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GEOGRAPHIC MARKET DEFINITION

-- Note by Australia --

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More documents related to this discussion can be found at [ww.oecd.org/daf/competition/geographic-market-definition.htm](http://www.oecd.org/daf/competition/geographic-market-definition.htm)

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-- AUSTRALIA --

1. Key issues

- This Australian submission focusses predominantly on geographic market definition in the context of the Australian Competition and Consumer Commission's (ACCC) merger clearance function.¹
- Given that Australia shares no land borders with other nations, the definition of the relevant geographic market in many merger assessments and issues with national/international market boundaries are likely to be different in Australia as compared with other jurisdictions that share land borders.
- The ACCC is able to consider markets that are broader than Australia, despite Australian legislation defining a market to be a 'market in Australia'. The ACCC may define multiple markets as relevant to its assessment of a merger. These markets may be global, multi-national, national, state-based, sub-state, regional or local.
- Where the relevant product(s) that are the subject of a merger investigation are supplied across national borders, the ACCC will consider the extent to which there is demand and supply side substitution which would support defining a geographic market broader than a national market.
- While supranational market forces often influence the behaviour of merger parties in Australia, it does not follow that the geographic scope of the market(s) relevant to assessing the competitive effects of a merger should be global or even supranational.

2. Merger clearance legislation in Australia relevant to geographic scope of market

1. The mergers test under section 50 of the *Competition and Consumer Act 2010* (CCA) prohibits mergers that would have the effect, or be likely to have the effect of substantially lessening competition in any market in Australia, or a state, territory or region of Australia. Accordingly, in assessing whether a merger is likely to substantially lessen competition, the ACCC examines the likely competitive impact of the transaction in the context of one or multiple relevant markets.²

¹ Under the most commonly used merger control process in Australia (the 'informal review' process), the ACCC does not make binding decisions about mergers. Instead, at the end of its review, the ACCC provides merger parties with its view as to whether a proposed acquisition would contravene s. 50 of the Act. Parties rely on that view to determine whether to proceed with the proposed acquisition.

² Merger parties can also seek authorisation by the Australian Competition Tribunal (Tribunal). The statutory test applied by the Tribunal is different to the substantial lessening of competition test under section 50 of the CCA. In effect it is a net public benefit test. This is explained further at footnote 9.

2. While the legislation specifies that the relevant ‘market’ must be a market ‘in Australia’ or in a state, territory or region of Australia, the ACCC has taken the view that this does not preclude it from analysing a merger proposal in the context of a geographically broader market – for example, a trans-Tasman market (Australia/New Zealand) or even a multi-regional or global market – provided that at least some part of that market is located in Australia (even if other parts of the relevant market are located outside of Australia).³
3. While this submission is focussed on the ACCC’s assessment of geographic market definition in the assessment of mergers, the issue of ‘market in Australia’ is central in the air cargo cartel case currently before the High Court of Australia.⁴
4. Section 50 mandates that, when determining whether an acquisition is likely to substantially lessen competition, consideration must be given to the actual or potential level of import competition in the market.
5. When considering import competition, the ACCC will, in most cases, define the relevant geographic market to be Australia or a part of Australia and take full account of any competitive constraint actually or potentially provided by suppliers located outside Australia that supply goods into Australia.
6. The ACCC may define multiple markets as relevant to its assessment of a merger. These separate, but often related markets may be global, multi-national, national, state-based, sub-state regional or local. Section 50 prohibits mergers that are likely to substantially lessen competition in *any* market in Australia. Therefore, a breach of section 50 can occur as a result of the impact of the merger in only one market, notwithstanding that the merger does not have anti-competitive effects in other relevant markets.
7. While section 50 does not prevent the market being defined more broadly than Australia, in some circumstances the jurisdictional reach of the legislation can nevertheless limit the ACCC’s ability to prosecute contraventions of the merger law where the acquisition occurs outside Australia unless the corporation is incorporated in Australia or carrying on business in Australia.
8. In recent years, the ACCC has considered a number of global mergers where the conduct occurs overseas and the merger parties are foreign corporations (i.e. two companies merge the parent companies of their global businesses, both of which are located outside of Australia). In some instances, these mergers raise potentially significant competition concerns in a market in Australia despite the merger parties not being incorporated in Australia or where the parties have asserted that they are not ‘carrying on business

³ Unlike in section 50 of the CCA, the provisions in the Act relating to misuse of market power (section 46) explicitly extend to misuse of market power in a trans-Tasman market (section 46A). However, the ACCC does not consider that the explicit reference to trans-Tasman markets in section 46A precludes it from analysing a proposed merger in the context of a geographically broader market where appropriate, provided that at least some part of that market is located in Australia.

⁴ In *Australian Competition and Consumer Commission v P T Garuda Indonesia Ltd* [2016] FCAFC 42, the majority of the Full Court of the Federal Court (FFC) (Dowsett and Edelman JJ; Yates J dissenting) held that markets for air cargo services from ports outside Australia to ports in Australia were “markets in Australia” within the meaning of s. 4E of the *Trade Practices Act 1974* (now the CCA) as important components of the air cargo services were provided in Australia, the services were marketed and supplied to significant customers in Australia, and there were Australian barriers to entry. This judgment overturned the lower court’s finding of no contravention because although the lower court held that the firms engaged in the impugned conduct in the view of the court they did not do so in a market in Australia: *Australian Competition and Consumer Commission (ACCC) v Air New Zealand Ltd; ACCC v PT Garuda Indonesia Ltd* [2014] FCA 1157 (Perram J) (rev’d). The airlines sought special leave to appeal the FFC decision to the High Court. Special leave was granted on 14 October 2016.

within Australia’ pursuant to section 5(1) of the CCA. The phrase ‘carrying on business within Australia’ is not defined in the CCA, and there has been some consideration of the phrase in a competition law context by the courts.⁵

9. Where global or cross-border mergers raise significant competition concerns in Australia, foreign merger parties generally submit to the jurisdiction of the CCA and offer undertakings pursuant to section 87B of the CCA where appropriate to remedy any competition concerns raised by the ACCC.⁶ However, this is not always the case.

10. In a recent review of competition law in Australia⁷, the ACCC made submissions recommending changes to the legislation to ensure that conduct/acquisitions that occur overseas but impact on Australia are captured. While the Government’s response to the report did not propose an amendment, it indicated that it will consider how best to effectively capture conduct that harms competition in an Australian market, taking account of international law and policy considerations.

3. Approach in Australia to defining geographic markets with a national or broader scope

11. The ACCC’s approach is that, while market definition is a useful tool for merger analysis, by itself it cannot determine or establish a merger’s impact on competition. The view expressed by the Australian courts is that market definition is purposive, in that the definition of a relevant market is designed to capture the substitution possibilities and identify the relevant (potential) competitors that may constrain the merged firm in order to assist in the assessment of the likely competitive effects of the particular merger under investigation.

12. The ACCC takes into account a range of other relevant factors in performing its merger clearance function and it is common for the ACCC to find it unnecessary to reach a concluded view on the strict boundaries of the relevant markets in forming a view on a merger. For example, if the consolidation of the merger parties’ activities is unlikely to substantially lessen competition in a narrow product and geographic area, then it is also unlikely to do so in a more broadly defined product and geographic area and, therefore, a conclusive view on the relevant market may not be necessary. Similarly, when a merger is likely to substantially lessen competition in any number of potential markets, it may be unnecessary to define the precise market boundaries of each market.

⁵ See, *Australian Competition and Consumer Commission v Yazaki Corp (No 2)* [2015] FCA 1304 (Besanko J) relying on *Bray v F Hoffman-La Roche Ltd* [2002] FCA 243, identified factors relevant to whether an overseas parent was carrying on business in Australia through its local subsidiary and also held that carrying on business did not require the parent to be carrying on all of the subsidiary’s business; see also *Trade Practices Commission v Australian Iron & Steel Pty Ltd* (1990) 22 FCR 305.

⁶ Where section 50 does not apply to an overseas merger, section 50A (acquisitions that occur outside Australia) may apply. This provision was introduced to bring some overseas mergers between foreign companies with subsidiaries in Australia within the jurisdiction of the CCA. If the Tribunal makes a declaration that an acquisition would have the effect of substantially lessening competition in a market and would not result in net public benefits, then the remedy requires the acquirer to cease carrying on business in the relevant market within six months. This provision is cumbersome and has never been used. In any event, the remedy may not assist in relation to improving competition outcomes.

⁷ The Competition Policy Review (Harper Review) was a comprehensive review of Australia’s competition laws and policy. The Harper Review Panel released its Final Report on 31 March 2015.

13. The ACCC has defined broader than national markets in some merger and adjudication⁸ cases (see Box 1) and is cognisant of the trend towards and the impact of globalisation on certain sectors. However, the ACCC takes the approach that the fact that firms are operating across national borders and having regard to supranational market forces does not necessarily mean that it should accept that a relevant geographic market extends beyond national boundaries for the purposes of assessing competition effects of the conduct. This does not mean that global or supranational forces will not be taken into account—it simply means that the competition assessment does not start with a presumption that these forces are likely to substantially constrain parties engaging in the conduct of concern. Competitive constraints from sources outside the relevant market will be considered in that context.

Box 1. ACCC's approach to geographic market definition when assessing applications for authorisation of airline alliances involving international carriers

When assessing the competition effects of airline alliances involving one or more international carriers, the ACCC usually defines the geographic scope of relevant markets by reference to the points of origin/destination served by each carrier and the areas and routes on which the parties' services overlap.

In airline matters, the ACCC is careful not to define the geographic scope of relevant markets so narrowly that it fails to take into account network-wide considerations that are relevant to the assessment of competitive effects. At the same time, the ACCC acknowledges that differing market conditions on each route often requires route-specific analysis. The way that it manages this is to recognise actual and potential future overlap routes as 'embedded' markets within a broader market that is defined by a set of routes.

For example, in its 2010 and 2013 authorisations of an **alliance between Virgin Australia and Air New Zealand**, the ACCC identified a relevant market for air passenger transport services between Australia and New Zealand (trans-Tasman geographic market) and assessed competition effects both at the trans-Tasman level and on the individual (city pair) routes where the airlines' operations overlapped or were considered likely to overlap in future absent the alliance.

The ACCC considered that the relevant geographic scope of the market was likely to be trans-Tasman wide, but it was important to have regard to particular trans-Tasman routes where substitution possibilities were likely to be limited. A geographic market broader than the trans-Tasman market was not considered appropriate taking into account regulatory restrictions, airport restrictions and sunk costs associated with advertising and marketing which serve to limit the degree of supply side substitution by carriers operating outside the trans-Tasman.

14. Even where it is determined that a global (or other market broader than Australia) market definition is not appropriate, global influences such as imports are an important element of the ACCC's assessment. Section 50(3) lists a number of 'merger factors' that must be considered as part of the competition test and the actual and potential level of import competition in the market is one of these factors. The Australian Government is currently seeking the views of interested parties on exposure draft legislation which contains proposed amendments to the CCA. An amendment, intended to clarify that the credible threat of import competition is a relevant component of competition analysis, has been proposed. It would amend the definition of 'competition' in section 4 of the CCA to include competition from goods and services that are, or are capable of being, imported into/rendered in Australia.

⁸ The ACCC is empowered to grant statutory protection against legal action under certain provisions of the CCA (except for misuse of market power and some mergers) where it is satisfied that the public benefits arising from the conduct outweigh public detriments, including detriment associated with any lessening of competition. Examples of conduct or arrangements where authorisation has been sought in the past include airline alliances and certain types of joint venture, collective bargaining arrangements, non-prescribed voluntary industry codes of practice, and industry levies (for example, as part of a product stewardship scheme).

15. The following three main cases arise in merger investigations where the relevant products are capable of being supplied across national borders.

3.1 *The relevant product is supplied into the domestic market and faces competition from imports*

16. If the merger parties supply into the domestic market and face competition from imports, the ACCC will recognise imports as an actual or potential source of constraint on the merged firm. However, this does not necessarily mean that the geographic scope of the relevant market is widened to include the source of the imports.

17. In many cases where imports are a factor, the ACCC has defined a national market and treats imports as a competitive constraint in that market.

18. The ACCC will consider the willingness of a sufficient proportion of buyers in Australia to switch supply of the relevant product to an independent supplier based in another country. This will be impacted on by a number of potential factors including: the freight costs (particularly as a proportion of the total value of the product); exchange rate fluctuations; regulatory or other practical constraints; the importance of local distribution channels and just-in-time supply. The willingness of customers to switch supply to an overseas based supplier may also change over time depending on these factors; for example, exchange rate fluctuations may change the willingness of customers to source products from overseas.

19. The ACCC will also test whether supply of the relevant product is readily available to customers from an overseas based supplier. In this context, readily available imports are considered as a supply option within the Australian national market, or alternatively as a potential new entrant if supply is not readily available. In industries where suppliers are active globally or multi-nationally, there may still be factors which necessitate defining a national market, such as where not all suppliers are active in Australia and barriers to entry and expansion are present.

20. Where actual or potential imports provide an effective constraint on the merged firm's operations in Australia, the ACCC is unlikely to have competition concerns.

Box 2. Actual or potential competition from imports

The ACCC has cleared (or not opposed) a large number of mergers across a wide range of industries on the basis of actual or potential direct competition from imports, even though, in many of the cases, the merger would have led to a significant reduction in the number of domestic competitors. In those cases imports were considered to provide an effective constraint on the merged firm. For example, in 2007 the ACCC decided not to oppose **OneSteel's proposed acquisition of Smorgon Steel** which resulted in a monopoly of domestically based manufacturers of a range of steel products, but was cleared due to the effective competitive constraint imposed by imports.

21. Imports are considered more likely to provide an effective constraint if the following conditions are met:

- Independent imports (that is, imports distributed by parties that are independent of the merger parties) represent at least 10 % of total sales in each of the previous three years.
- There are no barriers to the quantity of independent imports rapidly increasing that would prevent suppliers of the imported product from competing effectively against the merged firm within a period of one to two years (for example, government regulations, the likelihood and impact of anti-dumping applications on imports, customer-switching costs or the need to establish or expand distribution networks).

- The (actual or potential) imported product is a strong substitute in all respects (that is, quality, range, etc.) for the relevant product of the merged firm, taking into account factors including the need to meet any relevant Australian or industry standards, any increase in the complexity of customers' logistical arrangements, increased transport times and costs, and the risk of adverse currency exchange rate fluctuations.
- The price of actual or potential landed imports, including any tariffs or other import-specific taxes and charges, (that is, the import parity price) is close to the domestic price of the relevant product that would prevail in the absence of the merger.
- Importers are able to readily increase the supply volume of the product they import with minimal or no increase in the price paid.
- The merged firm and other major domestic suppliers do not have a direct interest in, are not controlled by, and do not otherwise interact with, actual or potential import suppliers.

22. The ability of imports to expand (import supply elasticity) is a key consideration in the ACCC's competition analysis. If the supply of imports is either unable to respond, or only able to respond slowly, to an increase in demand by Australian consumers, imports are unlikely to effectively counteract any increased market power of the merged firm. For example, where there are production capacity or supply constraints, or where imports targeted to niche segments would not be profitable on a wider scale given their cost structures, import competition is unlikely to be sufficient to prevent a substantial lessening of competition.

3.2 *The relevant product is supplied into the domestic market and exported*

23. If the merger parties supply into the domestic market and export the relevant product overseas, the ACCC will consider if it is appropriate to identify both a national and global market.

24. This approach has been considered appropriate where the constraint offered by suppliers in different regions will depend on variable factors such as exchange rate and transport cost fluctuations. Where exchange rates or freight costs limit offshore suppliers from posing a strong competitive constraint on domestic suppliers in supplying domestic users, a narrower national geographic market is likely to be considered appropriate.

25. Further, where there is a significant gap between the domestic price and the import parity price for products which are exported from Australia, the domestic price often settles close to an export parity price. If following a merger, a merged firm has market power in the domestic market it may have sufficient freedom to restrict supply in that market pushing the domestic price up to the price at which imports become commercial.

Box 3. Both national and global geographic markets may be considered where appropriate

In 2008 the ACCC decided not to oppose **BHP's proposed acquisition of Rio Tinto**, having considered the impact of the merger in both global and national markets for the supply of iron ore lump and iron ore fines. In 2010, the ACCC considered a proposed iron ore production joint venture between BHP and Rio Tinto. In both matters, the ACCC defined global and national markets for the supply of iron ore lump and iron ore fines. Iron ore is a globally traded commodity used almost exclusively in the manufacture of steel. The ACCC considered that it was appropriate to consider the competitive effects of each transaction in national and global markets. This is because the extent of demand-side substitution by steel makers sourcing iron ore from suppliers in global geographic regions varied depending on sea freight prices. To the extent that sea freight prices varied over time and had the potential to increase significantly, narrower geographic markets were considered likely to be appropriate.

3.3 *Input product is acquired in domestic market and the end product is exported*

26. If the merger parties acquire inputs in the domestic market and export the final product, the ACCC will consider separate acquisition and supply markets. This may result in a domestic geographic market being defined for the input product and a global market (or other market broader than Australia) being defined for the end product.

27. While competition in export markets may prevent the merged firm from raising its export prices, the merged firm's export operations may not limit its ability to exercise market power in acquisition markets in Australia.

28. In some cases, it has been argued that the reduced competition that results from a merger in domestic markets is outweighed by public benefits related to the creation of a 'national champion' which may compete more effectively in global markets. In Australia, merger parties may apply to the Australian Competition Tribunal for merger authorisation on public benefit grounds. The Tribunal may consider whether gains in efficiency (such as increasing scale to compete globally) constitute a public benefit that outweighs the public detriment arising from any lessening of competition.

29. The ACCC considers that preserving domestic competition is important for promoting the global competitiveness of domestic firms. When local industries are subject to vigorous domestic rivalry, this puts pressure on firms to innovate and improve driving firm efficiency which leads to increased competitiveness globally.

Box 4. Scope of geographic markets may vary at different levels of the supply chain

This issue arose in 2013 in **Murray Goulburn's merger authorisation application to the Tribunal for its proposed acquisition of Warrnambool Cheese and Butter**. The ACCC had competition concerns with respect to the proposed merger of two dairy processing facilities which acquired raw milk from dairy farmers as an input to products sold domestically and internationally. Much of the production of the dairy processing facilities was sold in competitive export markets. The ACCC was nevertheless concerned that the proposed acquisition would substantially lessen competition in the acquisition of raw milk from dairy farmers in the regions surrounding the processing plants.

The ACCC considered that in addition to the export markets for processed dairy products (cheese, milk powders, whey products), it was also relevant to consider the impact of the proposed acquisition in domestic markets (for the acquisition of raw milk from dairy farmers). The geographic boundaries of markets for the acquisition of raw milk are limited by the physical location of dairy processing facilities and the transportation distances for raw milk. These markets were considered to be regional in nature and limited to only domestic competitors (dairy processors) and where suppliers of raw milk (dairy farmers) are unable to redirect their raw milk supply to export markets.

Murray Goulburn's merger authorisation application to acquire Warrnambool Cheese and Butter was withdrawn prior to any decision being reached by the Tribunal.⁹ Had the Tribunal made a final determination of the application for merger authorisation, the Tribunal's determination would have taken into account the competitive impact of the merger on the markets in Australia, taking into account domestic and international competition and that prices were to some extent set by reference to global prices, against the public benefits likely to result from the acquisition.

⁹ Under the informal merger clearance process, the ACCC applies the substantial lessening of competition test under section 50 of the CCA. For merger authorisations however, the Tribunal applies in effect a net public benefit test under section 95AZH(1) of the CCA: The Tribunal must not grant authorisation of a merger unless it 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 occur. The Tribunal is required to regard a significant increase in the real value of exports and a significant substitution of domestic products for imported goods as benefits to the public: section 95AZH(2)(a). The Tribunal must also take into account all other relevant matters that relate to the international competitiveness of any Australian industry: section 95 AZH(2)(b).

4. Challenges and limitations to existing geographic market definition tools

30. While the presence of online services, online retailers and multi-sided platforms has presented some challenges to market definition, the ACCC has to date not found it necessary to adopt any alternative tools or approaches. The more challenging markets appear to have been those where innovation is causing the market to change rapidly, blurring the product and geographic boundaries of the markets. Significantly, none of the mergers of this type were opposed and therefore the market definition was not ultimately disputed or tested.

31. As outlined above, the ACCC and the courts have tended to rely on qualitative evidence to support market definition. This provides a certain degree of flexibility to assess the competition issues arising from the various areas of overlap by not excluding constraints on the basis that they are not included in the market.

32. Not surprisingly, the emergence of online suppliers has in some cases prompted the ACCC to adopt a broader geographic market (see Box 5).

Box 5. Scope of geographic market may be broadened due to online constraints

The ACCC did not oppose significant market concentration of 'bricks and mortar' travel agents in Australia (**Jetset Travelworld's acquisition of Stella Travel Services** which included the retail brands Harvey World Travel and Best Flights, among others) in large part due to the significant growth in online travel agents which were expected to compete strongly against the merged entity.

The ACCC identified a number of markets including the retail supply of leisure travel products in Australia, including 'bricks and mortar' retailers, online retailers and direct retail supply by travel content suppliers. Although 'bricks and mortar' and online were considered in the same market, the ACCC noted that the degree of substitution between these different retailers was likely to vary according to different customers.

In terms of geographic market, the ACCC concluded that while 'bricks and mortar' are likely to compete on a local basis, the relevant market was national since customers were able to make bookings over the internet or telephone with agents or travel content suppliers located anywhere in Australia.

33. Alternatively, in other matters the emergence of online supplies has resulted in the adoption of a narrower online market definition being adopted by the ACCC (see Box 6).

Box 6. Separate markets may be considered for online and 'bricks and mortar' channels

In the 2015 review of the **Expedia/Wotif** transaction involving online travel agents, the ACCC defined a market for the distribution/booking of Australian accommodation through the online channel only, as accommodation providers were considered unlikely to switch enough inventory from online channels to bricks and mortar travel agents to make a small but significant increase in online distribution costs (e.g. an increase in commission rates charged by online travel agents) unprofitable.

Online channels were considered to capture unique consumers not captured through the bricks and mortar channel because, for a significant proportion of consumers, bricks and mortar travel agents are not a close substitute for online travel agents. These consumers were found to have a preference for comparing a wide range of accommodation providers, accessing reviews from fellow travellers to inform their decision and favour the convenience of booking online without the need to visit a store or speak to a customer service person.

The ACCC also found that online travel agents were not a close substitute for a significant proportion of consumers that frequent bricks and mortar travel agents. These consumers often have a preference for drawing on the advice and expertise offered by sales agents and favour the ability to book personalised holiday packages, particularly when travelling overseas.

Accordingly, the ACCC considered it appropriate to consider the competitive effects of the proposed acquisition with reference to a market for distribution/booking of accommodation that was limited to online channels, taking into account bricks and mortar agents only to the extent that they offer online booking services (for example, as Flight Centre does through Quickbeds.com.au). With the market being restricted to online, the geographic dimension of the market was found to be a market for the distribution/booking of Australian accommodation, encompassing bookings made by Australian residents and inbound bookings from overseas residents.

5. Investigation challenges with respect to the definition of markets that are potentially national or broader

34. Significantly, the voluntary notification regime in Australia and the associated absence of compulsory upfront information requirements means that the data available to the ACCC is often more limited and therefore market definition is supported by more qualitative information with evidence from market participants often being critical.

35. The exception to this is in relation to some retail acquisitions in local markets. In these cases the ACCC has been able to use available customer loyalty data and credit card transaction data to determine the relevant geographic scope of the local markets. However there is generally limited data available for the purposes of determining whether the relevant market is national or broader.

36. The ACCC regularly liaises with other competition authorities on merger investigations, however, as a purposive approach to market definition is applied by the ACCC and given that Australia shares no land borders with other nations, the assessment of the relevant geographic market in many merger assessments is likely to be different in Australia as compared with other jurisdictions.

37. The geographic isolation of Australia means that for many products and services, cross-border transport costs are typically higher relative to other countries with shared land borders. In some cases, this will tend to limit the competitive constraint posed on the merger parties by external sources of supply. For online markets or any market where there is not a physical transfer of goods or services to/from Australia, the geographic isolation of Australia may not have such relevance.

38. The ACCC's experience is that liaison with other competition authorities on merger assessments tends to focus less on market definition than on other relevant competition issues.