DIGECON RESEARCH

# Submission to the Senate Environment and Communications Legislation Committee inquiry into the provisions of the Broadcasting Legislation Amendment (Media Reform Bill) 2016

## Introduction

DigEcon Research made a submission to the inquiry by the committee in the 44th Parliament. That the Committee intends to refer to those submissions is noted.

This submission draws on the evidence presented by the ACCC at the public hearing on 31 March 2016 and the draft media merger guidelines published on 26 August 2016.

The core issue at question is a misunderstanding of the role of the ACCC in relation to mergers, a position that the ACCC Chair Rod Sims has perpetuated in his evidence. With the proposed repeal of the "2 out of 3" rule the only limitation on proposed media mergers is the *Competition and Consumer Act 2010 (*the **Act***).* Section 50 of the Act prohibits mergers that are likely to substantially lessen competition in the market.

This submission has two parts. The first is to outline how the evidence from the ACCC and its draft media merger guideline provides misleading information on the legality of mergers that lessen media diversity. The second provides an example of where the absence of an explicit law resulted in industry restructuring contrary to policy intent.

## The ACCC and mergers

The ACCC's functions in relation to mergers and acquisitions are outlined in Division 3 of Part VII of the Act. On application the ACCC may grant a "clearance" for a proposed merger or acquisition; the clearance may be accompanied by other conditions. The basis on which the ACCC is to decide on whether to grant the clearance is whether in the ACCC's assessment the merger or acquisition results in a breach of section 50, that is, results in a substantial lessening of competition.

The ACCC provides both an informal and a formal clearance process, only the latter offers legal protection. Specifically, if the ACCC grants the clearance then "section 50 does not prevent" the acquisition so long as it occurs in accordance with the clearance.

However, the ACCC does not have the power to block a merger or acquisition. If the application for clearance is refused the parties have recourse to the Australian Competition Tribunal. Parties can apply directly to the Tribunal for authorisation.

The legislation makes no reference to the ACCC's merger guidelines. They exist for the convenience of parties. The ACCC's website describes the informal procedure guidelines as:[1]

> *The Informal Merger Review Process Guidelines 2013 supplement the Merger Guidelines 2008 by providing a reliable, comprehensive and detailed guide to merger*

[1] See http://www.accc.gov.au/publications/informal-merger-review-process-guidelines-2013

> *parties, the business community, their advisers and the public that they can draw on to predict the processes that will be applied by the ACCC to merger reviews.*

In the introduction to the Draft Media Merger Guidelines the ACCC writes:[2]

> *The purpose of the guidelines is to highlight particular issues likely to be relevant to the ACCC's assessment of a media merger under section 50 of the Act. In doing so, the guidelines complement the ACCC's general Merger Guidelines. Accordingly, a media company contemplating a merger should refer to both guidelines.*
>
> *The Media Merger Guidelines are intended to help prospective merger parties develop a greater awareness of the general issues likely to be of interest to the ACCC when assessing a media merger. This will assist merger parties and third parties to provide the ACCC with more relevant and targeted submissions, and enable merger parties to anticipate the ACCC's likely areas of inquiry.*

This material is extremely helpful to applicants. It assists applicants to understand the circumstances under which the ACCC will provide a clearance.

It is, however, entirely unhelpful to the Parliament.

In removing the "2 out of 3" rule the Parliament's concern is primarily over what mergers will be blocked. The ACCC's guidelines on when it would not provide a clearance is of no particular relevance at all. The only thing that will matter is the interpretation of the Australian Competition Tribunal.

In evidence before the committee Mr Sims was asked "But is there anything specific in these acts that would require the ACCC to consider the impact of proposed mergers on diversity of media content, not just outlets? I am specifically talking about news and current affairs." He replied:

> *In many ways, yes.*
>
> *On the one hand, the test we look at is substantial lessening of competition as distinct from diversity. But substantial lessening of competition always has three components. One is price, two is quality of service and three is almost diversity really.*
>
> *To take an example of the latter—and I hate to use the supermarket example again, since that comes up too often in our lives—when we have looked at supermarket transactions, we have considered not just whether it will affect the price of groceries, opening hours and quality of service but also whether you are getting a range of products in the acquired store that you would not get if it was taken over by the acquirer. Here in media, because much of the content is superficially free, in the sense that it is free to air or radio, I think the question of the diversity of voices—to pick up your news, current affairs and opinion—would be a relevant criteria. So I think the overlap with diversity is strong. Whether the SLC test, which is our test, meets people's needs for diversity is of course a subjective matter, but potentially the main thing we would be looking at is diversity but through the lens of substantial lessening of competition.*

Later the following exchange occurred:

> *Senator McAllister: We have been talking around this, and I would like to understand a little more about how this question of diversity relates to your fundamental mandate for regulating competition. From my perspective, they are subtly different*

[2] https://consultation.accc.gov.au/mergers-and-adjudication/draft-media-merger-guidelines/supporting_documents/Draft%20Media%20Mergers%20Guidelines.pdf

> *ideas, not least because competition is for the benefit of consumers but, of course, consumers of media content, particularly free media content, are not ordinary consumers—they interact with those providers in a very different way. It is not clear to me that your mandate to regulate competition does provide you with a mandate to also regulate diversity.*
>
> *Mr Sims: The substantial lessening of competition and diversity are overlapping; how much they overlap is in the eyes of the beholder. When we look at mergers, we look at price—and, as you say, that may not be that relevant here—we look at the quality of the service and we look at the diversity of the service offering. We do that always. What I think what will apply here is that that diversity of service offering will be one of the more important things we look at, because, as you say, price is not that important. It will be important whether there is a good market for advertisers and good market for the supply of content, but when you are talking about the distribution of content and what consumers see, the diversity issue will rank highly in our minds. Whether that gives the result you want because we are looking at substantial lessening of competition rather than diversity per se, I am not sure, but diversity will play a big part in what we will be looking at.*

The critical phrase here is "the diversity issue will rank highly in our minds."

If a merger is to be blocked because it results in a substantial lessening of competition the ACCC isn't really the arbiter. In terms of deciding if a reduction in media diversity is a substantial lessening of competition has nothing at all to do with how highly it might rank in the minds of the ACCC.

The ACCC is only a decision maker in clearing mergers not in blocking them.

I am not aware of any expert evidence presented to the Department, the Minister or the Parliament that makes a compelling case that the Tribunal would accept that there is any case that simple loss of diversity would constitute a substantial lessening of competition.

## Industry Structure and Competition Law

The proponents of removing the "2 out of 3" rule and relying on competition law are asking the Parliament to accept a proposition that merger law will work well in reserving a competitive industry structure.

There is unfortunately an example from another industry that suggests such confidence is misplaced.

Through the many processes of energy market reform in Australia the four production stages of generation, transmission, distribution and retail were structurally separated and extensive market structures and regulatory frameworks developed to promote the long term interests of consumers.

The exclusion of some businesses from participating in other parts of the value chain were established by regulation, but not all.

In 2003 the retailer AGL proposed to acquire 35% of the Loy Yang generator and ACCC opposed the acquisition. AGL obtained an order from the Federal Court to allow the merger to proceed.[3]

Critical factors in the case included Justice French disagreeing with the ACCC's definition of the market, that it was considerably broader in geographic and product terms. His Honour also rejected the ACCC's contention that there would be a bandwagon effect.

[3] http://www.allens.com.au/pubs/comp/focldec03.htm

Most notably the Court rejected the ACCC's economic evidence that the acquisition would result in an increase in wholesale electricity prices.

Economic analysis following the acquisition has revealed that the observed price changes have actually matched the expectations advanced by the ACCC's experts.[4]

Worse, the band wagon effect did occur and the position of the three largest retailers as "gentailers" is a cause of concern for many analysts.

The case of energy market reform is a salutary lesson on two fronts. The first is that the ACCC is not the authority that blocks mergers, and that the ACCC's view does not necessarily determine the Court's view. The second is that leaving industry structure to the operation of competition law is, at best, a gamble. No guarantees can be taken from an assessment prior to an actual transaction of how the court will view it.

## Conclusion

Absent a specific legislative provision requiring the consideration of media diversity in proposed mergers competition law cannot be relied upon to preserve diversity. The removal of the "2 out of 3" rule without some other legislative provision places media diversity at significant risk.

[4] Joshua Gans and Frank Wolak 'A Comparison of Ex Ante versus Ex Post Vertical Market Power: Evidence from the Electricity Supply Industry'
http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1288245

DIGECON RESEARCH

# About DigEcon Research

## Purpose

DigEcon Research is a stand alone research body. Ultimately, its pursuit is policy research, the focus of which is the meaning and significance of the Digital Economy. This policy research encompasses both economic and social research.

## Researching the significance of the Digital Economy

The concept generally referred to as the Digital Economy is frequently discussed but there is little shared meaning in the term. A key definitional issue is whether the Digital Economy is something yet to happen or in which we are now embedded.

DigEcon Research focuses on the analysis of social and economic change rather than an analysis of a notionally static "Digital Economy". Analysis of the change as it occurs should highlight those areas where there is genuine policy choice rather than merely a need to adapt policy to changes that have already occurred.

Before Thomas Kuhn popularised the idea of "paradigms" J.K.Galbraith railed against the "conventional wisdom". There is no denying that what Kuhn called "normal science" or the repeated application of existing theory to new problems results in most practical developments. It is equally true that the application of existing theory to problems they were not designed for results in, at best, vacuous solutions and, at worst, wildly dangerous outcomes.

The Digital Economy challenges the fundamental concepts of neo-classical economics. It also challenges most of the precepts of how societies are organised. In this context policy research needs to focus on what is different, not on what is the same. The Digital Economy is not just a matter of means of production but about the fundamental structures of social organisation.

## Work program

This research is designed both to inform policy makers and to assist those who would seek to influence policy makers or to make business decisions. DigEcon Research however does not provide strategy recommendations nor undertake policy advocacy on behalf of any party.

A key element of the research will relate to the direct regulation of the converging industries of telecommunications, media, consumer electronics and information technology. However, the agenda encompasses the wider economic and social policy issues.

The scope of the research agenda will ultimately depend upon the researchers who wish to participate in what is more an idea than an entity.

In the crowded Australian research field there are a number of "bodies" that share some of the objectives of DigEcon Research. DigEcon Research aspires to contribute to the work of these and any other researchers in the field.