

**Bar Association of Queensland, 15 July 2010**

**Commentary on Mr Glenn Owbridge's Paper –**

**"Planes, Keynes and Supply Chains: Globalisation, the Information Age, and Market Definition under the *Trade Practices Act 1974 (Cth)*"**

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## **Introduction**

1. The Internet has added a new dimension to global trade and has spawned e-commerce – the buying and selling of goods over the Internet. E-commerce is divided into two broad categories: business-to-business (b2b) and business-to-consumer (b2c).<sup>1</sup> As a result of these developments traditional sellers with a physical presence ("bricks and mortar retailers") now face competition from b2c suppliers comprising both "clicks and mortar retailers" (those with a physical presence that have also ventured on-line) and Internet suppliers that have no physical presence and operate only on-line ("clicks only retailers") such as Amazon.com.
2. Glen Owbridge canvasses many market definition issues in his thought-provoking paper, but the one I would like to focus on in my commentary is the impact of the Internet when defining the geographic dimension of the market.
3. He states (at p 18 of his paper):

The Internet itself further allows sales without a physical presence and with greatly reduced transactional costs. For products that do not need to be inspected in advance, such as air fares, housing loans and shares, they can be sold virtually anywhere in the world by the posting of schedules and prices on the Internet. They can similarly be paid for electronically.

On pages 19-21 he provides an example of the potential impact of the Internet as a competitive constraint on bricks and mortar record stores. He states:

The effect of these developments [the Internet] may well prove profound in the recorded music markets. If a chain of music stores cannot increase its price without consumers simply switching to another source, then no amount of industry concentration can lessen competition.

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<sup>1</sup> See Bye, "The Competition Law Implications of Business-to-Business Electronic Commerce" (2001) 29(4) *Australian Business Law Review* 292 at 296-7 who asserts: 'In many cases b2b markets will be truly global because the Internet is borderless and the inputs sought from suppliers in the upstream market will be traded on an international basis. This can be evidenced by a number of global exchanges...The mining hub, for example, will operate on an international basis through three regional hubs...'

4. I would like to consider the following questions:

- How profound is the impact of the Internet on retailing?
- Is the availability online music a close substitute for physical format music (CDs) such that they can be said to fall into the same product market, and is the geographic dimension of this market global?
- Do global markets exist and are the administrative agencies prepared to recognise them?

5. Before I answer these questions, I would like to consider the context in which market definition occurs. I will also need to consider some of the uncertainties surrounding the definition of “market” in s 4E of the *Trade Practices Act 1974* (Cth) (TPA) and outline some of the current tests used to define the geographic dimension of markets.

#### **Context in which market definition occurs**

6. The central issue in any competitive analysis under the TPA is not market definition, but market power.<sup>2</sup> Market power is discretionary power or freedom from constraints. For example, the power to raise prices or impose other terms and conditions on customers, or reduce the level of quality, without losing sales to competitors.

7. Traditionally, that assessment of market power occurs in two separate stages. The first stage focuses on market share. In the absence of a detailed economic analysis to provide key information about market power, market share is used as a proxy, and in order to calculate the market shares of the incumbents, it is necessary to first define the market. Market definition is a process of sorting existing products into economic categories.

8. Once market shares have been calculated, we need to ask whether any conclusions can be drawn at that stage about market power. Market shares can be a very

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<sup>2</sup> Brunt, *Economic Essays on Australian and New Zealand Competition Law* (Kluwer Law Int'l, 2003), p 314.

misleading indicator of market power. The second stage in the assessment of market power focuses on the processes of competition in the market identified. It is concerned not just with the “here and now” (incumbent competitors), but with what might happen in the foreseeable future. It is concerned with constraints not just from firms not physically present in the market, but firms “as yet unborn”. If barriers to entry are low, potential new entrants will exercise a constraining influence so that an incumbent with a market share of 100% may not have market share.

9. There is sometimes a tendency in defining markets under stage one, to lose sight of the fact that the central task is identifying market power and competitive constraints. Market share may be proxy for market power and it is generally a worthwhile exercise to calculate market shares, but the real work is performed under stage two.

#### **Uncertainties surrounding the definition of “market”**

10. Let me now turn to consider the definition of “market”. Section 4E provides:

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

11. This definition is imprecise in at least the following respects:

- First, it does not explain what operational mechanism is to be used for determining whether goods or services are substitutable and should be included in the same market.
- Secondly, it does not specify what degree of substitutability is required.
- Thirdly, it does not explain what is meant by the words ‘otherwise competitive with’.
- Finally, the significance of the words “market in Australia” is not clear.

#### **‘Market’: an economic concept**

12. A “market” for the purposes of the TPA is an economic concept. It does not bear its common or everyday meaning of a physical place, such as a supermarket, where

buyers and sellers come together to transact business. Rather, as the Full Federal Court observed in *Universal Music Australia v ACCC*:

The concept of a “market” is a metaphor used to describe a range of competitive activities by reference to function, product and geography. The application of the metaphor may be informed by economic analysis, provided it is rooted in commercial realities.<sup>3</sup>

13. A market then is not an observable entity: it is a metaphor.<sup>4</sup> In *Queensland Wire Industries Pty Ltd v Broken Hill Proprietary Company Ltd*, Deane J stated:

The most that can be said is that “market” should, in the context of the Act, be understood in the sense of an area of potential close competition in particular goods or services and their substitutes.<sup>5</sup>

14. Defining a market is a process of classifying goods or services into those that are “in” the market and those that are “outside” the market. This classification process depends on whether two goods or services are substitutes, but s4E does not tell what operational mechanism we are to use in deciding whether goods or services are substitutes.

### **Operational mechanism for determining substitutability**

15. Section 4E is consistent with the economic concept of a market, but it does not tell us what operational mechanism we are to apply to determine whether goods or services are substitutable. The courts and the administrative agencies now accept that the operational mechanism to apply in testing substitution possibilities is the SSNIP test (Small but Significant Non-transitory Increase in Price) or hypothetical monopolist test (HMT). The SSNIP test gives effect to the principles of substitutability contained in the definition of “market” in s4E of the TPA.<sup>6</sup> It tests substitution

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<sup>3</sup> *Universal Music Australia Pty Ltd v ACCC* (2003) 131 FCR 529 at [53] (Wilcox, French and Gyles JJ).

<sup>4</sup> A ‘metaphor’ is defined in the Macquarie Dictionary to mean: ‘...a method of suggesting likeness’.

<sup>5</sup> *Queensland Wire Industries Pty Ltd v Broken Hill Proprietary Company Ltd* (1998) 167 CLR 177, 195 (Deane J).

<sup>6</sup> See *Seven Network Ltd v News Ltd* (2009) ATPR 42-301 at [668]-[671] (Dowsett and Lander JJ)(C7 case). For an analysis of the C7 case see Justice Greenwood’s paper, “Recent Developments in Market Definition” 2010 Competition Law conference, Sydney, 29 May 2010. For useful discussions of the HMT see: ACCC Merger Guidelines (November 2008) at [4.18]-[4.22]; King, The 2008 ACCC Merger Guidelines: How and Why Have They Changed? (2009) 32(1) *University of New South Wales Law Journal* 263; King, The Role of the Hypothetical Monopolist Test in Market Definition Under the Merger Guidelines (2006) 14 *Competition & Consumer Law Journal* 89; Crocioni, The Hypothetical Monopolist Test: What it Can and Cannot Tell You (2002) 23(7) *European Competition Law Review* 354; Coate and Fischer, “A Practical Guide to the Hypothetical Monopolist

possibilities by asking whether a hypothetical monopolist would find it profitable to increase the price for a product by 5-10% for a non-transitory period, say 12 months. If substitution would occur for other products, or other regions, those other products and other regions must be included in the relevant market.

16. In relation to the product dimension of the relevant market, goods are substitutable if, holding real income constant, an increase in the price of one (or the supply of inferior products) leads to an increase in sales of the other. For example, digital music is music that is manufactured as a digital file. It can be delivered by two formats: on compact discs (“CDs”) and online via the internet (“Internet Music”). Music downloading is a relatively new form of distribution of music to consumers over the Internet. It is a technology permitting the electronic transfer of an entire music file to a device before playback is allowed. The file remains on the person’s device as a permanent copy.
  
17. Does Internet music downloading online compete with the physical sale of a CD? If a 5-10% increase in the price CDs causes a significant number of consumers to switch to Internet Music there is only one market, Digital Music, consisting of both CDs and Internet Music.
  
18. The geographic dimension of the relevant market is tested in the same way. The process begins with the narrowest geographic area and one asks whether or not a hypothetical monopolist could or could not sustain a 5-10% increase in price. If it would be unprofitable because of lost sales to another geographic area, that geographic area is included in the relevant market. The process is repeated until a geographic area is found where the firm could profitably impose a 5-10% increase in price because there are no further lost sales to other geographic areas.
  
19. However, in applying the HMT the relevant price for testing is the ‘competitive price’ for the product or service (marginal cost) in question which may not be the current market price. The data may not be available to calculate the competitive price. In *Seven Network Ltd v News Ltd*,<sup>7</sup> it was not possible to identify a competitive price, and as a result it was necessary to adopt a *qualitative* rather than a *quantitative* approach – in economic terms “a thought experiment”.<sup>8</sup>

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Test for Market Definition” (2008) 4(4) *Journal of Competition Law and Economics* 1031.

<sup>7</sup> (2009) ATPR 42-301.

<sup>8</sup> *Seven Network Ltd v News Ltd* (2009) ATPR 42-301 at [626].

20. Dowsett and Lander JJ expressed a cautionary note about over-reliance on the SSNIP test in market definition:

We do not treat the SSNIP test as being irrelevant to the question of market identification. However, a qualitative application of the test requires identification of its purpose. As we understand it, the test looks to the actual or likely effect of competitive conduct, or potential competitive conduct, upon price and other conditions of supply, including quality of the product. However competitive conduct may not have an immediate and obvious effect upon those matters. Particularly in a relatively new industry, competitors may be looking for longer term, rather than shorter term, advantages. The “richness” of the concept of competition referred to in *Re Queensland Co-operative Milling Association Ltd* means that competition may take many forms. Its effect may be immediate or delayed. The SSNIP test addresses the effects of competition, but it does not define the way in which it occurs.<sup>9</sup>

21. This is a cautionary reminder that market definition is not an end in itself and that we need to focus its purpose. The purpose of market definition is to aid the identification of competitive constraints on market power. The processes of competition are not affected by how one defines the market.

22. For example, if the market is defined narrowly this will result in exaggerated market shares, but the inquiry does not stop there. We need to ask whether those high market shares are a reliable indicator of market power. If those suppliers who were not included in the market because it was defined narrowly, are considered as potential new entrants, they may exercise a considerable constraining influence on the incumbents, which will downplay the significance of the high market shares resulting from the narrow market definition. The conclusion may be that the high markets shares are not a reliable proxy for market power and that because entry barriers are low none of the incumbents has market power.

23. The next question that arises for consideration is: what degree of substitutability is required to include a product or supplier in the relevant market and what evidence can be relied upon in testing actual substitution or predictable substitutability?

#### **What degree of substitutability is required?**

24. The definition of “market” in s 4E is imprecise: it does not prescribe the degree of

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<sup>9</sup> *Seven Network Limited v News Limited* (2009) ATPR 42-301 at [670].

substitutability or closeness required to include a product in a market. Closeness is a matter of degree. It is not possible to state what level of cross-elasticity of demand and what level of cross-elasticity of supply, is required to include or exclude a product in a market. This is a matter for the court's or the administrative bodies' subjective assessment.

25. This issue was considered by the Full Federal Court in the *C7* case. In that case, Seven pleaded that there was a *wholesale sports channel market*, being a market for the wholesale acquisition and supply of channels consisting of sports programming for the providers of services in the retail pay television market. This was central to Seven's case since it alleged that the acquisition of the AFL pay television rights by Foxtel, and the acquisition of the NRL pay television rights by Fox Sports increased the market power of Fox Sports and Foxtel and prevented C7 from competing with Foxtel in the supply of sports channels to retail pay television platforms. Seven submitted that in order to reach sufficient critical mass to be economically viable, a retail pay television operator must have access to a sports channel that incorporates a "major" sport known as a "Marquee Sport" and that there were only two Marquee Sports in Australia, AFL and NRL.
  
26. The trial Judge, Sackville J concluded that there was no wholesale sports channel based upon two factual findings. The first finding related to the product dimension of the market. His Honour held that the C7 product (AFL) was not a substitute for the Fox Sports product (NRL), because each retail pay television platform was committed to subscribers who preferred either the NRL competition or the AFL competition. The second finding related to the functional definition of the market. His Honour held that a retail pay television platform, or other potential entrant could easily become a supplier of sports channels, if it could obtain rights to a Marquee Sport, so the market was not limited to wholesale suppliers.
  
27. On appeal, Dowsett and Lander JJ (with whom Mansfield J agreed on this aspect of the case) adopted the approach taken by Gyles J in *Australian Rugby Union v Hospitality Group Pty Ltd*,<sup>10</sup> in relation to the question of substitutability of major sports, and the need to identify close substitutes in defining markets.<sup>11</sup> Their Honours accepted that s 4E is concerned with identifying "close" substitutes measured by a high cross-elasticity of demand, but that closeness is a matter of

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<sup>10</sup> *Australian Rugby Union v Hospitality Group Pty Ltd* (2000) 173 ALR 702 at [51].

<sup>11</sup> *Seven Network Ltd v News Ltd* (2009) ATPR 42-301 at [621].

degree.

28. Dowsett and Lander JJ disagreed with the trial judge regarding the product dimension of the market. Their Honours observed:

A major step in his Honour's [Sackville J's] reasoning was the conclusion that C7 (with AFL match coverage) was not a constraint upon Fox Sports (with NRL match coverage) because pay television platforms carrying Fox Sports' channels would not treat C7's channels as substitutes. This was because subscribers to a platform or channel with NRL coverage would not consider a platform with AFL coverage to be a substitute for it. We consider that this approach placed too great an emphasis upon existing circumstances and gave too little consideration to *the potential for change*.<sup>12</sup> (Emphasis added)

29. Dowsett and Lander JJ held that the relevant product consisted of general sports channels which included marquee match coverage (either NRL or AFL).<sup>13</sup> They inferred that each supplier was anxious to supplant the other as supplier of the rights to NRL and AFL matches to pay television platforms and increase their subscriber revenue.

30. Their Honours concluded:

...there can be little doubt that C7's activities as suppliers of sports channels carrying a Marquee Sport had *an actual or potential effect* upon Fox Sports' behaviour as a supplier of similar channels...We accept that a pay television platform, subscribers to which were predominantly committed to one of the Marquee Sports, would not readily have chosen to change Marquee Sports. However, such a platform would have sought to broadcast both Marquee Sports and would have dealt with whichever suppliers were able to provide them... Further, each supplier had the capacity to become the supplier of the other's Marquee Sport, thus strengthening its position as a supplier of channels and perhaps excluding the latter from the market.<sup>14</sup> (Emphasis added)

31. The extent of the constraint imposed by C7 on Fox Sports' conduct was to be measured by reference to market opinion or conduct, and to the activities of the two entities.<sup>15</sup> Fox Sports and C7 were seeking to maximise their respective shares of pay television subscriptions. They could only do that at each other's expense.

### **What is meant by the words 'otherwise competitive with'?**

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<sup>12</sup> *Seven Network Ltd v News Ltd* (2009) ATPR 42-301 at [662].

<sup>13</sup> *Seven Network Ltd v News Ltd* (2009) ATPR 42-301 at [667].

<sup>14</sup> *Seven Network Ltd v News Ltd* (2009) ATPR 42-301 at [686]-[697].

<sup>15</sup> *Seven Network Ltd v News Ltd* (2009) ATPR 42-301 at [689].

32. As we have seen, stage one of the market power analysis is concerned with classifying products into different markets. Section 4E tells us that in carrying out this process of classification we must include in the same market goods and services that are ‘substitutable, or otherwise competitive with’ the first mentioned goods or services. What do the additional words ‘otherwise competitive with’ mean? Are they no more than a synonym for ‘substitutable’ or do they extend the range of goods and services to be included in the relevant market? Is the same degree of “closeness” required under “substitutable” required for “otherwise competitive with”?

33. Prior to the decision of the Full Federal Court in *C7*, I held the view that the words “otherwise competitive with” were merely a synonym for “substitutable”.<sup>16</sup> The practical justification for that view was that to expand market definition beyond close substitutes would “muddy the waters” and bring too much uncertainty to the process of market definition.

34. My view was rejected by Dowsett and Lander JJ in the *C7* appeal. Their Honours held:

The better view is that s 4E addresses constraints upon the supply or acquisition of the relevant goods or services. In that context the word “substitutable” is used in a narrow sense whilst the words “or otherwise competitive with” include degrees of “substitutability”. We accept that the section addresses “close” competition and that “closeness” is a matter of degree.<sup>17</sup>

35. This construction recognises that under the stage one analysis, not all incumbents have an equal constraining influence on the firm engaging in the conduct at issue. One considers first the most direct constraints from close substitutes; and then the less direct constraints from “less close” substitutes. In deciding whether two goods or services are “otherwise competitive with” each other, even though they are not close substitutes, and whether substitution between them is feasible or likely one considers “...customer attitudes, technology, distance, cost and price incentives”.<sup>18</sup> Their Honours did not express a view as to what degree of “closeness” is required, other than that it is less than the high degree necessary for the two goods or services to be close substitutes.

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<sup>16</sup> See Corones, *Competition Law in Australia* (4<sup>th</sup> ed., Lawbook Co, 2007) at [2.30]

<sup>17</sup> *Seven Network Ltd v News Ltd* (2009) ATPR 42-301 at [621].

<sup>18</sup> *Re Queensland Co-operative Milling Association Ltd and Defiance Holdings* (1976) 25 FLR 169 at 190.

36. Practically, it may be difficult to demonstrate as a matter of evidence that although two products are not close substitutes, they are nevertheless “otherwise competitive with” each other and should be included in the same market. The problems of deciding which products are “in” the market and which products are “outside” the market are likely to be an on-going problem requiring further refinement and analysis especially in the context of new and emerging markets involving high technology and intellectual property rights. It is important to remember, at stage one, market definition we are only concerned with innovation and potential substitution or potential close substitution by firms already in existence.

### **What is the significance of the words “market in Australia”?**

37. Finally, we come to the words ‘market in Australia’ in s 4E. We saw that in determining whether goods or services are substitutable we had to consider the geographic dimension of the market, and that the mechanism for determining this was the HMT. Under this test, there is no reason why the market might not extend beyond the territorial boundaries of Australia, if there is evidence that consumers will switch to an overseas source of supply in response to a 5-10% increase in price. Do the words ‘market in Australia’ dictate that we are to stop the HMT analysis at the territorial boundaries of Australia, and that markets for the purposes of the TPA are to be confined to Australia?

38. This was the subject of considerable comment and criticism at the time of the Dawson Committee Inquiry. It was seen as too restrictive and as not reflecting reality in the case of global markets that extend beyond Australia’s territorial borders.<sup>19</sup> Maureen Brunt in her submission to the Dawson Committee observed that one consequence of the narrow market definition in s 4E is that practitioners’ attention is unduly focused upon domestic evidence and argument, and she had difficulty seeing how s 50 might apply to the merger of the iron ore operations Rio Tinto and BHP which she characterised as largely a “merger for export”.<sup>20</sup> The Dawson Committee concluded that no change was necessary.

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<sup>19</sup> See Clarry, “Contemporary approaches to market definition: Taking account of international markets in Australian competition law” (2009) 37 *Australian Business Law Review* 143 at 162-5 for a summary of the submission to the Dawson Committee Inquiry and the findings of the Committee.

<sup>20</sup> Brunt, *Submission to the Dawson Committee* (28 August 202) p2.

39. The approach adopted by the ACCC is set out in its 2008 *Merger Guidelines*:

Section 4E specifies that “market” is a market in Australia. The ACCC's view is 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 or even a global market – provided that at least some part of it is located in Australia. In most cases the ACCC will define the relevant market to be Australia or a part of Australia, and take full account of any competitive constraint provided by suppliers located outside Australia when considering import competition.<sup>21</sup>

40. The courts also accept that the definition of “market in Australia” in s 4E excludes a market that is wholly outside Australia.<sup>22</sup> Let me now try to answer the three questions I posed earlier

### **How profound is the impact of the Internet on retailing?**

41. The value of e-commerce sales in Australia has reached \$24 billion and is predicted to rise to \$34 billion in 2012. However, the majority of e-commerce transactions (40%) are imports made on international websites. Online sales constitute only 3% of total retail sales in Australia. Major “bricks and mortar retailers” see the Internet as a marketing tool rather than a sales outlet and have a relatively limited on-line offer. Some are gradually building a “clicks and mortar” presence. For example, Woolworths has launched a Big W online site which offers 4,000 items compared with 60,000 in a Big W store.<sup>23</sup>

### **Is the availability online music a close substitute for physical format music (CDs) such that they can be said to fall into the same product market, and is the geographic dimension of this market global?**

42. Where Internet sellers compete with traditional sellers, defining the geographic market becomes complex. One possible approach would be to define the market as global so long as the Internet seller is prepared to deliver goods ordered over the Internet globally at a competitive price. However, expanding the geographic market in this way would have the consequence of including, not just Internet sellers, but

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<sup>21</sup> ACCC, *Merger Guidelines*, (November 2008), [4.31].

<sup>22</sup> *Riverstone Computer Services Pty Ltd v IMB Global Financing Australia Ltd* [2002] FCA 1608 at [21], [22]; *ACCC v Qantas Airways Limited* (2008) 253 ALR 89 at [33]-[34]; *Auskay International Manufacturing and Trade Pty Ltd v Qantas Airways Ltd* (2008) 251 ALR 166; and *Singapore Airlines Ltd v ACCC* (2009) ATPR 42-297 at [70]-[71] (Black CJ, Mansfield and Jacobson JJ).

<sup>23</sup> See Mitchell, “Majors miss out on online retail sales” *Australian Financial Review*, 8 July 2010, p18.

also bricks and mortar music retailers in remote areas that exert no constraining influence on local bricks and mortar music retailers.

43. In relation to the product dimension, it is unlikely that “bricks and mortar” CD retailers will provide a strong competitive constraint to on-line music retailers, at least in the short to medium term. The key advantages that online music retailers offer consumers is that they can buy online music immediately from any computer with Internet access, without having to wait or visit a store. Consumers can also download individual tracks online without buying the entire album. Both of these advantages possessed by online music mean that consumers are unlikely to switch to physical format recorded music in response to a SSNIP of 5-10% by on-line music retailers, in which case there is a separate product market for on-line music.<sup>24</sup>

44. Indeed, it may be possible to define the online music product market more narrowly on the basis of the perceived advantages of one mode of delivery over another. Online music can be downloaded over the Internet via a computer, or via a mobile phone. The advantages of downloading music via mobile telephony such as convenience may mean that personal computers do not exercise a constraining on mobile telephony as a mode of delivery. Alternatively, they may be part of the same converging market rather than separate product markets.<sup>25</sup>

45. As regards the geographic dimension of the market, this will vary according to cultural and linguistic differences regarding the choice of music, but is likely to be national rather than global.

46. This appears to be the ACCC’s current approach in its merger assessments. For example, in its Public Competition Assessment of the proposed acquisition by A&R

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<sup>24</sup> See Case No COMP/M.2050- Vivendi/Canal+/Seagram (Date: 13/10/2000) available at: [http://ec.europa.eu/competition/mergers/cases/decisions/m2050\\_en.pdf](http://ec.europa.eu/competition/mergers/cases/decisions/m2050_en.pdf). For European Union competition law analysis see: “Market Definition in the Media Sector – Economic Issues” (European Economics Report) available at : [http://ec.europa.eu/competition/publications/studies/european\\_economics.pdf](http://ec.europa.eu/competition/publications/studies/european_economics.pdf); “Market Definition in the Media Sector – Comparative Legal Analysis” (Bird & Bird Report) available at: [http://ec.europa.eu/competition/publications/studies/legal\\_analysis.pdf](http://ec.europa.eu/competition/publications/studies/legal_analysis.pdf). There are also more documents available on the European Commission’s website addressing competition within the media sector, which can be accessed via this link:<http://ec.europa.eu/competition/sectors/media/documents/index.html>

<sup>25</sup> Case No COMP/M.5272 - Sony/ Sony BMG (Date: 15/09/2008) available at: [http://ec.europa.eu/competition/mergers/cases/decisions/m5272\\_20080915\\_20310\\_en.pdf](http://ec.europa.eu/competition/mergers/cases/decisions/m5272_20080915_20310_en.pdf).

Whitcoulls Group Holdings Pty Limited (ARW) of Borders Australia Pty Limited dated 27 February 2008,<sup>26</sup> the ACCC stated that although there was a national market for the acquisition of books by retailers from publishers and wholesalers, local markets existed for the retail sale of books to consumers. The ACCC recognised that Borders was a significant importer of books without copyright protection in Australia, and that consumers can also purchased books directly from overseas based on Internet sites.<sup>27</sup> However, the ACCC stated that the relevant geographic market for the retail sale of books was the area in which consumer substitution would occur in response to a SSNIP of 5-10%, rather than the catchment area of the stores. The ACCC concluded that the geographic dimension of the retail market was a series of local markets.

47. The ACCC's reasons for adopting a local market are contained in the following paragraph:

It is important to note that not every book retailer within the local market will impose the same competitive constraint. There are a number of factors that will increase the competitive constraint imposed by certain competitors in any given local market. In particular, proximity is an important factor in local book retailing markets. Market inquiries revealed that retailers tend only to pay close attention to book retailers operating in very close proximity to their stores. Other factors which affect the strength of the competitive constraint between two book retailers include similarity of range, size, service, target demographic, type of location (mall or strip), and format (independent or chain). Two retailers which are similar in each of these respects and which are located very close to each other will impose a much stronger constraint on each other than two retailers which are more distant from each other (geographically and/or in respect of the other factors listed here).<sup>28</sup>

48. The ACCC, in defining the geographic dimension of the market, is concerned with close substitutes (strong competitive constraints). It appears that on-line book sales by Amazon imposed only a weak, or negligible, competitive constraint in the retail market for books. The ACCC observed:

Consumers can purchase books from Australian and international websites, most notably from Amazon.com, which has no Australian website but sells into Australia via its UK and US sites. The landed price of Amazon books is generally comparable to prices at retailers with a shop-front presence (referred to in the book retail industry

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<sup>26</sup> Available at:

<http://www.accc.gov.au/content/item.php?itemId=811743&nodeId=b3c08475c249e40b918a28828f9bd416&fn=A&R%20Whitcoulls%20Group%20Holdings%20Pty%20Ltd%20-%20proposed%20acquisition%20of%20Borders%20Australia%20Pty%20Ltd%20-%2027%20February%202008%20-%20books.pdf>

<sup>27</sup> Ibid at [22]-[23].

<sup>28</sup> Ibid at [26].

as “bricks and mortar retailers”), although this varies with exchange rate fluctuations, order size, and postage costs. Many retailers noted that orders on Amazon do not include GST.

Bricks and mortar retailers offer consumers the ability to browse in store and to avoid the delay in obtaining a book via the internet or mail-order. These are the key advantages of bricks and mortar retailers over online stores.

The ACCC’s inquiries indicated that the bricks and mortar retailers do not consider internet pricing when setting prices (although it appears more likely that they consider the websites of other bricks and mortar retailers).

The ACCC considers that, although the internet may be an increasing channel for book purchases in Australia, it is not a close substitute for the merger parties and is not comparable to the bricks and mortar retailers in terms of the competitive constraint it would provide to the merged entity.

Specifically, the ACCC considers that the internet is unlikely to provide a strong competitive constraint on bricks and mortar book retailers, at least in the short to medium term, and the ACCC did not rely on the internet as a constraint in reaching its decision.<sup>29</sup>

### **Do global markets exist and are the administrative agencies prepared to recognise them?**

49. This analysis does not deny the existence of global markets. The ACCC is prepared to recognise them. Its treatment of them is set out in its *2008 Merger Guidelines*:

Section 50(6) also states that “market” means a market for goods or services in Australia, or in a State, a Territory or region of Australia. In addition, s 4E specifies that “market” is a market in Australia. The ACCC’s view is 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 or even a global market – provided that at least some part of it is located in Australia. In most cases the ACCC will define the relevant market to be Australia or a part of Australia, and take full account of any competitive constraint provided by suppliers located outside Australia when considering import competition<sup>30</sup>

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<sup>29</sup> Ibid at [61]-[65].

<sup>30</sup> ACCC, *Merger Guidelines*, (November 2008), [4.31].

50. In its Public Competition Assessment of BHP Billiton's proposed acquisition of Rio Tinto Ltd and Rio Tinto plc dated 1 October 2008,<sup>31</sup> the ACCC market inquiries established that:

The vast majority of traded iron ore is supplied under long term contracts. Steel makers and iron ore miners typically prefer long term contracts for security of supply and investment certainty. While a small proportion of global iron ore trade occurs on a spot market basis, the volume traded on the spot market has increased in recent years. Most of the iron ore supplied under long term contracts is currently priced with reference to global benchmark prices. Global benchmark prices for each form of iron ore are determined by annual negotiations between the main global suppliers and the main steel makers and generally reflect a consensus as to the balance between supply and demand over the coming year. ...Significant quantities of iron ore are supplied in Australia at prices that are linked to global iron ore prices. Global iron ore prices therefore have a direct effect on Australian steel makers. Furthermore, since iron ore is a significant input into the production of steel, the price of iron ore also has an impact on the price of steel and other steel-based products consumed in Australia.<sup>32</sup>

51. The ACCC's market inquiries confirmed that suppliers of iron ore lump and iron ore fines were likely to face strong competitive constraints from suppliers located outside Australia, although the extent of that constraint would vary depending on fluctuations in sea freight prices.<sup>33</sup> The relevant markets were defined as:

- the global seaborne supply of iron ore lump;
- the global seaborne supply of iron ore fines;
- the national (Australian) supply of iron ore lump; and
- the national (Australian) supply of iron ore fines.<sup>34</sup>

### Concluding remarks

52. Let me conclude by advancing the following propositions:

- First, markets are constantly changing over time as technologies and modes of delivery change. We need to be cognisant of these changes and take

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<sup>31</sup> Public Competition Assessment , *BHP Billiton Ltd – proposed acquisition of Rio Tinto Ltd and Rio Tinto plc* (1 October 2008) available at: <http://www.accc.gov.au/content/item.php?itemId=844626&nodeId=7c9647298cc13cbf422bd85316445250&fn=BHP%20Billiton%E2%80%94proposed%20acquisition%20of%20Rio%20Tinto%E2%80%941%20October%202008%E2%80%94mining.pdf.pdf>

<sup>32</sup> Ibid at [20]-[22].

<sup>33</sup> Ibid at [24]. See Nilsson, "Merger policy and the EU: How can the Air-tours decision affect minerals and energy markets?" (2002) 17(4) *Minerals & Energy - Raw Materials Report* 18-24.

<sup>34</sup> Ibid at [26].

account of them in defining markets for the purposes of competitive analysis if they make a real difference to the status quo.<sup>35</sup> However, in the short to medium term, the Internet is unlikely to have a profound impact on the way geographic markets are defined. For the immediate future there is a risk of over-stating the geographic dimension of markets by expanding them outward to encompass Internet sellers. The Internet is unlikely to exercise a strong competitive constraint on bricks and mortar retailers in most markets for consumer goods and services.

- Secondly, at least so far as the ACCC is concerned, there will continue to be a tendency to define geographic retail markets as a series of local markets rather than national or global ones because bricks and mortar retailers only exercise a strong constraining influence on others that are in close proximity.
- Thirdly, despite the reference to “market in Australia” in the definition of market in s 4E, the courts and administrative agencies are not precluded from analysing conduct in the context of a geographically broader market outside Australia – even a global market – if there is evidence that prices are set on a global basis and buyers in Australia are affected by the global price setting.

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<sup>35</sup> For example, in 1995 the ACCC allowed program sharing arrangements between Foxtel and Australis on the basis that Pay-TV and free-to-air TV were part of the same product market. In less than nine months the ACCC had redefined the market and rejected the proposed merger between pay-TV companies, Foxtel and Australis on the basis that Pay-TV and free-to-air TV are separate product markets. See Veljanovski, *Pay TV in Australia Markets and Mergers* (Institute of Public Affairs, Melbourne, 1999), p 50.