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The Treatment of Global Mergers: An Australian Perspective

*S. G. Corones**

I. INTRODUCTION

The liberalisation of trade and investment policies' improvements in information technology, communications and transportation has resulted in a dramatic increase in global commerce and global competition. To obtain access to new markets and compete globally, firms are entering into global mergers and global alliances.

In terms of competition, global mergers can be anti-competitive, pro-competitive, or neutral. The competition concerns raised by global mergers are the same as those raised by domestic mergers. Global mergers are anti-competitive if they increase unilateral market power, which the merged firm can exploit by raising prices. They can result in a reduction in the number of major market participants, thereby increasing the scope for coordination through international cartels.

In the past, tariff and non-tariff barriers may have effectively insulated domestic producers from import competition. However, as these barriers have been removed and international trade has grown, domestic producers have been increasingly confronted with competition from imports. Entering into a global merger is one way to eliminate import competition. This kind of merger may be considered anti-competitive.

On the other hand, global mergers can have pro-competitive effects when they introduce vigorous new competition into domestic markets where local potential competitors have faced high barriers to entry in those markets.

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Competition regulators ensure anti-competitive mergers challenged and pro-competitive or neutral mergers proceed unchallenged.

Australia's competition regulator, the Australian Competition and Consumer Commission ("ACCC"), recognises the trend towards global mergers in its 1999 Merger Guidelines. It states:

Increasingly the Commission must deal with acquisitions in a global context. This may involve consideration of global competition, or even global markets, and the role of mergers in enhancing efficiency and international competitiveness.... In addition, the mergers themselves may occur on a global scale, often involving multinational companies. Where these mergers impact on a market in Australia they will generally be subject to the Act.... Firms involved in these mergers will often have to deal with multiple competition agencies around the world. The Commission is increasingly involved in discourse and cooperation with these agencies and the OECD Committee on Competition Law and Policy recently approved a report reviewing and synthesising member countries' merger notification practices into a 'Framework for a Notification and Report Form for Concentrations'.¹

The purpose of this article is to examine some recent global mergers from an Australian perspective. The article begins by considering the administrative tribunal and Court structure in Australia, as well as the procedural, substantive, and remedial aspects of Australian laws regulating global mergers.² It then considers the Merger Guidelines and their focus on the unilateral and co-ordinated post-merger effects that are likely to occur. The article examines a number of recent global mergers, including *Coopers & Lybrand/Price Waterhouse*, *BAT/Rothmans*, *Pepsi Co/Smith's Snack Foods* and *Coca-Cola/Cadbury Schweppes*, as well as their assessment by the ACCC. Finally, it considers some of the problems posed by multiple merger review by competition agencies around the world.

II. THE ADMINISTRATIVE AND COURT STRUCTURE IN AUSTRALIA

Australia's competition law is contained in the Trade Practices Act of 1974 (*amended* 1986) ("the Act"). Part IV of the Act is headed "Restrictive Trade Practices."³ It contains a number of prohibitions that have the objective of promoting effective competition. Sections 50 and 50A prohibit mergers and acquisitions that substantially lessen competition.

¹Merger Guidelines, Australian Competition and Consumer Commission ¶ 3.11 (Canberra June 1999) [hereinafter Merger Guidelines].

²Very little has been written on the special problems posed by global mergers in Australia. The Chairman of the ACCC, Professor Allan Fels, set out his views in a helpful but brief paper, *Global Mergers – ACCC Approach*, 20 AUSTL. COMP. & CONSUMER COMM'N. J. 1 (1999). See also Rhonda L. Smith, *Globalisation: What Does It Mean For Competition Policy?* in 25 YEARS OF AUSTRALIAN COMPETITION LAW 166 (Steinwall ed., Butterworths, Sydney, 2000).

³For a doctrinal analysis, see S.G. Corones, *COMPETITION LAW IN AUSTRALIA* (LBC Information Services, Sydney, 1999).

Australia has adopted a dual adjudication system with two tiers of regulation in relation to mergers. The first tier provides for regulation by the Courts. Jurisdiction has been conferred on the Federal Court of Australia to hear and determine whether a breach of section 50 has occurred. The ACCC, an administrative agency, is responsible for enforcing section 50 of the Act by initiating Court proceedings for an injunction to prevent a merger or for divestiture in the case of an anti-competitive merger that has been completed.⁴

The second tier provides for regulation by the ACCC. While the courts are responsible for deciding whether there has been a contravention of section 50, the ACCC has an adjudicative role to play in assessing applications for authorisation⁵ where a merger would be likely to result in a public benefit that outweighs any anti-competitive detriment. The ACCC considers these authorisations exemptions from the Act, conferring immunity from legal proceedings.

The Australian Competition Tribunal, a quasi-judicial body, hears appeals from determinations made by the ACCC. Its President is a Federal Court Judge who determines questions of law, while the other members of the Tribunal are expert economists and business people.

III. PROCEDURAL, SUBSTANTIVE AND REMEDIAL ASPECTS OF GLOBAL MERGERS

The Act has no mandatory requirement for parties proposing an acquisition to notify the ACCC in advance to seek a clearance.

Delay and uncertainty can prove fatal to a proposed merger. Where there is a risk a proposed merger may lessen competition, the parties generally notify the ACCC in advance. The ACCC requires adequate time to make market inquiries and expects to be given the same notice and relevant documentation as overseas competition authorities. In its 1999 Merger Guidelines, the ACCC states that parties should advise the Commission of their plans at least three or four weeks before entering into an agreement.⁶

In a Discussion Paper entitled "ACCC Merger Assessment Informal Notification and Timing Issues" (December 1999) the Commission divides mergers into two broad categories: less complex mergers and more complex mergers. Less complex mergers are those that do not breach the ACCC's concentration thresholds set out in the Merger Guidelines discussed below.

⁴Section 80 provides for the grant of injunctions. Section 81 provides for divestiture orders. Trade Practices Act of 1974, §§ 80-81 (*as amended* in 1986). The Trade Practices (Transfer of Market Dominance) Act of 1986 and the Trade Practices Revision Act of 1986 amended the original Trade Practices Act of 1974. The resulting statute is now commonly referred to as the Trade Practices Act of 1974 (*as amended* in 1986). References to "the Act" throughout the remainder of this article are to the Act as amended in 1986.

⁵Trade Practices Act, *supra* note 4, at Part VII.

⁶Merger Guidelines, *supra* note 1, para. 4.13.

In relation to less complex mergers the ACCC will generally provide a response within ten to fifteen days. The written submission should contain the following information: (1) background information about the parties; the structure of the market, including any relevant information about other major market participants; (2) the commercial rationale for the merger; and (3) analysis of the proposed acquisition in terms of the factors referred to in section 50(3) of the Act.

In relation to more complex mergers that cross the concentration thresholds, the ACCC will require about a month to conduct a more detailed inquiry. A small number of major transactions that raise substantial issues may take six to eight weeks to consider. In relation to these more complex mergers the ACCC will require the following additional information: all marketing plans, business plans and strategic plans made available to senior management concerning the transaction or related transactions; all Board minutes and reports considered by the Board relating to the transaction and any reports/studies relating to the transaction presented to the Board; detailed customers and suppliers information as requested; and any financial data information as requested.

The ACCC states that offshore acquisitions and global mergers generally require "more time" for the relevant information to be assessed and for the Commission to liaise with overseas competition regulators.

If the ACCC forms the view that the proposed acquisition is unlikely to substantially lessen competition the parties can proceed. If the ACCC forms the view that the proposed merger is likely to lessen competition the acquirer will be required to divest sufficient assets pursuant to a section 87B undertaking to ensure that the merger does not have anti-competitive effects in Australia. These section 87B undertakings are in the nature of consent injunctions and if the parties were to breach them, the Court could make an order directing the parties to comply without the need for a full trial.

If the parties to a proposed merger are unable to re-structure the arrangement to avoid a breach, they have no choice but to apply to the ACCC for an authorisation. The ACCC is empowered by section 88(9) of the Act to grant an authorisation to a person to acquire shares or assets or to acquire a controlling interest in a body corporate that would otherwise be contrary to section 50 or section 50A. The test to be applied is set out in section 90(9), namely that it must be satisfied in all the circumstances that the proposed acquisition would result, or be likely to result, in such a benefit to the public that the acquisition should be allowed to take place.

The main focus of section 50 is on domestic mergers but it also applies to global mergers. Section 50 must be considered in the context of section 5(1) which extends its operation. Section 5(1) provides: "Part IV [in which section 50 appears]...extend[s] to the engaging in conduct outside Australia by bodies corporate incorporated or carrying on business within Australia...."

The ACCC takes the view that the acquisition occurs where the property is situated rather than where the agreement is signed or the shares are acquired.⁷ Thus, for example, in *TPC v. Australia Meat Holdings Pty. Ltd.*⁸ an Australian incorporated company, Australia Meat Holdings Pty. Ltd., acquired the issued capital of Thomas Borthwick & Sons (Australia) Ltd. from two United Kingdom companies which were in turn, owned by Borthwicks Plc., another United Kingdom company. The acquisition of share capital occurred in London. Even so, the merger was prohibited by section 50.

The Commission relied on section 50 when it reviewed the Gillette Company's acquisition of the Wilkinson Sword Ltd. 'wet shaving' business, a transaction initiated by entities outside Australia and occurring wholly outside Australia.⁹

Section 50 does not extend to prohibit mergers between purely foreign companies operating outside Australia which result in domestic subsidiaries coming under the common control of the merged foreign parent. A separate section, section 50A, was introduced into the Act to deal with this situation. Section 50A adopts the same threshold test as section 50, namely whether the merger is likely to lessen competition substantially in an Australian market. However, a different set of procedures and remedies is provided for in section 50A.

Section 50A prohibits certain acquisitions occurring outside Australia that have anti-competitive effects within Australia. The elements of a section 50A(1) claim are: an acquisition occurring outside Australia (the first controlling interest); results in the acquiring person obtaining a controlling interest in a corporation in Australia (the second controlling interest); the Tribunal is satisfied that the obtaining of the second controlling interest will have or be likely to have the effect of substantially lessening competition in a market in Australia; and the Tribunal is satisfied that the obtaining of the second controlling interest would not result in sufficient public benefit that it ought to be disregarded.

In effect, section 50A(1) provides that the Tribunal may make a declaration that if the Australian operations of the parties had formally merged

⁷ Merger Guidelines, *supra* note 1, para 3.12.

⁸ *TPC v. Australia Meat Holdings Pty. Ltd.*, 83 A.L.R. 299 (1988).

⁹ See A. I. Tonking, *The Gillette Case – A Close Shave*, 3 COMPETITION & CONSUMER L. J. 62, 80 (stating "The Commission's argument was that the worldwide agreement purported to affect the right or title to assets of the Wilkinson Sword business situated in Australia by conferring upon Gillette a proprietary interest in those assets. Australian law, it was contended, as the *lex situs* of those assets determined whether, and the extent to which, such an interest was effectively vested in Gillette in consequence of the agreement. The interest arose under Australian law, which was the source of the relevant property rights; it arose in Australia and therefore could be said to have been acquired in Australia.").

there would have been a contravention of section 50(1) or (2) and that the bidder would not have been able to obtain an authorisation.

A person shall be taken to have a controlling interest in a body corporate if the body corporate is or would be a subsidiary of the person.¹⁰ A subsidiary for the purposes of section 50A is defined in section 4A which provides that a corporation will be a subsidiary if another body corporate controls the composition of its board of directors; is in a position to cast more than fifty percent of the maximum number of votes that can be cast at a general meeting; or holds more than fifty percent of the issued share capital.

If the Tribunal makes a declaration, as outlined above, then section 50A seeks to ensure that the market power acquired as a result of the acquisition outside Australia is dissipated until the merged entity no longer substantially lessens competition. This can be achieved by means of a partial or full voluntary divestiture. Following a partial divestiture it would be necessary to apply to the Tribunal pursuant to section 50A(4) seeking a revocation of the declaration made under section 50A(1).

Section 50A does not prohibit the merger of foreign parents. Rather, the procedures and remedies are directed at the Australian subsidiaries. Section 50A provides for declarations to be made by the Australian Competition Tribunal that the merger substantially lessens competition and does not give rise to an overriding public benefit. If a declaration is made, the domestic subsidiary corporations have six months to cease operations or to divest themselves of sufficient assets to avoid the anti-competitive effect of the merger.

This may be commercially unattractive given the short time frame left to find an acceptable purchaser. If the entity continues to carry on business beyond the six-month period without having the declaration revoked, the entity would contravene section 50A(6). In that event, the ACCC could seek divestiture under section 81(1B) ordering the disposal of such assets within a specified period of time.

IV. SUBSTANTIAL LESSENING OF COMPETITION: UNILATERAL EFFECTS AND CO-ORDINATED EFFECTS

In January 1993 the standard applied in the threshold test in section 50 was changed from 'dominance' to 'substantially lessening competition' by the Trade Practices Legislation Amendment Act 1992 ("1992 Amendment Act").

The Explanatory Memorandum accompanying the 1992 Amendment Act stated:

The previous test of market dominance has been interpreted by the court as a situation where one firm has a commanding influence in the market. It is a

¹⁰Trade Practices Act, *supra* note 5, at § 50A(8)(a).

test which focuses largely on changes to the structure of a market that would be affected by the acquisition but it also takes some account of the likely effect on the competitive process of such an acquisition. The substantial lessening test focuses on changes to the state of competition in the relevant market. As the Trade Practices Act is about competition, a test which concentrates on competition and whether there is a lessening of that competition is more consistent with the policy underlying the legislation.

The term 'substantially lessening competition' is used widely through the Principal Act. It is here intended to mean an effect on competition which is real or of substance, not one which must be large or weighty. While in many cases, a merger or acquisition would be caught by either the 'dominance' or the 'substantial lessening' test, there are some acquisitions that are more likely to be subject to the new test, for example, where an acquisition of a small effective competitor results in two well-matched competitors being left in the market.¹¹

Unlike the dominance threshold which is only concerned with the position of the acquirer in the market and the unilateral effects of the merger in terms of the ability of the merged entity to raise price above competitive levels, the substantial lessening of competition test is concerned with unilateral effects and the likelihood that the firms remaining in a market after a merger will engage in explicit or tacit collusion. Both the unilateral and the coordinated effects of the merger must be considered. In relation to the coordinated effects, the parties to a proposed merger must rebut the inference that the removal of a competitor as a result of the merger will inevitably lead to collusion.

The Act lists a number of matters that must be taken into account by the Court in determining the anti-competitive effect of a merger. It provides:

Without limiting the matters that may be taken into account for the purposes of subsections (1) and (2) in determining whether the acquisition would have the effect, or be likely to have the effect, of substantially lessening competition in a market, the following matters must be taken into account:

- the actual and potential level of import competition in the market;
- the height of barriers to entry to the market;
- the level of concentration in the market;
- the degree of countervailing power in the market;
- the likelihood that the acquisition would result in the acquirer being able to significantly and sustainably increase prices or profit margins;
- the extent to which substitutes are available in the market or are likely to be available in the market;
- the dynamic characteristics of the market, including growth, innovation and product differentiation;

¹¹ Explanatory Memorandum, Trade Practices Legislation Amendment Bill 1992, paras. 11, 12.

- the likelihood that the acquisition would result in the removal from
- the market of a vigorous and effective competitor;
- the nature and extent of vertical integration in the market.

The list of factors in section 50(3) is not exclusive. The Court and the ACCC will take into account other matters that may affect the likely competitive outcome of the merger. The focus on co-ordinated effects as well as unilateral effects is expressed in the Merger Guidelines:

5.167 One factor which is of general relevance is the extent to which the market is characterised by conditions conducive to coordinated conduct. While the exercise of unilateral market power does not require accommodating action by remaining firms in a market, the exercise of coordinated market power does. This does not necessarily involve collusion of the kind covered by § 45 but may simply involve signaling or conscious parallelism. Features of the market which impinge on the likely rewards from coordination, the likelihood of reaching an agreement, and the ability of the parties to detect and punish deviations from the agreement, are all relevant to the likelihood of such conduct occurring and being successful in the future.

5.168 Some of the factors affecting the likelihood of coordinated conduct are:

- a small number of firms increases the likelihood that firms will recognise mutual benefits from cooperation, and makes it easier to reach an agreement and detect cheating;
- the absence of potential entrants or fringe competitors makes it less likely that coordinated conduct will be undermined;
- inelastic demand increases firms' returns from coordination versus competition;
- product homogeneity makes it easier to reach an agreement and easier to detect deviations;
- firm homogeneity, similarity of cost and other conditions, *e.g.* vertical integration, product lines, or production capacity, affecting the interests of rivals makes it easier to reach an agreement;
- posted prices or open bids, *i.e.* transparency of prices, make monitoring an agreement easier;
- vertical relationships may enable price signalling [sic] or price monitoring downstream;
- size and frequency of purchases affects firms' incentives to cooperate or compete; and
- industry associations and for a may facilitate the flow of information on prices and outputs between market participants and/or may facilitate them reaching an agreement.

5.169 If a merger increases the likelihood of coordination it is likely to substantially lessen competition. Both horizontal and vertical mergers may have this effect. For example, mergers can increase the level of concentration in a market, they may remove a maverick competitor which has destabilised past attempts at market coordination, they may create rivals with a greater commonality of interest, or they may increase the visibility of pricing through downstream integration. In other circumstances a merger which disrupts mar-

ket conditions, e.g. by reducing the costs of the merged firm or eliminating a technology disadvantage, may disturb the terms of coordination and may make such coordination less likely.

5.170 When considering the likelihood of future coordination the Commission will also consider any existing relationships between firms and the past history of market conduct, whether it has been characterised by price fixing, parallel pricing or vigorous price competition and how such conduct is likely to be affected by the merger.¹²

The Merger Guidelines do not make clear when the Commission will rely on unilateral effects, or co-ordinated effects, or both, to oppose a merger. In *Ampol/Caltex*, for example, Caltex Australia Ltd. and Ampol Ltd. announced a merger of their Australian petroleum operations. The Commission initially opposed the merger since it would have resulted in a reduction in the number of major refining and marketing companies in the petroleum industry from five to four. The four firm concentration ratio would be 100 percent and the merged firm would be the largest supplier well in excess of the threshold of fifteen percent. Import competition was not an effective competitive constraint and barriers to entry were substantial. There were considerable sunk costs involved in the construction of a petroleum refinery and economies of scale were also considerable. In relation to other structural and behavioural market features there was extensive vertical integration and close vertical relationships through retail distribution arrangements. There was little countervailing power from buyers.

The Commission was concerned about the potential exercise of unilateral market power because of the homogeneous nature of the product and the likelihood that the reduction in the number of refiners from five to four would facilitate the exercise of co-ordinated market power.¹³

By way of contrast, in *Wattyl/Courtaulds*,¹⁴ the Commission emphasised the potential exercise of coordinated market power rather than unilateral market power.

The parties applied for an authorisation rather than risk the Commission challenging the merger in the courts. The Commission gave the following reasons for refusing the application:

6.249 However, there are strong reasons for doubting that...competition would exist following the merger. The more likely outcome is that the two major firms would cooperate rather than compete. This would be to the detriment of competition and efficiency. The probability of cooperation emerging rather than competition is substantial given the structural features of the architectural and decorative paint market.

¹² Merger Guidelines, *supra* note 1, at paras. 5.167-5.170.

¹³ See Jill Walker and Luke Woodward, *The Ampol/Caltex Australia Merger: Trade Practices Issues*, 4 TRADE PRAC. L. J. 21, 21 (1996).

¹⁴ A.T.P.R. (CCH) 50-232 (1996). See Smith, *Issues Raised by the Proposed Acquisition of Taubmanns by Wattyl* (1996) 9 CORP. & BUS. L. J. 223.

6.250 In reaching this conclusion, the Commission has considered the factors that are conducive to the exercise of both unilateral and coordinated market power. One such factor is a reduction in the number of firms in the market. This raises the likelihood that remaining firms will engage in cooperative behaviour because it is easier to reach and monitor agreements (both explicit and tacit). In this matter, the number of substantial effective competitors falls from three to two...

6.252 Coordination is also facilitated if firms have similar cost structures as each firm has a similar view as to the appropriate price... The net effect is that cost structures between Taubmanns/Wattyl and Dulux are likely to be similar.

6.253 Furthermore, if there are few close substitutes, such that the price elasticity of demand is low, it is easier for firms to maintain price near monopoly levels. There are no close substitutes for paint...

6.255 Cooperative behaviour is easier to sustain if there is an even flow of frequent and small sized sales because the potential pay-off from undercutting a rival is smaller than if sales are in large lots and occur infrequently. This condition is generally satisfied in this case.¹⁵

The Commission was primarily concerned with the potential exercise of unilateral market power in *Bristile Holdings Ltd.*¹⁶ Bristile Holdings Ltd. ("Bristile") lodged an application for authorisation to acquire the Western Australian concrete tile assets of Pioneer Building Products ("PRT") Pty. Ltd. ("Pioneer"). Bristile was the only manufacturer of clay roof tiles in Western Australia. In the Commission's view, the relevant product market was the market for clay and concrete roof tiles. The other suppliers in the market, apart from Bristile and Pioneer, were Monier ("CSR") and Harmony Tiles produced by the Buckeridge Group ("BGC"). The Commission was concerned that the merged entity would be in a position to exercise unilateral power by raising prices and disciplining its competitors if they refused to follow:

5.87 The Commission's concerns with the proposed acquisition derive from two key consequences resulting from the acquisition. First, Bristile will be able to exert a considerable degree of control over both clay and concrete tile prices in the market...

5.89 Second, Bristile will derive economies of scope from the transaction by sharing overheads between its concrete and clay tile business[es]. These savings will commit Bristile to pursue concrete tile prices that cannot be sustained by either BGC or Monier in the long run. Given the tight financial position of both BGC and Monier, Bristile might take the view that it can force its competitors from the market by lowering concrete tile prices for a period and supporting itself with profits from its clay tile business. Such an approach by Bristile would be encouraged by the presence of ongoing substantial excess capacity in the industry and the perception that some form of capacity rationalisation may be inevitable.

¹⁵ A.T.P.R. (CCH) 56-637-38 (1996).

¹⁶ A.T.P.R. (CCH) 50-250 (1997).

5.90 Alternatively, Bristle's ability to drive concrete tile prices down presents a credible threat to the concrete tile manufacturers if Bristle attempts to lead prices up but does not receive the 'cooperation' of BGC and Monier.¹⁷

It seems that the ACCC's primary concern where products are differentiated lies with unilateral effects and whether the merger would lead to higher prices for the products sold by the merged firms. Even though two products may be in the same market, a corporation with a differentiated product, nevertheless, may have scope for exploiting unilateral market power by raising price. On the other hand, where the products at issue are homogeneous, such as petroleum or other commodities, the ACCC is more likely to be concerned with the potential for coordinated conduct arising post-merger.

V. THE ACCC'S MERGER REVIEW PROCESS

At the administrative level the ACCC, in deciding whether to challenge a proposed merger, adopts a five-stage process of review which incorporates the section 50(3) factors. The review process is summarised by the ACCC:

1. The Commission identifies the relevant market, in its relevant product, geographic, functional and temporal dimensions.
2. The Commission assesses the level of concentration in the market of the merged firm in order to determine whether the merger falls below certain thresholds.... If the threshold is exceeded the Commission proceeds to its next stage of evaluation.
3. The Commission assesses the actual and potential level of import competition in the market to determine whether it provides an effective constraint on the merged entity.
4. The Commission assesses barriers to entry to determine whether it is likely that new entrants will establish themselves in the market on a sufficient scale within a reasonable time to inhibit the exercise of market power by the merging firm.
5. If the acquisition is still under consideration the Commission will examine a series of other factors including:
 - the degree of countervailing power in the market;
 - the likelihood that the acquisition would result in the acquirer being able to significantly and sustainably increase prices or profit margins;
 - the extent to which substitutes are, or are likely to be, available in the market;
 - the dynamic characteristics of the market, including growth, innovation and product differentiation;
 - the likelihood that the acquisition would result in the removal from the market of a vigorous and effective competitor; and
 - the nature and extent of vertical integration in the market.¹⁸

¹⁷ *Id.* at 57-307-08.

A. Stage 1: Market Definition

Where the conduct at issue is an alleged anti-competitive merger, one needs to consider the purpose of section 50, which is to prevent the merged entity from exercising market power after the merger by raising its price to the detriment of consumers. Thus, in defining the market one needs to ask whether a post-merger price rise would be profitable or whether the merged entity would lose sales as a result of consumers switching to other products. If such demand substitution is likely, those other products will be included in the relevant market.

In testing demand-side substitutability, the ACCC commences with the product that is the subject of the merger and considers the effect on demand of a small but significant and non-transitory increase in price (hereinafter "SSNIP") by a hypothetical monopolist supplier of the product. The 1992 U.S. Department of Justice *Merger Guidelines*¹⁹ usually adopt a five percent increase in price, in applying the SSNIP or hypothetical monopolist test.

Applying this test to the *Coca-Cola/Cadbury Schweppes* merger, the question becomes: Is Coca-Cola constrained in its price-increasing ability by other beverages? If so, they should be included in the same market.

Areeda, Hovenkamp and Solow have identified the fundamental problem:

The obvious problem lies in the varying degrees of constraint. The most immediate constraints on the prices of regular Coca-Cola are the prices of other widely advertised colas. These prices in turn are constrained by the prices of widely advertised cola beverages without sugar or without caffeine, by similar private brand products, by some other flavoured and highly promoted sodas, and by soda beverages generally. These prices may even be affected by the prices of other beverages such as fruit juice, milk, wine, beer, and perhaps even gin or cognac.²⁰

The process of product definition is a fact of intensive inquiry involving value judgements about which there are frequently differences of opinion. For example, in the *Coca-Cola/Cadbury Schweppes* merger, Coca-Cola's various brands (Coke, Fanta, Sprite and others) accounted for 51 percent of global carbonated soft drink sales. The parties to the merger argued that the relevant product market should include all beverages including tap water and that its share of the market is only two percent.²¹

¹⁸ *Exports and the Trade Practices Act*, AUSTL. COMPETITION & CONSUMER COMM'N J., Oct., 1997, at 12-13. For a fuller discussion, see *Merger Guidelines*, *supra* note 1, at paras. 5.23 to 5.33.

¹⁹ See U.S. Department of Justice and Federal Trade Commission, *Horizontal Merger Guidelines* (1992), reprinted in 4 TRADE REG. REP. (CCH) 13, 104.

²⁰ AREEDA, ET AL., ANTITRUST LAW, para. 533 (Little Brown Vol. 11A 1995).

²¹ *Software, Soft Drinks*, THE ECONOMIST, Aug. 14, 1999, at 14.

Such an approach to product market definition was rejected by the United States District Court for the District of Columbia in *FTC v Coca-Cola Co.*²² Proceedings were brought by the Federal Trade Commission for an interlocutory injunction to enjoin Coca-Cola from acquiring Dr. Pepper pending FTC hearings to determine whether the acquisition violated section 7 of the *Clayton Act*, which prohibits acquisitions that may substantially lessen competition in any line of commerce. The Court was persuaded that the appropriate "line of commerce" for measuring the probable effects of the acquisition was the carbonated soft drink market. It concluded:

In view of the structure and operation of this industry, the relevant line of commerce in evaluating the acquisition is assuredly not what Coca-Cola Company suggests -- "all...beverages including tap water" -- even though it is true that other beverages quench thirst and that "[t]he human stomach can consume only a finite amount of liquid in any given period of time." The market or submarkets delineated need not be this broad (anything potable) nor as unduly narrow (concentrate flavoring) as lawyers or economists may choose to suggest.

Moreover, the major participants in the market do a nationwide business and specialize mainly in carbonated soft drinks. They make pricing and marketing decisions based primarily on comparisons with rival carbonated soft drink products, with little if any concern about possible competition from other beverages such as milk, coffee, beer or fruit juice.²³

The ACCC in the Coca-Cola and Cadbury Schweppes merger reached the same conclusion and defined the relevant product market as carbonated soft drinks.

The ACCC has indicated that it will have regard to the following information in establishing the relevant product dimension of the market:

(1) end use of the product and potential substitutes; (2) physical and technical characteristics of the product and potential substitutes; (3) costs of switching purchases between the product and potential substitutes; (4) views and past behaviour of buyers regarding the likelihood of substitution between products; (5) costs of switching production and distribution systems from another product line to a product which is closely substitutable with the relevant product; (6) views, business records and past behaviour of suppliers regarding the impact of price and marketing decisions by the suppliers of potential substitute products on their own pricing and marketing decisions; and (7) relative price levels and price movements of the product compared to potential substitutes.²⁴

Geographic market definition poses particular problems in relation to global mergers. In Australia the geographic market is defined using the same price elevation relied upon for product market definition. The test re-

²²Fed. Trade Comm'n v. Coca-Cola Co., 641 F. Supp. 1128 (D.D.C. 1986).

²³*Id.* at 1133.

²⁴Merger Guidelines, *supra* note 1, at para. 5.59.

quires one to infer what the response would be if a supplier in one location, for example, in Sydney, raised its price. If, because of the supplier's geographic isolation, there would be no response from suppliers in other geographic locations, then the Sydney supplier occupies a separate geographic market. If, on the other hand, the Sydney supplier is constrained in its price setting by suppliers in other parts of Australia or Southeast Asia, then the market is broader than the Sydney market.

In relation to global mergers, it is necessary to take account of possible changes in transport costs and exchange rates. A devaluation of the Australian dollar will make imports expensive and discourage foreign suppliers from selling in Australia. Market shares for imports may be overstated. A strengthening of the Australian dollar will allow foreign suppliers to sell at prices below the domestic prices and imports will increase.

The extent to which imports should be taken into account in competition analysis has been the subject of much debate.²⁵ The debate was triggered by an influential article by Landes and Posner,²⁶ who argued that traditional market definition was unsatisfactory because it resulted in exaggerated market shares. They concluded that all of the actual or potential output of foreign sellers, should be included in the relevant market where non-trivial imports are present, regardless of transport costs.²⁷ Their approach focused on diversion and they argued in favour of including all imports in such circumstances "because the distant seller has proved its ability to sell in the market and could increase its sales there, should the local price rise, simply by diverting sales from other markets."²⁸ The application of such an approach might reduce the market share of the local seller to a point where the relevant statutory competition test may not apply.

The Commission states in its 1999 Merger Guidelines:

Section 4E defines a market to be a market "in Australia", while § 50(6) defines a market to be a market "in Australia, in a State or in a Territory". Arguably, the Act does not require that the relevant market be defined as wholly within Australia, only that at least some part of it be in Australia. For practical purposes, there will generally be significant discontinuities in substitution between domestic and imported supply. In most cases the Commission will define the relevant market to be Australia or a part of Australia (but including imports). However, in some circumstances it may be relevant to define the market as broader than Australia, eg trans-Tasman, or even a world market.²⁹

It will have regard to the following types of information:

²⁵ See, e.g., Richard Calvini, *The Uncertainties of International Geographic Markets* 32 WORLD COMP. 93 (1998).

²⁶ William M. Landes & Richard A. Posner, *Market Power in Antitrust Cases*, 94 HARV. L. REV. 937 (1981).

²⁷ *Id.* at 966.

²⁸ *Id.* at 963.

²⁹ Merger Guidelines, *supra* note 1, at para. 5.63.

(1) the convenience to customers of accessing alternative sources of supply; (2) the costs of switching to alternative sources of supply; (3) views and past behaviour of buyers regarding the likelihood of switching between geographic sources of supply; (4) the costs of transportation or access to the alternative sources of supply; (5) the perishability of the product; (6) any regulatory or other practical constraints on suppliers selling to the customers of the merging firms; (7) the costs of extending or switching production and distribution systems to supply the customers of the merging firms; (8) views, business records and past behaviour of suppliers regarding the impact of price and marketing decisions in one geographic area on supply from another geographic area; and (9) the relative price levels and price movements of different geographic sources of supply.³⁰

B. Stage Two: Concentration Levels

In stage two of its analysis, the ACCC will focus on market structure, in particular, whether market concentration has risen to such a level that the merger is likely to have adverse anti-competitive consequences. The Commission uses the traditional four firm concentration ratio ("CR4"), which is the sum of the actual shares of the four largest firms. It states:

If the merger will result in a post-merger combined market share of the four (or fewer) largest firms (CR4) of 75 percent or more and the merged firm will supply at least 15 percent 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 percent or more of the market the Commission will want to give the merger further consideration. The twofold thresholds reflect concerns with the potential exercise of both coordinated market power and unilateral market power.³¹

C. Stage Three: Import Competition

Stage three of the Commission's analysis is to consider the effect of import competition on those mergers that pass through the concentration screen or filter.

Economists divide goods and services into two broad categories: those that are able to be traded internationally and those that are not. Most services are non-tradable. Some goods are non-tradable because of their weight and high transportation costs make their importation unprofitable. It is estimated that only a quarter of Australia's gross domestic product consists of goods that are tradable. In its investigation of global mergers the Commission focuses on the non-tradable sector.

The Commission tends not to recognise the existence of world markets. Rather, it defines the relevant geographic market to be Australia or a part of

³⁰*Id.* at para. 5.62.

³¹*Id.* at para. 5.95.

Australia and to treat the market share of imports as indicative of their competitive role in that market. The Merger Guidelines provide guidance on the ACCC's assessment of import competition. If import competition is an effective check on the exercise of market power the ACCC is unlikely to oppose the merger.

For example, in *Email/Southcorp* the two major manufacturers of whitegoods in Australia were allowed to merge because of significant imports into Australia by a New Zealand manufacturer, Fisher & Paykel. The ACCC stated:

Import Competition: The parties submitted that despite the high level of market concentration that would result from the merger, the proposal was unlikely to result in a substantial lessening of competition due to the existing and potential level of import competition in each market.

The ACCC rigorously explored this issue. Factors considered included: Market shares of imported products; (1) Range of imported products available within each product market; (2) Price competitiveness of imported products; (3) Ability of importers to establish adequate distribution channels and presence in local retail outlets; (4) Ability of importers to provide adequate "after care" service; and (5) Other factors which could impede the ability of imported products to provide effective competition including perception of brand loyalty and ability of local competitors to engage in strategic behaviour to deter the growth of imports.

While recognising the increased level of concentration, the ACCC noted that in most product markets the level of imports were significant. Imports were found to be obtained from a variety of sources from Asia, the US, Europe, and Turkey.

Given that the products within these markets are not homogenous products but include a variety of product lines which range in price as well as features, particular attention was given to assessing whether the imports were competitive across markets as a whole, rather than just within discrete market segments.³²

The Commission has been criticised for failing to accord sufficient weight to the importance of import competition. According to the Industry Commission whenever imports exceed ten percent, there should be a presumption that mergers will not substantially lessen competition.³³

The Industry Commission's recommendation of providing a "safe harbour" for mergers where imports exceed ten percent has, itself been criticised. Professor Henry Ergas has observed:

Taken as it stands, this is an extremely curious recommendation. In effect, it amounts to proposing that a firm which has a 50% market share should

³² *Email Acquisition Of Southcorp's Whitegoods Not Opposed*, AUSTL. COMPETITION & CONSUMER COMM'N MEDIA RELEASE, MR 24/99 (Mar. 11, 1999).

³³ See Industry Commission, MERGER REGULATION: A REVIEW OF THE DRAFT MERGER GUIDELINES ADMINISTERED BY THE AUSTRALIAN COMPETITION AND CONSUMER COMMISSION para. 3.3.1 (June 1996).

be permitted to merge with a firm with a 40% market share so long as imports account for the remainder of the market. Thus, were such an approach adopted, GM could merge its Australian operations with Ford, with the ACCC not even inquiring as to the competitive effects which the merger would entail.³⁴

D. Stage Four: Barriers to Entry

Stage four of the Commission's analysis is to consider the height of barriers to entry, which are widely defined to include "any feature of a market that places an efficient prospective entrant at a significant disadvantage compared with incumbent firms."³⁵ The examples given include access to scarce resources, economies of scale and scope, product differentiation and brand loyalty and sunk costs.

E. Stage Five: Efficiency Claims, Market Dynamics, etc...

Stage five of the Commission's analysis is to consider a number of other qualitative market factors that are linked in section 50(3), namely whether the merged firm will face any countervailing market power; the availability of substitutes; whether the merger will result in the removal of a vigorous and effective competitor; vertical integration; the dynamic characteristics of the market; and the likely impact of the merger on opportunities for firms in the market to co-ordinate their conduct; efficiencies and prices and profit margins.³⁶

One of the major unresolved issues in Australia relates to whether efficiency is a relevant consideration in assessing the effect of a merger on competition. Efficiency is not specifically mentioned in the list of matters in section 50(3) that are relevant under the substantial lessening of competition test although section 50(3)(g) requires the dynamic characteristics of the market to be considered. The list is inclusive not exhaustive. Efficiency is a public benefit and is frequently taken into account by the ACCC as part of its authorisation assessment. In this context as a public benefit efficiency generally refers to cost savings which can be passed on to consumers in the form of lower prices. However, efficiency can also enhance the merged entity's ability to compete against its rivals, so that it should also be taken into account as part of the competition analysis rather than only being considered as a trade off with competition in an authorisation context.

This line of reasoning that efficiencies strengthen the competitive process was recognised by the Tribunal in *Queensland Independent Wholesal-*

³⁴Henry Ergas, *Are the ACCC's Merger Guidelines Too Strict? A Critical Review of the Industry Commissions Information Paper on Merger Regulation*, 6 COMP. & CONSUMER L. J. 171, 176 (1998).

³⁵Merger Guidelines, *supra* note 1, at para. 5.116.

³⁶*Id.* at paras. 5.129 to 5.179.

*ers Pty. Ltd.*³⁷ Following its failed attempt to acquire Queensland Independent Wholesalers Pty. Ltd. ("QIW"), Davids subsequently acquired the South Australian Independent Grocery, Independent Holdings Ltd. This was part of a long-term strategy under which Davids proposed to combine all of the independent groceries in Australia to form a 'fourth force' in grocery retailing to compete with the three integrated chains, Coles Myer, Woolworths and Franklins. The next step in its 'fourth force' strategy was to acquire Composite Buyers Ltd. In relation to this proposed acquisition Davids sought to obtain an authorisation which was granted by the Commission. QIW appealed against the grant of the authorisation to the Tribunal, which held:

The 'fourth force' contention was presented to the Tribunal as though its achievement would constitute a self evident benefit. We think the nature of that benefit should be spelled out. We conclude that it is a benefit of real substance with the following elements:

It would strengthen the competitive process, enlarge the options available to consumers and enhance consumer welfare.³⁸ While the Tribunal's analysis of efficiencies was in the context of a trade-off with competition effects under the authorisation process, it raises the possibility that efficiencies may need to be integrated within the substantial lessening of competition test in a § 50 context as well.

The Courts, however, appear to be reluctant to take efficiencies into account in their competition assessments under section 50. In *Davids Holdings Pty. Ltd. v Attorney General of the Commonwealth*,³⁹ a case involving an attempt by Davids Holdings Pty. Ltd. to acquire QIW Retailers Ltd., Drummond J. stated:

It has frequently been said that the provisions of Part IV of the Trade Practices Act are designed to foster competition...but the justification for this is that the underlying objective is to protect the interest of consumers, the assumption being that competition is a means to that particular end... Provisions such as Section 50 are not tools designed to enable the court to strike a balance between the economic advantages that might flow from the economies of scale and other efficiencies resulting from a particular merger, on the one hand, and economic detriments of the merger, such as increased prices that consumers may have to pay, on the other. The proscription contained in Section 50, in its pre-1993 form, applies if the result of the intended merger is that the merged firm would be in a position to dominate a particular market. It is no answer, once that is established, to show, eg that a moderate reduction in price competition resulting from a particular merger would be greatly off-set, so far as the general public interest in the efficient allocation of resources is concerned, by benefits created by the merger. Any such balancing exercise is for the Trade Practices Commission to carry out in dealing with an authorisation application

³⁷ Queensland Independent Wholesalers Pty. Ltd., 132 A.L.R. 225 (1995).

³⁸ *Id.* at 283-4.

³⁹ *Davids Holdings Pty. Ltd. v Attorney General of the Commonwealth*, 121 A.L.R. 241 (1994).

under §§ 88(8) and (9) not the court that has to consider whether Section 50 bars a particular merger.⁴⁰

This passage highlights the fundamental problem that confronts efficiency analysis as a standard of liability for the courts. While anti-competitive risks that arise from structural conditions such as high concentration and barriers to entry can be assessed with a reasonable degree of accuracy, it is much more difficult to assess future efficiencies and balance them against anti-competitive effects. This is a task which administrative bodies such as the Commission and the Tribunal are better qualified to perform.

While the courts have so far been reluctant to embrace efficiency analysis under section 50, the Commission explicitly recognised the efficiency analysis as a relevant consideration in its *1999 Merger Guidelines*:

5.16 Increased exposure to global markets is placing pressure on domestic firms to reduce cost, improve quality and service and innovate in order to become more competitive. Mergers may be one means of achieving such efficiencies. Section 50 is concerned with the lessening of competition in a market, not with the competitiveness of individual firms. However, an acquisition which increases the competitiveness of the merged firm may also increase (or not substantially lessen) competition in a market. While efficiencies generally arise as a question of public benefit, which falls for consideration under authorisation...they are relevant in a § 50 context to the extent that they impact on the level of competition in a market.

5.17 The analysis of efficiencies in a § 50 context must be integrated within the framework of competition analysis, rather than being considered as a trade-off with competition effects, as might be done in an authorisation context.

5.171 As discussed in paragraphs 5.16-5.17, although § 50 is concerned with the level of competition in markets and not the competitiveness of individual firms, and while efficiencies are more generally relevant in the context of authorisation, the extent to which any efficiency enhancing aspects of a merger may impact on the competitiveness of markets is relevant in the context of § 50.

5.172 Where a merger enhances the efficiency of the merged firm, for example by achieving economies of scale or effectively combining research and development facilities, it may have the effect of creating a new or enhanced competitive constraint on the unilateral conduct of other firms in the market or it may undermine the conditions for coordinated conduct. Pecuniary benefits, such as lower input prices due to enhanced bargaining power, may also be relevant in a § 50 context.

⁴⁰*Id.* at 277.

VI. RECENT GLOBAL MERGERS: CASE STUDIES

A. Global Merger Cleared: *Coopers & Lybrand/Price Waterhouse*

On March 13, 1998, the ACCC announced that it would not oppose the merger between "Big Six" accounting firms Coopers & Lybrand and Price Waterhouse since the merger was unlikely to lessen competition substantially.⁴¹ The ACCC identified the following professional services as being relevant: (1) audit and accounting services; (2) taxation advice; (3) management consultancy services; (4) corporate recovery and insolvency advice; (5) corporate financial advice; and (6) actuarial services.

The ACCC defined the geographic scope of the relevant markets to be Australia-wide.

The question of market definition in service industries as opposed to traded goods poses particular problems. If a multinational corporation requires audit services, in a number of different countries and the merged entity is able to provide those services on a world-wide basis, it could be argued that the relevant geographic market is world-wide. However, if the SSNIP test is applied, and the audit regulations of countries differ, a hypothetical monopolist in Australia could raise prices without being constrained by auditors in other parts of the world. This analysis assumes that each subsidiary of a multi-national corporation is free to engage its own auditors and that decision is not adopted on a world-wide basis. The ACCC correctly identified the geographic market, as confined to Australia.

Having identified the product and geographic dimensions of each market the ACCC then sought to identify the market shares of the parties in each of the six markets. The markets with the highest concentration levels were those for tax advice and auditing and accounting services.

In relation to the provision of tax advice the merged entity would have a post-merger market share of slightly in excess of forty percent, which exceeds the ACCC's concentration threshold. Nevertheless, the ACCC concluded that a substantial lessening of competition was unlikely given the presence of alternative suppliers of such services, namely lawyers and second tier accounting firms.

Regarding the auditing and accounting services market the merged entity would have a market share of between twenty-four and twenty-six percent. The four largest accounting firms would have a post-merger combined market share of between seventy-seven and seventy-nine percent. This satisfied the Commission's CR4 threshold in its Merger Guidelines. Nevertheless, the ACCC concluded that the clients of the "Big Five" firms were well informed about the fees paid by the competing "Big Five" firms

⁴¹ AUSTL. COMPETITION AND CONSUMER COMM'N MEDIA RELEASE, MR 46/98 (1998). In relation to this merger the ACCC issued a comprehensive background paper setting out its analysis and findings.

and tendering for audit services was common place among large corporate clients.

The countervailing power exercised by these clients would lead to increased competition so that the merger was unlikely to lead to a substantial lessening of competition in the market for auditing services in Australia.⁴² As regards the significance of countervailing power the ACCC stated:

Market inquiries revealed that audit clients widely believed that they could ensure a competitive price for the "Big Six" services they purchased. This is true both in the context of an ongoing relationship with incumbent auditors and in the context of a tender process for audit services.

Most clients were well informed buyers. They generally monitored the fees paid by their competitors (through public annual reports and corporate returns in Australia and overseas). In almost all cases, the Chief Financial Officers of the client companies who hire the "Big Six" accounting firms are members of the accounting profession themselves, and are often ex-"Big Six." They are well aware of price, quality and value in relation to the audit product.

Most clients have rigorous internal processes to ensure good service and competitive pricing. These processes often have two or three stages of review. For example, external auditors may have to agree to an indicative audit program and costs with the client's Chief Financial Officer, and then have this reviewed by the company's Audit Committee and signed-off by the Board of Directors.

There is also the ever present threat to go to tender.

This is certainly not a step that clients take lightly because of the costs involved in the tendering and selection process, the time and management resources taken to bring a new auditor up to speed, the statutory requirements to notify these changes and the general discomfort involved. Put simply, switching costs are high and incumbent auditors know this.

Against this, the incumbent auditor will stand to lose a prestigious audit client, and with it related accounting and other work which tends to flow to the auditor in many cases. There are also significant costs for Big Five firms in re-searching, preparing and costing a tender proposal.

The implicit threat of taking the work to tender is an important source of power for clients. If the work is taken to tender, large and prestigious clients can expect very competitive bids from other "Big Six" firms. As discussed below under product bundling, low ball bids may be put in merely to secure a large and on-going contract, especially where that client has a non-standard reporting date.

The ACCC found that clients are increasingly testing the market through formal and informal tender processes to ensure value for money from their

⁴² See Garry K. Goddard, *ACCC Assessment of the Coopers & Lybrand and Price Waterhouse Merger: Analysis of Competition in the Provision of Professional Services by Big Six Accounting Firms*, 26 AUSTL. BUS. L. REV. 402, 413 (1998).

auditor. Some clients said that they are paying significantly less for auditing since they tested the market.⁴³

The ACCC appears to have been concerned only with the likely unilateral effects of the merged entity and whether the merger would lead to higher prices in any of the markets for services identified. It does not appear to have considered whether the merger would have made tacit or explicit co-ordination more likely. Since the services in question are tailored to meet the specific needs of each individual client, co-ordinated effects are unlikely in such an industry. The Commission considered it unlikely that the merger would substantially lessen competition in any of the markets identified mainly because there would remain five vigorous competitors in the market place and because of the substantial degree of countervailing power exercised by clients.

B. Global Mergers Cleared Subject to Divestiture Undertakings: British American Tobacco and Rothmans

On March 31, 1999, the ACCC announced that it would oppose the proposed merger between British American Tobacco ("BAT") and Rothmans.⁴⁴ BAT, a UK corporation, had a sixty-seven percent interest in the Australian cigarette manufacturer, WD & HO Wills Holdings. Rothmans BV., a company incorporated in The Netherlands, had a fifty percent interest in the Australian cigarette manufacturer Rothmans Holdings Ltd.

The merged entity would have a 62 percent share of the Australian cigarettes market. The ACCC examined the effect of the merger on concentration levels in three segments or sub-markets namely premium cigarettes, main stream cigarettes and value cigarettes. It found that the merged entity would have a 96 percent share of the premium cigarette segment; forty-nine percent share of the main stream cigarette segment; and a 61 percent share of the value cigarette segment.

The parties to the merger argued that the merged entity would not be able to increase prices because of the potential for increased import competition. The ACCC inquiries among market participants revealed that import competition was limited by barriers to entry, in particular, establishing retail distribution links; brand loyalty among smokers; and restrictions on tobacco advertising that limited opportunities to build cigarette brand images. There was no evidence of significant planned imports of generic cigarettes by wholesalers or retailers.

On June 3, 1999, the ACCC announced that it would not oppose the merger following a section 87B undertaking given by the parties to divest a

⁴³ See Austl. Competition and Consumer Comm'n, *ACCC Background Paper, Merger of Coopers & Lybrand and Price Waterhouse*, para. 4.5 (Aug. 31, 1999).

⁴⁴ *British American Tobacco Plc and Rothmans International BV*, 21 AUSTL. COMP. & CONSUMER COMM'N. J. 16 (June 1999).

number of cigarette brands to the Imperial Tobacco Group Plc.⁴⁵ The divestiture resulted in the merged BAT and Rothmans having a market share of 44 percent rather than 62 percent. Imperial Tobacco would gain a 17 percent share of the cigarette market including a brand in the premium segment of the market. The European Commission cleared the *BAT/Rothmans* merger without requiring any divestiture.⁴⁶

The ACCC appears to have been concerned principally with the unilateral effects of the proposed merger, rather than coordinated effects. In Australia, the merger as originally proposed would have given the merged entity a market share of 62 percent so that there was a risk that it could exercise unilateral market power. The claim by the parties that proposed changes to certain tax arrangements would result in the merged entity facing a flood of imports was not taken seriously by the ACCC. In order to convince the ACCC that the exercise of unilateral market power was unlikely it was necessary for the parties to divest a 17 percent share of the cigarette market to Imperial Tobacco. This resulted in three large competitors (BAT/Rothmans, Philip Morris and Imperial Tobacco) and significantly enhanced prospects for competition.

1. Pepsi Co/The Smith's Snack Food Company

In November 1997, the ACCC was notified by Pepsi Co. Inc. (the U.S. parent company of Frito-Lay Australia) that it intended to acquire from United Biscuits (Holdings) Plc a number of businesses around the world.⁴⁷ These included The Smith's Snack Food Company, which was the manufacturer of several Australian salty snackfood icon brands such as, CCs, Twisties, Cheezels and Smith's Original Potato Chips. The effect of the acquisition was that the second largest Australian producer of salty snackfoods, Frito-Lay Australia, would acquire the largest Australian producer of salty snackfoods (The Smith's Snackfood Company).

Frito-Lay informed the ACCC that in order to avoid a substantial lessening of competition in any market, it would agree to divest a package of brands.

The ACCC obtained a section 87B undertaking from Pepsi Co. that it would complete the acquisition of The Smith's Snackfood Company only in conjunction with a simultaneous divestiture of assets. The divestiture process resulted in the creation of Snack Brands Australia, which acquired the

⁴⁵ *ACCC Accepts Cigarettes Divestiture*, AUSTL. COMP. & CONSUMER COMM'N MEDIA RELEASE, MR 83/99, (June 3, 1999); *British American Tobacco Plc. and Rothmans International BV*, 22 AUSTL. COMP. & CONSUMER COMM'N. J. 43 (1999).

⁴⁶ *BAT/Rothmans*, Case IV/M 1415, Art. 6(1)(b), Council Regulation (EEC) 4064/89 on the Control of Concentrations Between Undertakings, 1989 O.J. (L 395) 1, as amended by 1990 O.J. (L 257) 14.

⁴⁷ AUSTL. COMP. & CONSUMER COMM'N. MEDIA RELEASE, MR 161/98, (Aug. 21 1998).

original Frito-Lay production facilities and several key brands such as CCs and Cheezels.

In mid-June 1998, the ACCC was informed that Frito-Lay's preferred acquirer for Snack Brands Australia was Dollar Sweets Holdings, a manufacturer of food and confectionery products.

Prior to the merger Smith's had a market share of 50 percent and Frito-Lay a market share of 29 percent with other suppliers responsible for 21 percent of the market. After the merger Frito-Lay had a market share of 48 percent and Snack Brands Australia a market share of 31 percent.

The Commission concluded that, in light of the purchase of Snack Brands Australia by Dollar Sweets Holdings, the acquisition of The Smith's Snackfood Company by Pepsi Co. was unlikely to result in a substantial lessening of competition. The ACCC formed the view that the sale to Dollar Sweets would result in a continuation of the vigorous competition that occurred in the market prior to the merger. As with the BAT/Rothmans merger, the Commission needed to be satisfied that a vigorous and effective competitor to the merged entity would remain in the market, so that it would not be able to exercise unilateral market power and raise prices after the merger.

C. Global Merger: Clearance Denied

1. *Coca-Cola Company/Cadbury Schweppes*

It is fitting that Coca-Cola should be the subject of a global merger since it is the quintessential global product: wherever one buys the product in the world, it will taste the same. In December 1998, the Coca-Cola Company announced it intended to acquire all of the Schweppes soft drinks business worldwide, with the exception of the U.S., France and South Africa. The European Commission conducted an investigation of the competitive effects of the transaction under the EC Merger Regulation by sending requests for information to competitors and customers of Coca-Cola and Schweppes throughout Europe. The Commission received several complaints about the effects of the proposed merger in Europe.

On May 24, 1999 Coca-Cola and Schweppes announced a restructuring of their global merger to exclude all European Union Member States with the exception of the UK, Ireland and Greece.

On February 16, 1999 the ACCC was advised of the Australian aspects of the merger.⁴⁸ The international brands affected by the acquisition in Australia included "Dr. Pepper", "Canada Dry" and "Schweppes" branded beverages, including Schweppes mixers, its carbonated soft drinks such as

⁴⁸ *ACCC Opposes Revised Coke/Schweppes Acquisition*, AUSTL. COMP. & CONSUMER COMM'N. MEDIA RELEASE, MR 89/99, (Jun. 8, 1999); *The Coca-Cola Company and Cadbury Schweppes*, 21 AUSTL. COMP. & CONSUMER COMM'N. J. 15 (June 1999).

lemonade and cola, as well as its flavoured mineral waters. In Australia the acquisition involved the retention by Coca-Cola of these international brands while national and regional brands, such as "Solo" and "Tarax," were to be divested to an undetermined third party.

The Commission identified the relevant product market as carbonated soft drinks. It determined that fruit juice, milk and other cold beverages were not close substitutes and that a small but significant price increase in carbonated soft drinks did not lead to a substantial switching of purchasers to other beverages.

As a result of the acquisition by Coca-Cola of Schweppes international brands, Coca-Cola's market share would increase from 65 percent to 75 percent in the carbonated soft drink market. Concentration would be even higher in the non-supermarket segment, such as the supply of carbonated soft drinks to refrigerators in convenience stores or to hotels, clubs and sporting venues.

Apart from increasing the level of concentration, the ACCC determined that the proposed merger would increase barriers to entry. The merged entity would have a very powerful portfolio of established brands covering most parts of the market (supermarkets and non-supermarket segments such as supply of carbonated soft drinks to refrigerators in convenience stores and to hotels, clubs and sporting venues). Other barriers to entry identified were Coca-Cola's extensive distribution system including beverage vending machines and glass door refrigerators in convenience stores.

The Commission considered that no competitor, even with the national brands of Schweppes which Coca-Cola proposed to divest, could provide an effective competitive constraint on the merged entity.

The acquisition of Schweppes international brands would result in the removal of a vigorous and effective competitor to the Coca-Cola business. The Commission considered that if the merger proceeded it was likely that prices would rise in the carbonated soft drink market. Accordingly, the ACCC advised the parties that the proposal to merge the international brands of Coca-Cola and Cadbury Schweppes in Australia would be likely to have the effect of substantially lessening competition. The merger parties lodged a revised proposal in April 1999. The revised proposal did not address the ACCC's competition concerns since the premium Schweppes branded drinks remained a part of the transaction. On June 8, 1999, the ACCC announced its opposition to the revised merger proposal.⁴⁹

During its investigation the Commission received complaints from the non-supermarket segments of the market about certain vertical behaviour by Coca-Cola. The Commission is conducting a further investigation to de-

⁴⁹ *The Coca-Cola Company and Cadbury Schweppes*, 22 AUSTL. COMP. & CONSUMER COMM'N. J. 42 (1999).

termine whether Coca-Cola has contravened other provisions of the *Trade Practices Act* namely section 47 which prohibits exclusive dealing and section 46 which prohibits taking advantage of market power.⁵⁰ These complaints suggest that Coca-Cola was already in a position to exercise unilateral market power prior to the merger, despite the presence of Pepsi as a vigorous and effective competitor.

Not only did Coca-Cola fail to acquire the international brands of Schweppes in Australia, it attracted the close scrutiny of the ACCC and a wide-ranging investigation into its conduct in the market place. This may lead to court proceedings for the imposition of substantial pecuniary penalties for breaches of the rules prohibiting exclusive dealing and misuse of market power.

D. Global Joint Venture: Authorisation Granted

Global mergers and joint ventures which have an anti-competitive effect in Australia could give rise to a public benefit. In such a case it is necessary to apply to the ACCC for authorisation. The Commission's analysis of horizontal joint ventures tends to follow its analysis of horizontal mergers. The ACCC has considered two global alliances in relation to the market for airline services. These alliances covered both passenger and cargo transportation services with respect to round-trip flights on routes between various Australian capital cities and other destinations in Europe. They involve joint price setting by the parties. Horizontal price fixing is prohibited absolutely in Australia. It is deemed to substantially lessen the competition. There is, however, an exception to the deeming provision in relation to joint venture pricing. Joint venture pricing will only be prohibited if, in fact, it has the purpose, effect or likely effect of substantially lessening competition.

In relation to market definition a preliminary issue was whether the passenger and cargo transport market should be defined by region or by route and whether they should be defined by customer type. In *Qantas/British Airways*⁵¹ and *Air Alliance*⁵² the Commission concluded that the relevant air passenger and cargo transport market should be defined by region. It concluded that there was a separate market for air passenger travel between Australia and Europe including all passenger types and all classes

⁵⁰It appears that conduct involving "partnership discounts" tied not to objective criteria such as increases in sales but to excluding Pepsi from restaurants and hotels is also being practised in Europe. See *Going for Coke*, THE ECONOMIST, Aug. 14, 1999, at 51. In December 1999, the Italian competition regulator fined Coca-Cola-Italian US\$16.1 million and prohibited it from offering "partnership discounts" awarded to wholesalers in exchange for pledges not to sell Pepsi. See Sue Mitchell, *Italian Ruling No Better for Coke*, THE AUSTRALIAN FIN. REV., Dec. 22, 1999, at 19.

⁵¹A.T.P.R. (CCH) 50-184 (1995).

⁵²A.T.P.R. (CCH) 50-265 (1998).

of travel and a separate cargo transport market between Australia and Europe. This broad market definition is at odds with the ACCC's tendency to define markets narrowly in merger cases (e.g. carbonated soft drinks, premium cigarettes and salty snack foods).

Regarding the market for passengers, the Commission took the view that given the existence of a dense network of connecting flights within Europe, most flights from Australia to Europe would be substitutes for the most direct flight paths between city pairs. Accordingly, the relevant geographic market should be the terminating region. It is arguable that business travelers booking for a direct flight between Sydney and London do not regard an indirect flight to another European hub as an effective substitute. The elasticity of demand for business passengers is likely to be inelastic.

By way of contrast the European Commission in its analysis of the *Lufthansa/SAS* co-operative agreement of 1998, the Official Journal of the European Communities identified the relevant markets as several city pairs between Scandinavia and Germany.⁵³

In order to obtain an authorisation it is necessary to convince the ACCC that the merger or joint venture will give rise to public benefits which outweigh any anti-competitive detriment. This is similar to the analysis conducted by the European Commission pursuant to article 85(3) of the Treaty of Rome. The public benefits claimed in the *Air Alliance* authorisation were: (1) increased competition; (2) a stronger international and domestic airline; (3) more efficient use of resources; (4) improved consumer service (e.g. larger network, integration of information systems, new products, seamless travel, expanded frequent flyer scheme); (5) increased tourism; and (6) facilitation of trade and enhanced employment opportunities.

The Commission accepted some of the public benefits but not others. It concluded that public benefits would arise from increased competition, a stronger Ansett International, new products, more efficient use of resources, the facilitation of seamless services and enhanced frequent flyer programs. The ACCC was unable to conclude that the claimed public benefits associated with employment, trade and tourism would eventuate. However, it authorised the alliance agreement for a period of five years.

VII. GLOBAL MERGERS – A GLOBAL PERSPECTIVE

There are now a significant number of jurisdictions with merger filing and merger review procedures in place. Rowley and Campbell state that

⁵³ See 1998 O.J. (L 54) 28. See also Crocioni, *The Lufthansa/SAS Case: Did the Commission Get the Economics Right?* ECLR 116 (1998).

over 50 countries have enacted merger regimes and that more are under consideration.⁵⁴

Multiple reviews by different regulators in different jurisdictions applying different merger review standards can significantly increase transaction costs and may lead to different conclusions about the likely anti-competitive effect of a merger.

Rowley and Baker⁵⁵ have identified three categories into which most merger review systems fall: *Market Dominance Regimes*, which provide that a merger, which enables a leading firm to achieve or strengthen a dominant position in a market may be prohibited (e.g. European Union and New Zealand). *Substantial Lessening of Competition Regimes*, which seek to prevent mergers that are likely to tighten coordinated conduct in a market or provide a single firm with market power (e.g. U.S., Canada, Australia). *Public Interest Regimes*, which consider not only the effect on competition of a proposed transaction, but such other public benefits such as employment, export promotion and international comparative advantage (e.g. United Kingdom, France, Spain).

The Boeing/McDonnell Douglas merger illustrates the problem. The Federal Trade Commission in the United States decided on July 1, 1997 that it would not raise any antitrust objection to the acquisition.⁵⁶ In a joint statement, four commissioners expressed the view that in the commercial aircraft sector McDonnell Douglas was no longer a meaningful competitive force. While it could not be said to be a failing company, there was no prospect of significant commercial sales and accordingly it could no longer be regarded as an effective competitor.

Boeing had entered into twenty-year exclusive contracts with three major airlines, American Airlines, Delta Airlines and Continental Airlines, to purchase only Boeing planes. The four commissioners in their statement expressed the view that these contracts were potentially troubling. Boeing was the largest player in the global commercial aircraft market and the contracts foreclosed about eleven percent of that market. The four commissioners stated that they would monitor the potential anti-competitive effects of these and any future long-term exclusive contracts.

⁵⁴ J. William Rowley QC & A. Neil Campbell, *Multi-jurisdictional Merger Review – Is It Time for a Common Form Filing Treaty?* in POLICY DIRECTIONS FOR GLOBAL MERGER REV., 9, 10. See also Organisation for Economic Cooperation and Development, MERGER CASES IN THE REAL WORLD – A STUDY OF MERGER CONTROL PRACTICES (1994) (noting that the Gillette/Wilkinson Sword acquisition was notified in 14 jurisdictions); Joseph P. Griffin, *Antitrust Aspects of Cross-Border Mergers and Acquisitions*, 19 EUR. COMP. L. REV. 12 (1998).

⁵⁵ See INTERNATIONAL MERGERS: THE ANTITRUST PROCESS 4, (Rowley and Baker eds., Sweet & Maxwell, London 1996).

⁵⁶ See *FTC Won't Ground Consolidation of Boeing and McDonnell Douglas*, 73 ANTITRUST & TRADE REG. REP. 4 (BNA) (1997).

On March 19, 1997, the European Commission announced that it had "serious doubts" about the transaction even though neither Boeing nor McDonnell Douglas had any facilities or assets in the EU. The U.S. viewed the European Commission's stance as a protectionist measure since the merger would adversely affect the ability of the sole remaining European manufacturer, Airbus Industrie, to compete.

After an intensive five-month investigation the European Commission concluded:

Boeing...already had a dominant position in the world-wide market for large commercial jet aircraft. Boeing's existing dominance stems from its very high market share (64% world-wide), the size of its fleet in service (60% world-wide), and the fact that it is the only manufacture that offers a complete family of aircraft. This position cannot be challenged by potential new entrants, given the extremely high barriers to entry in this hugely capital intensive market. Boeing's dominance is further demonstrated by the recent conclusion of long-term exclusive supply deals with three of the worlds leading carriers, American, Delta and Continental Airlines who would have been unlikely to lock themselves into 20-year agreements with a supplier who did not already dominate, and seem likely to continue to dominate, the large jet aircraft market.⁵⁷

The Commission gave its approval subject to Boeing giving undertaking to refrain from entering into exclusive supply agreements until 2007, and not to enforce to the exclusivity rights in existing contracts.⁵⁸

It is generally acknowledged that the harmonisation of substantive merger rules is not likely in the foreseeable future. This is not surprising given the widely differing stages of economic development and economic policies that prevail. Some countries in Asia, such as Indonesia and South Korea, are promoting foreign investment at any cost and have no or weak competition laws. Some countries, such as the U.S., Australia and New Zealand, have court-centered competition law regimes. Others, such as the EU, are regulated primarily by an administrative agency.

The obstacles to harmonization are not just technical or legal; they are embedded in broader cultural, social and political differences among countries. Countries do not trust each other; as globalisation gathers pace each country feels it must do what it can to protect its national interests. What happens when national interests collide? If there is a down turn in the global economy, protectionist measures emerge. While there may be a broad consensus about which mergers are likely to lessen competition sub-

⁵⁷ See 5 CMLR ANTITRUST SUPPLEMENT 253 (1997).

⁵⁸ For an analysis of the issues raised by extraterritoriality and merger regulation, see J.D. Banks, *The Development of the Concept of Extraterritoriality under European Merger Law and Its Effectiveness Under the Merger Regulation Following the Boeing/McDonnell Douglas Decision 1997*, 19 EUR. COMP. L. REV. 306 (1998); Andre R. Fiebig, *International Law Limits on the Extraterritorial Application of the European Merger Control Regulation and Suggestions for Reform*, 19 EUR. COMP. L. REV. 323 (1998).

stantially, there is no general agreement about whether mergers should be authorized or approved in the public interest. Some countries will be concerned about the employment consequences of a merger.

Some degree of harmonisation may be possible in relation to procedures for review by the adoption of a multilateral treaty, which would provide for common timing rules, filing forms and information sharing arrangements, but leave the domestic enforcement bodies to make assessments. The Organisation for Economic Cooperation and Development ("OECD") Committee on Competition Law and Policy has adopted a common filing form, but the form has not yet been endorsed by the OECD Council, and Member States may not adopt it. The World Trade Organisation ("WTO") had met in Seattle last November. The EU, Japan and Korea argue that the ambit of the talks should include the development of global rules on investment and competition policy.⁵⁹ However, the WTO is primarily a trade organisation and is probably not the appropriate forum for assessing the competition effects of global mergers.

Other forms of information sharing between regulators and co-operation are likely. On June 4, 1998, the U.S. and EU signed an agreement clarifying the circumstances under which they will refer cases involving anti-competitive conduct to each other under the doctrine of "positive comity".⁶⁰ The U.S. and EU have agreed that some circumstances will justify parallel investigations. While neither side waives its authority to institute its own enforcement actions, each side will normally defer or suspend enforcement activities aimed at anticompetitive conduct which occurs in the other's territory in favour of a positive comity referral to the other party. The new agreement does not at present apply to mergers because of the strict statutory deadlines of U.S. and EU merger review regulation. A system of suspension or deferral of investigations may, however, be the only way to deal with the problem of over-regulation of global mergers.

VIII. CONCLUSION

Australia's recent experience of global mergers suggests that the ACCC will scrutinise carefully their effect on domestic competition in Australia. The ACCC has discretion whether to challenge a global merger in the courts. Its administrative decision making is generally well-reasoned and based on a large amount of factual information. Unlike the European Commission, which publishes quite lengthy reasons when opposing or

⁵⁹Brendan Pearson, *Heavies in Conflict over WTO Negotiations*, THE AUSTL. FIN. REV., Aug. 16, 1999, at 6. For a consideration of the WTO as a possible forum for multilateral antitrust cooperation, see Claudio Cocuzza and Massimiliano Montini, *International Antitrust Co-operation in a Global Economy*, 19 EUR. COMP. L. REV. 156, 160-63 (1998).

⁶⁰See U.S. and European Union Sign Antitrust Cooperation Agreement, 74 ANTITRUST & TRADE REG. REP. 587 (BNA) (1998); Council and Commission Decision 98/386/EC, ECSC, 1998 O.J. (L 173) 26.

blocking a proposed merger, the ACCC rarely publishes its detailed reasons. It relies instead on a one page press release which merely summarises its conclusion. This lack of transparency may give the impression that it acts arbitrarily.⁶¹

If the Commission forms the view that the proposed acquisition is unlikely to substantially lessen competition the parties can proceed. The *Coopers & Lybrand/Price Waterhouse* merger illustrates such an outcome. Another possibility is that the acquirer will be required to divest assets pursuant to a § 87B undertaking as the "price" for allowing the merger to proceed. Divestitures occurred in relation to the *BAT/Rothmans* merger and the *Pepsi Co/Smith's Snack Food* merger.

If the parties to a proposed merger cannot convince the ACCC that it is unlikely to substantially lessen competition, or cannot restructure and divest to the ACCC's satisfaction, they have no choice but to apply to the ACCC for an authorisation. Such authorisation was granted for the *British Airways/QANTAS* air alliance.

Those contemplating a global merger should not underestimate the thoroughness of the ACCC's merger investigations. The *Coca-Cola/Cadbury Schweppes* merger illustrates that the ACCC is prepared to block the Australian component of a global merger.

On April 27, 1999 the Australian government and the United States government signed an agreement on mutual antitrust enforcement assistance. It is likely that the enforcement authorities in each jurisdiction will assist each other in investigating the competition effects of a global merger. Accordingly, the parties need to consider in advance whether to waive their rights to confidentiality in order to expedite the clearance process.

In the *Coopers & Lybrand/Price Waterhouse* merger the parties waived their rights to confidentiality and this allowed for an exchange of submissions made to competition regulators in Australia, the U.S., the EU and Canada.

However, the problems raised by global mergers give rise to multiple notifications, review by multiple enforcement authorities, the collection of information outside national boundaries; thus, merger standards and remedies are likely to remain inconsistent for the foreseeable future.

⁶¹The ACCC is not alone in this regard. See Rowley & Campbell, *supra* note 54, at 29. Rowley and Campbell conclude in their comparative study that "with the notable exception of the European Union, the level of transparency for decisions on specific transactions is modest to abysmal." *Id.*

