Forum

Global mergers — ACCC approach

The following is an edited version of a speech presented by ACCC Chairman Professor Allan Fels to the Current Affairs Study Centre on 11 March 1999. It discusses the Commission's approach to international mergers and takeovers in the light of their possible effect on competition in Australian markets.

The last 18 months has seen a dramatic increase in the number of global mergers including Guinness Plc/Grand Metropolitan Plc, Price Waterhouse/ Coopers & Lybrand, and PepsiCo/United Biscuits plc (Smith's Snackfoods). Furthermore, this trend shows no signs of abating as is evidenced by the current proposals before the Commission involving Exxon/Mobil, Coca Cola/Cadbury Schweppes, and British American Tobacco/Rothmans International. The impact of this increased merger activity is resulting in a number of interesting challenges for industry, the Commission and other overseas competition regulators. The Commission also notes that a number of Australian companies are looking at offshore mergers and acquisitions as well.

The Commission recognises that many of these mergers are driven by a need to cut costs, increase productivity, enhance efficiencies of scale and a range of other reasons which are often driven by a desire to remain competitive in a global marketplace. Naturally the Commission will approach each merger proposal on a 'case-by-case' basis and will evaluate an international merger on its merits. The Commission is, however, concerned that there appears to be an assumption 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.

The Trade Practices Act through ss 50 and 50A provide the Commission with the necessary legislative tools to ensure that any mergers or acquisitions that occur in Australia, whether they be Australian companies or the subsidiaries of overseas companies, do not result in a substantial lessening of competition.

The Commission's approach to assessing merger proposals is outlined in its revised *Merger guidelines* published in 1996. The guidelines do not bind the Commission, but they provide parties with an indication of what the Commission considers when investigating mergers and importantly indicate to industry what the Commission is looking for in a submission outlining a proposed acquisition. They are currently being finetuned and new guidelines will be available in 1999.

The guidelines provide a five stage process for the Commission's assessment of substantial lessening of competition.

- **Market definition.** In establishing the market boundaries, the Commission seeks to include all those sources of closely substitutable products to which consumers would turn in the event that the merged firm attempted to exercise market power. A market involves four dimensions, namely product, geographic, functional and time.
- **Market concentration.** If the market concentration ratio falls outside the Commission's thresholds, the Commission

will determine that a substantial lessening of competition is unlikely. The Commission looks at concentration in two separate ways. The first assesses the post-merger combined market share of the four largest firms (CR4). The Commission will examine the matter further if their market share is over 75 per cent of the market and the merged firm will supply at least 15 per cent of the relevant market. Secondly, if the merged firm will supply 40 per cent or more of the market, the Commission will want to give the merger further consideration.

- **Potential or real import competition.** 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.
- **Barriers to entry to the relevant market.** If the market is not subject to significant barriers to new entry, incumbent firms are likely to be constrained by the threat of potential entry and to behave in a manner consistent with competitive market outcomes. A concentrated market is often an indication that there are high barriers to entry.
- **Other factors** which are outlined by the legislation (s. 50(3)). These include whether the merged firm will face countervailing power in the market, whether the merger will result in the removal of a vigorous and effective competitor, or whether the merger is pro-competitive, not anti-competitive.

Critical mass arguments

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

It is often argued that Australian industries need to develop the 'critical mass' necessary to compete internationally. However, I think it is important to point out that obstacles to export growth can face industry participants of all sizes. It is not apparent that, simply by entering a collaborative arrangement like a merger or joint venture, a participant's ability to compete internationally is enhanced. Moreover, 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.

Global mergers

The following case studies highlight 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. From the point of view of precedent, an important global merger that the Commission dealt with was the Gillette/Wilkinson Sword merger.

Gillette/Wilkinson Sword

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 a part of that sale, The Gillette Company (a US company) acquired, in effect, the non-European Union based Wilkinson Sword wet shaving businesses worldwide. The Gillette Company also financed (and took an equity interest in) the management buyout (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 buyout company, Eemland. Eemland, as a result of action by the EC competition regulators, was 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 of all wet shaving products sold and Wilkinson Sword accounted for about 17 per cent. 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 Trade Practices Act. The transactions were entered into without notice to, or being conditional on 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's proceedings and claimed that:

- the Federal Court had no jurisdiction over it as it was a foreign company which did not carry on business in Australia;
- s. 50 of the Trade Practices Act did not apply to the acquisition of the Australian Wilkinson Sword wet shaving business, as alleged by the Commission, as it was an offshore transaction;
- the Commission had not sufficiently alleged, or established at a prima facie level, any breach of s. 50 of the Act; and
- sub-sections 81(1) and (1A) of the Trade Practices Act, which provide 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 Federal Court, the Full Federal Court and the High Court. It was unsuccessful in these claims.

Subsequently The Gillette Company approached the Commission with a proposed settlement which involved giving the Court an undertaking that the Wilkinson Sword business in Australia would be licensed to, and operated by, a company fully independent of and unrelated to The Gillette Group of companies.

Not all global mergers have an impact on competition in Australia

At any given moment in time there are a number of global mergers but not all of them have a direct impact on the Australian market. First, many, probably 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. Second, potentially anti-competitive global mergers are usually stopped (or modified) by regulators in North America, Europe and sometimes elsewhere.

Third, some global mergers may have little effect in Australia because the possible anti-competitive effects are mitigated by import competition. Other mergers may cause concerns overseas without causing any competition concerns in the Australian market, such as the merger between Guinness Plc and Grand Metropolitan Plc.

Guinness Plc/Grand Metropolitan Plc

Guinness Plc announced in late 1997 that it proposed to enter into a worldwide merger with Grand Metropolitan Plc.

Guinness Plc is involved in the production, marketing and sales of spirits and beers around the world, publishing and hotels. Grand Metropolitan is a consumer goods company involved in food manufacturing, fast food restaurants, pubs, and the production and marketing of distilled spirits. The Commission considered 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. It 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 in their respective jurisdictions. Consequently, the merger proceeded with no divestiture requirements in Australia but with divestiture required in some of the other jurisdictions.

Globalisation of competition laws

Competition laws are rapidly reaching a level of maturity in several countries. As a result 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, which 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 medium that adequately addresses both points.

From a regulatory perspective it is beneficial for competition agencies in different jurisdictions to have a strong working relationship with each other as this may assist them in their own inquiries. Greater cooperation between countries could be achieved through a uniform notification procedure for transnational mergers. This could result in countries adopting a basic set of questions to which the merging parties would need to provide answers to all relevant competition agencies. 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. Second, 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 cooperation between regulators.

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.

Current cooperation between the regulators

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

Price Waterhouse/Coopers & Lybrand

The Commission was informed in November 1997 that Price Waterhouse/Coopers & Lybrand 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' 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 ACCC, the Department of Justice in the US, DG IV in Europe and the Canadian Bureau of Competition to waive confidentiality for information exchange between the four competition agencies. The parties did not object, which enabled the Commission to share information with the other regulators.

The Commission 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. The KPMG/Ernst & Young merger was called off by the parties for commercial reasons.

Possible solutions to competition concerns

The following discusses some of the methods that may be used to address certain competition concerns that may arise from a merger proposal. It must be stressed, however, that there is no set formula for every case.

Authorisation

One mechanism 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 which permits a party to be in breach of the Trade Practices Act if there are public benefits to offset the competition concerns. Since 1993 the Trade Practices 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 Trade Practices 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. Over half of authorisations have in fact been successful. A number of them have related to cases where the merger would cause a substantial reduction in competition in Australia but would bring international type benefits. The Commission's publication on *Exports and the Trade Practices Act* provides a number of case studies including the DuPont/Ticor merger authorisation. The publication 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, for example, Dow Chemical/Huntsman Chemical, Chemcor/Hoeschst Plastics and ICI Australia/Auseon.

DuPont/Ticor

DuPont and Ticor applied for authorisation for inter alia a joint venture between their subsidiaries to take over and expand Ticor's sodium cyanide manufacturing plant. The industry has a high concentration internationally, with only three major international producers of 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 that imports were likely to play in imposing a competitive constraint on domestic prices. With the removal of DuPont, previously the major importer of the product, 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.

Divestiture

It is interesting to note that the majority of global transactions before the Commission relate to consumer goods. These include British American Tobacco/Rothmans International, Coca Cola/Cadbury Schweppes, and Pepsico/United Biscuits plc (Smith's Snackfoods) which involved 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.

With global mergers it may be possible to structure deals to overcome the specific competition concerns in Australia. The PepsiCo/United Biscuits plc (Smith's Snackfoods) is a good example of a case where the Commission's competition concerns were overcome through the divestiture process.

PepsiCo/United Biscuits plc (Smith's Snackfoods)

In November 1997 the Commission was notified by PepsiCo, the USA parent company of Frito-Lay Australia, that it intended to acquire from United Biscuits (Holdings) plc a number of businesses including The Smiths Snackfood Company. The Smiths Snackfood Company produces Australian brands of salty snack foods such as CC's, Twisties, Cheezels and Smiths Original Potato Chips.

PepsiCo advised the Commission that as a condition of the acquisition it intended to divest a portfolio of brands and production facilities sufficient to ensure that the acquisition did not result in a substantial lessening of competition.

After conducting market inquiries the Commission formed the view that, without simultaneous divestment, the acquisition would result in a substantial lessening of competition. The Commission obtained an undertaking from PepsiCo that it would complete the acquisition of The Smiths Snackfood Company only in conjunction with a simultaneous divestiture of assets. Undertakings were also obtained to ensure the smooth transition of the sale of assets to Dollar Sweets.

The divestiture process resulted in the creation of Snack Brands Australia, which will own the original Frito-Lay production facilities and several Australian brands such as CC's and Cheezels. The buyer identified for Snack Brands Australia was Dollar Sweets Holdings, owner of Players Biscuits as well as AV Jennings Homes. The Commission considered that, owned by Dollar Sweets, Snack Brands would have the benefit of a parent company with experience in manufacture and wholesale of grocery products. The Commission concluded that, in light of the purchase of Snack Brands Australia by Dollar Sweets Holdings, the acquisition of the Smiths Snackfood Company by PepsiCo was unlikely to result in a substantial lessening of competition.

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 mergers can be structured in such a manner that they do not apply to Australia. Examples of mergers applying only in some countries include the current Coca Cola/Cadbury Schweppes merger. It must be stressed, however, that this case is used only as an example to highlight the structure of this merger proposal rather than to indicate any possible competition concerns that the Commission may have with this case.

Coca Cola/Cadbury Schweppes

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. This transaction, however, does 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.

Undertakings

Section 87B has become a very important part of the Trade Practices Act. Although it has attracted greatest attention in relation to its use in merger situations, in fact the Commission is very sparing in its use of undertakings to resolve merger questions. The Ampol/Caltex merger provides the best known example.

Ampol/Caltex

The Commission formed the view that the proposed merger between Ampol and Caltex was likely to substantially lessen competition and so advised the parties. They sought reasons for the Commission's decision and then suggested undertakings which would neutralise the anti-competitive effects of concern. The Commission, after much consideration and negotiation, accepted undertakings and the merger went ahead. The Commission did not see itself as engaging in social engineering, even in this case. The parties had sought to merge, which would have had the likely effect of lessening competition in the petroleum products market. 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. 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 marketplace aided by players currently involved in the marketplace. There is, however, opposition by some firms that want to make undertakings confidentially.

There are some circumstances in which the Commission may accede to such 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 it has considered a range of mergers in recent years. There are two merger proposals which were highly unlikely to proceed had the Commission not agreed to accept undertakings confidentially. These were the National Foods Limited proposed takeover of Pauls Limited and Wesfarmers attempt to acquire ICI's Australian assets which were, however, both aborted for commercial reasons.

Tariff/non-tariff barriers

In addition to the standard solutions of authorisations, divestitures and s. 87B undertakings, there are other options that could be looked at in order to address competition concerns. In some cases imports may be restrained due to high tariffs or due to onerous safety standards. If these matters can be addressed, either through tariff reductions or changes to the Australian standards, then imports may become viable and act as a restraint on any potential misuse of market power by the merged firm. The recent Caroma/Fowler Bathroom Products merger provides a good example of how changes to safety standards may alleviate the Commission's concerns.

Caroma/Fowler Bathroom Products

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 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 enforceable undertakings from Caroma to withdraw two representatives from these committees so that its representation would be the same as importers of toilets and basins.

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

Conclusion

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 they are, they are likely to be blocked by North America or European authorities. Even if they are anti-competitive in some overseas countries, they may not be in Australia, depending on market circumstances such as the state of import competition and the structure of the market.

If they are, on the other hand, anti-competitive in Australia there is normally jurisdiction under the Trade Practices Act to deal with them. Where undertakings are appropriate, practical commercial solutions are usually available. Appropriate policy offsets may also be applied such as the reduction of tariffs to neutralise the anti-competitive effect.

Finally, the Commission's approach to competition law enforcement was recognised last year by a study reported in *The Economist* (16 May 1998, p. 121) which stated that 'Australian laws are the best in the world at preventing unfair competition' and ranked Australia's competition laws as the fairest.

Note: The Commission's decisions on the Coca Cola/Cadbury Schweppes and British American Tobacco/Rothmans International mergers will be published in full in *ACCC Journal* issue no 21.

Section 80 injunctions and section 80A orders — corrective advertising

This article by Kylie Sturtz of the ACCC's Brisbane office gives a brief summary of the type of injunctive relief that can be obtained under the Trade Practices Act. In particular it focuses on orders for corrective advertising and gives an example of the type of orders that may be made under ss 80 and 80A of the Act.

The power to grant injunctions to prevent conduct that contravenes Part IV, IVA, IVB or V of the Trade Practices Act lies within s. 80 of the Act. Section 80 allows the Minister, the Commission, or any other person, regardless of whether they have suffered loss or damage, to bring an application for an injunction.[1] The Court's power to grant a s. 80 injunction is broad and:

> designed to ensure that... the Court should be given the widest possible injunctive powers, devoid of traditional constraints, though the power must be exercised judicially and sensibly.[2]

Traditionally the grant of an injunction as an equitable remedy involved the Court exercising its discretion in making such an order. While the above from the case above demonstrates that the Court continues to be guided by equitable principles when deciding whether to grant s. 80 injunctions, it also suggests that it will not be limited to the consideration of these alone. Where s. 80 injunctions are sought, the public interest is also a highly relevant factor. Where conduct which is the subject of an application includes allegations of misleading conduct, or an application is brought to prevent some anti-competitive practice, there is a clear public interest issue.

Section 80 is sufficiently broad to extend to the granting of mandatory injunctions, compelling the party against which they are ordered to undertake some positive remedial act, as well as prohibitory injunctions preventing a party from engaging in particular conduct.

In addition to this s. 80A allows the Court, on the application of the Minister or the Commission, to make orders requiring a person involved in a contravention to publish advertisements at his or her own expense, in a manner and form which comply with the court order.

However, it should be noted that the purpose of corrective advertising is not to impose punishment on the offending party. Rather, it is to protect the public interest by correcting a misrepresentation.[3] Consequently, if the Court is satisfied that the respondent has taken sufficient steps to rectify or correct the misleading representations, or if a lengthy period of time has passed between the misrepresentation and the application, the Court may exercise its discretion not to order corrective advertising.