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ACCC ssnip'ed in Metcash

The controversy over merger controls in Australia

Emmett J's eagerly awaited judgment in *ACCC v Metcash* refused the Australian Competition and Consumer Commission's (ACCC) injunction to block the merger between grocery wholesaler Metcash and supermarket Franklins. He comprehensively rejected the ACCC's approach to market definition, and threw out its counterfactual, concluding that far from substantially lessening competition; the proposed merger would enhance it. The ACCC is to appeal. Here the judgment is examined.

Market Definitions

The first requirement of a merger assessment is to define the relevant market. The ACCC approached market definition by envisaging whether a hypothetical monopolist of the product in question (wholesale packaged groceries to independent retailers) could profitably raise its 'price' by 5%. This is the so-called SSNIP test set out in the ACCC's *Merger Guidelines* (rev'd 2008).

But in an idiosyncratic move the ACCC argued that instead of using a price, it would use Metcash's wholesale margin. This, Emmett J said, had 'no foundation in logic and reality', and he could have added economics.

The SSNIP test is applied to the price of the focal product (wholesale packaged groceries in this case) to determine the degree of substitutability between it and other products. Margins are relevant to the SSNIP test to gauge whether the given price increase is likely to be profitable, and therefore would be undertaken by a profit-seeking hypothetical monopolist. If the (wholesale) margin is high it is more likely that the hypothetical monopolist will be able to profitably raise price, all things equal. But margin analysis alone is not the SSNIP test.

Emmett J also rejected the ACCC's narrow market definition as the provision of wholesale packaged groceries to independent grocery retailers, but for another more sophisticated reason. He concluded that integrated grocery chains (Coles and Woolworths) administered a downstream competitive constraint on independent retailers such as Franklins and those supplied by Metcash, and hence on wholesale grocery suppliers to independents. Simply, if retail prices were being kept down by competition between all retail outlets, wholesale prices (and margins) would be constrained. So the relevant market was broadened to the supply of wholesale packaged groceries to both independent and integrated retailers.

The ACCC believes the judge is wrong (*News Release*, 9 Sept. 2011). It says the Full Federal Court in David Jones Holdings in 1994 backs its market definition, and it is obvious that Metcash, Franklins, and exceptionally Spar are the only wholesalers supplying independent retailers. These are weak arguments. Market definition is not a matter of precedent, and in any case the ACCC opposed the Federal Court's 1994 narrow market definition siding with Metcash, and subsequent rulings support Emmett J. Second, and crucially, as Emmett J pointed out even if he accepted the ACCC's argument that downstream competitive pressures should not be taken into account in market definition, they would become relevant at the second stage competitive assessment with the same result. (Emmett J could have found support for his approach in *Racecourse Association v OFT* [2005] CAT 29, [2006] CompAR 99).

The Counterfactuals

With its market analysis rejected, the ACCC's case was effectively killed off. But Emmett J decided to push on to demolish the ACCC's competitive assessment, and come to an opposite finding – that the acquisition would likely enhance competition.

Under section 50 of the *Competition and Consumer Act 2010* whether or not a proposed merger or acquisition is likely to substantially lessen competition is assessed using a counterfactual test. This compares the likely competitive situation with a merged entity to the likely competitive environment in the absence of the proposed merger. The latter is the counterfactual.

The default counterfactual is the continuation of prevailing market conditions. But the ACCC's merger guidelines correctly recognise that there can be other counterfactuals including the prospect that the target firm may fail or exit the market in the absence of the merger. Franklins owner claimed exactly this - if the merger was blocked it would withdraw from the Australian market.

In the face of this 'failing firm defence' a regulator has a number of possible counterfactuals against which to benchmark the transaction – (1) accept that the firm is likely to fail and that it will exit the market; (2) that the firm will be acquired by another party not giving rise to

competition concern; or (3) that it fails but its assets and customers are distributed to other firms. These are not easy to apply nor exhaustive (see below), and the judge rejected all of them.

The ACCC argued that Franklins would be acquired by another party i.e. (2) above. It first said that the Queensland-based SPAR would purchase Franklins' retail outlets, but then changed this to a proposed consortium of independent retailers called 'Bidco' or KKK.

The judge rejected the ACCC's counterfactual as 'pure speculation', and said the law required a 'real chance' of the counterfactual happening and not a 'mere possibility' or as the respondent aptly put it a 'chain of speculative contingencies'. Bidco was not financed nor its membership certain. It was a consortium of retailers who would have had to develop a wholesale business, and it had not yet put together a credible and acceptable bid. The ACCC had not provided adequate evidence of the commercial credibility of its counterfactual. On balance Emmett J concluded that the proposed merger would strengthen the competition faced by the retail chains. This in part flowed from his conclusion that independent and integrated grocery retailers were for the most part in direct competition.

The ACCC says in its *News Release* that the judge set an onerous test which required it 'to satisfy stringent and commercially unrealistic standards', and that he was too quick to accept the seller's (presumably self-serving) position about the unacceptability of KKK's prospective bid. Maybe, but the judge's counterfactual was based on a plausible theory of competitive harm, and consistent with the evidence, at least as discussed in the judgment.

Speculative counterfactuals

As noted elsewhere (Veljanovski, *Competition LJ*, 2010) counterfactuals are simply shorthand for a protagonists' or regulator's theory of the competitive process and forecasts of what might happen. As *Metcash* shows even reasonable lawyers and judges can disagree about these.

A regulator, and others, can be prone to work back from their desired outcome, and use contentious counterfactuals to underpin this. This is not confined to Australia. For example, in *Stagecoach/Preston Bus* the UK Competition Commission rejected the failing firm rationale advanced by Stagecoach. It concluded that the appropriate counterfactual was not the prevailing conditions of competition at the time Stagecoach acquired Preston Bus, but rather the conditions of competition some 18 months previously, before Stagecoach had expanded its presence on the local market in which Preston Bus was present. In the Commission's view, Stagecoach's expansion on the local market had had the effect of bringing about the merger, in that it ushered in a period of what the Commission described as 'abnormal' competition between the two firms which severely weakened Preston Bus. The Commission felt that it was appropriate to disregard this 'abnormal' competition when positing the counterfactual.

The UK Competition Appeal Tribunal (*Stagecoach v Competition Commission* [2010] CAT 14) rejected this approach in uncompromising language. The CAT held that the Commission had no basis on which to disregard what actually happened in this market prior to the merger, and to take an earlier period as the counterfactual. The CAT regarded this as an 'unprecedented' application of the counterfactual unsupported by the Commission's merger guidelines, any legal authority, and/or any analysis. *Stagecoach* demonstrates that counterfactual analysis may simply disguise the lack of a credible position, or a credible position which an appellate body does not support.

Conclusions

The ACCC's case failed at a basic level. The approach to market definition was idiosyncratic, wrong and simplistic, and the counterfactual not backed by sufficiently credible evidence. Similar concerns have been highlighted in our previous *Casenote* (August 2011) in the context of the ACCC's Issues Paper on the proposed Foxtel/Austar merger. Apart from the adverse impact on the ACCC's credibility, the case will put pressure for an internal review of the way mergers are assessed, if only to judgment proof them. The stakes have increased now that the ACCC has appealed.

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