# THE 5TH ANNUAL DEAKIN LAW SCHOOL ORATION

# THE *TRADE PRACTICES ACT* AFTER 25 YEARS: MERGERS AND THE ROLE OF THE ACCC

ALLAN FELS*

## I INTRODUCTION

The *Trade Practices Act 1974* (the Act) first came into effect on 1 October 1974, 25 years ago. It is an appropriate time, therefore, to consider the role of the Australian Competition and Consumer Commission (the Commission), and its predecessors in administering the Act.

This discussion will focus on the mergers provision of the Act and the Commission's experience in relation to this provision. In particular, I will look at the issue of global mergers, and the applicability of Australian law to such mergers.

The last two years has seen a dramatic increase in the number of global mergers. The major ones have included Guinness Plc with Grand Metropolitan Plc, Price Waterhouse with Coopers & Lybrand, PepsiCo with United Brands (Smith's Snackfoods), Exxon with Mobil, Coca Cola with Cadbury Schweppes, and British American Tobacco with Rothmans International. Furthermore, this trend shows no signs of abating. In addition, a number of Australian companies are looking at offshore mergers and acquisitions as well.

* Chairman, Australian Competition & Consumer Commission. This is a revised version of the address delivered 23 September 1999.

This increased merger activity is producing a number of interesting challenges for industry, the Commission and other overseas competition regulators. Many of these mergers are driven by a need to cut costs, increase productivity, enhance efficiencies and a range of other reasons which are often driven by a desire to remain competitive in a global marketplace. Naturally, the Commission approaches each merger proposal on a 'case-by-case' basis and evaluates an international merger on its merits. There is, however, some concern shown by some players that Australia will be forced to accept a merger between Australian subsidiaries of two overseas companies merely because the parent companies are merging. This is a view that needs to be dispelled as it is essential to the welfare of all Australians that the Australian economy remains competitive and the Commission will not approve a merger if it is likely to result in a substantial lessening of competition.

The *Trade Practices Act 1974*, through ss 50 and 50A, provides the Commission with the necessary legislative tools to ensure that any mergers or acquisitions that occur in Australia, whether they involve Australian companies or the subsidiaries of overseas companies, do not result in a substantial lessening of competition. This paper aims to give a general outline on how the Commission deals with both domestic and global mergers, using some case studies to highlight how it has dealt with a range of issues that arise with global mergers.

## II WHY THE FOCUS ON MERGERS?

Over the 25 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, and its predecessor the Trade Practices Commission.

Given the emphasis on mergers in recent years, it is somewhat surprising that early anti-trust legislation lacked specific provisions against mergers. The *Australian Industries Preservation Act 1906* was the earliest attempt by the Federal Parliament to legislate in the field of restrictive trade practices. This Act attempted to cover foreign, trading, and financial corporations, and persons not being corporations who were engaged in interstate, overseas trade or commerce. Then, on 1 September 1967, the *Trade Practices Act 1965* became operative. Neither this version of the Act, nor its 1971 successor, had a specific mergers provision. It was not until the 1974 Act was passed that this was rectified. Essentially, early trade practices legislation focused on conduct and did not seek to limit future problems by considering the implications of structural changes resulting from mergers for conduct.

The reason why mergers have been the focus of attention over the last 25 years arises from recognition of the link between market structure and conduct. Market structure may change through time and this may have implications for the competitive process. Such changes may result from firms which are very successful in the market, driving less successful competitors out of business. This is simply the outcome of the competitive process. Alternatively, structural changes may result from new entry (a more competitive industry) or from exit (a more concentrated industry) in response to changing market conditions. Mergers have a variety of possible purposes but may result in a reduction in competition by reducing the number of sellers competing in the market and in some cases by raising the barriers to new entrants, for example by gaining control of an essential raw material or a particularly favourable location. In the absence of a mergers provision in trade practices legislation, a merger could be used to circumvent collusive conduct, which is a breach of the Act, by obviating the need to enter into a collusion agreement.

## A *The Competition Test*

Since 1993, s 50 of the Act has prohibited mergers or acquisitions which have the effect or likely effect of substantially lessening competition in a substantial market. Section 50 operates subject to the Commission's ability to authorise (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, s 87B is available for undertakings to overcome the anti-competitive effect of mergers where appropriate.

The Commission 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 these may have on a market. In most cases, the effects of mergers and joint ventures are very similar.

Where governments privatise, they normally refer questions about the competitive effect of acquisitions to the Commission. As the Commission believes that s 50 generally applies to these cases, scrutiny of privatisations has become a significant part of the Commission's mergers work.

## B *Merger Statistics*

Earlier, the Commission published a detailed statistical analysis of mergers.[1] The statistics show that in 1998 – 99, the Commission considered 185 mergers. Of these, seven (or approximately four per cent) were opposed, while 10 (or approximately five per cent) were resolved via authorisation or s 87B undertakings.

In some respects the four per cent figure overstates the extent of the Commission's opposition because many mergers do not raise competition issues at all and are not considered by the Commission. On the other hand, there may be some mergers that are not brought forward to the Commission because the nature of the s 50 prohibitions is well known. In our experience, however, business people are not shy in approaching the Commission to sound it out about possible mergers, even impossible looking mergers, although these have been quite infrequent.

[1] Australian Competition & Consumer Commission, *Mergers and Proposed Mergers 1998 – 1999*.

## III THE ACCC APPROACH TO MERGERS

The next step is to examine the approach that the Commission follows when assessing merger proposals. This process is substantially the same regardless of whether it is a purely domestic merger or whether the merger forms part of an international merger.

As a guide for industry, the Commission has published Merger Guidelines. The most recent version of the Guidelines was published in June 1999.[2] The 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 more importantly, indicate to industry what the Commission is looking for in a submission outlining a proposed acquisition. These Guidelines are currently being revised and the new Guidelines will be available soon.

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

1. The **market is defined**. 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.

2. **Market concentration** ratios are assessed. If the merger will result in a post-merger combined market share of the four (or fewer) largest firms of 75 per cent or more and the merged firm will supply at least 15 per cent of the relevant market, the Commission will want to give further consideration to a merger proposal before being satisfied that it will not result in a substantial lessening of competition. In any event, if the merged firm will supply 40 per cent or more of the market, the Commission will want to give the merger further consideration. If the market concentration ratio falls outside the thresholds, the Commission will determine that substantial lessening of competition is unlikely.

3. Potential or real **import competition** is looked at. 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.

4. The Commission looks at the **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 to behave in a manner consistent with competitive market outcomes. A concentrated market is often an indication that there are high barriers to entry.

5. Finally, the Commission looks to **other factors** which are outlined by the legislation (s 50(3)). They include whether the merged firm will face countervailing

[2] Australian Competition & Consumer Commission, *Merger Guidelines* (1999).

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.

## IV CRITICAL MASS ARGUMENTS

Business people frequently raise the question of whether or not the merger provisions of the Act prevent mergers that are 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 resultant anti-competitive effect on the Australian market.

It is often argued that Australian industries need to develop the 'critical mass' necessary to compete internationally. It is important to point out, however, that obstacles to export growth may face industry participants of all sizes. It is not apparent that simply by entering into 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 remain 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 larger size may not be a necessary condition 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—something that is often claimed to be an advantage of operating under a single desk system. However, ongoing improvements in information technology and electronic commerce suggest that this is likely to be less of an issue in the future.

## V MERGER POLICY

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 national competition policy. Trade practices merger law conforms with the principles of natural competition policy agreed to by all Australian governments. These principles include:

- No participant in the market should be able to engage in anti-competitive conduct against the public interest; and
- Conduct with anti-competitive potential that is said to be in the public interest should be assessed by an appropriate transparent assessment process, with provision for review, to demonstrate the nature and evidence of the public costs and benefits claimed.

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 hindered.

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—in other words, of borderline validity. Critics sometimes argue that there is inconsistency in decisions. Whilst I do not agree with this, the significance of the criticism must be placed in context. When a series of close mergers is considered by the Commission, it is not so difficult to mount a case of apparent inconsistency. Often there will be very similar structural circumstances, but the Commission will decide differently depending on the weight accorded to particular factors. The fact that the Commission has to make difficult 'on-balance' decisions about a few borderline mergers each year does not mean that there is not general consistency in the application of the Act to the vast majority of mergers which it must consider.

## VI DEREGULATING SECTORS

The real agenda of merger policy relates largely to the deregulating sectors of the economy. Deregulation gives rise to circumstances in which mergers are likely to occur. Some mergers are necessary for efficiency and should not be blocked. Others are sought to undo the pro-competitive effects of deregulation and may need to be opposed. As stated earlier, the present test is superior to the dominance test in dealing with those matters.

In recent years, State, Territory and Commonwealth governments have initiated various pro-competitive reforms, involving horizontal and vertical disaggregation of government owned monopolies, corporatisation or privatisation, and the removal of various restrictions on the operation of free markets. These initiatives were given further impetus by the Competition Principles Agreement, whereby all governments agreed to a systematic review of all legislation restricting competition.

As a consequence of this, the assessment of privatisation proposals has become a much more significant part of the Commission's work in recent times. In many cases involving individual asset sales, a number of bidding consortia require individual consideration. The Commission's role is to ensure that the acquisition of an asset does not result in a substantial lessening of competition in a market. In assessing privatisations, the Commission considers the existing interests of all bidders.

In the great majority of cases, bidders for privatised assets do not raise competition concerns and therefore do not raise problems under the Act. Of course, those instances which are problematic are the ones generating the most publicity. For example, in the case of certain asset sales in the Victorian electricity sector, the Commission did object to some bidding consortia. It took the view that the interests of certain consortia parties would have raised potential competition concerns through horizontal linkages in the Victorian electricity generation sector.

In the case of the privatisation of Hazelwood power station, for example, the Commission raised its concerns with one bidding consortium. No further action was taken as the consortium's structure and composition were changed during the course of the sale process in such a way that the Commission's initial concerns were no longer relevant to the bid. In another case involving the sale of Loy Yang, a power station, the Victorian Government sales group required bidders to give certain undertakings addressing the Commission's competition concerns about board representation and information flows.

In performing its assessment of any proposed acquisition, one of the matters which the Commission must take into account is the likelihood that the acquisition or merger would result in the acquirer being able to significantly and sustainably increase prices or profit margins.

Network industries can differ from others in that market power and the associated ability to increase prices is not always proportional to the amount of capacity controlled by any particular organisation. Market power can also arise through technical characteristics of, for example, electricity generators—for example, at peak periods gas or hydro generators with the ability to 'ramp up' quickly may have greater market power than base load generators with larger capacity.

The Commission has also focussed on mergers and acquisitions within the electricity industry because of concerns arising from the fact that the sector is not subject to the competitive discipline of import competition and because of the lack of direct substitutes for electricity.

In its authorisation determination on the National Electricity Code, the Commission expressed concern over the structure of the market in a number of jurisdictions. The issue of market structure is not only crucial at the commencement of the National Electricity Market (NEM) but will be of on-going interest, particularly in respect of possible re-integration of firms participating in the NEM. Concerns also include possible mergers within each segment of the market, arrangements whereby NEM participants operate in upstream or downstream sectors (such as a generation company also operating a retailing business) and merger proposals between different energy suppliers (such as an electricity industry participant buying a gas industry participant).

## VII CONVERGENCE

The issue of convergence is one that the Commission is likely to have to consider in assessing mergers and acquisitions in the utilities sector in the future. There have, for example, been recent reports in Australia of joint ventures and acquisitions involving telecommunications companies and energy distributors and retailers. The development of multi-utility service provider companies is a logical further step.

Convergence raises challenges to effective competition policy, in terms of possibilities for regulatory 'bypass' and for incumbents if the policy approach and the manner of regulation is uneven across different industry sectors. It can also be argued that convergence has the potential to create substantially-resourced business units holding market power. At the same time, however, convergence may lead to industry growth and diversity and therefore lead to greater competition between products and greater choice of suppliers for customers. There are arguments for convergence in terms of economies in carrying out common functions, for example, integrated billing for energy and reduced consumer transaction costs. These benefits are likely to be maximised by having an integrated regulator who takes a consistent approach across industry sectors.

## VIII REAGGREGATION

Another issue that the Commission is likely to have to consider in the near future is that of reaggregation of utility companies. Consider for example, the possibility that in Victoria the five power generation companies seek to merge or to take over or to be taken over by the distribution companies. Of course there are some cross ownership restrictions built into Victorian law (until around 2002). If these mergers went ahead they could undo the pro-competitive effects of the Victorian divestiture of the former State Electricity Commission of Victoria. Likewise when deregulation gives rise to the replacement of state by national markets, firms often manoeuvre and merge in order to cope with the new situation. Again, sometimes there are considerable efficiency gains, but other times, considerable anti-competitive effects.

To take the energy industry as an example, there are several kinds of mergers which may arise for consideration in future. First, horizontal mergers within a state, an example being between power generators or distributors within one state located in the same state. Secondly, there may be vertical mergers between, for example generators and distributors in a state. Thirdly, there may be conglomerate mergers between different utilities, such as between gas and electricity utilities, in the distribution and or retail field. Fourthly, there may be interstate mergers combining some or all of the above elements.

These matters will be assessed under s 50 of the Act. In assessing them, one background factor worth noting is that the ownership structure of the energy industry and some other deregulating industries has been greatly affected by public ownership arrangements over the years. The ownership pattern which might have emerged in a privatised market subject to competition laws has not been present, owing to the preference of most governments for the public utilities to have both horizontal and often vertical integration. Clearly the deregulation of current public utilities brings advantages compared with the artificial integration established by governments.

For example, the Victorian disaggregation of the electricity industry would seem to represent an improvement over the pre-existing monopoly arrangements. However, it is not especially likely that an initial disaggregation will yield the optimum ownership patterns in the industry. In free markets, reliance is placed on the workings of the capital markets to achieve more efficient ownership arrangements and on competition policy to make sure that those arrangements are not anti-competitive (unless they can be shown to be in the public interest). The present Victorian electricity market starts without the benefit of these processes unfolding over the years. It is quite likely that restructuring pressures will arise to create more efficient arrangements. The possible efficiency benefits of such mergers will need to be recognised and accepted under the Act. Equally, however, it will be important to ensure that mergers are not simply anti-competitive and designed to undo the pro-competitive effects of deregulation.

These kinds of considerations apply to all mergers in sectors of the economy undergoing deregulation.

## IX GLOBAL MERGERS

The next matter to address is some of the specific issues that arise in relation to global mergers. One of the principal points to note is that it is now settled law that the Commission has the power to deal with a merger that is primarily an overseas merger. The Gillette merger with Wilkinson Sword was an important, precedent-setting global merger for the Commission. It is worth examining in detail.

On 27 August 1992 the Commission instituted proceedings against The Gillette Company and others, in relation to the 1990 worldwide sale of the Wilkinson Sword wet shaving business by the Swedish Match Group of companies. As part of that sale, The Gillette Company (a US company) acquired, in effect, the non-European Union Wilkinson Sword wet shaving businesses worldwide. The Gillette Company also financed (and took an equity interest in) the management buy-out (through a company called Eemland) of the European Union based Wilkinson Sword wet shaving businesses.

Following action by the US Department of Justice, The Gillette Company was subsequently required to sell the US Wilkinson Sword wet shaving business back to the management buy-out company, Eemland. Eemland was, as a result of action by the EC competition regulators, subsequently forced to divest the entire European Union based Wilkinson Sword wet shaving businesses.

In New Zealand the acquisition by The Gillette Company of the NZ Wilkinson Sword wet shaving business was cleared by the NZ Commerce Commission.

In Australia, The Gillette Company accounted for about 50 per cent, and Wilkinson Sword for about 17 per cent, of all wet shaving products sold. The Commission was concerned that in the event that the Gillette Company acquired control of the Australian Wilkinson Sword wet shaving business, it would dominate the Australian wet shaving market. In mid-June 1991, The Gillette Company advised the Commission that it had completed the acquisition of the Australian Wilkinson Sword wet shaving business through a series of offshore transactions involving New Zealand companies which had not carried on business in Australia. These New Zealand transactions were done in such a way that it appeared that they fell outside of the extra-territorial scope of the Act. The transactions were entered into without either notice to, or being conditional upon the approval of, the Commission.

The Commission claimed that s 50 applied to the overseas transaction and the assignment of the trademarks to the foreign Gillette Company. The Gillette Company vigorously opposed the Commission proceedings on four main grounds:

- that the Federal Court had no jurisdiction over it as it was a foreign company which did not carry on business in Australia;
- that despite the Commission's allegations, s 50 of the Act did not apply to the acquisition of the Australian Wilkinson Sword wet shaving business, as it was an offshore transaction;
- alternatively, that the Commission had not sufficiently alleged, or established at a prima facie level, any breach of s 50 of the Act; and
- that s 81(1) and (1A) of the Act, providing for the divestiture of assets or shares acquired, and the setting aside of acquisitions entered into, in breach of s 50, were unconstitutional.

The Gillette Company raised these matters before the Full Federal Court and the High Court.[3] In the end, it was unsuccessful. In particular, the Court held that, prima facie: (i) there was evidence that The Gillette Company carried on business in Australia; (ii) the Gillette Company was subject to the jurisdiction of the Court; (iii) the Commission had established that The Gillette Company was subject to the Act and that s 50 applies to the Australian part of the worldwide transaction notwithstanding that the transaction was entered into overseas; (iv) there was evidence that

[3] *Trade Practices Commission v The Gillette Company* (1993) 118 ALR 280. Leave to appeal to the Full Federal Court and the High Court was denied.

the conduct that the Commission alleged in the Statement of Claim has occurred and that this conduct would constitute a breach of s 50; and (v) s 81(1) and (1A) are constitutionally valid.

Subsequently, The Gillette Company approached the Commission and proposed a settlement whereby, pursuant to an undertaking to be given by The Gillette Company to the Court, the Wilkinson Sword business in Australia will be licensed to and operated by a company fully independent of and unrelated to The Gillette Group of companies.

## A *Global Mergers and Their Impact on Australian Business*

At any given moment there are a number of global mergers but not all of them have a direct impact on the Australian market for a number of reasons. First, it is likely that most global mergers do not have the effect of substantially lessening competition in any market in any country, just as most mergers in Australia do not substantially lessen competition (as evidenced, for example by the small number of Australian mergers opposed by the Commission). Secondly, potentially anti-competitive global mergers are usually stopped (or modified) by regulators in North America, Europe and sometimes elsewhere. Thirdly, some global mergers may have little effect in Australian because the possible anti-competitive effects are mitigated by import competition. For example, the Commission would need to look at any major global motor vehicle manufacturer mergers but that sector does see significant imports into the Australian market. Other mergers may cause concerns overseas without causing any competition concerns in the Australian market. An example of this type of merger was the merger between Guinness Plc and Grand Metropolitan Plc.

Guinness Plc announced in late 1997 that it proposed to enter into a worldwide merger with Grand Metropolitan Plc. Guiness Plc is involved in the production, marketing and sales of spirits and beers around the world, as well as owning pubs and hotels. In Australia, Guinness spirit products were distributed by its local subsidiary, United Distillers (Australia). Grand Metropolitan is a consumer goods company involved in food manufacturing, fast food restaurants, pubs and the production and marketing of distilled spirits. In Australia, GrandMet brands were distributed by Swift & Moore under an agency arrangement.

The Commission considered that the spirit industry was highly brand oriented and products tended to be marketed as individual brands rather than under the brand name of the supplier. Further, each brand tends to be specific to a particular category, and brand extensions do not usually cross spirit categories. The Commission found that the merged entity would control a number of category leaders but that the merger was likely to increase concentration only in the vodka and gin categories. The Commission concluded that the effect of the merger on concentration in scotch, which is the largest spirit category, would be minimal.

Because of the worldwide nature of the merger the Commission had discussions with competition regulators overseas, including the New Zealand Commerce Commission, the United States Federal Trade Commission (FTC) and the Canadian Competition Bureau. The regulators had different concerns based on the market conditions existing in their respective jurisdictions. Consequently, the merger proceeded with no divestiture requirements in Australia but with divestiture required in some of the other jurisdictions. On 16 October 1997 the European Commission announced that it had cleared the merger subject to conditions, including the divestment by the merged company of some brands on a regional or Europe-wide basis. On 15 December 1997 the FTC gave tentative approval to the merger after the companies agreed to divest their worldwide rights to Dewar's Scotch, Bombay Original Gin, and Bombay Sapphire Gin.

### B *Globalisation of Competition Laws*

Competition laws are rapidly reaching a level of maturity in several countries. This means that companies participating in a global merger are being forced to address competition concerns that may arise in several jurisdictions simultaneously. On the one hand, this may raise the transaction costs for the companies involved and has the potential to deter some beneficial mergers. On the other hand, all countries have the right to examine a merger proposal to ensure that it will not have a detrimental impact upon that country's domestic market. It is, therefore, important to find a solution that adequately addresses both points.

From a regulatory perspective it is beneficial to have a strong working relationship with competition agencies in other jurisdictions as this may assist the relevant agencies with their own enquiries. One possible solution for greater co-operation between countries could be through a uniform notification procedure for transnational mergers. This could result in countries adopting a basic set of questions which the merging parties would need to provide to all relevant competition agencies. Information which should be included would be matters such as: identifying the parties to the merger; describing the merger; describing the activities of the parties in the relevant country; identifying the markets which the merger would impact upon both horizontally and vertically; and including certain key documents such as the contractual documents covering the sale and annual reports for the parties involved. A uniform notification procedure would assist the work of the regulator and may also reduce transaction costs for the merging parties by reducing the duplication of regulatory requirements in different countries.

It must be stressed that any notification system is likely to be in addition to existing national laws as there are substantial differences in the merger control provisions of different countries. The impact of a uniform notification system could, however, have two beneficial side effects. First, it may lead, over time, to a gradual harmonisation of merger provisions. Secondly, the information that would be sought is material that would, in any event, need to be prepared for all the regulators involved in the process. This could result in reduced transaction costs for the parties and lead to enhanced co-operation between regulators as they have the same core information to work on.

This process of a uniform notification procedure is, however, only in its infancy and has more relevance to those jurisdictions where there is compulsory pre-merger notification. Australia does not have a legislated pre-merger notification or merger clearance system. Parties are not required to inform the Commission of their intention to enter into transactions, although many choose to do so.

## C Current Cooperation Between Regulators

Even without uniform notification provisions there has been an increase in the level of co-operation between regulators. Confidentiality requirements are one of the key issues limiting greater co-operation between regulators. It is, however, often in a company's best interest to waive confidentiality requirements in order to enable information sharing between regulators as this is likely to enhance the processing of merger enquiries. The Coopers & Lybrand merger with Price Waterhouse involved a high degree of co-operation between different regulators.

The Commission was informed in November 1997 that Coopers & Lybrand and Price Waterhouse intended to merge their operations globally. This matter was complicated by an announcement that KPMG and Ernst & Young were also considering a global merger. This would have resulted in the 'big six' accounting firms becoming either the 'big five' or 'big four'. The big six accounting firms operated in the markets for auditing and accounting, corporate recovery and insolvency, taxation advice, corporate financial services, management consulting and actuarial services.

The merger raised similar issues in the United States, Canada and Europe. The parties were, therefore, approached by the Commission, the Department of Justice in the US, DG IV in Europe and by the Canadian Bureau of Competition to waive confidentiality for information exchange between all four competition agencies. The parties did not have any objections to the information sharing which enabled the Commission to share information with the other regulators.

The Commission was able to finalise its own enquiries and announced on 13 March 1998 that the merger was unlikely to substantially lessen competition in Australia. Similar decisions were reached in other jurisdictions enabling the parties to complete the deal. As for the KPMG and Ernst & Young merger, it was called off by the parties for commercial reasons.

## D The Role of Other Agencies

The Commission is not the only government agency which has to consider the implications of globalisation. All countries around the world maintain controls over foreign direct investment.

Foreign investment in Australia is governed by the *Foreign Acquisitions and Takeovers Act 1975* (Cth) (FATA). The Foreign Investment Review Board (FIRB) examines proposals by foreign interests for direct investment in Australia and makes recommendations to the Treasurer on whether those proposals are suitable for approval. Under the FATA, the Treasurer has the power to block proposals determined to be against the national interest.

Most sectors of the economy within OECD countries are open to foreign investment. However, all OECD nations maintain some form of authorisation and notification system for foreign investors and maintain tight restrictions in certain key sectors.

Developing Asian economies have undergone rapid liberalisation in regard to foreign direct investment in recent years. Investment arrangements are generally more complex and restrictive than those that exist in OECD nations. The level of foreign investment is often conditional on entering joint ventures with domestic parties or meeting certain operational requirements.

The issue as to whether there is increasing foreign ownership within various sectors of the Australian economy is not an issue of direct relevance to the Commission's merger work, but there are indirect effects. For example, it is sometimes argued that if Australia's big banks are not allowed to merge, one of them will be acquired by a foreign bank. The Commission would have to look closely at any such acquisition as it would have the potential to lead to increased merger activity among remaining industry participants. Further, it would raise significant public interest questions which might be considered under the authorisation provisions of the Act. Any such acquisition would also have to be considered by the Treasurer and other regulatory bodies before it would be allowed.

There are also other government organisations that have an important role to play in considering mergers in the financial services sector. For example, apart from FIRB, the Treasurer also has a role under the *Financial Services (Shareholdings) Act 1998* (Cth). Division III of this Act provides for approval of shareholdings which exceed a 15 per cent limit. Section 14(1) allows the Treasurer to grant approval for shareholdings over 15 per cent where this would be in the national interest.

Under s 11 of the *Financial Sector (Transfers of Business) Act 1999* (Cth), the Australian Prudential Regulation Authority (APRA) must approve transfers of business in the financial services sector. Section 12 states that in carrying out its functions under this Act, APRA must consult with the Commission. The Commission is currently in the process of finalising a memorandum of understanding with APRA in relation to its functions under this Act.

## X POSSIBLE SOLUTIONS TO COMPETITION CONCERNS

The next area to cover is some of the methods that may be used to address certain competition concerns. It must be stressed, however, that there is no set formula for every case and what is suitable in one case may not be suitable in another.

### A *Authorisation*

One of the most powerful tools available to a company that risks breaching s 50 is to seek an authorisation. Australia, unlike many other countries, provides for the possibility of granting an authorisation permitting 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 all authorisations have 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 benefits. The Commission's publication on 'Exports and the Trade Practices Act'[4] provides a number of case studies including the DuPont and Ticor merger authorisation (1996) which illustrates the Commission's approach to international issues in an authorisation application. The publication identifies the kinds of arguments that the Commission considers most relevant to claims for mergers that will enable Australian firms to take part in world markets, even where the effects may be anti-competitive in the home market. There are, of course, instances in which the trade off of loss of competition in the home market versus benefits to Australia from a firm playing a role in world markets is unfavourable in terms of the public interest and in some cases mergers create monopolies or 'home champions' in the home market. They are not necessarily firms well prepared to compete in world markets as Professor Michael Porter's study, *The Competitive Advantage of Nations* demonstrated.[5]

The DuPont and Ticor merger provides an example. DuPont and Ticor applied for authorisation for a joint venture between their subsidiaries to take over and expand Ticor's sodium cyanide manufacturing plant. Sodium cyanide is a chemical agent that is essential for the extraction of gold from its ore. The industry has a high concentration internationally, with only three major international producers of

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[4] Australian Competition & Consumer Commission, *Exports and the Trade Practices Act* (October 1997).

[5] Michael Porter, *The Competitive Advantage of Nations* (1990). *Exports and the Trade Practices Act*, above n 8, also lists a number of other mergers where the Commission has taken into account the global nature of markets and the competition constraint imports place on Australian industry. See, for example, Dow Chemical and Huntsman Chemical; Chemcor and Hoeschst Plastics; ICI Australia and Auseon.

sodium cyanide, two of whom had significant shares of the Australian market. The Australian market was close to self sufficient, with about 90 per cent of domestic demand satisfied by domestic production. DuPont was the major importer of sodium cyanide into the Australian market.

The Commission considered that there was potential for anti-competitive conduct, stemming mainly from the entrenchment of the existing market structure and the limited role imports were likely to play in imposing a competitive constraint on domestic prices. With DuPont removed as a potential entrant in its own right, the joint venture would reduce the effectiveness of imports as a competitive constraint.

The Commission considered that the undifferentiated nature of the product, combined with the oligopolistic nature of the industry, had the potential to lead to cooperative arrangements between the major players at the expense of competition.

In its determination of public benefits the Commission accepted that increased production would satisfy increased demand otherwise likely to be satisfied by imports, thereby assisting Australia's external trade account over the medium to long term. While it was questionable whether significant export of the product would be forthcoming (due to the increase in domestic demand expected), this did not detract from the import substitution benefits. The authorisation was granted.

### B *Divestiture*

It is interesting to note that the majority of global transactions considered by the Commission relate to consumer goods with strong brands and trade marks. Australia is generally seen as a significant market where brands and trade marks do have value. Therefore, there is a possibility in some mergers to transfer certain brands or trade marks to an independent third party in order to alleviate the possible anti-competitive effects of the proposed merger.

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 or operations diminish in value. The brands themselves are worth significant amounts of money and the companies would maintain or seek value to them. With global mergers it may be possible to structure deals to overcome the specific competition concerns in Australia. The PepsiCo and United Brands (Smith's Snackfoods) merger and the British American Tobacco and Rothmans International merger are good examples of proposals where the Commission's competition concerns were overcome through the divestiture process. It is worthwhile discussing the British American Tobacco and Rothmans International merger in detail.

In January 1999 the Commission was notified of British American Tobacco Plc's (BAT) proposed worldwide merger with Rothmans International BV (Rothmans). BAT had a 67 per cent interest in the Australian cigarette manufacturer, WD & HO Wills Holdings Limited and Rothmans had a 50 per cent interest in the Australian cigarette manufacturer, Rothmans Holdings Limited.

The Commission conducted extensive market inquiries into this matter and concluded that the merger was likely to breach the provisions of the Act. The proposed merger would have given the merged group a 62 per cent share of the Australian cigarettes market. The merged group would have had a 96 per cent share of the premium cigarette segment, 49 per cent share of the mainstream segment and 61 per cent share of the value segment. The merged group would have controlled nearly all of the major Australian cigarette brands, including Benson & Hedges, Winfield, Holiday and Horizon. Independently distributed imports had market share of only about 0.6 per cent, of which Philip Morris accounted for approximately 0.5 per cent.

The Commission's view reflected its concern about the likely impact of the increase in market concentration and the merged group's control of major Australian cigarette brands in a market where import competition is negligible and barriers to entry are substantial. The potential for import competition to increase was limited by:

- barriers to establishing retail distribution links independently of incumbent suppliers;
- the existing trading arrangements between manufacturers and retailers that restrict the opportunities for new entrants to gain brand visibility;
- brand recognition and brand loyalty among smokers; and
- restrictions on advertising that limit opportunities to build brand images.

In response to the Commission's concerns, the merger parties offered the Commission a divestiture proposal. The divestiture proposal involved the sale to Imperial Tobacco Group PLC of a group of brands in each of the premium, mainstream and value cigarette segments, and in the roll-your-own market. Imperial Tobacco is a major British-based tobacco company that sells its tobacco products in over 70 countries.

On 3 June 1999 the Commission announced that it had accepted a court-enforceable undertaking for the divestiture of cigarette and roll-your-own tobacco brands to Imperial Tobacco Group PLC, which paid $325 million to acquire the brands from the merged group in Australia and New Zealand.

The divestiture has maintained three competitors in the cigarette market and restricted the merged group's market share to 44 per cent, rather than 61 per cent if the merger had proceeded without the Commission's intervention. As a result of the divestiture, Imperial Tobacco's market share of the cigarette market is 17 per cent, including a brand in the premium segment that will benefit from the change to the per-stick excise system for cigarettes in November 1999. Also, Imperial Tobacco has Virginia-blend brands in overseas markets which it may introduce to the Australian market. Further, Imperial Tobacco will operate an independent telesales facility for receiving orders from customers and will employ an independent field sales force. Imperial Tobacco will also implement changes to the divested brands to ensure they remain competitive after the change to the per-stick excise system.

The Commission concluded that, in light of the purchase of the cigarette and roll-your-own brands by Imperial Tobacco, the global merger between BAT and Rothmans was unlikely to result in a substantial lessening of competition in the Australian cigarette market.

### C *Structure of Mergers*

Divestiture may not always address the competition concerns arising out of a proposed merger. In those cases it is worth remembering that a merger can be structured in such a manner that it does not apply to Australia. An example of a merger applying only in some countries is the Coca Cola and Cadbury Schweppes merger.

The Coca Cola Company announced on 11 December 1998 that it proposed to acquire Cadbury Schweppes' beverage brands in more than 120 countries for approximately US $1.85 billion. Schweppes and Canada Dry tonic waters, club sodas and ginger ales were included, as were a variety of juice products, bottled waters and dilutables. The transaction also included the acquisition of beverage plants in Ireland and Spain. The transaction, however, did not apply to the US, France or South Africa. This highlights the manner in which a global merger can be structured to apply to most countries whilst leaving some key markets outside the scope of the merger.

The Commission opposed this merger, concluding that there would be a substantial lessening of competition in the market for the production and wholesale supply of carbonated soft drinks in Australia. The Commission's inquiries indicated that carbonated soft drinks are close substitutes with one another and that price rises in carbonated soft drinks do not lead to substantial switching of purchases to other beverages, like juices. For example, if there was a price rise in one carbonated soft drink, demand switches to other carbonated soft drinks more so than to other types of beverages.

The merger parties lodged a revised proposal in April 1999 after being advised of the Commission's decision. Under the revised proposal The Coca-Cola Company still proposed to acquire the international beverage brands of Cadbury Schweppes. Rights to produce, sell and distribute these brands would subsequently be licensed to The Coca-Cola Company's part-owned Australian bottler Coca-Cola Amatil. Cadbury Schweppes' Australian subsidiary, Cadbury Schweppes Australia, would otherwise remain intact. In addition, the proposal envisaged that Cadbury Schweppes Australia would acquire ownership of all carbonated soft drink brands currently owned by Coca-Cola Amatil and not licensed from The Coca-Cola Company. These brands include Kirks, Halls, Gest, Shelleys, Ecks, Marchants and Deep Spring.

The revised proposal did not address the competition concerns that the Commission had previously expressed over the original proposal. The Commission's core concern was that the premium Schweppes branded drinks remain part of the transaction. Consequently, it decided that the revised proposal was likely to breach the merger provisions of the Act.

### D *Undertakings*

Section 87B, related to undertakings, 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 the Commission is very sparing in its use of undertakings to resolve merger questions.

The Ampol and 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 this decision and then suggested undertakings which would neutralise the concerned anti-competitive effects. The Commission, after much consideration and negotiation, accepted undertakings and the merger went ahead. Although to some it reflected a form of social engineering, the Commission did not see itself as so engaged, even in this case. The parties had sought to merge and in doing so to cause an outcome in which the petroleum products market would be much less competitive than in the past. The Commission needed to be satisfied that the undertakings balanced or neutralised the anti-competitive effects. Whether this is called engineering or not is a semantic matter. The fact is that the Act clearly contemplates that undertakings can be used in these situations. Thus, mergers can go ahead and realise many of their benefits.

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. There is, however, opposition by some firms which want to make undertakings confidentially. There are some circumstances in which the Commission may accede to these requests. These include cases where the Commission is reasonably well informed about the industry's history and circumstances, as it was in the dairy industry where a range of mergers in recent years had been considered. Two merger proposals in which it was highly unlikely they would have been able to proceed had the Commission not agreed to accept undertakings confidentially are the National Foods Limited proposed takeover of Pauls Limited and Wesfarmers attempt to acquire ICI's Australian assets. Both were, however, aborted for commercial reasons.

It should also be noted that undertakings apply equally well to purely domestic mergers as they do to global mergers.

### E *Tariff / Non-Tariff Barriers*

In addition to the standard solutions of authorisations, divestitures and s 87B undertakings, there are other available options 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. The recent Caroma and Fowler Bathroom Products merger provides a good example of how changes to safety standards may alleviate the Commission's concerns.

In this case, the Commission was initially concerned about Caroma's acquisition of the James Hardie vitreous china manufacturing operations because this would give it over 90 per cent of the market. Caroma is part of the GWA International Ltd manufacturing group. It produces a range of bathroom products including vitreous china toilets and basins. Fowler had been the only other manufacturer. During the Commission's market inquiries in relation to this matter it became clear that many industry participants were concerned about Caroma's place on technical committees which draft Australian plumbing fixtures standards. In particular, it was feared that Caroma would inherit Fowler's positions on these committees and be able to unduly influence standards in its favour. The Commission accepted Caroma's enforceable undertakings to withdraw two committee representatives so that its representation would be the same as the importers.

While imports of toilets and basins into Australia were less than 10 per cent, the Commission expected that they would grow substantially in the future, thereby imposing a constraint on the behaviour of Caroma, particularly from highly efficient Asian producers.

## XI CONCLUSION

Since 1974 the Commission's experience with the mergers provisions of the Act provides business with a degree of certainty over the process of merger review. 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. Despite some criticism, merger law and the Commission's administration of it is clearly consistent with enabling Australian firms to realise greater international competitiveness.

A concern is sometimes expressed that in a world of global mergers national competition authorities are powerless. This concern is greatly overstated. Many, if not most, global mergers are not anti-competitive. If a global merger proposal is anti-competitive, it is likely to be blocked by North American or European authorities. Indeed, it is not unusual for multinational companies to complain that approvals are needed from so many authorities that mergers are unnecessarily impeded. This issue is currently receiving OECD attention.

Additionally, even if a merger proposal is anti-competitive in some overseas countries, it may not be in Australia, depending on market circumstances such as the state of import competition and the structure of the market. If, on the other hand, an international merger appears to be anti-competitive in Australia there is normally jurisdiction under the Act to deal with it and remedies are usually available in the form of fines, injunctions, undertakings, authorisations, and powers to divest. It is only in rare circumstances that a global merger that lessens competition in Australia is likely to pose great difficulties. There have been few, if any of these, in recent years.

Moreover, where undertakings are appropriate, practical commercial solutions are usually available. Brands or assets can be sold off, or companies can often be 'held separate'.[6] Further, appropriate policy offsets may be applied. For example, when BHP took over New Zealand Steel, Australian steel tariffs were lowered to neutralise the anti-competitive effect.

The effect of international mergers and takeovers on the Australian market is something that is examined on a case-by-case basis by the Commission. The aim of this paper has been to give both a general outline of how the Commission examines all mergers and also highlight some aspects that arise specifically in relation to international mergers.

In all, the Commission's work does not go entirely unrecognised. Our approach to competition law enforcement was recognised last year by a study reported in the *Economist* which stated that 'Australian laws are the best in the world at preventing unfair competition' and ranked Australia's competition laws as the fairest.[7] It is hoped that this will continue for at least another 25 years.

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[6] That is, a merger may proceed in some countries but not in others where there are anti-trust problems.
[7] See 'Competition Laws', (1998) 347(8068) *Economist* 121.