it promotes resource allocation to those areas in which the greatest *net* good can be realised by society as a whole.

Non-efficiency based objectives fall beyond the scope of antitrust regulation. Indeed, Professor Bork argues that "to abandon economic analysis theory is to abandon the possibility of rational antitrust law".[10] This position is grounded in claims of increased consistency, predictability and rationality through the use of defined economic theory and reference to the 'consumer welfare model'.[11] Despite some acknowledged limitations with the use of economic models, it is claimed that neo-classic economic theory can provide the framework for a workable antitrust policy. Moreover, in using economic principles alone, the nature of the decision-making process becomes increasingly 'normative free' as only 'objective' factors are assessed.

Although economic analysis is also used by advocates of the Traditionalist School, it is neither limited exclusively to price theory analysis nor does such analysis prevail over all other considerations. The approach of the 'traditionalists' is a much broader one which recognises goals other than just economic efficiency and consumer welfare.

While the achievement and maintenance of a competitive *process* is primary, the ultimate goals of antitrust have been defined widely. Unlike the Chicago School, the 'traditionalists' have described the role of antitrust variously as including dispersion of economic (and hence political power), redistribution of income, equality of economic opportunity, local control of business to protect against labour dislocation, and the enhancement of general economic welfare.[12]

Moreover, it is argued that the efficiency approach prescribed by 'Chicagoists' is laden with as many normative judgments as any other system.[13] The 'traditionalists' suggest that the underlying political philosophy of the Chicago School closely shadows those associated with the conservative or libertarian philosophies.[14] Assumptions relating to the need for deconcentration of government power, the paramountcy of private business interests in determining

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8 H Hovenkamp, "Antitrust Policy After Chicago" (1985) 84 *Michigan LR* 213 at 240.

9 That is, where the benefits to allocative efficiency outweigh potential costs, if any, to productive efficiency.

10 R Bork, note 6 *supra*, p117.

11 See for example, *ibid*, chapter 5.

12 See P Areeda, *Antitrust Analysis - Problems, Text, Cases*, Little Brown and Co (3rd ed, 1981) at [120-3].

13 E Fox, "The Modernization of Antitrust: A New Equilibrium" (1981) 66 *Cornell LR* 1140 at 1156.

14 The divergences between Chicago School thinking and 'liberal' philosophy are summarised by C K Rowley, *Antitrust and Economic Efficiency*, Macmillan Press (1973) pp 67-9.

resource allocation, and the linking of net consumer welfare with general consumer welfare, each point to an approach which largely seeks to preserve the status quo.

Additionally, it is argued that the training of persons equipped to administer such economic analysis may also influence how the laws are both conceived and implemented.

Claims of increased predictability and consistency in decision-making through reliance on economic analysis is also strongly challenged. Economic models cannot be used to extrapolate consistent answers, as they are based on fundamental assumptions which do not exist in the real world. Moreover, price theory economics is based on static market conditions which differ considerably from dynamic and functioning markets. Accordingly, the 'traditionalists' claim that such data is usually inadequate to provide the basis for effective merger policy.

While acknowledging that the balancing of economic and non-economic objectives may produce some conflict in approach, the 'traditionalists' argue that the judiciary is well equipped to undertake that process.[15] The judiciary is often confronted with competing public interests and is able to impose an internal consistency within its own decision-making process.[16]

## B. Regulating for Merger Activity

As one of the underlying objectives of the Traditionalist School is to curb the aggregation of excess market power, merger regulation is primarily designed to regulate power accumulated through acquisition. In determining the nature and extent of such regulation, reliance has been placed on the learnings of industrial organisation theory and its empirical findings.

Of particular significance is the relationship between market structure and market performance. Data which evidences a link between high market concentration and supracompetitive pricing and profits,[17] has provided the foundations for a structurally-based analysis of market power. Kaysen and Turner, two of the original proponents of the Traditionalist School, summarised

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15 R Pitofsky, "The Political Content of Antitrust" (1979) 127 *U Penn LR* 1051.

16 Pitofsky suggests that one way of integrating the differing sets of goals is by subjugating non-economic goals to economic ones in the event of conflict. In this way, limited disruption would occur and consistency would be achieved even while incorporating such political and social factors. See R Pitofsky: *ibid*. Alternatively, Fox suggests that integration of converging efficiency and non-efficiency goals could be achieved through the use of 'consumer interests'. If a conflict arises between the two sets of ideas, the consumer interest should be used as the guiding interest. However, 'consumer interest' is not defined. See E Fox, note 13 *supra* at 1191. For other proposals see eg, L Sullivan, "Antitrust, Microeconomics and Politics: Reflections on some Recent Relationships" (1980) 68 *Calif LR* 1; J Flynn, "Introduction, Antitrust Jurisprudence: A Symposium on the Economic, Political and Social Goals of Antitrust Policy" (1990) 125 *U Penn LR* 1182; L Schwartz, "'Justice' and Other Non-Economic Goals of Antitrust" (1979) 127 *U Penn LR* 1076.

17 See L W Weiss, "The Concentration-Profits Relationship and Antitrust" in HJ Goldschmid, HM Mann and JF Weston (eds), *Industrial Concentration: The New Learning*, Little Brown & Co (1974) p 184; DE Waldman, *Antitrust Action and Market Structure*, Lexington Books (1978) and FM Scherer, "Structure-Performance Relationships and Antitrust Policy" (1977) 46 *Antitrust LJ* 864.

their analysis:

> If we wish to eliminate unreasonable market power, we must in general move towards less concentrated markets in which there are more sellers and smaller shares.[18]

> The persistent ability of a firm to behave 'uncompetitively' can only arise, say the traditionalists, where 'entry' or 'competitive growth' in a market is suspended by the existence of structural barriers. Barriers to entry are defined widely to include product differentiation, advertising, research and development and even some economies of scale.[19] These 'barriers' can easily be erected or manipulated (especially through product differentiation) by firms with entrenched market power.[20]

'Economies of scale' are largely regarded as barriers to entry (rather than efficiencies) as it is believed that very few industries generate the need for such 'scale' activities. Only where infrastructure costs are very high, would 'economies of scale' justify an otherwise anti-competitive level of concentration.

Moreover, in the context of structural oligopolies, it is thought that "high concentration implies the monopolistic power to elevate price".[21] Although there is some general agreement that high concentration can lead to supra-competitive pricing, 'traditionalists' consider that non-competitive behaviour can occur at reasonably low concentration levels.[22]

As market structure is so closely linked to market power, even 'incipient' impairments to that structure would require regulation. Kaysen and Turner recommended that any acquisition of a competitor by a firm "with 20 per cent or more of its market" should be prima facie illegal.[23]

Market structure has largely been analysed by reference to five criteria:[24]

(1) the breadth of the market and the character of demand;
(2) the number and size distribution of sellers and buyers;
(3) the conditions of entry for new sellers and expansion for existing sellers;
(4) the character and importance of product differentiation; and
(5) the degree of independence of action among sellers and buyers.[25]

No single model representing a competitive market structure has been adopted. However, "competition" has been variously defined by reference to a wide range of 'imperfect competition' models, including the concept of 'workable competition',[26] which have been moulded to suit the purposes of antitrust analysis.

By contrast, the Chicago School rejects much of the so-called evidence upon which the 'traditionalists' rely. Both the methodology used and conclusions drawn

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18 C Kaysen and D F Turner, *Antitrust Policy: An Economic and Legal Analysis*, Harvard U Press (1959) p 75.
19 The treatment of economies of scale has proven contentious even within the Traditionalist School. For arguments in favour of inclusion of 'economies of scale' as barriers to entry, see J Bain, *Barriers to New Competition: Their Character and Consequences in Manufacturing Industries*, Harvard U Press (1956).
20 *Ibid.*
21 FM Scherer, note 17 *supra* at 866.
22 Note 18 *supra*, pp 1-42.
23 *Ibid*, p 133.
24 *Ibid.*
25 *Ibid*, p 71.
26 *Ibid*, p 81.

have been the subject of aggressive challenge.[27] Brozen has stated that "[T]he data eventually convinced me that where concentration rules, costs and prices are lower than they would be if the market had been prevented from becoming concentrated".[28]

Even where it is accepted that the evidence shows a link between high concentration and increased profitability, the conclusions drawn from such evidence are disputed. Bork counters that:

> High rates of return are consistent with other factors besides restriction of output, primarily superior efficiency, so that if these debatable correlations could be made to stand up, they would prove nothing of interest to antitrust policy.[29]

Accordingly, any government regulation which seeks to 'deconcentrate' markets would have the propensity to reduce the efficient functioning of a market.[30]

Rather than focussing on structure and barriers to entry as the predeterminants of market power, the Chicago School targets restrictions on output to determine the need for regulation. Output is likely to be restricted where either monopoly or oligopoly conditions exist. However, the degree of concentration necessary to produce such restrictions relates not to structural criteria, but to the level at which tacit collusion can occur.

Relying on the collusion theory developed by Stigler,[31] the Chicago School recognises that at certain levels of concentration, monopolistic power will be derived through price leadership[32] or the mutual recognition of common interest. However, Bork considers that the actual level of concentration necessary to ensure effective tacit collusion, must be very high: "Evidence supplied by antitrust cases [indicates] that ... even overt collusion among oligopolists frequently breaks down...".[33]

Accordingly, only limited regulation is required as artificial restrictions on output may only be achieved in very limited situations.[34] Bork summarises the overall approach of the School clearly: "If a practice does not raise a question of output restriction ... we must assume that its purpose and therefore its effect are either the creation of efficiency or some neutral goal".[35]

To establish whether behaviour may restrict output, price theory analysis will be applied (see above). Where a restriction on output exceeds the efficiencies derived from the change, consumer welfare will be diminished as a dead weight or

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27 See S Peltzman, "The Gains and Losses from Industrial Concentration" (1977) 20 *J L & Ecs* 229; S Lustgarten, *Industrial Concentration and Inflation*, American Enterprise (1975).

28 Y Brozen, "The Concentration-Collusion Doctrine" (1977) 46 *Antitrust LJ* 826 at 827. See also H Demsetz, "Two Systems of Belief About Monopoly" in *Industrial Concentration: The New Learning*, note 17 *supra*.

29 Note 6 *supra*, p 181.

30 Scherer argues that if there is no "monopoly power" by the firms then why do those firms compete with one another on a price basis until they earn only "normal" profits? Thus, simply relating these findings to superior "efficiency" is challenged: see F M Scherer, note 17 *supra* at 866.

31 *Ibid.*

32 JW Markham, "The Nature and Significance of Price Leadership" (1951) 41 *Am Ec Rev* 891.

33 Note 6 *supra*, p 81.

34 *Ibid*, p 122.

35 *Ibid.*

efficiency loss (as described by the consumer welfare trade-off model)[36] will arise. Efficiency, in this context, reflects the *net* efficiency gain produced by a change, which will be calculated by reference to both allocative and productive efficiencies.[37]

Efficiency will be promoted through 'competition'. According to neoclassic economic theory, competition is defined to refer to a "state of affairs in which consumer welfare cannot be increased by moving to an alternative state of affairs through judicial decree".[38] This is largely a static analysis of competition which defines an end result rather than a process.[39]

Accordingly markets are viewed as competitive even where only a small number of firms operate. Unlike the 'traditionalists', the Chicago School contends that market forces will tend to "self correct"[40] on the basis that the supranormal profits earned by those firms will attract new entry. Regulation, at best, can facilitate this correction process. More often, however, it imposes high costs and administrative burdens which are unjustified.[41]

A brief overview of the differences between the two Schools highlights the areas in which merger policy and regulation diverge.

*(i) Market Power Definition*[42]

Proponents of the Chicago School have analysed market power in terms of the ability to reduce output by raising price above marginal cost, by a significant amount, for a significant period of time.[43] Easterbrook has suggested that a 10 per cent increase over a two year period would constitute the relevant "significant" amounts and times.[44]

'Traditionalists' define market power by reference not only to price, but also to quality and choice, as well as to whom and how supply should be made. The power to raise price or change any other material element of the good would each indicate the existence of market power.[45]

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36 This model was described by O J Williamson in "Economies as An Antitrust Defence: The Welfare Tradeoffs" (1968) 58 *Am Econ Rev* 18.

37 "Allocative efficiency" has been defined by Bork to refer to the "placement of resources in the economy, the question of whether resources are employed in tasks where consumers value their output most" and "productive efficiency" to refer to the "effective use of resources by particular firms": note 6 *supra*, p 91. However, for further explanation of these terms, see generally, chapter 4.

38 Note 6 *supra*, p 61.

39 See J Flynn, "Antitrust Policy and Concept of a Competitive Process (1990) 35 *NYLSLJ* 893, for an analysis of the distinction between the concepts of competition as a 'fixed state' and 'as a process'.

40 S Easterbrook, "The Limits of Antitrust" (1984) 63 *Texas LR* 1 at 2.

41 *Ibid.*

42 The author has relied heavily on the work of E Fox and R Pitofsky, "The Antitrust Alternative: Appendix: Rewriting the Lexicon" (1987) 62 *NYULR* 931 at 969-88, in relation to the following comparisons.

43 Marginal cost is the cost of the item plus a "normal" margin of profit which justifies the continued production of further units.

44 S Easterbrook, note 40 *supra* at 19-23.

45 See for example, E Fox, note 13 *supra* at 1174-5.

The determination of market power by the 'traditionalists' is carried out both by reference to "the market structure in which it operates and the efficiency dimensions of its performance"[46] as *precise* correlations between structure and performance do not exist.

Advocates of the Chicago School differ insofar as they de-emphasise reliance on structural indicators in favour of behavioural considerations which would evidence the ability to raise price in the manner described.

*(ii) Definition of Competition*

The distinction between a static definition of competition defined by reference to price theory analysis, clearly contrasts with the process-oriented definition accorded to competition under the 'traditionalist' approach (see above).[47]

*(iii) Definition of Markets*

Market definition is carried out to determine "market power" as defined above. The 'traditionalists' regard market definition as a finding of law, not economic theory. It is an instrument "for carrying out the substantive policy behind the antitrust laws".[48] It is necessary not only to ascertain market structure and potential competition in response to a hypothetical price rise, but also the competitors who will effectively challenge the merged firm.[49]

For the purposes of Chicago School analysis, all potential competitors must be included as they are regarded similarly to actual competitors (see below). The purpose of the inquiry is to determine who is in a position to restrict output.

Consistent with this approach to potential competitors is the extension of the geographic dimension of a market by reference to the situs of foreign competitors. Posner[50] suggests that:

> all sales from plants that had recently made some significant sales in the area should be included in the market, unless those sales from more distant plants had been made only in the periods of shortage when prices in the local area were high.[51]

The presence of imported goods/services in a market is considered to have an impact both on geographic market definition and extent of market power.

The 'traditionalists', however, only recognise the impact of imported goods/services in the assessment of the market power of a firm. The geographic market is not generally extended in this manner.

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46 *Ibid* at 1176.

47 E Fox, note 13 *supra* at 981. See also J Flynn, note 39 *supra*, for an analysis of the distinction between competition as 'a process' and an 'end result'.

48 E Fox, note 13 *supra* at 981.

49 Se RG Harris and TM Jorde, "Market Definition in the Merger Guidelines: Implications for Antitrust Enforcement" (1983) 71 *Calif LR* 464 at 486-93.

50 RA Posner, *Antitrust Law: An Economic Perspective,* U of Chicago Press (1976).

51 *Ibid,* p 3.

*(iv) Barriers To Entry*

The classification of barriers to entry produces some of the clearest distinctions between the two Schools.

Under Chicago School thinking, only externally imposed barriers such as legal or other regulatory conditions constraining entry, are regarded as barriers to entry. Stigler[52] argues that a barrier to entry is "a cost of producing (at some or every rate of output) which must be borne by a firm which seeks to enter an industry but is not borne by firms already in the industry". He requires an asymmetry to the cost of entry.

Bork confirms this approach stating that to characterise economies of scale as barriers would lead to a system which "fails to meet a basic test of economic rationality".[53] It is argued that if a wider view is taken, most mergers would be "bad, because it will almost certainly create other market power or efficiency".[54]

On the other hand, the 'traditionalists' include factors such as product differentiation, advertising, research and development and some economies of scale as barriers to entry. This analysis is based on the assumption that these market conditions may either prevent new competitors from entering the market on a sufficiently profitable basis or restrain firms within a market from growing to a reasonably competitive size.

*(v) Incipiency*

The regulation of incipient concentrations is considered by the Chicago School to be of "no value whatever"[55] as concentrations may often lead to efficiency in a market. Thus, a regulation preventing the development of incipient concentration may prevent the emergence of efficient industry.

With respect to 'tiebreaker' situations (where the likelihood of harm from the activity is as great as the likelihood of benefit), Bork considers that "the law should not intervene".[56] The rationale for this argument lies in the costs of intervention; the fact that a private restriction on output may have a lesser effect than a mistaken law which inhibits efficiency and a more general preference for freedom from legal coercion.[57]

This stands in direct contrast to the 'traditionalist' approach, which perceives that even small changes to the structure of a market may have a significant impact on market conduct and performance. Thus, it is necessary to regulate before the market is overly concentrated.

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52 G Stigler, *The Organization of Industry*, RD Irwin Inc (1968).
53 See R Bork, note 6 *supra*, p 109.
54 *Ibid.*
55 *Ibid*, p 131.
56 *Ibid*, p 133.
57 *Ibid.*

*(vi) Potential Competition*

The role of potential competition in antitrust analysis differs significantly between the two schools. In Chicago School thinking a market will be competitive where there is substantial potential competition. This holds true even where the market is highly concentrated. Thus, it is unlikely that enforcement of antitrust regulation will be needed where there is effective potential competition.

While recognising the influence of potential competitors, the 'traditionalists' do not consider that they can directly constrain market power to the same extent as an actual competitor. Empirical studies showing that prices are higher in the absence of direct competition,[58] are cited to support this conclusion. Potential competition is recognised, however, as providing competitive pressure in a concentrated market where collusion or conscious parallelism may otherwise exist.

*(vii) Vertical Restraints*

According to orthodox Chicago theory, all vertical restraints are beneficial to consumers and should thus not be regulated. This position is justified by arguments that:

> Basic economic theory tells us that the manufacturer who imposes such restraints cannot intend to restrict output and must (except in the rare case of price discrimination, which the law should regard as neutral) intend to create efficiency.[59]

On the other hand, the 'traditionalists' consider that vertical restraints can often produce anti-competitive effects. Fox comments that:

> The antitrust laws favor low prices and disfavor exploitation; thus, antitrust favors the fostering of open channels for discount distribution. Moreover, the law values entrepreneurial independence and access. It also reveals a preference for consumers' freedom to select different quality goods at different prices.[60]

Additionally, such restraints can be undesirable as smaller competitors may need to charge consumers higher prices as they may not have access to more efficient distributors.[61]

*(viii) How Does Each School Perceive the 'Ideal' Merger Regulation?*

As horizontal, vertical and conglomerate[62] mergers can all increase the market power of a firm and thus limit competitiveness in a market, the 'traditionalists'

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58 For example, GD Call and TE Keeler, "Airline deregulation, fares and market behaviour: some empirical evidence" in A Daughety (ed), *Analytical Studies in Transport Economics,* Cambridge U Press (1985) referred to in E Fox, note 13 *supra* at 976.

59 Note 6 *supra,* p 297. See also R Posner, "The Next Stop in the Antitrust Treatment of Restricted Distribution: Per Se Legality" (1981) 48 *U Chi LR* 6 at 22-6.

60 E Fox, note 14 *supra* at 983.

61 See TG Krattenmaker, S Salop, "Anticompetitive Exclusion: Raising Rivals' Costs to Achieve Power over Price" (1986) 96 *Yale LJ* 209 at 230-47.

62 Not all members of the Traditionalist School accept that conglomerate mergers should be regulated. Arguments in favour are often characterised by the desire to decentralise economic power: see FM Scherer, note 17 *supra.* Compare with DE Waldman, note 17 *supra,* p 108 and OJ Williamson, *Markets and Hierarchies: Analysis and Antitrust Implications,* Free Press (1975) p 108.

advocate regulation for each type of merger. Quick and peremptory regulation is crucial as the potential for fundamental changes to the structure of the market is considerable.

It follows that a relatively strict prohibition against horizontal mergers is advocated by 'traditionalists' on the basis that these are most likely to produce undue concentration in a market. Efficiencies arising from, for example, economies of scale, could be achieved equally well through internal growth. In considering the effects of a tough merger policy, Scherer confirmed that "it does inhibit the growth of concentration, and that the vigour of competition is in turn probably affected".[63] He concluded however, that "[i]n short, although exceptions surely exist, most mergers at a scale large enough to attract antitrust attention yield inappreciable efficiency benefits".[64]

Predictably, the approach of the Chicago School to merger regulation is much more narrow. First, only horizontal mergers could produce the type of inefficiency which could warrant regulation.[65] Moreover, as the trend to concentration more often indicates the development of efficiencies rather than collusive behaviour, regulation should ensure promotion of those efficiencies. Regulation must take the form of a "welfare trade-off"[66] between the extent of restriction on output and the efficiency gained. However, the use of an efficiency defence, per se, is not endorsed. Bork explained that:

> The trade-off problem (between efficiencies and restrictions) arises primarily in the context of horizontal mergers and there we can take it into account by framing rules about allowable percentages that reflect the probable balance of efficiency and restriction of output ... Indeed it is precisely the introduction of an attempt to quantify economies that would make the law even more arbitrary than it need be, by eliminating the most important efficiencies from consideration.[67]

It is recommended by Bork that where a duopoly is created with firms of roughly equal size, this should be acceptable as they may well substantially enhance efficiencies.[68] A market share of between 60-70 per cent should also be permitted for the same reasons.[69]

Although the Chicago School's analysis has been criticised particularly for its lack of correlation between price theory models and reality, it has nonetheless

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63 FM Scherer, note 17 *supra*, p 870.

64 FM Scherer, "The Posnerian Harvest: Separating Wheat from Chaff" (1976) 86 *Yale LJ* 974 at 987-8.

65 With respect to vertical mergers, Bork notes that "The law against vertical mergers is merely a law against efficiency": see note 6 *supra*, p 234. He suggests that "all so-called vertical merger cases should be handled through the application of horizontal merger standards": *ibid*, p 238. On the other hand, Bork considers that "antitrust should never interfere with any conglomerate merger. Like the vertical merger, the conglomerate merger does not put together rivals and so does not create or increase the ability to restrict output through an increase in market share. Whatever their other virtues or sins, conglomerates do not threaten competition and they may contribute valuable efficiencies": *ibid*, p 248.

66 *Ibid*, p 219.

67 *Ibid*, p 128.

68 Bork suggests that "Since the amount of restriction of output seems to increase greatly from one-firm markets to two-firm markets," duopolies should not be regulated: *ibid*, p 221.

69 *Ibid*.

prevailed in United States antitrust enforcement circles since the Reagan administration.[70]

## III. OBJECTIVES OF MERGER POLICY IN AUSTRALIA AND THE EUROPEAN UNION

Legislators in Australia and the EU have approached the question 'why regulate for merger' in a substantially different way from the Chicago School. While the notion of efficiency has been embraced as a desirable goal, it supplies neither the sole nor even the principle goal for merger regulation in Australian or the EU. Until 1993, the underlying objectives for merger policy in each jurisdiction led to a convergent approach to merger regulation. While the objectives themselves differed, each policy sought to encourage merger activity while maintaining some level of competition.

In Australia, the economic imperatives of domestic efficiency and international competitiveness were considered to require 'consolidation' and 'rationalisation'. Consolidation of industry would achieve desired economies of scale while rationalisation could produce the efficiencies necessary for effective competition.[71] These same conditions were encouraged in the EU. Consolidation and rationalisation were sought primarily to further the EU goal of common market integration.

These economic goals were translated into regulations which facilitated more merger activity than they constrained. This was particularly evident in the EU,[72] where one of the key selling points for Union-wide merger regulation was that only one (rather than several sets of) regulatory approval would be required ('one-stop shopping').[73]

Since 1993, merger policy in Australia has changed. Objectives of microeconomic reform and international competitiveness are seen to be best served by increasing the extent of domestic competition in Australia.

The changes to merger policy have been expressed in two sets of amendments to the *Trade Practices Act* 1974 Cth (the "Act"). First, the threshold for merger regulation under section 50 has been lowered from a "dominance" standard to a "substantial lessening of competition" test. Secondly, a new s 90(9A) of the Act has been inserted into the authorisation provisions to deem as "benefits" to the

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70 For a particularly revealing critique of the Chicago School, see H Hovenkamp, note 8 *supra*.

71 In his Second Reading Speech to the Parliament, John Howard summarised the objectives of the merger provisions:

> The Government has decided that the categories of merger to be subject to the Act should be quite limited. There should be no unnecessary impediment, legislative or administrative, to the attainment of rationalisation of Australian Industry. It is in Australia's best interest to achieve economies of scale.

See Australia, House of Representatives 1977, Debates, vol HR 88, p 1478.

72 D Neven, R Nuttall, P Seabright, *Merger in Daylight: The Economics and Politics of European Merger Control*, Centre for Economic Policy Research (1993).

73 There are some exceptions to this 'one stop shop' principle: see Articles 9 and 21 of the Merger Regulation.

public those activities which increase exports, replace imports with domestic products or generally enhance international competitiveness of any Australian industry.

Merger regulation in Australia also seeks to achieve limited redistribution of income objectives through reduced pricing to consumers. This objective has been emphasised by legislators, regulators and judiciary alike. In the recent case of *Davids v Attorney General & QIW*,[74] Drummond J applied the reasoning in *Queensland Wire*[75] to section 50 of the Act:

> It has frequently been said that the provisions of Part IV of the Trade Practices Act 1976 [sic] are designed to foster competition ... But the justification for this is that the underlying objective is to protect the interests of consumers, the assumption being that competition is a means to a particular end.[76]

The Trade Practices Commission emphasised this goal in the recent *CSR Authorisation*.[77] Efficiencies achieved through rationalisation were discounted, as these benefits would not adequately have been passed on to consumers in the form of price reductions.[78]

Other objectives including fairness have also been expressed. Fairness, in this context, refers to the freedom to compete or fail rather than to protect competitors per se.

Each of these wider goals is to be achieved through the immediate and primary goal of promoting competition. When introducing the recent amendments to the Act, the then Attorney General, Michael Duffy MP, stated that:

> Part IV... is designed to facilitate and promote competition. This is based on the premise that competition will yield the best allocation of economic resources, the lowest prices to consumers, the highest quality of goods and the greatest national progress... the amendments [to s 50] ... will help to improve efficiency and fairness.[79]

Competition in this context has been defined by reference to the imperfect competition model of 'workable competition',[80] rather than the neoclassical

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74 *Davids Holdings Pty Ltd & Ors v Attorney-General of the Cth and QIW Retailers* (1994) 16 ATPR ¶41-304 at 42,098.

75 *Queensland Wire Industries Pty Ltd v The Broken Hill Proprietary Ltd* (1989) 167 CLR 177 (*Queensland Wire*).

76 *Ibid.*

77 Trade Practices Commission, *CSR Determination: Applications for Authorisation Lodged under ss 88(9) and 88(1) of the Trade Practices Act, by CSR Limited, Mackay Sugar Co-operative Association Limited, ED and FMan Australia Pty Ltd and Newco* (1994) 16 ATPR ¶50-138 *(CSR Authorisation)*.

78 *Ibid* at 80. The TPC said:

> Even if ... all the above efficiency and rationalisation gains are available and are likely to eventuate as a result of the proposed joint venture ... there is no assurance that all or any efficiency gains will be passed on in lower prices to purchasers in a market which is characterised by both concentration and high sunk costs. In this case the extent to which the benefits are public must be discounted.

79 Second Reading Speech, Australia, House of Representatives 1992, Debates, vol HR103, p 2405.

80 The definition of 'workable competition' adopted by the Trade Practices Tribunal, and since endorsed by the Federal Court, was one referred to in the *Report of the Attorney-General's National Committee to Study the Antitrust Laws*, 1955. It described workable competition (at 320) as follows:

> The basic characteristic of effective competition in the economic sense is that no one seller, and no group of sellers acting in concert, has the power to choose its level of profits by giving less and charging more.

definition described by the Chicago School. Although there are several formulations of the concept of 'workable competition',[81] the model emphasises the process of competition as a goal in itself.

A similarly broad range of objectives has been expressed in relation to the EU's Merger Regulation 4064/89 (Merger Regulation):[82]

> It should be understood that although the Treaty speaks of the establishment of a system of undistorted competition, competition policy has never been seen as a narrow economic concept linked solely to the promotion of efficiency but is intimately linked to our concept of democracy ... This understanding is also necessary to ... [avoid] decisions [being] determined by dogmatism that by definition can only take account of one amongst several goals.[83]

However, in the context of the Merger Regulations, the primary goal of integration has "trumped"[84] all others. Indeed all laws made under the Treaty of Rome[85] *must* be made for the purposes of promoting a European 'community' and economy.[86]

The promotion of market integration in the EU has been translated into two competing economic imperatives. First, the mergers envisaged by industry will generally help to adapt industrial structures to the single market so that the market can in fact generate the desired efficiency gains. Secondly, it is likewise vital that mergers should not be allowed to establish dominant positions in the Community, with the holders of such positions no longer exposed to sufficient competitive pressure. They would not then need to pass on to consumers the benefit of the increased efficiency secured through the merger; instead they could exploit consumers' new dependence on them.[87]

The first factor is not only designed to promote efficiency, but is also perceived to achieve another important goal: the enhancement of internationally competitive industries. Indeed, this aim has been so frequently expressed that one author has conjectured that the omission of any merger regulation from the Treaty itself was to allow "war ravaged and historically under-industrialised Europe to attain

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> Whether there is workable competition, rival sellers, whether existing competitors or new potential entrants into the field, would keep this power in check by offering or threatening to offer effective inducements.

Referred to in *Re Queensland Co-operative Milling Association Ltd and Defiance Holdings Ltd* (1976) 1 ATPR ¶40-012 at 17,246 (the *QCMA* case). For examples of Federal Court cases endorsing this approach see *Trade Practices Commission v Ansett Transport Industries (Operations) Pty Ltd* (1978) 2 ATPR ¶40-071 at 17,717-8 (the *Ansett* case) and *Austereo Limited* v *Trade Practices Commission* (1993) 15 ATPR ¶941-46.

81 JP Nieuwenhuysen has suggested that there are at least "18 authors [who] have proposed criteria for the concept of workable competition": JP Nieuwenhuysen, "The Theory of Competition Policy" in JP Nieuwenhuysen (ed), *Australian Trade Practices*, Croom Helm (1976) p 270.

82 Council Regulation (EEC) 4064/89, 21 December 1989 on the Control of Concentrations between Undertakings (OJ 1990 L257/14) (Merger Regulation).

83 K Van der Miert, "Competition Policy in the 90s", presented at the Royal Institute of International Affairs, 11 May 1993.

84 See BE Hawk, "The American (Antitrust) Revolution: Lessons for the EEC?" (1988) 13 ECLR 53.

85 Treaty establishing the European Economic Community, 25 March 1957 (Treaty of Rome).

86 See Article 2 of Treaty of Rome.

87 Commission of the European Communities, *XXIInd Report on Competition Policy*, Office for Official Publications of the European Communities, 1992.

American levels of industrialisation by encouraging the formulation of American sized giants".[88]

The second factor relates to the level at which market power will be regulated under the Regulation. Consistent with the objective of encouraging integration, merger regulation will only be triggered using the higher threshold of "dominance".

Both imperatives are balanced against the objective of increasing consumer benefits. The importance of consumer welfare objectives (in the broad sense) is emphasised in the Merger Regulation. Article 2 of that Regulation states that the interests of "intermediate and ultimate consumers" must be addressed in assessing whether a "concentration"[89] would be compatible with the Common Market.

Other objectives for merger regulation have assumed attention, if not importance. In the protracted 17 year debate which preceded the introduction of the Merger Regulation, the role of industrial, regional and social objectives became one of the most divisive issues. Although the Regulation seems to have resolved this debate in favour of a competition-based analysis alone,[90] some doubt lingers in relation to whether the technical and economic progress factor could be used to incorporate wider policies.[91]

Many of the more democratic objectives referred to by Karel Van Miert (cited above), have traditionally included the promotion of small and medium sized businesses, protection of economic opportunity and limitation of undue economic power. To date, however, these objectives have not been given as much attention under the Merger Regulation as under Articles 85 and 86.

Once, however, the common market achieves integration, greater emphasis is likely to be placed on *maintaining* the market by restricting the degree of consolidation and rationalisation. Although no change to the threshold for the Merger Regulation is envisaged, the more traditional objectives may assume greater importance. Notably, in its most recent Report on Competition the Commission recognised that "the priorities ... as regards competition are largely

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88 P Bos, J Stuyck and P Wytinck, *Concentration Control in the European Economic Community*, Graham and Trotman (1992) p 6.

89 "Concentration" is the term used to describe the type of activity which falls to be regulated under the Merger Regulation. See Article 3 of the Merger Regulation, note 82 *supra*.

90 In *Aerospatiale - Alenia/de Havilland* (Case IV/M053) (*de Havilland* case) the Commission rejected the merger application on the basis of purely 'competition' analsyis. This was seen as a 'victory' for competition objectives.

91 Sir Leon Brittan clearly stated his views on this argument in an introductory speech concerning the Merger Regulation:

> The technical and economic progress which a merger may bring about will certainly form part of the Commission's analysis of the reasons for a merger. However, this does not mean that such progress is a legitimate defence for a merger which creates a dominant position. In a competitive market, mergers may or may not give rise to technical and economic progress. In an uncompetitive market, even if they do, they will not be allowed. Indeed, in an uncompetitive market one would not expect to see technical and economic progress in the normal sense of those words at all. There may be some technical progress, but the economic progress would be confined to the dominant company itself in the form of monopoly rents.

L Brittan, "Competition Policy and Merger Control in the Single European Market" in *Hersch Lauterpacht Memorial Lectures*, Grotius Publications Ltd (1991) p 35.

determined by the contribution which competition policy can make to the Community's objective of growth, competitiveness and employment".[92]

## IV. COMPARISON OF MERGER REGULATIONS

How have these objectives been translated into law? Prior to 1993, this question produced largely the same conclusion.[93] Regulation of merger activity was triggered where a "dominant position" could be created or strengthened.[94] Although this threshold arguably allowed concentration in a market to the point of duopoly, longer-term objectives of efficiency and international competitiveness were persuasive of a narrower approach.

However, in 1993 the TPC successfully urged the need for a change to the threshold from a "dominance" to a "substantial lessening of competition" test. It was perceived that excess market power, particularly in the context of collectively held market power, was inadequately regulated.

In the same year, the Commission 'extended' the scope of the Merger Regulation by holding that the Regulation could apply to the creation or strengthening of "collective dominance".[95]

Although the change to a "substantial lessening of competition" test effected a quantitative change to the level of merger regulation, the qualitative nature of the inquiry may not have been fundamentally altered. On the surface, the "substantial lessening of competition" threshold calls for an examination of an effect on competition, while the "dominance" test examines a degree of market power.

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92 Commission of the European Communities, *XXIIIrd Report on Competition Policy,* Office for Official Publications of the European Communities, 1993 at 7.

93 Although the substantive tests overlapped, the procedure differ substantially. In the EU, prior notification must be given to the Commission under Article 4 of the Merger Regulation. Until approval is granted, all further activity with respect to the 'concentration' is suspended. In Australia, while a pre-notification procedure is due for introduction, there is no current requirement for notification to be made. Any breach of the threshold levels may trigger enforcement proceedings.

94 Prior to 21 January 1993, section 50 was cast in the following terms:

> A corporation shall not acquire, directly of indirectly, any shares in the capital, or any assets, of a body corporate if:
>
> (a) as a result of the acquisition, the corporation would be, or be likely to be, in a position to dominate a market for goods or services; or
>
> (b) in a case where the corporation is in a position to dominate a market for goods or services:
>
> (i) the body corporate or another body corporate that is related to, or associated with, that body corporate is, or is likely to be, a competitor of a body corporate that is related to, or associated with, the corporation; and
>
> (ii) the acquisition would, or would be likely to, substantially strengthen the power of the corporation to dominate that market.

Paragraph 3 of Article 2 of the Merger Regulation provides that:

> A concentration which creates or strengthens a dominant position as a result of which effective competition would be significantly impeded in the common market or in a substantial part of it shall be declared incompatible with the common market.

95 See *Nestle/Perrier* (Case IV/M 190), although this approach is still the subject of considerable debate, which may result in a challenge to the European Court of Justice at a later stage.

However, these separate inquiries describe two faces of the same coin as economic theory provides that "undue market power is the antithesis of competition".[96]

As market power bears an inverse relationship to competition, an inquiry into market power will simultaneously indicate the degree of market power and, inversely, the extent to which competition will be affected by such market power. Thus, where market power is excessive a "substantial lessening of competition" is also likely to occur. Central to both regimes, therefore, is the basic assessment of market power.[97]

Market power, however, is both difficult to define and complex to appraise.[98] Neither regulation attempts to define the concept of market power. Given the absence of legislative direction, enforcement agencies under each regime have resorted to economic theory to provide guidance.

Definitions of market power have ranged from the "ability to raise price and exclude entry" (which largely derives from price theory conceptions as described by the Chicago School) to concepts of "independence of behaviour from competitors and consumers" (which incorporates wider types of evidence to evince market power).

The Commission has tended to rely on the latter test to describe market power more widely under the Merger Regulation. In *Accor/Wagons-Lits,*[99] the Commission equated the power of a firm[100] to "behave to an appreciable extent independently of its competitors and customers"[101] with a "dominant" position being held in a market.

This is consistent with the approach adopted by Dawson J in the High Court case of *Queensland Wire.*[102] Dawson J endorsed the definition of market power developed by Kaysen and Turner:

> A firm possesses market power when it can behave persistently in a manner different from the behaviour that a competitive market would enforce on a firm facing otherwise similar costs and demand conditions.[103]

In the same case however, Mason CJ and Wilson J (in a joint judgment) defined market power by reference to "the power to raise prices above the supply cost without rivals taking away customers in due time ... ".[104] This price-based test has

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96 The *QCMA* case, note 80 *supra* at 246. See also the analysis of Northrop J in the *Ansett* case at 17.

97 See also M Brunt, "Market Definition Issues in Australian and New Zealand Trade Practices Litigation" (1990) 18 *Aus Bus LR* 86, for further discussion of the role of 'market power' as the central form of inquiry under Part IV of the Act; see also JW Rowley and A N Campbell, "Commonality and Divergence in Canadian and Australian Competition Law" in *Fordham Corp Law Institute* (1992). See chapter 10 for a similar approach in the context of comparing Canadian and Australian antitrust laws.

98 Note 50 *supra*, p 189. See also FM Scherer, *Industrial Market Structure and Economic Performance*, Rand McNally (2nd ed, 1980) p 11.

99 Case IV/M 126.

100 The term 'firm' is used in the economic, rather than legal, sense.

101 Case IV/M126 at [17].

102 The *Queensland Wire* case, note 75 *supra*.

103 C Kaysen and DF Turner, note 18 *supra*, p 75.

104 Per Mason CJ and Wilson J in the *Queensland Wire* case, note 75 *supra* at 188.

been adopted under the Merger Guidelines, although the TPC suggests it will also be "mindful" of the non-price effects of market power.

However, despite the theoretical differences in defining market power the practical assessment of market power is approached similarly. As market power cannot be calculated directly, both s 50 and the Merger Regulation provide a series of factors which indicate the existence of market power. Before market power can be assessed, however, a definition of the market must first be delineated. A two-staged inquiry is adopted under each regime. This approach is well summarised by Areeda who explained:[105]

> If we could measure [market] power directly, market definition would be superfluous. The law uses market definition and market share as a rough proxy. To serve that function - for whatever use a rough proxy may serve - we must use the single most appropriate relevant market and then make the best inferences of power that we can without losing sight of the other firms we marginally included or marginally excluded and in the light of the significant additional information that is available.[106]

Given, however, the artificiality of this two-staged process,[107] Australian courts have started to develop a more teleological approach to the market power inquiry. Whether this will provide truer results, while also achieving consistency and predicability, has yet to be determined.

## A. Market Definition

Regulators in both Australia and the EU have been charged with defining the market very narrowly.[108] While this may lead to consistency as only those very close substitutes are included, it can also result in overstatements of market power. Market definition, like market power, eludes simple formulation.[109] However, in both jurisdictions, analysis relating to product, geographic, functional and even temporal markets has been undertaken.

Market definition in Australia has largely been guided by the Trade Practices Tribunal (the "Tribunal") and the Courts. The legislature has provided only limited guidance in s 4E of the Act by referring to a "market" as:[110]

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105 P Areeda, "The Economics of Horizontal Restraints: Market Definition and Horizontal Restraints" (1993) 52 *Antitrust LJ* 553.

106 Note 12 *supra* at 113.

107 See the *Queensland Wire* case, note 75 *supra* at 187 where Mason C J and Wilson J held that:

> 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.

108 See G Walker, "Product Market Definition in Competition Law" (1980) 11 *Fed LR* 386, for an Australian analysis; BE Hawk, note 84 *supra*, for a discussion of the EU approach.

109 See Deane J in *Queensland Wire*, where he noted that "the word [market] is not susceptible of comprehensive definition when used as an abstract noun in an economic context": note 75 *supra* at 195.

110 Section 50(6) requires that the market be 'substantial'. A similar requirement is made under Article 2 of the Merger Regulation. The requirement of 'substantiality' has not constrained the exercise of either regulation significantly. In the EU, even a 'local' market within a region was considered substantial in the context of food distribution at the retail level: see *Promodes/Dirsa* (Case IV/M5).

> a market in Australia and, when used in relation to any goods or services, includes a market for those goods or services and other goods or services that are substitutable for, or otherwise competitive with, the first-mentioned goods or services.

Illumination of this concept was provided by the Tribunal in *Re QCMA*,[111] where it stated that a market "is the area of close competition between firms". In delimiting the outer boundaries of a market, it was stated that a "relatively high cross-elasticity of demand or cross-elasticity of supply..."[112] needs to be demonstrated.

While endorsing the general approach of the Tribunal to market definition, Dawson J in the High Court case of *Queensland Wire*,[113] suggested that market definition could not be resolved simply by applying notions of substitution and cross-elasticity. As the boundaries of any market "are likely to be blurred",[114] a further evaluative process must be undertaken in the context of the object of the inquiry. Mason CJ and Wilson J (in a joint judgment) considered that market definition must be assessed to "discover the degree of the defendant's market power",[115] while Deane J agreed that "value judgments" were necessary as the "economy is not divided into an identifiable number of discrete markets".[116]

This judicial overlay attempts to overcome some of the limitations inherent in a two-tiered assessment of market power. Through the use of a more teleological approach to market definition, the drawing of boundaries may become a less arbitrary and more directed process. In addition to substitutability and cross-elasticities, the definition of market must now be decided in the context of the terms of s 50 of the Act, the relevant conduct and the likely remedies available.[117] This approach was followed recently in *Singapore v Taprobane*,[118] where French J held that market definition "[i]n competition law has a descriptive and purposive role. It involves fact finding together with evaluative and purposive selection".[119]

The Merger Regulation provides even less legislative direction in terms of market definition. The Regulation requires that effective competition must be significantly impeded in the "common market or in a substantial part of it". No definition of the "common market" is provided, nor is there a general definition of "market". However, the prescribed pre-notification notice, Form CO,[120] provides a working, although not binding, definition of a product market:

111 See the *QCMA* case, note 80 *supra*.
112 *Ibid* at 17,247.
113 The *Queensland Wire* case, note 75 *supra*.
114 *Ibid* at 196, per Deane J.
115 *Ibid* at 187, per Mason CJ and Wilson J.
116 *Ibid* at 196, per Deane J.
117 See note 97 *supra* for a more detailed analysis of the 'purposive' approach to market definition in Australia.
118 *Singapore Airlines Ltd v Taprobane Tours WA Pty Ltd* (1991) 104 ALR 633.
119 *Ibid* at 649.
120 Form CO relating to the Notification of a Concentration Pursuant to Council Regulation (EEC) 4064/89.

> A relevant market comprises all those products and/or services which are regarded as interchangeable or substitutable by the consumer, by reason of the products' characteristics, their prices and their intended use.[121]

To the extent that a market is defined to include both products[122] and their "substitutes", the definition under s 4E and Form CO overlap. However, there are two significant differences between the two approaches.

First, Form CO defines "substitutes" by reference to consumer perception only, that is, 'demand side substitutability'.[123] Unlike the Australian approach, notions of 'supply side substitutability' are not incorporated under this definition. This difference is somewhat ironic given that the High Court relied on the dicta of the European Court of Justice (the "ECJ") in *Continental Can*,[124] to conclude that *both* 'demand side substitutability' and 'supply side substitutability' were relevant to market definition.[125]

Notwithstanding the terms of Form CO, the Commission has referred to 'supply side substitutability' in defining the market under the Merger Regulation. The Commission has taken the view that 'supply side substitutability' is generally not a "sufficient condition for extending the definition of the relevant market" and that it is "normally considered by the Commission under its assessment of possible dominance".[126] Implicit in this statement is the assumption that a narrow market definition will be equally effective to the ultimate determination of market power if a wide interpretation of 'potential competition' is adopted. This assumption, however, has not met with general agreement. Rather, it has been argued that this practice renders the utility of market share criteria "rather uninformative", and will lead to a distortion in the assessment of market power.[127]

Moreover, the Commission has not applied this factor consistently. 'Supply side substitutability' has at times been used as an aid to market definition,[128] at others, during the second stage of inquiry referring to the determination of market power,[129] and in further cases, not at all.[130]

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121 This definition was used by the Commission in the *de Havilland* case (Case IV/M 053).

122 While the discussion is relevant to both products and services, for convenience reference will only be made in the text to 'products'.

123 Demand cross-elasticity is a measure of the competitive relationship between two products in terms of the reaction of purchasers to price changes. If the cross-elasticity between two products is high, a small price rise in one product will cause a significant shift in demand to the other. If the cross-elasticity is low, a high increase in price will be necessary to cause substitution.

124 *Europemballage Corporation and Continental Can Co Inc v Commission* (Case 6/72) [1973] ECR 215 (the *Continental Can* case).

125 See, in particular, Toohey J in the *Queensland Wire* case, note 75 *supra* at 210.

126 Commission of the European Communities, *XXIIIrd Report on Competition*, Office for Official Publications (1993) at [276].

127 Note 72 *supra* at [3.4.1.1].

128 See *Viag/Continental Can* (Case IV/M 026) where the Commission had to decide whether the beverage packaging market should be treated as one market comprising glass, plastic and cans, or whether it should be further distinguished into different submarkets. They opted for the latter.

129 See, for example, *Du Pont/ICI* (Case IV/M 214); *BTR Pirelli* (Case IV/M 253).

130 See, for example, *Renault/Volvo* (Case IV/M 004).

The effects of this approach are twofold. First, a lack of consistency in market definition may result. Secondly, where supply side substitutability is not considered at the market definition stage, reliance on market share may be misleading.

Moreover, as the Commission has not adopted a purposive approach to market definition, this may lead to more unpredictable boundaries being drawn.

*(i) Product Market Definition*

In Australia, the High Court defines the product market as "including products which compete with the defendant's and excluding those which because of differentiating characteristics do not compete".[131] Reference was made to two decisions of the ECJ under Article 86 of the Treaty to expand upon these principles. In relation to the extent of substitutability required to group products within the same market, the ECJ held in *Hoffman-La Roche v Commission*,[132] that there must be a "*sufficient* degree of interchangeability between all the products forming part of the same market".[133] In determining however the point at which products should be excluded from a market, the ECJ in *United Brands v Commission*,[134] held that "it must be possible for [the product] to be singled out by such special features distinguishing it from other ...[products] that it is only to a limited extent interchangeable with them and is only exposed to their competition in a way that is hardly perceptible".[135]

Under its Merger Guidelines, the TPC has adopted a general formulation of "market" which applies both to product and geographic market definition. It largely reflects the price-based analysis advocated by Chicago School proponent, Judge Posner,[136] in seeking to establish the market by reference to the reaction to "a small but significant and non-transitory price increase from the competitive level".[137]

Although there is no equivalent statement by the Commission in relation to its approach to market definition under the Regulation, the Commission did indicate in the *Du Pont Case*[138] that two products would be regarded as being "substitutable" where:

> ... the direct customer must consider it a realistic and rational possibility to react to, for example, a significant increase in the price of one product by switching to the other product in a relatively short period of time. Each product must be a reasonable alternative for the other in economic and technical terms.[139]

While the Commission specifies a "relatively short period of time" in which the reaction must occur, the relevant time frame under the TPC's formulation is less

131 The *Queensland Wire* case, note 75 *supra* at 188, per Mason CJ and Wilson J.

132 [1979] 1 ECR 461; 3 CMLR 211.

133 *Ibid* at 272 (my emphasis).

134 [1978] 1 ECR 207; 1 CMLR 429.

135 *Ibid* at 482-3.

136 See R Posner, note 50 *supra*, p 133.

137 Merger Guidelines at [4.37].

138 Case IV/M214.

139 *Ibid* at [25].

clear. For 'supply side substitutability' to be included in its assessment, the potential sources must be likely to "rapidly switch their production". However, the Tribunal suggested in *Re Tooth,*[140] that "given the policy objectives of the legislation, it serves no useful purpose to focus attention upon a short-run, transitory situation. We consider we should be basically concerned with substitution possibilities in the longer run".[141]

Whereas each formulation refers to cross elasticities of demand, neither has attempted to quantify the extent of the increase required. The Commission's approach, however, seems somewhat narrower as the price rise must be "significant" in contrast to the TPC's "small but significant" rise.

Most clear, however, is the difference between the extent of substitutability which is required. Whereas in Australia, the defining feature of a market is the existence of "close" substitutes, under the Merger Regulation the Commission requires the substitute to be "reasonably interchangeable". Although it is difficult to assess the extent to which these two formulations have led to differences in overall market definition, the latter approach is clearly wider.

Due to the empirical difficulties of collecting and appraising meaningful data in relation to price elasticities, each jurisdiction has had recourse to alternative criteria to determine where the break in "close"/"reasonable" substitutability will occur. The following table highlights the degree of overlap between the factors considered under s 50 and the Merger Regulation.

**Factors taken into account in product market definition**[142]

| | Australia | European Union |
|---|---|---|
| Physical Characteristics | • | • |
| Technical Characteristics | • | • |
| Price | • | • |
| Relative Price Levels and Movements re Substitutes | • | • |
| End Use | • | • |
| Consumer Preferences | • | • |
| Perceptions of Purchasers re Market | • | • |
| Costs of Switching Purchases between Product and Substitutes | • | • |
| Views/Past Behaviour of Suppliers in Following Price or other Changes re Other Suppliers of Potential Substitutes. | • | Inconsistently |
| Costs of Switching Production and Distribution Systems for Supply Substitutability. | • | Inconsistently |

140 *Re Tooth & Co Ltd and Tooheys Ltd* (1978) 39 FLR 1.

141 *Ibid* at 38-9.

142 The 'factors' referred to in the table indicate those set out in the Merger Guidelines at [4.41] and other factors which have been emphasised by regulators in both jurisdictions. However, this list is not meant to identify all factors considered.

Several immediate observations arise from this comparison. First, the extent of overlap is considerable. Secondly, the approach taken both by the Australian Courts and the Commission has tended to be more unstructured, with each examining varying combinations of factors from case to case. It is unclear whether the Australian courts will now adopt a more structured approach by relying on each of the Guideline factors as the starting point for each product definition inquiry. Thirdly, neither jurisdiction has indicated the relative significance of each of these factors. This results in a loss of predicability in market definition. However, some guidance can be gleaned from the 'case law' in each jurisdiction which has tended to emphasise the following factors in their definition of product market: physical and technical characteristics of a product;[143] the price;[144] and the intended use[145] of the product.

Under the Merger Regulation, the Commission has also identified the conditions of competition as being relevant to differentiate product markets under the Merger Regulation, where the products are technically substitutable but service different types of markets.

This type of analysis was clearly followed in the *Arvin/Sogefi* case.[146] There, the Commission had to determine whether there were one or two markets for original and replacement car exhaust components and spare parts. Although the physical/technical characteristics of these components were very similar, the Commission found two separate markets. This was based on the differences in customer demands and expectations for each product which included: the extent of the product range (original part manufacturers tended to have a narrower product range); consistency in quality of the product (the original products were found to be more technically reliable); and the nature of the accompanying service and distribution systems (original part distributors had more effective systems and could provide a quicker and more reliable service).

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143 See for example, the *de Havilland* case (Case IV/M 053) where the Commission had to define the relevant market/s for different categories of turbo propeller commuter aircraft. It relied on the different numbers of seats in each plane to distinguish three product markets: 20-39 seats, 40-59 seats and 60 seats and over; see also *Du Pont/ICI* (Case IV/M 214) where technical differences in the performance of nylon and polypropylene fibres for carpets led to a finding of two different markets. In the Australian context, see *Australia Meat Holdings Pty Ltd v Trade Practices Commission; Trade Practices Commission v Australia Meat Holdings Pty Ltd* (1989) 11 ATPR ¶40-932 (the *AMH* case) where the 'readiness for slaughter' of feed lot cattle and fat cattle resulted in separate product markets being found.

144 See for example, the *de Havilland* case (Case IV/M 053) where the significant differences in prices between planes were regarded as an important factor in distinguishing the markets. See also *Nestle/Perrier* (Case IV/M 057) for examination of the differences in pricing between soft drinks and locally sourced spring water. In Australia, see for example, *Re Tooth*, note 140 *supra* where the Tribunal considered, amongst other things, the differences in the price of beer and other alcoholic beverages.

145 See for example, *Digitale/Kienzle* (Case IV/M 057) where different product markets were found for personal, small and medium sized computers on the basis of both end use differences and technical characteristics. In the Australian context, see for eg, the *AMH* case, note 143 *supra*, where markets for 'feed lot cattle' and 'fat cattle' were differentiated on the basis that the latter was intended for 'immediate slaughter', whereas feed cattle required further 'nurturing' before slaughter.

146 Case IV/M 360.

Consumer preferences,[147] and the perceptions of purchasers,[148] are germane to the assessment of the "conditions of competition" test.

Similar factors have also been considered in Australia under the banner of 'structure of supply and demand'. In the *Arnotts* case,[149] the Federal Court focused on the structure of supply of biscuit products, to find a single national market for biscuits. Persuasive were factors relating to the perceptions of industry participants to the existence of a 'general biscuit industry', the fact that retailers recognised a distinction between biscuits and other processed foods by shelving biscuits separately and, most significantly, that "Arnotts" advertised its biscuit product generally, rather than using brand-specific promotions.[150]

Consumer preferences were also emphasised in *Re Tooth*,[151] where the Tribunal rejected an argument that packaged and bulk beer formed part of a general 'alcoholic beverage market'. Instead, it referred to the fact that beer "still has its characteristic times and places of consumption and its devotees",[152] it still formed the 'standard alcoholic drink' in New South Wales and, despite the increased popularity of wines and spirits, it continued to be perceived differently by consumers.

To date, the approach of the Commission and the Australian courts to product market definition has overlapped considerably. Rather than attempting precise quantification of substitutability, they have focused their analysis on historical data which indicates the nature and extent to which substitutability has occurred in the past.[153] Under the Merger Guidelines, the TPC has sought to place increased emphasis on the quantification of substitutability through factors relating to actual costs of switching purchases or production. However, given the difficulties involved in collecting and appraising such information in a meaningful way, it is unlikely that the approach of Australian regulators will change substantially. Moreover, until pre-notification is introduced certain of the evidence relating to price substitutability may not even be admissible in court.[154]

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147 See for example, *Nestle/Perrier* (Case IV/M 190) in which strong emphasis was placed on the degree of consumer and brand loyalty commanded by the bottled source water produced by Perrier; see also *Nestle/Italgel* (Case IV/M 362) where the Commission noted a preference for domestically produced ice cream. However, this decision has been criticised for taking this factor into account as part of the product market definition. Rather, this factor should have been considered in the determination of the relevant geographic market.

148 See for example, *Costa Crociere/ Chargeurs/ Accor* (Case IV/M 334) where the Commission initiated a large survey to determine consumer perceptions of segments within the packaged holiday market.

149 *Arnotts Limited & Ors v Trade Practices Commission* (1990) 24 FCR 313 (the *Arnotts* case).

150 *Ibid* at 333-4.

151 Note 140 supra.

152 *Ibid* at 41.

153 See for example, the *AMH* case, note 143 *supra*, in the Australian context, and *KNP/BT/VRG* (Case IV/M291) under the Merger Regulations.

154 See *Trade Practices Commission v Ansett Transport Industries (Operations) Pty Ltd* (1978) 32 FLR 305 per Northrop J, although compare with the *Arnotts* case, note 149 *supra*.

*(ii) Relevant Geographic Market*

The approach to geographic market definition is very similar. The Merger Guidelines defines the geographic market both in terms of "close" substitutability and price elasticities resulting from a "small but significant" price increase.[155]

The Courts, however, have emphasised the need to define geographic markets to reflect the "commercial realities" of the industry and to represent an "economically significant trading area",[156] although it is acknowledged that there will inevitably be some "inexactitude" as to where the boundaries are drawn.

Form CO to the Merger Regulation defines the relevant geographic market as comprising:

> the area in which the undertakings concerned are involved in the supply of products or services, in which the conditions of competition are sufficiently homogeneous and which can be distinguished from neighbouring areas because, in particular, conditions of competition are appreciably different in those areas.[157]

The Commission has found local,[158] national,[159] regional,[160] community[161] and world[162] markets. The determination of the relevant geographic market has been referred to by the Commission as an "economic and factual"[163] assessment which describes where competition operates.

A comparative table of the factors included in geographic market definition, similarly highlights the overlap in approach under s 50 and the Merger Regulation.

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155 Merger Guidelines at [4.37].

156 V Kalinowski, *Antitrust Laws and Trade Regulation*, Vol 3 as cited in the *AMH* case, note 143 *supra* at 50,091.

157 Section 5, Form CO. It also lists certain factors relevant to the assessment of the market including the "nature and characteristics of the products or services concerned, the existence of entry barriers or consumer preferences, appreciable differences of the undertakings market shares between neighbouring areas or substantial price difference". This definition is consistent with that provided under Article 9(7) of the Merger Regulation which describes referral of 'concentration' to the competent authorities of Member States.

158 Local markets have been found where proximity is crucial to substitutability (see for example, *Promodes/Dirsa* (Case IV/M 027) or *Kingfisher/Darty* (Case IV/M 300).

159 National markets are often characterised by district national consumer habits and brand loyalty. See for example, *Nestle/Italgel* (Case IV/M 362) where an Italian market was found for ice cream due to the consumer preference for Italian-made ice cream. Differences in language and specific nationally based advertising campaigns, have also indicated a national market (see also *Costa Crociere/Chargeurs/Accor* (Case IV/M 223)).

160 See for example, *Rhone Poulenc/SNIA II* (Case IV/M 355) where price differences were not significant at least within western Europe and there was certain interpretation between the markets.

161 Where major producers have a number of plants in each member state, purchasing is effected on a European-wide basis, transport costs within the Union is less than 5 per cent, and a significant part of total sales is made on a cross-border basis, the Commission has found a community-wide market. See for example, *BTR/Pirelli* (Case IV/M 253); *Harrisons and Crosfield/AKZO* (Case IV/M 310).

162 See for example, *Dasa/Fokker* (Case IV/M 237) where the absence of tangible barriers to importation of aircraft into the EU, the negligible transportation costs and the significant mutual interpenetration between, particularly, northern America and Europe, led to a finding that the geographic market was the world. See also the *de Havilland* case (Case IV/M053) where the Commission found that a world market (other than China and eastern Europe) existed.

163 See note 92 *supra* at [236].

**Factors taken into account in Geographic Market Definition**[164]

| | Australian | European Union |
|---|---|---|
| Geographic Distribution of Market Shares | • | • |
| Geographic Location of Major Suppliers | • | • |
| Shipment Patterns | • | • |
| Imports/Exports | • | • |
| Consumer Preferences | | • |
| Transport Costs | • | • |
| Perishability of Product | • | • |
| Regulatory Constraints | • | • |
| Costs of Extending/Switching Production and Distribution Systems | • | |
| Relative Price Levels and Movements of Different Geographic Sources of Supply | • | • |
| Costs of Switching to Alternative Source of Supply | • | Inconsistent |
| Convenience to Customers of Accessing Alternative Sources of Supply | • | • |

In each jurisdiction, particular emphasis has been placed on sales and purchase patterns to determine the geographic market. In *KNP/BT/VRG*[165] the Commission stated that a market for paper manufacturing operations was national as purchasers relied on local distributors for maintenance and service, distribution was organised along national lines and there was a significant difference in pricing between Belgium/Netherlands and Germany which was not explicable in terms of transport costs.

These "patterns" were also examined by the Federal Court in the *Australian Meat Holdings* case.[166] In that case, Wilcox J held that the market for "fat cattle" was northern Queensland as historical sales patterns indicated that negligible sales were made beyond that region. This was largely due to the "bruising" and "loss of condition" sustained by the cattle during transport. The correlation which existed between prices for fat cattle throughout the State of Queensland was not considered persuasive of a State-wide market. Pricing, and relative shifts in pricing, were

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164 Factors set out include those matters set out in the Merger Guidelines at [4.42] and other matters which have frequently been referred to under each jurisdiction. These do not reflect all the factors that have been considered either under s 50 or the Merger Regulation, but indicate some of the more important considerations.

165 Case IV/M 291.

166 Note 143 *supra*.

considered more indicative of seasonal changes and international factors, than of a single market.

Given the size of both Australia and the Union, transport costs and other factors, which constrain the physical supply of goods to customers, have also been used as general indicators for market definition. Central to the Court's finding in *QIW Retailers*[167] was the fact that transport cost per unit cost of product was very high. Such costs made the distribution and sale of wholesale grocery items beyond Queensland and northern New South Wales uneconomic. Additionally, the positioning of separate grocery distribution centres in each state indicated that the distributors perceived that the markets were also approximately state based.

Similarly, the Commission held in *Waste Management International Plc/SAE*,[168] that a market for disposal of non-hazardous waste was likely to be "local". This was based both on the high costs associated with transporting the waste and the stringent regulatory constraints imposed on its removal.

Finally, legal and regulatory barriers have assumed considerable significance in determining the extent of the geographic market. Although in Australia there can be no formal barrier to interstate trade,[169] restraints have still been erected by way of marketing schemes.[170] On the other hand, while regulatory restraints are being removed in the EU, significant barriers still exist due to different national requirements for the operation of certain industries. This was highlighted in *Sanofi/Sterling Drug*,[171] where the market for certain drugs was held to be "national" due to the very tight legal framework under which prescribed drugs operated.

Although there was initial concern that the Commission would err on the side of leniency in defining the geographic market to promote purposes of market integration, this does not seem to be supported by an examination of the cases. Indeed, Sir Leon Brittan cautioned that the opening of markets would take some time, even with the removal of regulatory barriers. Where the Commission has recognised that regulatory barriers will be removed in the short to medium term, this factor has been incorporated into its assessment of "dominance", rather than at the market definition stage.[172]

Neither the Commission nor the Courts have followed the Chicago approach in extending the geographic market definition to include foreign sellers. Only rarely has the market been defined to extend beyond Australia and the EU respectively. This approach has been criticised in Australia as leading to "findings which would be purely formal, devoid of economic content, or indeed commercial common sense".[173] Under the Merger Regulation, there has even been suggestion[174] that the

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167 Note 74 *supra*.

168 Case IV/M 283.

169 Australian Constitution, s 92.

170 See for example, *Victorian Egg Marketing Board v Parkwood Eggs Pty Ltd* (1978) 33 FLR 294.

171 Case IV/M 027.

172 See, for example, *Alcatel/Telettra* (Case IV/M 042).

173 See M Brunt, note 97 *supra* at 115.

reference to "potential competition from undertakings located .... outwith [*sic*] the community" expressly require foreign markets to be included in the geographic market definition.

To date, however, there has only been limited evidence of the Trade Practices Tribunal extending the market wider than Australia.[175]

## B. Threshold Tests

Once the boundaries of the market are defined, the inquiry required by the two regulations diverges. At their most superficial level, a comparison of the two prescriptions raises several points of difference. These relate to (a) the level at which market power will be regulated; (b) the scope of the tests (ie whether incipient market power will also be regulated); and (c) the extent to which efficiency and other non-competition based criteria will be incorporated into the assessment of a potential breach.

This superficial comparison, however, fails to appreciate the fundamental similarities underpinning the regulations. As the centralising theme under both regulations is 'market power', each inquiry will be directed towards its quantification. The differences in threshold relate to the point at which market power will be regulated, while the factors indicate the existence of such power.

### *(i) "Substantial Lessening of Competition" Test - Section 50*

As there has been no judicial consideration of this test in the context of s 50 of the Act, it is still unclear how the courts will assess this threshold.[176] Some legislative guidance as to the assessment of market power is provided by s 50(3) of the Act. This section sets out a list of indicators or merger factors which must be taken into account when determining whether a "substantial lessening of competition" in a market would occur. These factors relate both to the structural and behavioural features of the market.

Notably, all of the factors included in the assessment of "dominance" under the former test, are included within s 50(3). The factors used to identify "dominance"

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174 See for example, GB Dunn, "EC Merger Control and 1992: Can the New Regulation Meet the Challenges of the Common Market?" (1990) 23 *Intl Law & Pols* 115 at 144.

175 See for example, *Koppers/BHP* (1981) 3 ATPR ¶40-203; and *Fletcher Challenge Ltd* (1988) 10 ATPR ¶50-077, where the Tribunal and Court respectively extended the geographic market to a 'quasi-international' market.

176 In an attempt to create a 'consistent' approach to assessing whether the threshold would be reached the TPC has detailed a 'five stage evaluation process' which will be followed in ascertaining whether a substantial lessening of competition arises (see Merger Guidelines at [4.20]).
This process starts with an assessment of the market and is followed by a determination of market structure by reference to certain concentration ratios. If the relevant concentration ratios are satisfied the TPC will consider the effect of import competition, the height of barriers to entry and any other factors indicating the existence of countervailing power in the market. However, the relevance of this evaluation process is limited while pre-notification is a voluntary procedure. Further it is unclear whether the Courts will adopt this approach. It does, however, indicate the process which the TPC will follow in deciding whether to apply for an injunction (assuming the acquisition has not been consummated).

under the former s 50 were enunciated in the *Ansett-Avis* case.[177] In determining these factors, Northrop J drew largely on the jurisprudence of the ECJ,[178] which had considered both the nature and the meaning of "dominance" under Article 86 of the Treaty.[179]

In determining whether a position of dominance could be created or strengthened, the Court looked to: (1) the firms operating in the market and the degree of market concentration; (2) the capacity to determine prices without being consistently inhibited by other firms; (3) the height of barriers to entry; (4) the extent to which product differentiation and sales promotion characterises the products in the market; and (5) the character of corporate relationships and the extent of corporate integration.[180]

The only additional factors listed for consideration under s 50(3) relate to the effect of import competition on the market,[181] the dynamic characteristics of the market and whether a vigorous and effective competitor will be removed. These factors, however, do not indicate a substantial change to the nature of the inquiry. Rather, they indicate a shift of emphasis towards a more dynamic approach to the assessment of market power.

Although the approach to market power analysis is guided by s 50(3), the greater difficulty lies in determining that degree of power which will amount to a "substantial lessening of competition" in a market. Legislative direction on this issue is limited.

Section 4G of the Act defines the phrase "lessening of competition" to include a "reference to preventing or hindering competition". Section 4 states that "competition" includes "competition from imported goods or from services rendered by persons not resident or not carrying on business in Australia". No statutory definition of "substantial" is offered.

As there is no case law which considers the meaning of "substantial lessening of competition" in a market in the context of s 50, reference must be made to decisions under other sections of the Act. However, the illumation provided by these decisions is limited as the courts have taken a divergent approach to the definition of the word "substantial".[182]

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177 Note 154 *supra*.

178 He referred to *United Brands Co v Commission of the European Communities* [1978] 1 CMLR 429 (the *United Brands* case) which considered whether a dominant position had arisen under Article 86 of the Treaty. This Article deals with abuse of dominant positions rather than mergers directly.

179 Article 86 relates to the abuse of a dominant position in a market.

180 These five criteria were adopted by the TPC under its 1986 Merger Guidelines under the former s 50 of the Act: Trade Practices Commission, *Merger Guidelines: A Guide to the Commission's Administration of the Merger Provisions (ss 50/50A) of the Trade Practices Act 1974 (Cth)*, 1986 at 9.

181 This factor has been emphasised as part of the drive to "open" up markets to international competition. See *infra*, concerning import competition.

182 Bowen CJ and Deane J in *Tillmans Butcheries Pty Ltd v The Australian Meat Industry Employees Union and Ors* (1979) 42 FLR 331 (the *Tillmans* case) considered that "substantial" in the context of phrase "substantially lessening competition" under s 45 of the Act, referred to an effect which was real or of substance rather than insubstantial or nominal. See also Lockhart J in *Radio 2UE Sydney Pty Ltd v Stereo FM Pty Ltd*

The debate centres around whether the term should be interpreted quantitatively or qualitatively. If it indicates a quantitative measurement, then the effect on competition would need to be "considerable or big".[183] If, however, a qualitative interpretation is adopted, the "lessening of competition" would only need to be "real or of substance rather than insubstantial or nominal".[184]

On balance, it seems that the latter interpretation will be favoured in the context of s 50.[185] This interpretation was adopted in both the Explanatory Memorandum to the Trade Practices Legislation Amendment Bill 1992[186] and the Merger Guidelines.[187]

Unlike the Merger Regulation, the test under s 50 extends beyond those acquisitions which would result in a "substantial lessening of competition". Section 50 also includes acquisitions which would be "likely" to produce that result. The Federal Court[188] has held that the term "likely" relates to "probable effects rather than possible or speculative effects". [189] Additionally, a temporal limitation is imposed to require that the "effect" occurs within the "foreseeable future".[190]

Accordingly, the "substantial lessening of competition" test may signal more of a quantitative, than qualitative, change. The TPC has indicated a strong commitment to enforcing these provisions particularly in areas where there is limited import competition. This approach has already been illustrated in the TPC's successful challenge of the Rank/Coles Myer bid for Foodlands. How the courts will react to this approach is still unclear.[191]

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(1982) 62 FLR 437. Compare with *Cool and Sons Pty Ltd v O'Brien Glass Industries Pty Ltd* (1981) 3 ATPR ¶40-220.

183 See *Palser v Grinling* (1948) AC 291 at 317, per Viscount Simon.

184 See note 182 *supra.*

185 See *Trade Practices Commission v Arnotts Ltd & Ors* (1990) 12 ATPR ¶41-002, Beaumont J adopted the reasoning in the *Tillmans* case, note 182 *supra*, in the context of the former section 50 of the Act in holding that "substantially" suggests a degree of strengthening that is real or of substance and not insubstantial or nominal. This was affirmed in the full Federal Court in the *Arnotts* case, note 149 *supra.*

186 *Explanatory Memorandum*, Trade Practices Amendment Bill 1992 at [12].

187 Merger Guidelines at [4.6]. This endorsement was somewhat qualified by Senator Tate, the then representative for the Attorney-General, who stated that the "Government intends that the test should apply to effects upon competition which are not merely discernible but which are material in a relative sense in the impact that they may have upon effective competition in the marketplace": see Australia, Senate 1992, Second Reading Speech, vol S 20, p 4766. However, R Baxt has suggested that a court may not even consider these extraneous materials in view of the similarities in the language of the statute to other provisions, and the list of factors set out in s 50(3). If so, the balance of case law would probably point to an interpretation meaning "real or of substance": see R Baxt "A Close Look at s 50 of the Trade Practices Act: Substantial Lessening of Competition", presented at Trade Practices Workshop, 16-18 July 1993, p 13.

188 See the *Tillmans* case, note 182 *supra* at 339, per Deane J and at 339, per Bowen CJ, noting, however, that this decision was made in the context of section 45 of the Act.

189 The *QMCA* case, note 80 *supra* at 17, 243. The phrase was there considered in the context of the authorisation provisions which refer to conduct "likely to result in a substantial benefit to the public".

190 *Ibid.*

191 The TPC successfully sought an ex parte interim injunction against Coles Myer Limited, Rank Commercial Ltd (and others) to restrain the lodging of a Part A Statement with the Australian Securities Commission. Beaumont J found that as approximately 75 per cent of Western Australian grocery retail outlets would fall under the control of Coles Myer if the takeover were successful, there was a "serious question" to be tried.

*(ii) Dominance Test under the Merger Regulation*

The threshold test under the Merger Regulation not only requires that a position of "dominance" be created or strengthened, but also that "effective competition" in the Common Market be significantly impeded.

Although the concept of "dominance" has received much judicial consideration under Article 86 of the Treaty, this analysis cannot be directly applied to the test under the Merger Regulation. Sir Leon Brittan, the then Commissioner for Directorate General IV,[192] stated that the threshold used by the Merger Regulation was different from the "dominance" threshold under Article 86, as it established the additional requirement that effective competition be impeded. Thus it "marked the beginning of a new legal development".[193]

This legal development has evolved through the Commission's own case law as no cases (on this point) have yet been considered by the ECJ. Accordingly, it is to the Commission's decisions that reference must be made.

A "dominant position" has been found by the Commission where "... the new entity could act to a significant extent independently of its competitors and customers".[194] In assessing "independence", reference must be made to Article 2 of the Merger Regulation which provides a series of factors for consideration. These factors relate to the assessment of both structural and behavioural conditions within a market, and converge with those provided under s 50(3) of the Act (see comparative table below).

Similarly, however, these factors do not indicate the *degree* of "independence" which the firm must exhibit before a position of dominance would be created or strengthened.

In the *de Havilland* case,[195] the Commission found that a sufficient degree of "independence" would have been attained by the merging firm in the "40-60 seat" commuter market, as the firm would have held over 72 per cent of that market, its nearest competitor would have held only 22 per cent of the market and provided very limited competition, and that the countervailing power held by buyers was relatively weak as they were "locked in" to a particular vendor once they had purchased one or more of its fleet.

In the *Renault/Volvo* case,[196] the Commission linked the concept of "independence" to the ability to "raise price without losing market share". Although a price-based analysis was introduced, this advanced the practical

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Even Coles Myer had acknowledged that the takeover would raise a serious question in relation to a breach of s 50 (although this was not conceded by interests associated with Mr Hart). Notably, the Court required that the case be heard within two months of the interim injunction. Notwithstanding, Coles Myer/Rank withdrew their takeover bid. See *Trade Practices Commission v Rank Commercial Ltd; Coles Myer Ltd and Ors* (Federal Court, Beaumont J, 12 July 1994).

192 This is the Department which deals with Competition Policy.

193 L Brittan, note 91 *supra*, p 36.

194 See the *de Havilland* case (Case IV/M 053) at [51].

195 *Ibid.*

196 Case IV/M 004.

assessment of "independence" only marginally as accurate calculations of price-elasticities are very difficult.

The second part of the threshold has been interpreted to introduce a temporal dimension to the finding of "dominance":

> In general terms, a concentration which leads to the creation of a dominant position may however be compatible with the Common Market ... if there exists strong evidence that this position is only temporary and would be quickly eroded because of high probability of strong market entry. With such market entry the dominant position is not likely to significantly impede effective competition within the meaning of Article 2(3) of the Merger Regulation.[197]

This approach was also adopted in *KNP/BT/VRG.*[198] There, a "significant impediment" to competition would have arisen as the dominant position of the merging firm would not have been eroded quickly.[199]

The test has been used thus far to emphasise a more dynamic appraisal of markets and market power. Additionally, it may provide a *de minimis* argument to parties where, for example, the "strengthening" of the "dominant" position is small. However, whether this interpretation will be accepted, is unclear.

Finally, although expressed as a separate requirement under the Regulation, the Commission has tended to consider this requirement alongside its assessment of "dominance". As it is integral to the question of 'market power', similar considerations arise under each analysis.[200]

## C. Merger "Factors" Considered under Section 50 and the Merger Regulation

The factors which are considered in the assessment of market power largely derive from s 50(3) of the Act and Article 2 of the Merger Regulation. The former expressly provides that the Court is not limited to the factors listed in s 50(3). Article 2 is not as clear. However, the Commission has not considered the factors in Article 2 exclusively, and has employed a range of other factors where appropriate.

In balancing the relative importance of information provided by these inquiries, each of the Courts and the Commission have stressed factors relating to "barriers to entry" and "market concentration". Increasingly, however, the focus is shifting towards a more dynamic analysis of the market, where the behaviour of firms within the market is being scrutinised more closely.

The following table indicates the factors considered in assessing "dominance" under the former s 50, "dominance" under the Merger Regulation and "substantial lessening of competition" under the current s 50. The listed factors are those set out under s 50(3) of the Act.

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197 The *de Havilland* case (Case IV/M053).

198 *KNP/BT/VRG* (Case IV/M 291).

199 *Ibid* at [30].

200 See FL Fine, "The Substantive Test of the EEC Merger Control Regulation: The First Two Years" (1993) 61 *Antitrust LJ* 699 at 705-6.

| **Australia** Factors listed under s 50(3) for finding of "Substantial Lessening of Competition" | **Australia** Factors considered in finding of "Dominance" under former s 50 of the Act | **European Union** Factors considered in finding of "Dominance" under Article 2 of the Merger Regulation |
|---|---|---|
| Actual and Potential Level of Import Competition in a Market | | • |
| Height of Barriers to Entry | • | • |
| Level of Concentration in the Market | • | • |
| Degree of Countervailing Power in the Market | • | • |
| Likelihood that Significantly and Sustainable Increase Prices of Profit Margins | • | • |
| Extent to which Substitutes are Available | • | • |
| Dynamic Characteristics of Market | | • |
| Removal of Vigorous and Effective Competitor | | |
| Nature and Extent of Vertical Integration | • | • |

Although it is beyond the scope of this article to consider each of the criteria in detail, those areas in which notable divergences occur between the two regulations or which reflect a particular adoption or deviation from Chicago School analysis, will be considered.

*(i) Market Shares*

Determination of market concentration has traditionally been considered first in the analysis of market power and has been emphasised as an important factor in both Australia and the EU. [201].

Under the old "dominance" test in Australia, a generally applied minimum threshold of 45 per cent was used to infer a position of dominance.[202] No judicial

201 The relevance of market share data will also be referable to the manner and consistency in which such data has been collected. Accordingly, measurement of market shares has been prescribed under [4.49] of the Merger Guidelines, as requiring calculations on "both a volume and a value basis" particularly where there is considerable product differentiation.

Although not specifed under the Merger Regulation, the Commission has adopted a similar approach. In *Nestle/Perrier* (Case IV/M190), where there was a significant degree of product differentiation due to brand loyalty and considerable advertising, both volume and value measurements were used to assess market shares. Other factors have also been used by the Commission including, in the *de Havilland* case (Case IV/M053), the number of aeroplane seats owned. Merger Factor (c) of s 50(3) directs attention to the "level of concentration in the market", while Article 2 lists as its first factor the "structure of all markets concerned".

direction has yet been made to guide the determination of a minimum market share threshold in the context of the new section 50 test. However, the TPC has proposed the introduction of a "concentration ratio" which will indicate those mergers which are "unlikely to give rise to any competitive concerns".[203] The TPC will generally investigate the potential effects on competition only where:

> The merger will result in the four largest firms having a market share of 75 per cent or more and the merged firm having a market share over 15 per cent, or if the four largest have less than 75 per cent, and the merger will result in the merged firm having 40 per cent or more ...[204]

In relation to the level at which single firm market power will be assessed, the approach is largely consistent with the old "dominance" threshold as applied in Australia, and has attracted little criticism (notwithstanding that it falls well below the 60-70 per cent "acceptable" threshold advocated by Bork).[205]

The threshold in relation to collective dominance, however, has been the subject of considerable debate. Under the old "dominance" test there was considerable doubt as to whether the section extended to regulate oligopolistic dominance. While this doubt has now been removed, the threshold level of 15 per cent has been more controversial. Further, the considerable gap between the percentage thresholds of single firm and concentrated market shareholdings has been criticised.

As the Guidelines are still in draft form, these thresholds may not be maintained. Indeed, the Commissioner of the TPC, Professor Fels, has acknowledged that the 15 per cent market share for a merged firm in a concentrated market is too low but suggested that "it would be a rare situation in which the Commission wished to challenge a merger which created a firm with a market share below 15 per cent".[206] He has also recognised that there may be a "potential problem" with respect to the "gap" between single and collective dominance thresholds and "is looking again at this issue".[207]

Ironically, the introduction of such ratios could increase the emphasis that may be placed on structural considerations by the TPC. The Guidelines provide that the role of these "bright lines" are only designed to indicate which mergers would not usually be challenged. However, their role is more significant. Where the ratio is

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202 Under the 1986 Guidelines for the Merger Provisions of the *Trade Practices Act* 1974, the Commission stated that "it can be expected to inquire into all mergers where the outcome will be that the acquirer will have a share of the relevant market of 45 per cent or more and will be the largest competitor in the market, or will be the largest competitor and have a market share exceeding that of its nearest competitor by 15 per cent or more. In determining whether an already dominant firm is likely to strengthen its ability to dominate a market substantially as a result of a merger, the Commission will as a general rule investigate the merger if as a result of a merger, the market share of the dominant firm is likely to increase by 10 per cent or more".

203 Merger Guidelines at [4.22].

204 Merger Guidelines at [4.52].

205 Note 6 *supra*.

206 A Fels, "The Draft Merger Guidelines of the Trade Practices Commission", presented at *Trade Practices Workshop*, Canberra,16-18 July 1993, p 76.

207 *Ibid*, p 77.

reached, the onus is shifted onto the parties to convince the TPC that a "substantial lessening of competition" will not result.[208]

By contrast, the only reference to market share thresholds under the Merger Regulation is in the Recitals to the Regulation. Recital 15 states that where the market share of the "undertakings concerned does not exceed 25 per cent" such concentrations are not liable to impede effective competition. Although the recital is not binding law, it seems to have been followed by the Commission.

This threshold raises several questions. In the context of single firm dominance, it falls well short of the 40-45 per cent "dominance" threshold established by the ECJ under Article 86 of the Treaty.[209] Further, it sheds little light on the level at which oligopolistic dominance will be inferred. This is now of particular relevance given that the Commission has held that the Merger Regulation extends to the creation or strengthening of collective dominance.[210]

The analysis of market share data at the Commission level has provided even less illumination. While the Commission has stated that "a very high market share in a market could indicate that a dominant position exists",[211] the traditional 40-45 per cent "dominance" threshold referred to in the *United Brands* case[212] seems less relevant under the Regulation. Market shares ranging from below 40 per cent up to 90 per cent have not necessarily indicated dominance.[213]

Jones and Diaz[214] have attempted to group levels of market shares[215] to indicate when an inference of "dominance" may arise. However, they have concluded that

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208 *Ibid.*

209 The *United Brands* Case, note 178 *supra*. Note however, that this level was determined in the context of Article 86 of the Treaty which deals with abuse of a dominant position.

210 See *Nestle/Perrier* (Case IV/M 190). This finding may still be subject to challenge in the ECJ. Until such time, the Commission's interpretation of the width of the Regulation will apply.

211 *Alcatel/Telettra* (Case IV/M 018) at [38].

212 Note 178 *supra*.

213 For example, the following post merger market shares did not lead to a finding of dominance: *Alcatel/Telettra* (Case IV/M 018) 83 per cent post merger share in the Spanish telecommunications market; *Accor Wagons-Lits* (Case IV/M 126) 51 per cent in German contract group catering market, 58 per cent in French motorway catering market and 89 per cent in French motorway catering of light meals; *Nestle/ Perrier* (Case IV/M 190) 82 per cent of total French bottled water market by value (jointly held with BSN); and *Mannesman/Hoesch* (Case IV/M 222) over 60 per cent in German market for steel/gasline pipes.

214 C Jones and E Gonzalez-Diaz, *The EEC Merger Regulations*, Sweet & Maxwell (1992).

215 Summarising their findings:

1. Below 25 per cent of the relevant market - it is almost inconceivable that a finding of dominance occurs.
2. Between 25 per cent and 39 per cent of the relevant market - finding of single firm dominance rare but not excluded (Commission of the European Communities, *IXth Report on Competition Policy*, Office for Official Publications of the European Communities, 1980 at [22]), although would need many very small and ineffective competitors to make up the rest of the market and high entry barriers.
3. Between 40 and 69 per cent of the relevant market - most findings of dominance fall within this range - depending on importance of actual and potential competitors of merging firms (Commission of the European Communities, *XIXth Report on Competition* Policy, Office for Official Publications of the European Communities, 1990 at [150].
4. 70 per cent and above of the relevant market - very strong indication of dominance, however already clear from Commission's decisions that even in such cases other factors may outweigh this indication: *ibid* at 133-4.

such groupings do not provide any real correlation between market share and the Commission's findings of "dominance" under the Merger Regulation.

This could be the result of a combination of factors. First, it is arguable that the threshold test calls for a more dynamic assessment of market power, given that a "significant impediment to competition" must be shown to exist. Secondly, the Commission has emphasised the importance of factors outside market concentration data, even to the extent that a market share of over 89 per cent has not resulted in a finding of "dominance".[216] Finally, this approach may indicate an implicit recognition by the Commission that market power calculations may be overstated given the relatively narrow approach adopted towards market definition. Certainly this approach would be favoured by Chicago School thinking which emphasises the use of behavioural factors in determining market power.

Generally, however, market share data has provided greater guidance under the Regulation where it has been used comparatively or examined over an extended period. Where a gap between the market share of a merging firm and its largest competitor exceeds 20 per cent, this has generally led to an inference of "dominance" under the Merger Regulation.[217] This factor was also considered relevant in the Australian case of *Arnotts* as the gap in respective market shares of Arnotts and its nearest competitor would have exceeded 52 per cent. This factor, however, has not been expressly referred to under the Guidelines.

Moreover, where a high market share has been maintained consistently over a period of time, such evidence has been accepted as a persuasive indicator of market power.[218] The Merger Guidelines categorises such market share as constituting a high barrier to entry.[219]

Conversely, volatility in the respective market shares of competitors has been taken to indicate greater competition in the market. Where such volatility is

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216 This is supported by reference to cases such as *Alcatel/Telettra* (Case IV/M 018) where a shareholding of over 89 per cent of the relevant market was offset by the deregulation of the market and the countervailing power of the main buyer in the telecommunications industry.

217 In *Magneti/CEAc* (Case IV/M 043) the fact that the gap in market share between the merged firm and the next largest rival would be 40 per cent was highlighted as a real indicator of market power. In *Varta/Bosch* (Case IV/M 012) a gap of 25 per cent between the merged firm's market share and its competitors was viewed as "considerable". Stated as "important" was the gap between the 50 per cent market share of the new firm in the *de Havilland* case (Case IV/M 126) and the 19 per cent market share of the closest competitor. See also *Accor/Wagons-Lits* (Case IV/M 126 at [17] and [25]) in relation to group catering markets in Germany and Spain; *Nestle/Perrier* (Case IV/M 190 at [72]) in the context of bottled source water; and *Du Pont/ICI* (Case IV/M 214 at [32]) referring to fibres for carpet.

218 See the *Arnotts* case, note 149 *supra*, where the court found that its dominant position had never effectively been challenged. See also the *de Havilland* case (Case IV/M 053) in the context of the Merger Regulation. Although see the approach taken by the European Court of Justice in the *Hoffman-La Roche and Co AG v Commission* (Case 85/76) [1979] ECR 461) where the Court rejected the Commission's conclusions in relation to the maintenance of market share, holding that it was a neutral factor which could be the result of competition, the conduct of the firm or due to other factors.

219 Merger Guidelines at [4.45].

evidenced, less significance is accorded the current degree of market power or the firm.[220]

Imports have been included in the calculation of market share under the Merger Guidelines.[221] Indeed, a high market share is likely to be offset by evidence of effective international competition. While imports are also factored into the market share calculation under the Regulation, the degree of emphasis that has been placed on this aspect does not seem as great.

The market share of a firm is not regarded as dispositive of market power under either s 50 or the Merger Regulation. Indeed, due to the wide range of acceptable market share holdings, it is arguable that market share is given even less weight under the Regulation. Market shares are used in each jurisdiction as a starting point only.

*(ii) Barriers to Entry*

This is one of the clearest areas in which both regulations strongly depart from the Chicago approach.

Unlike the analysis proposed by Stigler,[222] each jurisdiction has adopted a wide definition of factors which may constitute a "barrier to entry".

In the Australian decision of *Arnotts,*[223] the Full Federal Court defined "barriers to entry" as those "which confront the entry of a new firm into the market or barriers that confront an existing firm seeking to increase its market share".[224] Although an element of "asymmetry" between the costs borne by the entering firm and the costs of the incumbent was recognised, the Court still found that barriers to entry arose as a result of: blocked access to the market through high market shares;[225] the need for considerable capital to compete "across the range" of Arnotts products; the competitive advantages of Arnotts resulting from its economies of scale and scope; product differentiation through significant advertising and brand loyalty; and legal restraints. Even the difficulty of procuring supermarket shelf space was considered a barrier, and historical evidence suggesting a general lack of willingness to compete with Arnotts across the full range of products was taken as further evidence of its market power.

The Commission has adopted a similar analysis in assessing the existence of "barriers to entry". In *KNP/BT/VRG* two large paper and packaging manufacturing operations were to merge. The Commission considered that a "dominant position" would have arisen on account of the high barriers that existed in the market and the relatively ineffective competitors which operated in the market. The "barriers to entry" which were found by the Commission related to:

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220 See F Fine note 200 *supra*. Although see *Du Pont/ICI* (Case IV/M 214) where the Commission still found dominance where the market share of Du Pont had been declining.

221 See Merger Guidelines at [45]. For further discussion of the role of imports see *infra* concerning import competition.

222 See note 52 *supra*.

223 Note 149 *supra*.

224 *Ibid* at 338.

225 The market share of Arnotts was 65 per cent in this case.

the need for extensive local service networks (as demanded by purchasers of printing presses); the wide product range which needed significant investment and time to reproduce;[226] considerable brand name awareness and loyalty associated with the product range; the ability to sell machines into a second hand market due to the associated "quality" of the brand; and constraints on customers switching from the merging firm to another firm due to the "lock-in" effect from ongoing maintenance requirements. The Commission even held that a "qualified team of staff" constituted a "barrier to entry" as it was difficult to find and train such personnel.

Other barriers recognised by the Commission have included the maturity of the market[227] and the cost of entry, even where there was little asymmetry in entry costs.[228] In *Nestle/Perrier*,[229] it was suggested that transport costs represented a "barrier to entry". Curiously, this factor may have been counted twice - once at the market definition level and once at the level of determination of market power. This approach would lead to both a narrower market definition and an artificially high estimation of market power.

*(iii) Potential Competition*

The constraining effect on market power from potential competitors relates to the time and basis on which a competitor can enter the market.

The effect of high barriers to entry has been displaced where "effective entry" is likely to occur. Under the Merger Guidelines such entry is defined as that "which is likely to occur within a two year period".[230] Under the Regulation, the Commission has adopted varying formulations[231] but has generally required that entry be "quick and effective".[232]

Additionally, a potential competitor will only be regarded as effective if the entrant can provide a comparable product range to the merging firm. In *Du Pont/ICI*,[233] the Commission discounted arguments in relation to potential competitors as it held that in the short to medium term, competitors were unlikely

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226 In this regard see *Du Pont/ICI* (Case IV/M 214) where it was recognised that the width of Du Pont's product range could not be readily produced both due to timing and considerable investment in research and development.

227 See *Nestle/Perrier* (Case IV/M 190) where there was found to be considerable excess capacity and no significant prospects for growth in the market.

228 See the *de Havilland* case (Case IV/M 053), where the cost of entry into the civilian or military helicopter market was considerable.

229 Case IV/M 190.

230 Merger Guidelines at [4.59].

231 For example in *Nestle/Perrier* (Case IV/M 190) the Commission stated that entry would have to occur within a short enough time period to deter the firms from exploiting their market power and would "quickly and effectively constrain" a price increase/ maintenance of supra-competitive pricing. While in *Accor/Wagons-Lits* (Case IV/M 126) potential entry was required only to be "possible, likely and successful". Finally, in the *de Havilland* case (Case IV/M 053) the Commission suggested that there must be "strong evidence of high probability of strong and quick market entry" and the question to be answered was whether there was "realistic significant potential competition in the commuter markets in the foreseeable future".

232 See *Nestle/Perrier* (Case IV/M 190).

233 Case IV/M 214.

to be able to develop a sufficiently broad product range due to the degree of research and development required. A similar argument was also developed by the Court in relation to the costs associated with competing "across the board" against Arnotts.[234]

*(iv) Vertical Integration*

Each merger regulation directs attention to the effects on market power arising through vertical integration.[235]

Notably, in the *Queensland Wire* case Mason CJ and Wilson J relied on the decision of the ECJ in the *United Brands* case to conclude that "[a]nother indication of market power ... is vertical integration".[236] However, this statement was qualified to the extent that "... its presence does not necessarily mean that a substantial degree of power exists".[237]

Generally, the effects of vertical integration have not been considered sufficient to give rise to a finding of market power under the Merger Regulation. Where other firms in the market are similarly integrated, the Commission has found that the presence of at least one non-vertically integrated supplier is sufficient to ensure that the market was not foreclosed.[238]

*(v) Import Competition*

In view of the objectives for micro-economic reforms in Australia and the reductions in tariff protection, the TPC has emphasised the importance of import competition in determining market power. This emphasis proceeds on the assumption that overseas firms may often derive considerable cost advantages due to economies of scale not readily available to Australian firms.

In the most recent TPC statement, "Outlook '94-'95",[239] the Commission has stated that "[i]n the traded goods sector, the presence of international competitors makes it less likely that a proposed merger would result in a substantial lessening of competition".

Paragraph 4.56 of the Merger Guidelines sets out the types of information to which the TPC will refer in assessing the effects of import competition. Two significant areas of inquiry relate to whether consistent inhibition of domestic suppliers exists through import suppliers or whether imports can provide close substitutes for the product without significant investment in sunk costs.

In the recent CSR Authorisation Application, the TPC found that import competition did not have a significant effect in inhibiting domestic suppliers as the imported price could only act as a "cap" and not as a "competitive constraint" on

234 The *Arnotts* case, note 149 *supra.*
235 See s 50(3)(f) of the Act and Article 2(1)(b) of the Merger Regulation.
236 The *Queensland Wire* case, note 75 supra; the *United Brands* case, note 178 *supra.*
237 The *Queensland Wire* case, note 75 *supra.*
238 See *Continental/Viag* (Case IV/M 026).
239 Trade Practices Commission, *Outlook '94 - 95'*, AGPS (1994) p 15.

CSR. This was the result of existing tariffs which increased the importers' wholesale price above the competitive market level.

Potential levels of import are assuming increasing significance in the Commission's analysis, especially where imports are likely to be supplied by the Eastern European markets. However, the Commission has required that the opening of markets to imports or competition must be fairly imminent before their effects will be assessed.[240] Significantly, however, the specific reference to effects of international competition on the Common Market, which appeared in Article 2(1)(a) of the January 1989 Draft of the Merger Regulation, was removed before the final Merger Regulation was passed.

*(vi) Dynamic Characteristics of a Market*

In the recent TPC consideration of the *New World* case,[241] particular emphasis was given to the "dynamics" of the Pay-TV market to displace otherwise strong inferences of market power. In this case, the TPC was required to consider (for the purposes of the *Broadcasting Services Act* 1992 (Cth)) whether the allotment of a satellite Pay TV licence to New World would create a "substantial lessening of competition" in the market as defined under s 50 of the Act.

New World already controlled a substantial number of MDS licences which enabled it to establish a limited Pay TV service in certain capital cities of Australia. Although this did not constitute a national Pay TV service, it nonetheless gave the company an important "foothold" in the embryonic Pay TV market in Australia. In addition, the allotment of a satellite licence would have clearly consolidated New World's position in the Pay TV market. At the stage of referral to the TPC, no other person held significant interests in MDS licences, although a second satellite Pay TV licence was due to be allocated to a non-associated party.

The TPC examined a number of different factors which gave rise to an inference of market power. Most significant were: (a) that there was only to be one other actual competitor in the satellite Pay TV market; (b) that the market (although not finally determined) would not be open to potential or import competition until at least 1997 when regulatory barriers to entry would be removed; and (c) that substantial economies of scope could be achieved by New World by holding both satellite and MDS licences (where the economies were regarded as 'barriers' and not 'efficiencies').

Notwithstanding these factors, the TPC held that no "substantial lessening of competition" would occur, even if the narrowest definition of market was drawn. Due to the rapid growth of the Pay TV market in Australia and the likelihood of changes in technology and new competitors in the market, the TPC decided that no

240 See *Mannesman/Hoesch* (Case IV/M 222) where the German market for steel gas pipelines was opening to imports due to a greater demand on account of German re-unification; see also *British Airways/TAT* (at [22]) and *Henkel/Nobel* (at [17]); see also *Thorn/EMI* (at [29]).

241 *New World Telecommunications Pty Ltd* (1994) 16 ATPR (Com) ¶55-101.

"substantial lessening of competition" would occur for any sustained period. A "watching" brief would, however, be maintained by the TPC in the event of further acquisitions or alliances.

Under the Merger Regulation, the Commission applied similar reasoning to the proposed acquisition of a company which would have controlled over 89 per cent of the Spanish telecommunications market. In finding that a dominant position would not be created or strengthened, the Commission referred to the imminent deregulation of the telecommunications market in Spain, which would leave it open to international competition.[242] By allowing the merger to proceed, arguably the Commission enabled a larger and potentially more internationally competitive company to emerge. Whether this ground has been used to further market integration objectives, however, is unclear.

*(vii) Monopsonistic Power*

Where monopsonistic power may be exercised in a market, this has been regarded as a significant factor in offsetting market power. It has been central to the Commission's decisions in several cases.[243] Monopsonies have been more effective in constraining market power where there are several sources of supply. In *Viag/Continental Can*,[244] "buyer power" was held to present considerable countervailing power where 60 per cent of the market sales were made to five buyers.

In Australia, paragraph 4.62 of the Merger Guidelines suggests that countervailing power will be "particularly significant where the firm is dependent on a small number of buyers who are subject to competitive restraints in their own output market".

*(viii) Ability to Significantly and Sustainably Increase Prices or Profit Margins*

This factor has been referred to by the Commission in providing alternate explanations for market power under the Regulation.[245]

It is the principal factor under s 50(3) which deals with the "conduct" of a firm. However, two difficulties arise in the analysis of this criterion. Northrop J in *Ansett- Avis*,[246] referring to the opinion of the ECJ in the *United Brands* case, confirmed that the "profitability" of a firm is of no real assistance in determining dominance, as profitability is not necessarily comparable between firms due to different accounting procedures.

Unlike the Commission, the Australian courts will not accept expert or survey evidence if it is directed to the question which the court must ultimately

242 Of equal if not greater importance was the countervailing market power held by the largest buyer in the market.

243 See *Alcatel/Telettra* (Case IV/M 018); *Viag/Continental Can* (Case IV/M 026) and *Alcatel/AEG Kabel* (Case IV/M 61).

244 Case IV/M026.

245 See *Renault/Volvo* (Case IV/M 004) where the Commission suggested that a firm would be able to behave independently of competitors and consumers where it was able to raise price on a significant and sustainable basis at [14].

246 The *Arnotts* case, note 149 *supra*. See the *Ansett* case, note 154 *supra*.

determine.[247] This provides an important difference in terms of the types of information which may be presented under the Act and the Merger Regulation. This type of evidence may, however, be presented to the TPC for consideration under an application for authorisation proceedings.

*(ix) Public Interest Factors*

Perhaps the most fundamental distinction between the approaches of the two regulations is in relation to the incorporation of 'public benefit' factors in assessing degrees of market power.

Section 50 refers only to "competition-based" inquiries in assessing whether the requisite degree of market power has been reached. This is consistent with the availability of an authorisation procedure which expressly weighs whether the proposed acquisition would result in "such a benefit to the public that the acquisition should be allowed to take place."[248]

By way of contrast, the Merger Regulation refers to two factors which could invoke 'public interest' matters. These considerations relate to the "interests of intermediate and ultimate consumers" and the development of technical and economic progress provided that it is "to the consumers' advantage and does not form an obstacle to competition".

The latter consideration, relating to technical and economic progress, was included as a political concession,[249] and has been interpreted narrowly giving weight to competition policy considerations only.[250] Although there has been some suggestion that it could provide the basis for an efficiency or "failing firm"[251] defence, neither has been developed under the Commission's case law.[252]

At a textual level, it is debateable whether there is no room for such defences, on the basis that if a dominant position were found, the efficiencies would not offset that obstacle to competition.

Moreover, the Commission has often regarded alleged "efficiencies" as being evidence of increased market power rather than features of technical or economic progress. In *AT&T/NCR*,[253] the Commission concluded that an alleged cost savings, resulting from a merger, would only increase the dominant position of the firm, especially where the cost savings are maintained by the firm. Similar

247 The *Arnotts* case, note 149 *supra*.

248 Section 90(9) of the Act.

249 See Part III *supra*.

250 See the *de Havilland* case (Case IV/M 053).

251 In the *de Havilland* case it was argued that although de Havilland would not immediately be liquidated, their production may be phased out in the medium to longer term. The Commission did not respond directly to the issue of whether Article 2 could provide such defence, but found in the circumstances of this case that no such argument could succeed: *ibid* at [31].

252 In relation to an efficiency defence, it has been argued that it is not available on a textual analysis as if a dominant position were found, efficiency would not be relevant.

253 *AT&T/NCR* (Case IV/M 009).

analysis was applied in *de Havilland*,[254] although in that case the cost savings were so small that they were regarded as negligible.

The Commission has not provided much guidance in relation to the type of factors that may be taken into account under the Merger Regulation in assessing the interests of the "intermediate and ultimate consumers". In a broadly analogous provision, Article 85(3) of the Treaty,[255] the Commission has interpreted the scope of these interests widely.

Benefits to consumers have not been limited to price reductions.[256] Such benefits as availability of a new product and increased sources of supply,[257] improved services[258] and greater stability in terms of quantities supplied and prices charged, have all been recognised.[259]

The time frame over which such benefits can be secured need not be immediate, especially where they derive from longer term rationalisation or reconstruction.[260] Additionally, the Commission will be interested in whether the benefits resulting from the merger will be passed on to consumers or retained by the undertakings concerned.[261]

It is suggested that "[i]n view of the broad concept of consumer benefit employed by the Commission, it should not be difficult to establish that merger benefits also accrue to ultimate consumers".[262] Yet these cases have not been decided under the Merger Regulation. If a similar approach is taken, these benefits will clearly be wider than the benefits recognised by the TPC under the authorisation provisions.

From a comparative viewpoint, the most significant feature is the point at which such considerations are included. Whereas 'public benefit' factors are taken into account in determining market power under the Merger Regulation, these factors are largely irrelevant to s 50 of the Act.[263] Public benefits are not balanced by the Court, but by the TPC under Part VII of the Act, if authorisation is sought.

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254 The *de Havilland* case (Case IV/M 053), where the Commission found that the alleged "efficiency" from the resulting increase in product range could add to the potential dominance of the firm through the achievement of economies of scope.

255 This Article broadly deals with arrangements which have the effect of restricting, lessening or hindering competition. However, it contains a public interest exemption where it is justified.

256 The comments in this discussion arise largely from the observations of M Afonso, "A Catalogue of Merger Defenses Under European and United States Antitrust Law" (1992) 33 *Harvard Intl LJ* 1 at 29.

257 See *Optical Fibres* (1986) OJ L/236/30, in TA Downes and J Ellison, *The Legal Control of Mergers in the European Communities*, Blackstone Press Ltd (1991).

258 See *DeLaval/Stork* (1977) OJ 215/11: *ibid.*

259 See *Carbon Gas Technologie* (1984) OJ L376/17: *ibid.*

260 See M Afonso, note 256 *supra* at 29 where she refers to the Commission decision of *ENI/Montedison* (1987) OJ (l5) 13 at [33].

261 See BE Hawk, *United States, Common Market and International Antitrust: A Comparative Guide*, Law and Business Inc (1990).

262 M Afonso, note 256 *supra.*

263 Note 74 *supra*, per Drummond J.

In Australia, Professor Fels described the authorisation procedure as providing "the framework for considering the combined effect of multiple market failure on overall economic efficiency".[264]

An otherwise anti-competitive merger may be authorised where the TPC "is satisfied in all the circumstances that the proposed acquisition would result, or be likely to result, in such a benefit to the public that the acquisition should be allowed to take place".[265]

Section 90(9A) of the Act states that the Commission must consider an increase in the real value of exports and a significant substitution of domestic products for imported goods as benefits to the public. All other matters relating to international competitiveness of Australian industry must also be considered in the balancing process.[266]

In the *QCMA* case, the Tribunal outlined the meaning of a "public benefit". It proposed a very wide test, stating it would not:

> ... rule out of consideration any argument coming within the widest possible conception of public benefit. This we see as anything of value to the community generally, any contribution to the aims pursued by the society including as one of its principal elements (in the context of trade practices legislation) the achievement of the economic goals of efficiency and progress.[267]

Additionally, the Commission guidelines to Authorisation sets out a wide series of factors which represent a benefit to the public.[268] Apart from factors relating to efficiency and enhancement of international competitiveness, a public benefit includes the promotion of industrial harmony, increased employment opportunities and even dissemination of consumer information.

The width of these benefits has recently narrowed. Professor Fels now suggests that:

> The dominant criterion in assessing public benefit is economic efficiency, but in some cases other factors such as regional employment considerations have been taken into account.

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264 A Fels and J Walker, "Competition Policy and Economic Rationalism" presented at a Melbourne University conference on *Economic Rationalism? Economic Policies for the 90s*, 16 February 1993.

265 Section 90(9) of the Act.

266 Although the *Explanatory Memorandum*, Trade Practices Amendment Bill 1992, note 185 *supra*, provides some discussion of these factors in paragraphs 63-75, the meaning of "international competitiveness" is left unclear. Must the competitiveness of the industry be global or merely regional? How is an Australian industry defined? See H Schreiber, "Some Aspects of Public Benefit in Authorisation", presented at *Trade Practices Workshop*, 16-18 July 1993.

267 Note 80 *supra* at 17,342.

268 These include promotion of competition in an industry, economic development, fostering business efficiency (especially where this results in international competitiveness), expansion of employment or prevention of unemployment in efficient industries, industrial harmony, assistance to efficient small business, improvements in the quality and safety of goods and services and expansion of consumer choice, supply of better information to consumers and business, promotion of industry cost savings resulting in contained or lower prices at all levels of the supply chain, growth in export markets and steps to protect the environment: see *CSR Authorisation*, note 77 *supra*.

However, as discussed under Part III, efficiencies will only be valued where they produce a direct "flow-on" effect to consumers. This approach has been followed in the Merger Guidelines.[269]

## V. FURTHER COMPARISONS AND CONCLUSIONS

Chicago School thinking has played a different role in shaping the merger regulations of Australia and the EU. While neither jurisdiction has subscribed to the narrow objectives prescribed by that School, each regulation has inherited certain of its characteristics.

Comparatively, the EU Merger Regulation has been its more faithful son. Regulation of merger activity is limited to acquisitions which create or strengthen a position of dominance. Collective dominance has only recently been regulated under the Regulation, and its basis has been questioned. Large market shares may be accumulated and resulting efficiencies can develop unfettered. The importance of market structure to a finding of "dominance" will be outweighed by evidence of actual or potential conduct in a market.

Filial duty, however, has not been pursued blindly. Pre-merger notification procedures, a wider concept of market power, a narrow approach to market definition and emphasis on a wide range of barriers to entry, differentiate the EU approach from Chicago orthodoxy.

In Australia, more fundamental divergence from Chicago School thinking has been heralded by the recent amendments to s 50. Regulation of merger activity can now be achieved where market power is exercised by one or more firms. Pre-merger notification awaits introduction, and concentration ratios will be used to shift the onus of proof onto merger aspirants. Some concession has been made to the Chicago approach with the shift to a more dynamic assessment of both market structure and conduct.

The changes to the Australian approach have also produced divergence between the merger regulations of Australia and the EU. At a textual level, the amendments introduce changes both to the threshold and scope of the regulation. However, the merger factors in s 50(3) indicate that the basic assessment of market power within Australia may remain substantially unchanged.

The most significant change will arise in the extent of merger regulation initiated in Australia. TPC action in the Rank/Coles Myer bid foreshadows a much more pro-active stance in the future. Pre-merger notification will strengthen the TPC's enforcement role and its approach will assume even greater significance.

This re-direction in the TPC's approach may foreseeably be reflected by the Commission in the EU. It is to be expected that once the primary goal of integration of the Union has been achieved, questions relating to the maintenance of the Community may narrow the Commission's hospitality to merger activity.

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269 Merger Guidelines at [2.31].

If these changes occur, the Australian and EU regulations may once again converge. Shared objectives of competitive markets, consumer interest and economic opportunity would then shape future policy. While integration, however, remains the primary objective, the merger regulations will differ. However, the underlying approach, at least regarding the assessment of market power, is likely to continue along parallel paths.