Merger authorisation—API and Sigma

The following article by Russell Phillips and Damien Kelly of the Commission's Mergers and Asset Sales Branch draws on the API/Sigma application for authorisation to outline how the process works.

On 12 September 2002 the Commission declined authorisation to Australian Pharmaceutical Industries (API) and Sigma Company Limited for their proposed merger. The Commission considered that there was insufficient public benefit to outweigh the detriment to the public that would result.

A merger authorisation differs from the usual authorisation process for other sections of the Trade Practices Act. Given that this has been the first merger authorisation for about five years, this article aims to provide some insight into the process and address some issues that arose during the API/Sigma merger authorisation.

The authorisation test

Under the Act parties may apply to the Commission for authorisation of mergers or acquisitions. Authorisation is the process of allowing, on public benefit grounds, mergers and acquisitions that would or might contravene s. 50 of the Act. Section 50 prohibits acquisitions that would have the effect, or likely effect, of substantially lessening competition in a substantial market.

Subsection 90(9) provides that the Commission shall not grant authorisation unless it is 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 Australian Competition Tribunal can review a Commission determination. An application for review may be made by the applicant for authorisation or by any person the tribunal is satisfied has a sufficient interest in the matter within 21 days of the determination. Once authorisation of an acquisition has been granted, and the appeal period passed, neither the Commission, the minister, nor third parties can take action under the Act to overturn the acquisition.

Confidential opinion of the merger

Mergers are generally assessed under the substantial lessening of competition test contained within s. 50 before being assessed under an authorisation process. The parties may approach the Commission on a confidential basis to gain an initial view on whether a proposed transaction is likely to contravene the Act.

On 13 November 2001 the Commission informed the parties, on the basis of a confidential proposal put forward by them at that time and on information before the Commission, that it did not intend to intervene in the proposed merger. It did, however, state that this view was formed without the benefit of market inquiries and that such inquiries would be made when the matter became public. The Commission also outlined several issues to the parties that needed to be confirmed through market inquiries. These included, but were not limited to the:

- influence of short-line wholesalers
- role and extent of turnover orders
- role and impact of banner groups
- role and impact of buying groups.

As discussed in the Commission's *Merger guidelines* in paragraphs 4.4 to 4.16, the Commission can provide a preliminary view, subject to confirmation by market inquiries. This preliminary view is not a finalised decision about the acquisition. The Commission is concerned that it does not give inappropriate comfort to the parties on the basis of a preliminary view of the transaction.

When the proposed transaction became known publicly, the Commission undertook market inquiries. At that time, the Commission obtained information from various sources, which revealed a more complete view of the competitive environment within the pharmaceutical wholesaling industry. Market inquires revealed that the market concentration of the merged entity would be high, barriers to entry in the market are high, there are few substitutes available and the acquisition would remove a vigorous and effective competitor.

With this additional information provided by market participants, the Commission formed the view that the proposed transaction would result, or be likely to result, in a substantial lessening of competition. This view was made known to the parties on 17 April 2002. The parties subsequently decided to seek authorisation for the merger.

Substantiation of claims

Parties applying for authorisation must substantiate their claims 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 onus is on the applicant to satisfy the authorisation test. They must substantiate public benefits and prove the merger is responsible for the realisation of the claimed public benefits. General statements about possible or likely benefits will not be given much weight unless supported by factual material.[32]

As a minimum, applicants should set out detailed particulars of the proposed acquisition. The Commission and the public must be able to ascertain with sufficient certainty what it is that is the subject of an application for immunity from the Act. It should be accompanied by a comprehensive submission setting out the benefit to the public expected to flow from the acquisition and commenting on any possible anti-competitive or other detriments that may result. The *Merger guidelines* and *Guidelines on authorisations and notifications* lists the type of information that should be provided in an application for authorisation.

Public benefits

In this current matter, the applicant claimed the following public benefits.

Efficiencies

In *ACI Operations Pty Ltd*,[33] the Trade Practices Commission stated that:

> In general, the Commission is rarely persuaded that there is sufficient over-all public benefit to authorise a proposed acquisition unless the applicant can demonstrate that the acquisition is likely to result in benefits flowing to consumers or the community at large. An acquisition which will merely enhance the market power of the acquiring company, thereby enabling it to make higher profits, will result in a private benefit to the company and its shareholders, but this does not represent a public benefit.[34]

More recently, in the Commission's determination of 28 March 1996 on Davids Limited's proposed acquisition of QIW Limited, the Commission noted that to the extent that there is a risk of savings not being passed onto the community at large, it may be said that the potential public benefits require discounting.[35]

A key argument made by the parties was that the merger would see efficiency savings through the removing of duplicated services worth about $20 million per year. The Commission accepted this resource saving as a public benefit. However, the Commission decided that the efficiency savings would not outweigh the anti-competitive detriment created by the enhanced capacity of the merged entity to raise prices on products, thus facilitating a transfer of income from consumers to shareholders.

In addition, the Commission considered that the proposed acquisition would impact negatively on the competitive dynamic of the industry. It also considered that the efficiency claims made by the parties failed to consider standards of service or quality and made no allowance for the loss of productive efficiency as a result of increases in managerial slack and x-inefficiency (cost inefficiencies arising from a lack of effective competition). That is, they focused on allocative efficiency and ignored dynamic efficiency.

Export enhancement/import replacement

The applicants also claimed the merger would result in some import replacement of its manufactured products. The Act requires that significant increases in exports or import replacement be considered as a public benefit. The Commission must also take into account all matters relevant to the international competitiveness of any Australian industry.[36]

In the Commission's view the applicants did not provide sufficient evidence that the claimed benefits were realised by the merger. The Commission accepted that the merger may have resulted in some benefit in relation to import replacement or export enhancement, however, on the information before it, only a small degree of benefit was shown.

Other claimed public benefits

The applicants also argued that the merger would benefit the public by:

- increasing capital market efficiencies
- increasing the ability to promote generic drugs
- improving community access to pharmaceuticals
- improving community health services regional and rural support
- improving innovation for access to pharmaceuticals and health services
- improving small business support.

32 Re *Howard Smith Industries Pty Ltd* (1977), ATPR 40-023.

33 [1991] ATPR (Com) 50-108 at 56.065.

34 ibid. at 56.077.

35 Australian Pharmaceutical Industries Limited and Sigma Company Limited final determination (11 September 2002) at paragraph 7.132.

36 Section 90(9A).

The Commission considered that the remaining claimed public benefits were likely to either accrue independently of the merger, be more appropriately provided by other members within the pharmaceutical industry, or were given less weight as the merger would predominantly benefit shareholders of the merged entity rather than the public at large.[37]

In examining the application for authorisation the Commission identified structural changes to the market. In particular it found that:

- the merger is likely to raise the height of some barriers to entry or expansion in the market
- the countervailing power possessed by pharmacists and small manufacturers is likely to be diminished following the merger
- the merger would result in the loss of a vigorous and effective competitor from the market.

The Commission believes that these factors would enhance the merged entity's ability to substantially and sustainably increase prices and/or decrease service levels. It was considered that if the merger did not proceed, there would be no, or very little, anti-competitive detriment. On balance, the Commission did not accept that the public benefits were sufficient to outweigh the public detriment.

Submissions

As a part of the authorisation process, the Commission seeks submissions from interested parties. It does not merely look at the number of submissions received for and against, but rather their substance. Its role is to balance the public benefits and detriments. A key aspect of this function is to undertake an objective analysis of the effect that the acquisition is likely to have on the structural features of the market.

The Commission took into account in reaching its decision the views of various stakeholders, including pharmacists, pharmaceutical manufacturers, pharmaceutical wholesalers, logistics providers. financial analysts, industry groups and government agencies.

Confidentiality

The Commission has published specific comments on applications for authorisation of mergers in its *Merger guidelines* and in a policy statement which it issues to parties interested in making submissions as well as to the applicant. Confidentiality is treated in the terms outlined in paragraphs 6.8 and 6.14 of the guidelines.

Authorisation is a public process. The Commission considers it important to receive submissions. It believes that if no submissions are received then any possible issues surrounding confidentiality are a moot point. To this end, the Commission granted confidentiality over the identity of several submissions during this authorisation process, principally on the grounds that the submitter held genuine concerns over the impact on their businesses from making a submission.

There are no assurances given by the Commission that confidentiality will be granted as a matter of course, or that confidentiality will be granted before a submission is lodged. There is a particular process prescribed in the Act that requires a person to request confidentiality at the time a submission is furnished. In the API/Sigma matter, for every submission that was granted confidentiality over identity, the Commission placed the substance of the argument on the public register.

The Commission is likely to attach less weight to information provided in confidence (if confidentiality is granted by the Commission) that contradicts, or is different to, publicly available information. This is because it is unable to test the confidential information publicly.

If the Commission denies a request for confidentiality, it will specify a period in which the material can be withdrawn and not considered by the Commission. If the Commission does not receive a response within the specified period the confidential material will be placed on the public register.

Decision of the Commission

For every application for authorisation of a merger the Commission issues a determination setting out the full particulars of the application and providing a comprehensive evaluation of the arguments for and against authorisation.[38] The determination for this matter and the Commission's *Merger guidelines* and *Authorisation and notification guidelines* can be obtained from the Commission's website at <http://www.accc.gov.au>.

[37] *Queensland Co-operative Milling Association Ltd and Defiance Holdings Ltd* (1976), ATPR 40-012 at 17,334.

[38] For other authorisations, a draft determination is required to be issued for comment before the Commission makes a final determination.