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A Tale of Two Cities: From Davids Holdings to Metcash

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In 1994, the Full Federal Court upheld the decision of the trial judge to prevent the acquisition of QIW by Davids, on the grounds that, Davids would become the only supplier of groceries to independent retailers in the geographic market. While the independent retailers faced significant competition in the downstream (retail) business from the integrated retail chains, the Court found that such competition would not be sufficient to prevent the exercise of monopoly power in the upstream (wholesale) business.

In 2011, the Full Federal Court upheld the decision of the trial judge not to prevent the acquisition by Metcash of Franklins. The acquisition had been opposed by the ACCC on the grounds that it would leave Metcash as effectively the only wholesale supplier of packaged groceries to independent retailers in New South Wales. The Court rejected the Commission's claim, finding that the merged firm would not be able to exercise market power due to the constraining presence downstream of the integrated retail chains.

Two cases with apparently similar facts. What explains the different outcomes? In this article, we try to identify a critical analytical difference in the way that the cases were presented to the Court and will suggest that this difference may have had a significant influence on the outcomes.

1 Introduction

In 1994, the Full Federal Court upheld the decision of the trial judge to prevent the hostile acquisition of a majority shareholding in QIW Retailers Ltd (QIW) by Davids Holdings (Davids), on the grounds that, as a result of the proposed merger, the merged company would be in a position to dominate a market defined as the supply of grocery products by independent wholesalers to independent retailers in Queensland and northern New South Wales.[1] The case was brought under the old s 50 of the Trade Practices Act 1974 (Cth) (as amended in 1977) which contained the dominance test. In January 1993, shortly after the trial in *Davids Holdings* had commenced, the Act was amended to incorporate the 'substantial lessening of competition' test that is still in effect today. However, the trial judge determined that, because the court proceedings had already begun, according to s 21(2) of the amendment the original terms of the Act would continue to apply.

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1 Hay wrote about the *Davids* case in an earlier article, 'Market Definition and Market Dominance: Issues from the Davids-QIW Merger Case' (1995) 3 *CCLJ* 2. For convenience and consistency, portions of that article will be used in the factual summary of the case and the various decisions in the case.

The basic claim of the applicants[2] was that, as a result of the merger, Davids would be the only supplier of groceries to independent retailers in the geographic market and would, as a result, be in a position to exercise monopoly power. While the independent retailers faced significant competition in the downstream (retail) business from the integrated retail chains (such as Coles and Woolworths), the court found that such competition would not be sufficient to prevent the exercise of monopoly power in the upstream (wholesale) business.

In 2011, the Full Federal Court upheld the decision of the trial judge not to prevent the acquisition by Metcash Trading Ltd (Metcash) of Interfrank Group Holdings Pty Ltd (Franklins). The acquisition had been opposed by the Australian Competition and Consumer Commission (ACCC) on the grounds that it would leave Metcash as (effectively) the only wholesale supplier of packaged groceries to independent retailers in New South Wales.[3] The court rejected the commission's claim, finding that the merged firm would not be able to exercise market power due to the constraining presence downstream of the integrated retail chains (primarily Coles and Woolworths).[4]

So we have two cases with, on the surface at least, very similar facts. Yet the outcomes in the two cases were 180 degrees apart. What explains the different outcomes? Of course, we have a different set of judges, different lawyers, mostly different economists,[5] somewhat different corporate entities, mostly different geographic areas affected, different counterfactuals,[6] and, of course, the passage of almost 20 years. Any or all of these may have mattered. However, in this article, we try to identify a critical analytical difference in the way that the cases were presented to the court and will suggest that this difference may have had a significant influence on the outcomes.

The analysis in *Davids* focused almost entirely, but with little concrete evidence, on the question of whether downstream price competition from the integrated chains, by itself, would be sufficient to prevent the would-be monopolist independent wholesaler from charging a supra-competitive price to at least some of its customers, the independent retail grocery stores; that is, whether such a price would turn out to be unprofitable because it would be passed on by the independent retailers who would then lose retail customers to the integrated chains. The conclusion that the court drew was that such a

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2 The applicants were QIW and the Attorney-General. The then Trade Practices Commission did not oppose the transaction.

3 *ACCC v Metcash Trading Ltd* (2011) 282 ALR 464; [2011] FCA 967; BC201106415 at [113] (*Metcash*.)

4 Ibid, at [340] and [430]. The court also took issue with the commission's proposed counter-factual: ibid, at [424]–[426] and [460]. The South African owner of Franklins (Pick n Pay) had made an apparently irreversible corporate decision to exit the Australian market, so the commission proposed a counterfactual that envisaged the Franklins stores providing the nucleus for a new wholesaler that would compete against Metcash: ibid, at [347]–[349].

5 Professor Hay was the only economist directly involved in both litigation matters. There were other economists who testified in *Davids* who may have had some involvement in *Metcash* but not as testifying experts.

6 The counterfactual in *Davids* was that the acquisition of the majority shareholding would not be permitted, leaving QIW to continue as an independent entity. As indicated below, by the time of the trial in *Metcash*, it seemed clear that the status quo ante was not a plausible option.

supra-competitive price would not result in such a substantial loss of business to the chains that it would be unprofitable and therefore concluded that the other independent wholesaler was the only thing standing in the way of Davids' achieving dominance.[7]

In contrast, the *Metcash* analysis (as presented by the respondents and apparently accepted by the court) identified in concrete terms a number of ways that the integrated chains had competed and would continue to compete against Metcash and demonstrated that with respect to all or almost all those forms of competition, the chains posed a greater threat than Franklins to any effort by Metcash to exploit market power. The implications for market definition then were that the market could not properly be limited to the 'wholesale supply of packaged groceries to independent supermarket retailers', as the applicant had urged.[8]

The factual backgrounds

Davids Holdings

Davids was the holding company of a group of companies whose principal activities were the wholesaling and distribution of a range of grocery products and liquor in Victoria, New South Wales, and Queensland. QIW was the holding company of a group of companies whose principal activities were the wholesaling and distribution of a similar range of grocery products in Queensland and northern New South Wales. The primary customers of Davids and QIW relevant for the analysis of the transaction were independent retailers of grocery products in Queensland and northern New South Wales, that is, those retailers of grocery products other than the three major chains carrying on business in the area (Coles, Franklins, and Woolworths).[9] For all practical purposes, Davids and QIW were the only companies serving independent retailers in the geographic area at the time. The chains, in contrast, were and still are vertically integrated, so that the function of getting the groceries from the manufacturer to the retail outlets was performed in-house. Both the independent retailers and the chains sold to the general public.

7 While the trial judge discussed the functional dimension of the market, his ultimate decision was not based simply on the formal notion that the merging parties sell almost entirely at the wholesale level and that the vertically integrated chains sell at the retail level. Rather, he asked the economically correct question of whether the retail operations of the chains operated as a significant check on the power of Davids and QIW and concluded that they did not. Presumably, had he found otherwise, he would have answered the dominance question differently, regardless of how he might have described or defined the market.

8 *Metcash* (2011) 282 ALR 464; [2011] FCA 967; BC201106415 at [1]. As will be discussed, there was some tension between the market definition proposed by the applicant and that preferred by its expert economist.

9 At the time, Franklins was operating as a vertically integrated grocery chain owned by Dairy Farm International. See, *Report of the ACCC Inquiry into the Competitiveness of Retail Prices for Standard Groceries*, July 2008, p 43 (*2008 Grocery Inquiry*.

Metcash

Metcash supplied grocery products on a wholesale basis to independently owned stores of all sizes in New South Wales and throughout Australia.[10] Metcash was, by a wide margin, the largest wholesale supplier of groceries to independently owned stores in New South Wales. In addition, while it did not own retail grocery outlets outright,[11] Metcash had a significant degree of contractual vertical integration in relation to independent stores operating under Metcash's IGA banner.[12] IGA stores were required to run their businesses according to Metcash standards governing the look and feel of the store and to price in accordance with advertised promotional activities.[13] Metcash offered the IGA stores a range of services including retail business advice, financial backing for leases, and investment subsidies in store refurbishments.[14]

In 2001, Pick n Pay (Pty) Ltd (Pick n Pay), a South African based grocery retailer acquired the Franklins brand and 70 retail grocery stores in New South Wales.[15] Over the ensuing decade, Pick n Pay made further investments to acquire and open new Franklins stores and to refurbish existing stores. In addition, in 2006, Franklins launched a programme to establish franchise stores that would operate under the Franklins banner.[16] By the time of the merger, Franklins owned 79 retail grocery stores, operated one more, and had franchise agreements with 10 stores.[17] Under Pick n Pay's ownership, Franklins also entered the upstream business of wholesale grocery supply although it never supplied third-party retail stores.[18]

Pick n Pay's total investment in Franklins by the time of the hearing was about $289 million, and Franklins had suffered losses in seven of the years it

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10 *Metcash* (2011) 282 ALR 464; [2011] FCA 967; BC201106415 at [21].

11 Metcash did have a 26% ownership interest in several IGA supermarket stores, which, in general, were high volume Supa IGA stores. Those investments were intended to secure Metcash's wholesale supply to the stores: *Metcash* (2011) 282 ALR 464; [2011] FCA 967; BC201106415 at [205].

12 Stores operating under the IGA banner accounted for between 70–75% of sales by Metcash's wholesale grocery division: *Metcash* (2011) 282 ALR 464; [2011] FCA 967; BC201106415 at [21].

13 Ibid, at [39]–[40].

14 Ibid, at [21], [258]–[259], [276]–[277]. Some services, such as the retail pricing service were available to Metcash's non-IGA customers as well: ibid, at [35].)

15 Pick n Pay acquired the Franklins brand and 50 stores from Dairy Farm International and 20 Fresco stores, all in New South Wales. Franklins stores not acquired by Pick n Pay, including those outside New South Wales, were either sold to competing retailers and re-branded, or closed: *2008 Grocery Inquiry*, above n 9, p 43. Pick n Pay did not acquire any wholesaling assets in these transactions: *Metcash* (2011) 282 ALR 464; [2011] FCA 967; BC201106415 at [72].

16 *Metcash* (2011) 282 ALR 464; [2011] FCA 967; BC201106415 at [285].

17 Ibid, at [13]–[14].

18 From 2001 through 2004, Franklins stores had acquired grocery inputs primarily through Metcash, but in 2005, Franklins began to self-supply groceries: *Metcash* (2011) 282 ALR 464; [2011] FCA 967; BC201106415 at [72]–[74]. Unlike Metcash, Franklins achieved much of its wholesale grocery supply service through contractual arrangements rather than through full-scale integration of the warehousing and distribution functions: *Metcash* (2011) 282 ALR 464; [2011] FCA 967; BC201106415 at [338].

was owned by Pick n Pay, for net losses of $105 million over the period.[19] Pick n Pay resolved to sell its Franklins assets, either in a block to a single buyer, or piecemeal if necessary.[20] In July 2010, Metcash proposed to acquire Franklins.[21] Metcash planned to close down Franklins' warehouse assets and sell the Franklins stores, with the hope of expanding the Metcash wholesale customer base in New South Wales and achieving greater economies of scale in wholesale activities.[22]

The proceedings

Davids Holdings

The takeover by Davids was not contested by the (then) Trade Practices Commission but was opposed both by QIW and by the Attorney-General, and litigation commenced in 1992 based on the claim that the proposed merger would violate s 50 of the Trade Practices Act. As discussed above, because the amendments to s 50 were not in place when it began, the litigation was based on the unamended version of s 50, that is, whether, as a result of the acquisition, the corporation would be, or would be likely to be, in a position to dominate a market for goods or services.[23] The applicants asserted that the relevant market was limited to wholesalers to independent retail stores and that the merged firm would have effectively 100% of such a market. The respondents claimed that the relevant market must somehow account for the activities of the chains and that, however the market was described, the merged firm would not be dominant.

A trial was held in the Federal Court in Brisbane in late 1992 before Spender J and a decision was handed down on 30 April 1993.[24] The trial judge held that the relevant market was for the supply of grocery products by independent wholesalers to independent retailers in Queensland and northern New South Wales, that the market was a substantial one, and that the merged entity would, or would be likely to, dominate the market. Davids appealed, but the decision of the trial judge was upheld by the Full Federal Court (Von Doussa, O'Loughlin and Drummond JJ) on 22 April 1994.[25]

Metcash

In November of 2010, the ACCC informed the parties that it considered the merger would substantially lessen competition in a market for the wholesale

19 *Metcash* (2011) 282 ALR 464; [2011] FCA 967; BC201106415 at [20].
20 Ibid, at [422].
21 Ibid, at [2].
22 Ibid, at [338] and [451].
23 Since then, the amended statute (where the test is based on a substantial lessening of competition) has gone into effect. However, whether the ultimate test is dominance or substantial lessening of competition, under either test, market definition is still usually the first and often most critical step despite a push by some academics (with some support from the US antitrust agencies) to bypass it. See, L Kaplow, Market Definition and the Merger Guidelines, *Review of Industrial Organization*, vol 39, 2011, pp 107–125 and US Department of Justice and the Federal Trade Commission, 'Horizontal Merger Guidelines', 19 August 2010, § 4 (US Merger Guidelines).
24 (1993) ATPR 41-227.
25 (1994) 49 FCR 211; 121 ALR 241; ATPR 41-304; BC9405829.

supply of packaged groceries to independent supermarket retailers in New South Wales and the Australian Capital Territory.[26] The ACCC commenced a proceeding to block the proposed acquisition, and a decision by Emmet J was issued in favour of the merging parties on 25 August 2011. The decision was upheld by the Full Federal Court (Finn, Buchanan and Yates JJ) in November 2011, and the acquisition of Franklins by Metcash was completed thereafter.

The decision in the initial hearing was based on a detailed discussion of the market in which Franklins and Metcash operated and the identification of players that were 'in' that market in the sense that they would constrain the ability of the merged entity to raise prices. A second issue the judge addressed, though he claimed that strictly speaking he need not,[27] was the likely competitive outcome with the merger compared to the likely competitive outcome without the merger.

The analysis

Davids Holdings

The respondents claimed, using a standard Chicago-school model, that, if at retail there was perfect (or near-perfect) competition between the independent stores and the integrated chains, then the retail prices of the independent stores would be completely constrained by the prices of the integrated chains, and therefore, even if the independent stores had no alternative but to buy from the post-merger monopoly wholesaler, there would be no opportunity for that 'monopolist' profitably to increase prices, because any attempt to increase prices would cause a significant shift by consumers to the integrated chains and a corresponding loss of sales by the single wholesaler. Therefore, the single wholesaler could not be said to be dominant in any economic sense. Analytically, if the independent stores and integrated chains were in the same retail market, then it did not make sense to treat the wholesaling activities of Davids and QIW as in a separate market from the wholesale 'activities' of the integrated chains.

The court in *Davids* was certainly aware that, at the retail level, the independent retail stores faced competition from the integrated chains, though the court never reached the point of agreeing that, at the retail level, the independents and the chains were in the same market. The court may either have disagreed with the respondents' proposition or thought it irrelevant to the analysis of the merger. One of the factors influencing the court's thinking was the degree of product differentiation it perceived to be present in grocery retailing. Independent stores were generally smaller, and typically operated longer hours (due at least in part to regulatory constraints on the chains' hours of operation), and at least for some customers, may have been more conveniently located. The independents also typically charged higher prices

26 *Metcash* (2011) 282 ALR 464; [2011] FCA 967; BC201106415 at [2] and [181].

27 Ibid, at [342]: 'The Commission has based its case solely on there being a separate market for the wholesale supply to independent retailers of packaged groceries, as defined. The commission's pleaded case as to market definition has not been made out. It follows that the proceeding must fail. However, I propose to deal with the issue as to the counterfactuals propounded by the Commission'.

for similar items, which the court took, probably mistakenly, as a sign that the independents enjoyed a non-trivial degree of market power. (The alternative view is that the higher prices were necessary to cover the independent stores' higher costs, and that the longer hours, and sometimes more convenient locations, were enhanced service offerings through which the stores offset the higher prices in an effort to retain customers.)[28] If the independent stores did enjoy a degree of market power, that is, their prices were not constrained to a competitive level by the retail prices of the integrated chains, then there might have been some market power rents for the post-merger wholesale monopolist to extract.[29]

Subsequent to the court's disapproval of the proposed merger, a nearly identical transaction was authorised by the tribunal on public benefit grounds.[30] While, technically, the tribunal did not overrule *Davids Holdings*, the tribunal's analysis was much closer to that proposed by the respondents in *Davids Holdings* than to that put forward by the court.

Metcash

As the respondents' expert discussed in the *Metcash* proceeding, the reality was more nuanced than the applicant's description of the grocery business as consisting of vertically integrated chains, on the one hand, and independent retail stores, on the other, with the independent retail stores being supplied principally by one of two wholesalers that participated in a market described as 'wholesale supply of packaged groceries to independent supermarkets'.[31] The overwhelming portion of Franklins' business was conducted through its 80 company-operated stores, so in that sense, while small, Franklins looked more like one of the vertically integrated chains.[32] Franklins' role as a supplier of groceries to independent retailers was limited to the sales it made to the 10 franchised Franklins stores, although there was the potential to expand Franklins' wholesale business at the expense of Metcash. But, strictly speaking, Franklins' actual share of a market described as 'the wholesale supply of packaged groceries to independent grocery stores' was, according to Metcash, small enough that there would be no significant increase in market concentration.[33]

At the same time, while Metcash did not own any retail stores outright, Metcash owned the IGA banner under which most of its largest retail customers operated and had complex contractual relationships with those retail stores, so there was vertical integration by contract rather than through ownership. Metcash was not simply a 'box-mover', that is, providing a depot

28 The judge in *Metcash* was of this alternative view: (2011) 282 ALR 464; [2011] FCA 967; BC201106415 at [252] and [256].

29 The trial judge also seemed heavily influenced by the fact that, when Davids originally entered the wholesale business against QIW, wholesale prices fell, at least temporarily, by as much as 3%. This historical evidence was never explained by the respondents to the satisfaction of the court and was taken to suggest that, after the merger, prices could go back up by 3%.

30 *Re Queensland Independent Wholesalers Ltd* (1995) 132 ALR 225; ATPR 41-324; BC9502743.

31 *Metcash* (2011) 282 ALR 464; [2011] FCA 967; BC201106415 at [110].

32 Ibid, at [331].

33 Ibid, at [437].

for and possibly transporting to customers the groceries that the customers had ordered from the suppliers. Metcash negotiated prices with the suppliers, on the one hand, and, on the other, offered a 'Mix and Match Retail Pricing System' that facilitated retailers' pricing within their chosen range against price-checked items offered by Woolworths and Coles.[34] In addition, in relation to the IGA banner, Metcash made strategic decisions about retail sites and stores, provided loans and adopted strategies for the refurbishment of stores,[35] funded marketing activity,[36] supplied a line of private label products,[37] and set out operating guidelines for a cohesive banner concept.[38]

Therefore, rather than focus on the debate about the right 'functional' definition of the market (a debate engaged in far more frequently in Australia than in the United States), the respondents posed the question quite simply: how, in principle, could Franklins operate as a competitive constraint on any attempt by Metcash to exercise market power? Three primary ways were identified:

a) By keeping the prices at which it supplied groceries to its franchised stores low (on the assumption that those low prices would be passed on at least in part by the franchised stores) and keeping the retail prices low at its company-owned stores, Franklins could constrain Metcash to keep its wholesale prices low lest Metcash-supplied stores passed on their higher costs to customers and lost sales to Franklins stores, and thereby caused Metcash to lose wholesale sales. Franklins could also do a variety of things to make its company-owned stores and franchised retailers more attractive from a non-price perspective, for example, by supporting or directly paying for improvements in store appearance.
b) If Metcash was seeking to exercise market power over its retail stores, Franklins could seek to convert those stores from Metcash to Franklins, either by seeking to entice a Metcash-supplied retailer to switch and become a Franklins franchisee or by acquiring Metcash-supplied stores and operating them as Franklins corporate stores. Franklins could also build new stores to operate as corporate stores or sell to franchisees. From 2001, when Pick n Pay acquired Franklins, the company saw a net increase of only 10 corporate-operated stores and 10 franchise stores.[39]
c) Franklins could decide to enter the business of offering wholesale supply to independent grocery retailers beyond the 10 Franklins franchise stores. The judge observed that Franklins did not consider

34 Ibid, at [35]–[38] and [258]–[259]. This service was available to wholly independent retailers as well as to the IGA stores.
35 *Metcash* (2011) 282 ALR 464; [2011] FCA 967; BC201106415 at [259].
36 Ibid, at [259].
37 Ibid, at [31]–[33].
38 Ibid, at [39]–[41].
39 From 2005, when Franklins adopted its franchising strategy, it succeeded in convincing only two owners of IGA stores to convert their stores to the Franklins franchise. Franklins did not win over any IGA store owners from Metcash after 2007: *Metcash* (2011) 282 ALR 464; [2011] FCA 967; BC201106415, at [275].

itself a wholesaler and had not set up its business on the basis of being a wholesaler to third parties.[40]

Next, the respondents compared this to the ways in which the vertically integrated chains might, in principle, constrain any effort by Metcash to exercise market power over the retail stores it supplied:

a) By acquiring groceries at low prices and in turn passing those savings on to the ultimate consumer in the form of low retail prices, the chains could put pressure on Metcash to keep its wholesale prices low lest the Metcash-supplied stores lose retail business to the chains, thereby reducing the volume of Metcash's wholesale sales. The judge found vigorous price competition between independent retailers and the major supermarket chains.[41] Metcash performed weekly price checks of 1200 to 1500 items at Woolworths and Coles stores and offered its customers pricing advice according to how closely each independent store sought to price against the chains.[42] As the judge correctly observed, it did not necessarily follow that retailers that priced 2 or more per cent higher than the chains were not closely constrained by vigorous competition. Rather, to the extent that some independent retailers charged prices above the prices of the major supermarket chains, that may have reflected higher costs rather than any supra-normal profits.[43] The chains could also engage in expenditures to make their retail stores more attractive from a non-price perspective. The judge found vigorous non-price competition between independent retailers and the major supermarket chains.[44] The major chains had improved access to their stores by acquiring or opening medium and small stores in locations that were previously served only by independent grocery stores. Thus chain-owned stores were 'ubiquitous across Australia' and 'available to almost everyone'.[45] Further, following upon the relaxation of regulations, extended trading hours had become standard for chain stores.[46] Efforts by the chain stores to develop stronger ties with local communities constituted another element of non-price competition by the chains that had grown over the decade.[47]
b) The chains could offer to buy out a Metcash-supplied retailer and convert that retailer to a chain retailer. The judge observed that over the past 10 years, Woolworths, and to a lesser degree Coles, had 'adopted a strategy of targeting particular independent retailers, including IGA bannered retailers, offering to buy their stores, often at a premium, and converting them into Woolworths or Coles branded stores'.[48] From 2002, Woolworths and Coles had acquired at least

40 Ibid, at [331].
41 Ibid, at [239].
42 Ibid, at [36].
43 Ibid, at [252].
44 Ibid, at [239].
45 Ibid, at [272].
46 Ibid, at [272].
47 Ibid, at [272].
48 Ibid, at [47].

seven stores that previously were supplied by Metcash.[49] This competition for retail outlets had led Metcash to adopt a strategy of acquiring minority equity interests in independent retailers' stores.[50] In addition, Metcash offered loans and sometimes became the head lessee in respect of a store site in return for a right of first refusal.[51] The chains could also build new stores. In all, Woolworths and Coles had acquired at least 37 independent grocery stores or store sites since 2002.[52]

c) It was possible that one or both of the chains would consider providing wholesaling services to independent grocery stores. The major chains did not offer wholesale supply to any third party retail outlets in New South Wales, although doing so was not foreign to Woolworths. From 1996 to 2002, Woolworths had supplied grocery products to independent retailers in the eastern states.[53] In 2004, Woolworths had considered entering into a joint venture with Pick n Pay to supply franchise stores, and Metcash contended that as recently as 2010 Woolworths had contemplated re-entering the grocery wholesaling business.[54] In addition, for a number of years, Woolworths had held a 60% ownership interest in a wholesale grocery business that supplied Woolworths and independent retailers in Tasmania.[55]

The empirical question then became very straightforward. Along each of these dimensions, or on the overall package, was Franklins more of a threat to Metcash than either of the integrated chains? If the chains were overall more of a constraint, then it was incongruous to define a market that contained Metcash and Franklins but excluded the chains. The US Merger Guidelines have a specific example that is right on point:

> *Example 6*: . . . [S]uppose that half of the unit sales lost by Product A when it raises price are diverted to Product C, . . . while one-third are diverted to Product B. Product C is a closer substitute for Product A than is Product B. Thus Product C will normally be included in the relevant market, even though Products A and B together satisfy the hypothetical monopolist test.[56]

The respondents argued that historically Franklins had been less of a threat to Metcash than the chains on any of the dimensions identified above.[57] The point was not that Franklins should be excluded from the market but simply that, if Franklins was included, then the chains should be included as well.[58] The trial judge agreed with this analysis:

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49 Ibid, at [273].
50 Ibid, at [274].
51 Ibid, at [274].
52 Ibid, at [273].
53 Ibid, at [47].
54 Ibid, at [289].
55 Ibid, at [289] and <http://www.igatas.com.au/at-last,-a-$75m-goer-distribution-centre> (accessed 7 December 2012).
56 US Merger Guidelines, above n 23, § 3.
57 *Metcash* (2011) 282 ALR 464; [2011] FCA 967; BC201106415 at [329]–[336].
58 With the chains included, the shares of the merging parties would have been quite low and the applicant would not have asserted that the merger should be stopped. This was litigated

> . . . I consider that the competitive constraint imposed by Franklins upon Metcash's wholesaling activities is far less significant than the constraint imposed by the major supermarket chains. Further, the constraint imposed by Franklins has diminished somewhat over time. On the other hand, the constraint imposed by the major supermarket chains is strong and is increasing.[59]
>
> Accordingly, if Franklins is in the relevant market with Metcash, *the major supermarket chains must also be included in that market*. Given that the major supermarket chains are a closer competitive constraint upon Metcash than Franklins, it follows that, if Franklins would be able to prevent a hypothetical monopolist wholesaler from imposing what I have described as a relevant increase in price, being a small but significant non-transitory increase in price, so must the major supermarket chains be able to do so. Necessarily, the application of the hypothetical monopolist test would include both the major supermarket chains and Franklins in the relevant market with Metcash.[60]

Approaching the problem this way eliminated several of the issues raised by the applicant and/or the applicant's expert economist. For example, the applicant's expert defined the market as a service market with Metcash providing wholesaling services for the supply of dry groceries to independent retail stores.[61] There are examples in the US Merger Guidelines involving a simple service in a supply chain as the relevant product and its identifiable mark-up as the relevant price for a SSNIP test, as in the case of pipelines transporting oil.[62] However, the respondents argued that to describe Metcash as providing simply 'wholesale services,' given the wide range of activities Metcash engaged in and the various sources of its revenues, badly mischaracterised what Metcash did, which was to obtain groceries from suppliers at favourable prices, warehouse them, and sell them to retail stores, while at the same time undertaking a multitude of activities to assist the retailer to sell more of those groceries and/or to sell them more profitably. The judge observed that following the applicant's logic, one might also describe a

as a traditional 'market definition, market concentration' case, rather than as a unilateral effects case. Of course, even if the chains were counted as 'in the market', there could still have been a unilateral effect resulting from a merger of Metcash and Franklins. However, based on small market shares and the historical evidence, the respondents would have been prepared to argue that any such effect would have been too small to be deemed a substantial lessening of competition.

59 *Metcash* (2011) 282 ALR 464; [2011] FCA 967; BC201106415 at [330].

60 Ibid, at [334] (original emphasis).

61 Ibid, at [121]. The applicant's expert pointed to §4.1.2 in the US Merger Guidelines for support for this approach. However, the judge did not agree: *Metcash* (2011) 282 ALR 464; [2011] FCA 967; BC201106415 at [191]–[200]. In the statement of claim, the market was defined as the 'supply of wholesale packaged groceries to independent supermarket retailers'.

62 US Merger Guidelines, above n 23, Example 8. The SSNIP test is used to define the smallest possible relevant market by asking whether a hypothetical monopolist in the market could profitably impose a 'small but significant and non-transitory increase in price' (SSNIP) above the price level that would prevail without the merger, assuming the terms of sale of all other products are held constant. See also, ACCC, Merger Guidelines, November 2008, at [4.19]–[4.22]. The judge found the grocery industry to be characterised by a high degree of vertical integration and considered that in applying the hypothetical monopolist test it was unrealistic to consider the wholesale margin as a basis for a SSNIP. The relevant basis, he concluded was the price charged by wholesalers to their retail store customers: *Metcash* (2011) 282 ALR 464; [2011] FCA 967; BC201106415 at [194]–[200] and [339]–[340].

retailer as a provider of a bundle of services. He concluded that the applicant's proposed distinction had no foundation in logic or reality. According to the judge, whether at the retail or wholesale level, the SSNIP was appropriately applied to the selling price, not to the seller's margin.[63]

The point of the narrow product definition proposed by the applicant's expert was to allow him to use Metcash's service fees, rather than the price of the goods that Metcash sold at wholesale as the basis for the SSNIP test. The service fees, of course, would have been a much smaller base for applying the 5% SSNIP test and, in response to a price increase in Metcash's fees of 5%, the impact on the retail price of goods sold by the retailer would have been so small that one might have claimed that the result would be only a trivial switch by consumers to shopping at the integrated chains rather than at the Metcash-supplied stores (thereby appearing to support a claim that the integrated chains were not in the same market as Metcash). But of course, the same would have been true, a fortiori, with respect to a loss of retail sales to Franklins stores. So the respondents' argument was simple: use whatever basis for a SSNIP you like, but if you want to assert that Franklins is in the same market as Metcash while it is clear that the threat of lost sales to the chains is at least as great as the threat of lost sales to Franklins (by virtue of all of the mechanisms identified above: loss of retails sales, conversion of stores, or switching at the wholesale level), then any market that includes both Metcash and Franklins must also include the chains.[64]

Indeed, the applicant's expert argued that a 5% SSNIP for such a small margin business as the supply of wholesale services would translate to a price increase of much less than 5% (0.26%) in the retail price and would be unlikely to cause sufficient lost retail sales to make the upstream increase unprofitable.[65] Therefore, if the wholesale price of groceries (rather than the wholesale service fees) were to be adopted as the basis for a price increase, a SSNIP as small as 1% would be appropriate.[66] The respondents' expert took issue with the relevance of the examples in the US Merger Guidelines referenced by the applicant's economist, but the bottom line was the same as above: use whatever percent you like for applying the SSNIP, but if, in response to whatever SSNIP you use, Metcash would lose more sales to the chains than to the only other 'independent wholesaler', any market that includes the other wholesaler must also include the chains.

Conclusion

So what to make of the different outcomes? The authors are quite confident that the outcome in *Metcash* was the correct one. Another way to think about the issue is to ask whether the chains were likely to face a more competitive

63 *Metcash* (2011) 282 ALR 464; [2011] FCA 967; BC201106415 at [198]–[200].

64 The applicant, in urging the narrower market definition, in effect had conceded that, if the market were defined to include the integrated chains, the merger would not lead to a substantial lessening of competition: *Metcash* (2011) 282 ALR 464; [2011] FCA 967; BC201106415 at [429].

65 *Metcash* (2011) 282 ALR 464; [2011] FCA 967; BC201106415 at [193].

66 The US Merger Guidelines discuss that, when a SSNIP based on the total price paid by customers represents a large value relative to suppliers' margins, a smaller price increase than 5% will be used. See, US Merger Guidelines, above n 23, Example 10.

world as a result of a strengthened Metcash resulting from the merger than they would have faced under either a continuation of the status quo ante or under any reasonably likely counterfactual. Almost certainly the answer lies with the former. The independent stores' best current hope for survival against the chains is a strengthened Metcash, able to take advantage of increased economies of scale in operations and enhanced purchasing power, and with a strong incentive to pass on at least some portion of these cost savings to its customers.

The authors (especially the one of us who testified in *Davids*) are also inclined to the view that the outcome in *Davids* was wrong but concede that the record on the extent of competition from the chains may not have been nearly as well developed in *Davids* as it was in *Metcash*, and, in any event, the degree of competition between and from the chains may have been substantially less in the early 1990s before the chains expanded their hours of operations and opened more stores so as to offset the possible locational advantage of the independents. So perhaps both outcomes were correct in their own time.

In any event, the experience is a valuable one going forward if it suggests a more sensible way of dealing with competition in markets that involve differentiated products and firms with varying business models, and especially different degrees of vertical integration.

Postscript — a side issue

The role of economists in trade practices litigation

It probably is fair to say that both experts (and their solicitors) in *Metcash* were somewhat taken aback by the limitations that the trial judge put on expert testimony. Both experts were cognisant of the reluctance of Australian courts to allow experts to engage in fact-finding, so both were careful to base their conclusions on a quite extensive set of factual assumptions, clearly laid out in their respective reports. Both experts started with a set of general economic principles about how to define markets and how to assess whether any given merger would lead to a substantial lessening of competition but then proceeded to apply those principles to the assumed facts of the case and draw fairly specific (contingent) conclusions (based on the assumption that the assumed facts would be proven) about the proper definition of the market and whether there would be a substantial lessening of competition.

However, the trial judge seemed interested in nothing more than the core principles of market definition and substantial lessening of competition, as they would be set out in an economics textbook, and thought it was then his task to determine the facts and apply the principles to those facts with no help from the economists. Indeed, he seemed uninterested even in the economists' views on the hypotheticals that referred to the businesses at issue in the trial. So at the end of the day, he accepted into evidence only those portions of the expert reports that contained purely abstract statements of economic principle and relegated the rest of the reports to submissions. Whether he was at all influenced by the content of the rest of the reports (which were of course heavily used in the lawyers' closing submissions as well) only he can say (though the opinion seems clearly to adopt a number of the arguments made in the 'rejected' portions of the reports).

We are not the people most qualified to assess whether the limited role that the judge was prepared to allow the experts to play was a strict manifestation of the rules of evidence or more a matter of personal preference. We would observe that, in other cases in which one of the authors was involved as an expert (including *Boral* and *C7*), the trial judges seemed prepared to allow the experts to play a more expansive role. But more importantly, solely from a policy perspective, such a limited role seems overly conservative. We think that both experts genuinely (and with good cause) believed that limiting the expert evidence merely to abstract principles that could be found in a good textbook failed to make effective (and helpful) use of the economists' skill, training, and experience. But since others, closer to the Australian scene, have written on this topic, we rest with those observations and comments.[67]

67 See, eg, M Brunt, 'Antitrust in the Courts: The Role of Economics and Economists' in B Hawk (Ed), *Fordham Corporate Law Institute: International Antitrust Law and Policy*, Juris Publishing, Huntington, New York, 1999, p 367, reprinted with updated commentary in M Brunt, *Economic Essays on Australian and New Zealand Competition Law*, Kluwer Law International, 2003. See also, R French, 'Expert Testimony, Opinion, Argument and the Rules of Evidence' (2008) 36 *ABLR* 263–80; J Mansfield, 'Opportunities and Challenges: Evidence in Cases Under the Trade Practices Act 1974', Presented at Competition Law Conference, 2008, 24 May 2008; and C Veljanovski, 'Economists in Court: A Comparative Assessment of Procedures and Experience in Australia and England & Wales from an Economist's Perspective', presented at 7th Annual University of South Australia Trade Practices Workshop, 16–17 October 2009 (with minor revisions November 2009).