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Merger Reform Information Team
Australian Competition and Consumer Commission (ACCC)
23 Marcus Clarke Street
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Dear Sirs,

Comments on draft merger guidelines

Thank you for the opportunity to provide feedback on the merger guidelines. The guidelines are really well written, simple, and clear. It's an excellent document. The comments below are in the order of the text; the main comments are in **bold** and the others are minor comments.

1. Page 23, item 2.7 and page 25, item 2.15. I agree that high switching costs should be included in this list, but contractual lock-in does not seem like the type of switching cost that is relevant. If I am locked into a contract with the merged entity, that contract should also preclude the firm from unilaterally raising the price that I pay. It's very difficult to imagine a contract that prevents me from changing suppliers but allows my current supplier to unilaterally raise the price. The list should include technological switching costs such as technological lock-in, for example if learning a system requires some investment, real or perceived, by consumers).
2. Page 26, item 3.2. Given that auctions are plagued with collusion problems, I would include "or which auction they will bid aggressively in".
3. Page 26, item 3.3. I may be misreading the meaning of "suppliers" in the Tribunal definition. Coordinated effects depend on the actions of my firm's competitors, not the actions of my firm's suppliers.
4. Page 26, item 3.5. It may not be necessary to mention here, since entry is addressed later; but the first two effects (reducing the number of competing firms and removing a maverick) only hold if there are barriers to entry. If there are no barriers to entry, then buying up a maverick just gives incentives for more mavericks to enter, for example.
5. Page 26, item 3.5. "Making the market more vulnerable to coordination". A brief example would be useful here, otherwise it sounds a bit tautological.
6. Page 28, item 3.14. "Profit-maximising firms have an incentive to coordinate when the expected profits from coordinating are greater than the expected profits from behaving independently." This is always true! Coordination always creates larger profits. So, I would say instead "Profit-maximising firms have more incentive to coordinate the greater the expected profits from coordinating relative to the expected profits from behaving independently".
7. Page 28, item 3.15. I would add "when some firms are under financial pressure or likely to exit the market".
8. Page 30, item 3.21. Mention pre-merger trends in bidding behaviour as well, given that collusion has been detected in a number of auctions.
9. Page 39, item 3.22. There could still be competition, but weakened competition, for example, less intense competition for new customers.

10. **Page 31. Vertical effects. Broadly speaking there are three main reasons for vertical mergers: supply assurance, raising rivals' costs, and providing incentives for relationship-specific investment. This explanation is exclusively focused on foreclosure, which spans certain types of supply assurance and raising rivals' costs; and so it's incomplete.**

    - Supply assurance relates to incentives to improve one's bargaining position vis-à-vis one's suppliers (or customers). If I buy out one of my suppliers, under certain cost and demand structures, the bargaining position of my remaining suppliers worsens. While the incentives for the merger are not about foreclosure, it can be re-cast as a foreclosure argument: the other suppliers are now experiencing worse terms. So, this does not require a change to the text.
    - Raising rivals' costs: because the merged firm will want to sell to other customers at higher prices (or restrict supply), the bargaining position of those other customers worsens with respect to other suppliers as well. Therefore, the text should be clearer that the anti-competitive effects could also include any changes in prices paid by other supplier firms to other customer firms. In particular, higher input supply prices are likely to have negative effects on consumers. (The discussion on page 12 could acknowledge this point.)
    - Providing incentives for specific investment (avoiding hold-up): the question here would be whether the other firms are more at risk of hold-up (and therefore less likely to invest) once the merger has taken place. The merger could be beneficial or harmful to them, when bargaining power shifts after the merger. The integrated entity might invest more, and other entities less, which could distort competition.

11. Page 33, item 4.10. "The market power of the firms selling those inputs" should be one of the factors considered, and possibly "the size of sunk investments costs in this industry" (relating to the third point, above).

12. **Page 34, item 4.13: this discussion does not quite line up with the academic literature (though it is possible that the academic literature has strayed into some less relevant considerations). The academic literature takes as its starting point the Chicago school critique: if there is upstream market power, why couldn't that market power be used before the merger, and why would the merger make it easier to use? So, it's not enough to ask whether the merged firm could profit from restricting supply to another downstream firm; you have to ask why the upstream firm couldn't restrict supply before the vertical merger. The literature based on Rey and Tirole (2007) has postulated that the upstream monopolist is unable to fully exercise his market power because when contractual terms are unobservable to non-contracting parties, he cannot resist offering 'secret price cuts' to downstream firms. As a result, the quantities are Cournot rather than monopoly quantities. After the merger, the firm internalises more of the downstream profits, and therefore reduces the quantity to the non-integrated downstream firm.**

13. Page 34-35, item 4.14 and 4.19 and 4.20. Related to the previous point, I don't think the statement in 4.19 is correct either. There is not an increase in demand for the upstream input, but a different ability to exercise market power. And in 4.14 and 4.20 there is no "volume of extra sales".

14. Page 35, item 4.18. The presence of a suitable alternative customer certainly reduces the likelihood of foreclosure; but the upstream firm may still receive lower prices after the merger, if its alternatives are fewer.

15. **Page 35, item 4.27 and 4.28. Similarly to the comment on item 4.13, this section on conglomerate effects needs to be tighter. The Chicago school critique would say that while firms can benefit from bundling complements and integrating products in a digital ecosystem, there is no reason that such actions would not be profitable in the absence of a merger. And forcing consumers to use a less preferred related product would lower profits. There needs to be either:**

    (a) a reason why the market power from one market cannot be fully exercised (for example, a popular comparison website wants to direct consumers to its own products because it cannot sell higher positions without losing reputation), or
    (b) a reason why entry is more difficult once the conglomerate merger has occurred (ie if an entrant needs to enter two markets at once), or
    (c) a reason (such as networks effects plus customer lock-in) why leveraging market power from one market into another will lead to long-term profits in that second market.

16. Page 43, item 5.30. If competitors will need to enter multiple markets to be competitive, then a merger across markets could lead to entry deterrence if the merged entity has more incentive to erect entry barriers (including pricing aggressively after entry). For example, most people shop in their local area, but Aldi needs to be able to set up multiple stores in a region in order to establish a distribution centre.

So, I would add an extra bullet point: "if competitors would need to enter multiple markets in close succession". This is mentioned in box 8 but should be in 5.30 as well.

17. Page 47, item 6.2 and following. It would be good to emphasise that there is a succession of potential entrants. Acquiring an entrant will lessen competition only if there are barriers to prevent future entrants. (For example, acquiring a particularly innovative entrant in a high-technology market could mean that significant time passes before another such entrant appears.)

18. Page 49, item 6.9. The success of past entrants is also relevant.

19. **Page 50, the section on Countervailing Power. This section is not quite tight enough. This section implies that customers have countervailing power if the consequence of a breakdown in supply are not serious for the customer, because the customer has good alternatives. But bargaining theory says that there is countervailing power if the consequences of a breakdown in negotiations are <u>symmetric</u>: that is, a breakdown in negotiations inflicts roughly the same costs on the buyer as on the supplier, even after a merger. The costs can be high or they can be low. For example, if the merger between Heinz and Rafferty's Garden (ACCC 2013) had gone ahead, a breakdown in negotiation between Heinz and one of the major supermarkets would be extremely costly for both parties. Customers might turn elsewhere to shop and Heinz would lose considerable income. But the impact of a breakdown would be more serious for a supermarket chain: there would be almost no baby food at all on the shelves of one supermarket, whereas Heinz-Rafferty's would still be able to sell through the other supermarket, and parents would probably switch to that other supermarket. That would suggest an asymmetric impact, and therefore each supermarket chain (despite having significant market power) would have insufficient countervailing power.**

    6.14 and 6.16 should be written so that we are not just looking at the outside options of the customer of the merged firm, but also the merged firm's outside options.

Yours sincerely

Catherine de Fontenay

Catherine de Fontenay
Commissioner

References
ACCC 2013, Statement of Issues: H.J. Heinz Company Australia Limited – proposed acquisition of Rafferty's Garden Pty Ltd, 7 February 2013, https://www.accc.gov.au/system/files/public-registers/documents/MER13%2B1190.pdf (accessed 22 April 2025).
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