Consumer Unity and Trust Society
Asia-Pacific Workshop on Competition

Dealing with Mergers and Acquisitions
The Australian Competition & Consumer Commission's Perspective

17th April 2000
Jaipur

Mr Ross Jones
Commissioner
Australian Competition & Consumer Commission

Introduction

My aim today is to give a general outline on how the Australian Competition and Consumer Commission (the Commission) deals with both domestic and global mergers. My focus will be on how the Commission administers the mergers provisions of the *Trade Practices Act 1974* (the Act) given the globalisation and internationalisation of markets and the issues this raises for both business and the Commission.

Over the twenty five year life of the Act, mergers have probably received more publicity than most other matters. They have also featured prominently in litigation undertaken by the Commission.

The anti-competitive conduct provisions contained in Part IV of the Act, including the merger provisions, are an attempt to enact economics as law. For this reason, interpretation of the Act is always going to be somewhat controversial and the Commission's decisions on some mergers will attract criticism and debate.

However, it is important to remember that the Commission does not posses unfettered discretion in its administration and enforcement of the Act. The Courts are the final arbiters on whether any breaches of the Act have occurred. Additionally, authorisation decisions made by the Commission can be appealed to the Australian Competition Tribunal. I make the point that there are ample safeguards for businesses who disagree with Commission decisions.

The Commission has a statutory obligation to educate the public and make general information available for guidance in respect to carrying out of its statutory functions. The Commission is a transparent agency in terms of its functions and decisions. In regard to today's topic, the Commission has recently published updated *Mergers Guidelines*.

Section 50 of the *Trade Practices Act* and the Commission's Role

Section 50 of the Act prohibits acquisitions which would or are likely to substantially lessen competition in a substantial market in Australia, in an Australian State or Territory.

The New Competition Test v's The Dominance Test

Section 50 was amended in 1993 from one which prohibited acquisitions that were likely to create or strengthen dominance in a market. The merger test now encompasses firms with a lower threshold of market power, and permits consideration of the potential for the exercise of coordinated market power by recognising the link between market structure and conduct.

With the introduction of the substantial lessening of competition test in 1993, the thrust of merger regulation has changed. The key change is that any merger or acquisition which is likely to substantially lessen competition in a substantial market is prohibited (unless authorised). Under the dominance test, only a sub-set of mergers which were likely to lessen competition substantially were prohibited (In fact the dominance test also prohibited mergers which were not anti-competitive but which merely enhanced the position of the dominant firm) that is those which gave rise to dominance or increased dominance in a substantial market.

Dominance occurs when there is only one large firm in an industry and it is free from effective competitors. A simple example would be where, in an industry with four players have 25 per cent market share each, a set of mergers occurred following which two 50 per cent players remained. There would then be no dominance because two big firms remained. The increased degree of concentration could, however, be associated with a substantial lessening of competition if there were few or no imports and high barriers to entry. In such circumstances anti-competitive co-ordinated pricing and behaviour could, for example, be facilitated.

The change in the test brought section 50 into line with the general principle underlying the rest of Part IV of the *Trade Practices Act*, which prohibits anti-competitive conduct. Also, underpinning this change is the understanding that in many cases domestic rivalry rather than national dominance is more likely to breed companies that are internationally competitive.

Section 50 operates subject to the Commission's ability to authorise, or grant legal immunity to mergers which would be likely to result in such a benefit to the public that the acquisition should be allowed to take place. Moreover, section 87B of the Act is available for undertakings to overcome the anti-competitive effect of mergers where appropriate.

Merger Policy

Merger and acquisition analysis constitutes an important part of the Commission's work. The Commission also examines joint ventures in a similar way. Although the reasons why parties enter into mergers and joint ventures might be substantially different, the Commission's interest lies in the effect they have on a market. In most cases, the effects of mergers and joint ventures are very similar.

Merger policy makes an important contribution to the achievement of a competitive and productive Australian economy. Regulation of anti-competitive mergers is an important part of Australia's National Competition Policy.

Merger policy is not some necessary evil. Rather, it has a positive contribution to make to Australia's international competitiveness. If mergers are allowed to occur without the application of competition law, then our exporters and import competitors will be supplied uncompetitively and inefficiently and their capacity to compete in world markets will be severely curtailed.

A general point which needs to be made about mergers is that most of the matters that receive detailed consideration from the Commission are mergers which are close to the margin, that are, in other words, "borderline". Some critics could argue that there is inconsistency in the Commission's decisions. However, any perceived inconsistencies arise from the fact that the Commission approaches each merger proposal on a case-by-case basis.

Why The Focus On Mergers?

The Commission recognises that many mergers are driven by a need to cut costs, increase productivity, enhance efficiencies of scale and a range of other reasons which are often driven by a desire to remain competitive in a global marketplace.

The Commission also examines joint ventures in a similar way. Although the reasons why parties enter into mergers and joint ventures might be substantially different, the Commission's interest lies in the effect they have on a market. In most cases, the effects of mergers and joint ventures are very similar.

Likewise, where governments privatise, they normally refer questions about the competitive effect of acquisitions to the Commission. In addition, the Commission believes that section 50 generally applies. Scrutiny of privatisations has become a significant part of the Commission's mergers work.

In 1997-98, of the 176 mergers considered by the Commission, only 5 were opposed.

Critical Mass Arguments

Business people frequently raise the question of whether or not the merger provisions of the Act prevent the mergers necessary for Australian firms to be of the size necessary to take part in global markets. The answer to this is rarely, if ever, and, if so, then only in circumstances where it is on balance undesirable because of the anti-competitive effect in the Australian market.

It is often argued that Australian industries need to develop the "critical mass" necessary to compete internationally. However, I think it is important to point out that obstacles to export growth may face industry participants of all sizes. It is not apparent that, simply by entering a collaborative arrangement like a merger or joint venture, a participant's ability to compete internationally is enhanced. Size is often not necessary to enhance the ability to compete on world markets. It has been convincingly argued that, in many cases, domestic rivalry rather than national dominance is more likely to breed businesses that are internationally competitive. When firms merge with the aim, for instance, of enhancing exports, there is the prospect that domestic prices may rise until they reach import parity (if the goods were previously priced below import parity) while exports are at a lower price. A merged entity may use its market power to increase domestic prices and so subsidise its export price. Ultimately, Australian consumers and industry may be forced to pay a higher price in order to underpin the merged entity's export sales. A report last year to the government which reviewed business programs in the context of an increasingly competitive global market noted that a lack of domestic competition was one of a number of impediments to building globally sustainable firms in Australia.

While size may not be necessary to enhance export opportunities, correct and complete market information is crucial. Small and medium sized enterprises may be disadvantaged when it comes to having access to adequate information. However, ongoing improvements in information technology and electronic commerce suggest that this is likely to be less of an issue in the future.

The Commission's Approach to Mergers

Only ***a small percentage*** of mergers brought to the Commission's attention raise significant competition concerns or are opposed by the Commission. In my view, Australia has a very efficient informal merger notification process that compares favourably with other OECD (Organisation for Economic Cooperation and Development) countries. In jurisdictions, such as Canada, the United States and the European Commission, where there is pre-merger notification, lengthy legislative time periods and information requests are often experienced.

As outlined in the recently updated Merger Guidelines, while Australia does not have any formal pre-merger notification, there is benefit for both the Commission and the parties in streamlining the process of informal consideration to reduce costs and the regulatory burden. The Commission expects to be given the same notice of international mergers as overseas agencies. The Commission requires adequate time to make market inquiries before it will be able to provide a clear response to any proposed acquisitions. It also expects to be given all relevant information relating to the international transaction including, for example, full details of international agreements relating to any Australian aspects of the transaction.

The Merger Guidelines also highlight that increased exposure to global markets is placing pressure on domestic firms to reduce costs, improve quality and service and innovate in order to become more competitive. Mergers may be one means of achieving such efficiencies. While efficiencies generally arise as a question of public benefit, which falls for consideration under authorisation, they are relevant in a section 50 context to the extent that they impact on the level of competition in a market.

The Commission's Merger Guidelines

As a guide for industry, the Merger Guidelines set out the process for, and issues relevant to, the Commission's administration of the merger provisions. The guidelines do not bind the Commission, but provide parties with an indication of what the Commission considers when investigating mergers and importantly indicate to industry what the Commission is looking for in a submission outlining a proposed acquisition.

The Guidelines provide a five stage process for the Commission's assessment of the substantial lessening of competition. The steps are:

- **Market definition**. In establishing the market boundaries, the Commission seeks to include all those sources of closely substitutable products, to which consumers would turn in the event that the merged firm attempted to exercise market power. A market involves four dimensions namely: product, geographic, functional and temporal.

- **Market concentration** ratios are assessed. If the market concentration ratio falls outside the Commission's thresholds, the Commission will determine that a substantial lessening of competition is unlikely. The Commission considers the post-merger combined market share of the four largest firms (CR4) and will examine the matter further if the merged firm's market share is over 75 per cent and the merged firm will supply at least 15 per cent of the relevant market. Alternatively, if the merged firm will supply 40 per cent or more of the market, the Commission will want to give the merger further consideration.

    Potential or real ***import competition*** is considered. When considering the impact of globalisation and internationalisation of markets, this is an important factor. If import competition is an effective check on the exercise of domestic market power, it is unlikely that the Commission will intervene in a merger. The Commission's Merger Guidelines have adopted an indicative position of not opposing mergers where a sustained and competitive level of imports has been at 10 percent or more of the market.

However, even though the Commission has set this as an indicative level, it is not the historical share of imports that is significant, but their potential to constrain the price and output decisions of the merged entity. In its assessment of import competition, the Commission will establish whether or not imports provide or are likely to provide a competitive discipline on a merged firm.

- **Barriers to entry** to the relevant market. If the market is not subject to significant barriers to new entry, incumbent firms are likely to be constrained by the threat of potential entry, to behave in a manner consistent with competitive market outcomes. A concentrated market is often an indication that there are high barriers to entry.

- **Other factors** which are outlined by the Act (section 50(3)) include whether the merged firm will face countervailing power in the market, whether the merger will result in the removal of a vigorous and effective competitor, or whether the merger is pro-competitive, not anti-competitive.

In applying its guidelines, the Commission recognises that many Australian firms operate in a global environment. There is, however, a distinction to be made between operating in a global environment where offshore investment and market access issues are a focus. The Commission, when considering globalisation issues is required to focus on the global competitive conditions applying to Australian markets. Domestic mergers of Australian firms where there is a clear and identifiable constraint from offshore have not been opposed by the Commission.

Market Definition

In this context, I note that there has been some speculation about whether the Commission takes an unduly narrow view of the relevant markets. I have already pointed out that the Commission assesses each merger according to its individual merits. In the case of market definition, the Commission considers evidence of supply and demand-side substitutability at the time of the merger.

Professor Maureen Brunt delivered a paper at the 25th Australian Trade Practices Workshop, commenting on Professor Frederic Jenny's paper entitled 'Globalisation, Competition and Trade Policy' (June 1999). She addressed the issue of market definition, stating that in relation to mergers with international implications it is important to give meaning to the formal elements of section 50, and therefore consider issues such as demand and supply elasticities, including business strategies, that originate overseas.

Professor Brunt cited the Australian Competition Tribunal as a body that will specify an international market if appropriate. She referred to the *Koppers*[1] case where the Tribunal commented that "we do not find it helpful to confine our attention too narrowly upon the domestic scene" and that the market was "in part national…; but, in part, international". She did query, however, how a court would deal with such a market definition. Brunt suggested

[1] (1981) ATPR 40-023

an amendment to definition of “market” in the *Trade Practices Act* to include “*Market* means a market *in relation to* Australia.”

In some circumstances, the Commission has found it more practical to define the market as broader than Australia, e.g. trans-Tasman, or even a world market. For instance, in its examination of RGC’s 1996 bid for Cudgen RZ, the Commission accepted that there was a world market for the supply of feedstock for chloride-route pigment production, and that the acquisition would improve the international competitiveness of the company, particularly given that the target company was a major exporter of the relevant products.

Possible Solutions to Competition Concerns

With mergers where the Commission identifies competition concerns, I would now like to cover some of the methods that may be used to address those concerns. I must, however, stress that there is no set formula for every case and what is suitable in one case may not be suitable in another.

Authorisation

One of the most powerful tools available to a company that risks breaching section 50 is to seek an authorisation. Australia, unlike many other countries provides for the possibility of granting an authorisation which permits a party to be in breach of the Act in the event that there are public benefits to offset the competition concerns. Since 1993, the Act has explicitly stated that export generation, import replacement or contributions to the international competitiveness of the Australian economy are public benefits.

Clearly the framework of the Act is not an obstacle to allowing Australian firms to merge to achieve the scale necessary for international competitiveness providing there is a sufficient public benefit. There are in fact many cases where authorisations have been permitted. Over half of authorisations have in fact been successful. A number of them have related to cases where the merger would cause a substantial reduction in competition in Australia but would bring international type benefits.

The Commission has a period of 30 days to complete an application. This may be extended to 45 days for complex matters. It may also be extended by Commission requests for information from the applicant. The Commission endeavours to deal with applications for authorisation as expeditiously as possible, subject to meeting its statutory obligations. If the Commission has not made a determination in the relevant period the authorisation is deemed to have been granted.

The authorisation process is a public process in which any interested party may make a submission, submissions are open for inspection on a public register, and there may be provision for a conference of interested parties. There is, however, provision for maintaining confidentiality of commercially sensitive information where it appears desirable for the Commission to grant confidentiality.

Divestiture

If the Commission reaches the conclusion that a merger is likely to substantially lessen competition it is difficult to accept that an overseas company would let the affected brands/operations diminish in value. Some brands, for example, are worth significant amounts of money and the companies would seek to maintain their value. With global mergers it may be possible to structure deals to overcome the specific competition concerns in Australia. The British American Tobacco/Rothmans merger (discussed above) is a good example of where the Commission's competition concerns were overcome through the divestiture process.

In this case, the Commission formed the view that, without simultaneous divestment, the acquisition would result in a substantial lessening of competition in the relevant markets. It was concerned to ensure that divestment created a vigorous and effective competitor with the ability to constrain the actions of British American Tobacco/Rothmans in Australia.

To this end the Commission obtained an undertaking from British American Tobacco that the acquisition would be completed in conjunction with a simultaneous divestiture of assets.

Structure of Mergers

Divestiture may not always address the competition concerns arising out of a proposed merger. In such cases it is worth remembering that a merger can be structured in such a manner that it does not apply to Australia.

Undertakings

Section 87B of the *Trade Practices Act* has become a very important part of the Act. However, it has attracted greatest attention in relation to its use in merger situations even though in fact the Commission is very sparing in its use of undertakings to resolve merger questions.

Case Study

Ampol/Caltex Merger

The Ampol/Caltex merger provides the best known example. The Commission formed the view that the merger was likely to substantially lessen competition and so advised the parties. They sought reasons for the Commission's decision and then suggested undertakings which would neutralise the anti-competitive effects of concern. The Commission after much consideration and negotiation accepted undertakings and the merger went ahead.

Case Study

Pirelli Cables

An example of where undertakings have been used was in the Pirelli Cables acquisition of Metal Manufacturers Energy Cables Division. The acquisition resulted in two key domestic manufacturers controlling just over 80% of the Australian energy cables market. The Commission made market inquiries into the possible effects of the proposed acquisition, and was concerned to discover the existence of an agreement between Metal Manufacturers and BICC (a UK based cable manufacturer which has extensive cable manufacturing facilities in the region), which effectively prevented BICC from competing in Australia.

These competition concerns were removed when Metal Manufacturers provided to the ACCC a court-enforceable undertaking that it would formally release BICC from the "no competition" provisions of the agreement, and that it would not enforce against BICC the "no compete" obligations arising from any other arrangements between the two companies. The Commission was satisfied that the existence of the Pacific Dunlop Cables Group, together with a number of small manufacturers and importers, combined with the ability of BICC to compete in Australia, was likely to ensure that the merger did not result in a substantial lessening of competition.

The Commission does not see itself as engaging in economic engineering, even in cases such as these. However, the Commission needs to be satisfied that the undertakings balance or neutralise the anti-competitive effects.

The question of whether undertakings should be negotiated publicly is sometimes raised. The Commission's preference is that undertakings should normally be made known publicly before being accepted so that there is a full opportunity of assessing their likely effects on the market place, aided by players currently involved in the market place.

Tariff / Non-Tariff Barriers

One issue that I would like to raise is that in addition to the standard solutions of authorisations, divestitures and section 87B undertakings there are other options that could be looked at in order to address competition concerns. In some cases imports may be restrained due to high tariffs or due to onerous safety standards. If these matters can be addressed either through tariff reductions or changes to the Australian standards then imports may become viable and act as a restraint on any potential misuse of market power by the merged firm.

Case Study

Caroma/Fowler Merger

The recent Caroma / Fowler Bathroom Products merger provides a good example of how changes to safety standards may alleviate the Commission's concerns. In this case, while imports of toilets and basins were less than 10 per cent, the Commission expected that imports would grow substantially in the future and impose a constraint on the behaviour of Caroma, particularly from highly efficient Asian producers.

Conclusion

Experience in the years since 1974 with the mergers provisions of the *Trade Practices Act* provides a degree of certainty in terms of the process. Through its Merger Guidelines, the Commission has sought to identify `safe harbours' for potential merger partners, as well as to highlight the structural features of a market which may result in difficulties.

In conclusion, the important point that I would like to reiterate is that Australia's merger laws and the Commission's administration of them are consistent with enabling Australian firms to realise greater international competitiveness.