THE CONTROL OF MERGERS IN AUSTRALIA

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The purpose of this article is to consider certain aspects of the Trade Practices Act 1965 and in particular the omission therefrom of any provisions relating to mergers. Although the Federal Government has never officially expressed doubt as to its constitutional power to regulate mergers, there is a very substantial constitutional law question as to the extent of the Commonwealth's powers to regulate mergers under s. 51 of the Commonwealth Constitution. Although the existence or acquisition of such power is an essential pre-requisite to Commonwealth legislation, it does not form the main subject matter of this article which proceeds on the assumption that the Commonwealth has or may acquire the necessary power. However it is essential to make a brief assessment of the present constitutional position.

CONSTITUTIONAL POWER TO REGULATE MERGERS

All Australian states have legislated to control the formation and operations of corporations, and clearly they have the legislative competence to regulate mergers between companies. However, unless all states introduced complementary legislation, merger control in one or several states only would merely invite companies intending to merge to carry out that operation in, or, if necessary, transfer their activities to, another state which did not regulate or prohibit mergers. The more important question, therefore, is whether the Commonwealth has power under the present Constitution to regulate company mergers. Possible heads of power are contained in placita (1), (xiii), (xiv) and (xx) of s. 51 of the Constitution.

S. 51(i) *The Trade and Commerce Power*

Under this placitum the Commonwealth may make laws with respect to trade and commerce with other countries, and among the states. The discussion for present purposes will be confined to inter-State trade and commerce. In contrast with the liberal interpretation accorded the trade and commerce power in the United States Constitution,[1] the High Court of Australia has required a showing that

[1] The wide range of the U.S. commerce power is summarized by Kitto J. in Airlines of N.S.W. Pty. Ltd. v. N.S.W. (No. 2), (1965) 113 C.L.R. 54 at 113-114.

legislation built upon s. 51(i) selects as ground for its operation or application some fact matter or thing which is directly related to inter-State trade or commerce.[2] In order to regulate mergers under this placitum, the Commonwealth would have to find some activity fact or thing forming a part of the merger transaction which was directly related to the concept of "inter-State trade or commerce". It is difficult to see how a part or whole of a merger, itself a localized act, like a contract or an insurance policy, can be directly related to inter-State trade.[3] It is possible that the High Court may in future adopt a more liberal interpretation of s. 51(i). However as the law now stands, it is doubtful whether there is any activity involved in a merger upon which an enactment under s. 51(i) could operate.

S. 51 (xiii) and (xiv) *Banking and Insurance Powers*

These placita permit the regulation of banking and insurance other than State banking and insurance, also State banking and insurance extending beyond the limits of the State concerned. State banking or insurance refers to the carrying out of these activities by a State government or its instrumentality. Examples are the Rural Bank of N.S.W. and the Government Insurance Office of N.S.W. The placita include intra-State banking and insurance (except where carried on solely by a government instrumentality) as well as inter-State banking and insurance. Although declaring parts of the Banking Act 1947 invalid on other grounds, Latham C.J., Dixon and McTiernan JJ. held in the *Banking Case* that s. 51 (xiii) conferred power to limit the taking over of one bank by another, since this related to the "business of banking".[4] It would not however enable the Commonwealth to prevent a State bank extending its operations by other means to other states since this would be contrary to s. 92.

The insurance power in placitum (xiv) has been similarly construed. In *Insurance Commissioner v. Associated Dominions Assur-*

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2 Redfern v. Dunlop Rubber Australia Ltd. (1964) 110 C.L.R. 194 at pp. 209, 213, 219, 220, 229.

3 Hospital Provident Fund Pty. Ltd. v. State of Victoria (1953) 87 C.L.R. 1, at pp. 14, 17, per Dixon C.J., a decision on s. 92.

4 Bank of N.S.W. v. The Commonwealth (1948) 76 C.L.R. 1, at p. 196 per Latham C.J., at pp. 334-5 per Dixon J.; and at pp. 392-3 per McTiernan JJ. A more limited view was expressed by Rich and Williams JJ. It would also appear that a State bank or insurance company trading in a Commonwealth Territory is within the Commonwealth's power to regulate State banking or insurance extending beyond the limits of the State concerned. Lamshed v. Lake (1958) 99 C.L.R. 132 per Dixon L.J., Webb, Kitto and Taylor JJ.

ance Society Pty. Ltd.[5] Fullagar J. held that it included the "power to prescribe conditions upon which any person, natural or artificial, may carry on an insurance business of any kind".[6] He also considered that the Commonwealth had power to order the judicial management or winding up of an insurance company. However he did concede that "it may be that the power does stop short of authorizing a direct provision for the actual dissolution of a corporation".[7] It would appear that the regulation of the conditions upon which insurance companies (or banks) may merge is more akin to an order for judicial management or winding up than it is to an order for actual dissolution. A merger by acquisition of stock or assets does not "affect the existence of a corporation" as a legal entity. Accordingly it would seem the Commonwealth has power under placita (xiii) and (xiv) to regulate mergers between banks and insurance companies respectively, except those which are both State-owned and confine their business operations wholly within a single state.

S. 51 (xx) *The Corporations Power*

The corporations power is confined to foreign corporations, and trading or financial corporations formed within the limits of the Commonwealth. It has been the subject of one direct authority and a number of *dicta*. First, a distinction has been drawn between (a) "trading and financial", and (b) manufacturing, mining and other activities in which corporations engage.[8] Thus the Commonwealth has no power to control companies engaged purely in manufacturing or mining, although it is obvious that in a commercial sense many manufacturing and mining companies would also be involved in the distribution or sale of their products. On the other hand, a company engaged solely in mineral exploration or extraction for profit on behalf of others would not appear to be trading, according to the present authorities.[9] Again a merger between the manufacturing subsidiaries of two companies which arranged for all their trading activities to be carried on by separate subsidiaries would appear to be outside the Commonwealth corporations power. Professor Lane advances

5 (1953) 89 C.L.R. 78.
6 Id. at p. 87.
7 Id. at p. 88.
8 Huddart Parker & Co. Pty. Ltd. v. Moorehead (1909) 8 C.L.R. 330 at pp. 392-3 per Isaacs J. Compare Beal v. Marrickville Margarine Pty. Ltd. (1965) 114 C.L.R. 283 at p. 306 per Menzies J. dealing with "trade, commerce" in s. 92.
9 Ibid.

four persuasive arguments in favour of an expanded and modernised interpretation of "trading corporations" in s. 51 (xx) to include manufacturing and mining companies.[10] Only time will tell whether the High Court is yet prepared to adopt this more liberal approach.

There are further limitations upon the Commonwealth's power as presently interpreted by the High Court. In declaring invalid ss. 5 and 8 of The Australian Industries Preservation Act, 1906, in *Huddart Parker & Co. Pty. Ltd. v. Moorehead*,[11] all Justices of the Court except Isaacs J. limited the Commonwealth's power to something less than control over the conduct of corporations. All Justices agreed that the Commonwealth could not control the creation of companies since s. 51 (xx) referred to corporations (already) *"formed" aliunde*. This view was confirmed in the *Banking Case*,[12] and in the *Associated Dominions Assurance Society Case*, Fullagar J., referring to s. 51 (xx), said: "If there is no general power to provide for the *creation* of corporations, it may be taken that there is no general power to wind up or dissolve corporations."[13] Of the other Justices in the *Huddart Parker* case, Griffith C.J. and Barton J. confined Commonwealth power to regulation of a corporation's capacity.[14] O'Connor J. restricted the power to imposing conditions of *recognition*.[15] Higgins J. confined the power to the regulation of status and

10 They are (a) Placitum (xx) is not confined to "trading" and "financial" corporations in relation to foreign corporations. Whilst it may be regarded as anomalous for the Commonwealth to have wider powers over foreign corporations than over corporations formed within the Commonwealth the *expressio unius est exclusio alterius rule* (the express mention of one thing implies the exclusion of another) would favour the presently accepted interpretation. (b) It is doubtful if the dichotomy between the "static" process of mining and manufacturing and the "dynamic" process of trade can be artificially preserved today. (c) Placitum (i), the trade and commerce power, is now construed to include mining and manufacturing. (d) By the rule of generic interpretation the power in placitum (xx) must keep pace with the country's progress, and adapt itself to new developments of time and circumstance. See P. H. LANE, THE TRADE PRACTICES ACT, ITS CONSTITUTIONAL OPERATION, 1966, pp. 81-2 and authorities there cited. Although Professor Lane does not state explicitly that he is relying on the power to make laws with respect to matters incidental to the execution of powers already vested in the Commonwealth contained in s. 51 (xxxix), it would appear from the authorities which he cites that his argument draws upon this power.

11 (1909) 8 C.L.R. 330.

12 (1948) 76 C.L.R. 1 at p. 202.

13 (1953) 89 C.L.R. 78 at p. 86. Italics added. This statement is obiter since the decision was reached under placitum (xiv).

14 (1909) 8 C.L.R. 330 at p. 354.

15 Id. at pp. 372-4.

capacity of corporation, and the conditions under which they could carry on business.[16] The result is that the majority view of the High Court in 1909 would appear to exclude the Commonwealth from regulating mergers.

There remain however three possible avenues by which the Commonwealth may effectively control mergers:

I. By acquiring a specific grant of power under a constitutional amendment, which would require a referendum.

II. By testing the present validity of the *Huddart Parker* decision. Professor Lane has suggested grounds upon which that decision might be successfully contested.[17]

III. Finally, a suggestion has been made by Professor Richardson[18] which might enable the Commonwealth to legislate within the existing constitutional framework and authorities. He suggests that a federal statute regulating the acquisition by a foreign corporation or a domestic trading or financial corporation of any part of the stock or share capital of another domestic trading or financial corporation would be within the Commonwealth's power over corporations as interpreted by the majority Justices in the *Huddart Parker* decision. The present writer agrees with Professor Richardson's characterization of such a statute as one "dealing with the corporate structure of corporations and the relationships of corporations with each other as distinct from their business activities". However, three comments appear necessary.

(i) Professor Richardson suggests that an acquisition of part of the shares or stock of another company is not an ordinary trading activity of a trading corporation. This proposition may be doubted in its present form since it is commonplace for trading companies to acquire large holdings of shares in companies engaged in activities totally unrelated to those of the shareholder companies. However where a company acquires a controlling or majority interest in another company, this is not a normal trading activity, unless of course the acquiring company is engaged in take-overs as a regular business activity.

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16 Id. at pp. 410-14.

17 Lane, op. cit. at pp. 79-81.

18 *Legal Aspects of the Control of Monopolies, Mergers and Restrictive Trade Practices in Australia,* (1962) 35 A.L.J. 423 at p. 432, and RICHARDSON, *The Control of Monopolies and Restrictive Business Practices in Australia,* (1962) ADELAIDE LAW REV. 239 at pp. 260-262.

(ii) the proposal does not envisage mergers by acquisitions of assets, nor would these appear to be within the constitutional competence of the Commonwealth as interpreted in the *Huddart Parker* case. An acquisition of assets does not affect the corporate structure of a corporation; nor does it affect the relationship of the buyer or seller *as corporations* although it may have a great effect upon their commercial relationship.

(iii) Professor Richardson's characterization of his proposed statute may be divided into two parts; a law dealing with (a) the corporate structure of corporation, and (b) the relationships of corporations with each other as distinct from their business activities. If this characterization is correct, the further question arises whether a merger statute must possess both sets of characteristics if it is to be *intra vires* the Commonwealth's corporations power. A law which possesses the first set is more likely to be *intra vires* the corporations power than one which only fulfils the description in (b). Therefore, if a merger is held to affect the relationship of the merging companies but not their individual corporate structures, a statute regulating mergers might be *ultra vires* the Commonwealth. It can be argued that a merger or take-over by acquisition of a majority of the shares of another company does not affect the corporate structure of either company in its capacity as a company. In one sense the only change which has taken place is that whereas prior to the take-over, the shares of the company acquired may have been held by a number of individuals or companies, after the take-over, a majority of the shares are held or controlled by the acquiring company. Yet, in another sense, there has been a critical change in the structural relationship of the two corporations in that normally one will have become the subsidiary of the other (holding company). This latter view is that appropriate to the company lawyer and from his view-point, it is submitted that a take-over should be considered as bringing about a change in the corporate structure of the companies themselves as well as in their relationship *inter se.*

Where a merger or take-over is effected by an individual personal shareholder acquiring or controlling a majority shareholding in several companies it would appear that placitum (xx) could not justify any regulation by the Commonwealth since the structure or relationship of the corporations as corporations is not affected. On the other hand where a holding company acquires control of two subsidiaries, the structural relationship between the subsidiaries (as well as with their parents) may be considered to be changed, since under the Uniform Companies Act the subsidiaries will now be treated as related companies.[19]

A final constitutional question is whether a Commonwealth law purporting to regulate wholly intra-State mergers would be invalid. There is no limitation upon such activity in the terms of s. 51 (xx), and the High Court has construed other placita, notably s. 51 (xxix), the external affairs power, as sufficient "to support laws made with a complete disregard of the distinction between inter-State and intra-State trade".[20]

THE NEED FOR MERGER CONTROL

It cannot be denied that many Australian industries are already highly concentrated. The overall degree of concentration which has been assessed at three times that pertaining in the United States,[21] has shown a marked increase since World War II, having been achieved in large measure through the medium of mergers.[22] Because of the highly concentrated structure of the major Australian industries, it might be thought that an anti-merger provision would be too late to prevent the creation of monopolies. It is obviously politically infeasible to break up the largest existing companies in concentrated Australian industries. Yet there is some incongruity in permitting existing huge enterprises to remain immune while preventing their smaller competitors combining. On the other hand, there is no reason why the trend towards further concentration should not be arrested. Due to the relative smallness of the Australian economy, there is more opportunity in Australia than in the United States or Great Britain for reducing industrial concentration by the encouragement of new entrants into expanding industries, while concurrently preventing existing monopolists and oligopolists from further expanding their market power by mergers. This would not in itself prevent a monopolist from increasing his existing share of the market by fair competitive means.

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19 Uniform Companies Act, 1961, s. 6 (5).

20 Airlines of N.S.W. Pty. Ltd. v. N.S.W. (1964) 113 C.L.R. 1, at p. 27 per Dixon C.J.

21 KARMEL AND BRUNT, THE STRUCTURE OF THE AUSTRALIAN ECONOMY, 1962 pp. 135-136; K. SHERIDAN, *An Estimate of the Business Concentration of Australian Manufacturing Industries, Economic Record,* VOL. 44, MARCH 1968, p. 26.

22 There were probably about twice as many mergers per one thousand firms in Australia as in the United States during the post World War II period. See BUSHNELL, AUSTRALIAN COMPANY MERGERS 1946-1959, (1961), pp. 126-128.

Since monopolization (as distinct from monopoly) is recognized by the Trade Practices Act as potentially harmful to free competition,[23] it is only logical that those mergers which tend to create monopoly power should be presumed to be harmful to competition unless otherwise justified. The argument that the prohibition of monopolization alone is sufficient to protect competition ignores the fact that prevention of a merger is cheaper, easier, less wasteful and more effective than post-merger divestiture or any other remedy. Similarly Sir Garfield Barwick pointed out that "where two or more may not lawfully agree to engage in restrictive practices, they may, by merger . . . do the very thing that was forbidden to be done by agreement".[24] On the other hand, the Government is naturally wary of the danger of unnecessarily stifling growth in Australia's young secondary industries, already hampered by high building costs, slow construction and limited loan moneys.

The Australian economy must also be viewed in relation to world trade. If it is necessary for an Australian manufacturer to expand in order to compete more effectively in world markets, and a merger is the most feasible means of expansion, the national interest sanctions the merger, even though it reduces domestic competition. The converse situation arises where Australian manufacturers are protected from foreign competition by an import tariff. Domestic competition may be stimulated by lowering the tariff wall, but this measure must be carefully regulated to permit the Australian firms to adjust their cost structure to meet the increased competition.

The Australian government's stated reason for omitting any restrictions on mergers from the Trade Practices Act is a consciousness "of the developing nature of the Australian economy and the need, in our present circumstances, for businesses in some industries to be able to expand in size so as to be able to take advantage of such economies of scale as will enable them to compete effectively on

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23 Ss. 36 (2), 37 (1) and 50 (3).

24 37 Parl. Deb. (Hansard) p. 3112 (6th December, 1962). Speech prepared by Sir Garfield Barwick, and delivered for him in his absence by Hon. G. Freeth. Dr. Walker points out that s. 52 (2) of the present Trade Practices Act could "be used as a rudimentary form of structural remedy for preventing the extension of market power by vertical integration, merger, interlocking directorates". WALKER, AUSTRALIAN MONOPOLY LAW, 1967 (CHESHIRE) at p. 283. While this statement appears correct in relation to interlocking directorates and "prospective" mergers, the section would not extend to the challenge of "completed" mergers.

world markets".[25] This statement is supported by Karmel and Brunt's conclusion[26] that "the market for Australian manufacturers is so narrow that for many industries a high degree of monopoly must be regarded as the inevitable cost of securing access to economies of large-scale production". Bushnell concurs in this conclusion, when he writes: "Undoubtedly mergers have done the community a great deal of good by helping to establish firms large enough to take advantage of the most modern production technology and management methods."[27] A close analogy can be drawn to the post-war situation in Canada, of which Brecher has written, "in general current levels of size and concentration represent absolute minima below which considerable losses would occur in efficiency of production and distribution".[28] It should be pointed out immediately that merely enabling firms to expand by means of merger will not necessarily make them more efficient or more willing to export their products.[29] If the merger places the new amalgamated company in a position of market dominance, it may result in less vigorous and efficient operations.

The Attorney-General's second reading speech gave the impression that the complex mechanical problem of devising a satisfactory criterion for judging whether a particular merger was in the public interest was the dominant reason for the failure to legislate in this field rather than questions of economics of scale or export markets. The evaluation of the two last mentioned questions in relation to merger-control involves the broad aims of Australian economic and social policy at home and abroad and will not be dealt with in this article. It will therefore be assumed for present purposes that the Australian government would favour generally a policy which struck a balance between (a) prohibiting mergers which threaten to curtail the beneficial effects of competition and (b) approving mergers in which the possibility of some reduction of competition is outweighed

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25 46 Parl. Deb. p. 1656 (19th May 1965). Speech by the then Attorney-General, The Hon. B. M. Snedden, Q.C., M.P., on the Second Reading of the Trade Practices Bill 1965.

26 KARMEL AND BRUNT, supra, at p. 135.

27 BUSHNELL, supra, at p. 165.

28 BRECHER: *Combines and Competition: A Re-Appraisal of Canadian Public Policy*, 38 CAN. B. REV. 523, 524.

29 Brecher concludes that "The empirical evidence on economies of scale is inconclusive. It does suggest, however, that they are frequently of modest proportions (excluding the economies of massive sales promotion); and that for many markets existing degrees of concentration are in excess of those required by scale economies." Id. at p. 569 and n. 120.

by other benefits to the economy. From this standpoint attention will be focused on the "mechanical" problems of formulating a satisfactory criterion and establishing a workable procedure for giving effect to the above-mentioned policy. The major considerations bearing upon this problem are the resources available to the government for the enforcement of its policy, the interests of an efficient administration in avoiding protracted litigation, procedural and evidentiary problems, and the business community's demand that the government's policy should be clear and the law certain.

A FORMULA—GENERAL OR SPECIFIC?

Assuming that the Australian government decides that it is desirable and constitutionally possible to regulate certain mergers, it will be essential to frame the criteria upon which such mergers will be examined. If the Government feels that the end result they wish to achieve is too difficult to spell out by means of specific criteria, a general formula such as that adopted in the United States,[30] could be adopted. While conferring a desirable degree of flexibility on the tribunal applying the formula, the tribunal would be left to develop subsidiary rules and principles to meet the varying circumstances and needs of differing industries.[31] The writer considers that this approach would indicate an avoidance by the Government of its responsibility for economic planning and policy.[32] The legislature should formulate more specific criteria to guide the tribunal.[33] An anti-merger law is not like a criminal statute. It is not better that nine harmful mergers should be permitted than one beneficial merger prevented, since the

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30 Clayton Act, s. 7 prohibits mergers "where, in any line of commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition or tend to create a monopoly".

31 Compare BOK, *Section 7 of the Clayton Act and the Merging of Law and Economics,* (1960) 74 HARV. L.R. 226 at p. 352: "Another reason that is sometimes given in support of flexible language is that such terminology provides 'free play' to accommodate the odd case or the special circumstance that always arises to plague efforts to place fixed rules upon the endless variety of human situations. Surely, however, it is better to treat special situations of this sort expressly as exceptions to the general rule instead of taking advantage of flexible language to make them appear as normal cases." The U.K. Monopolies and Mergers Act, 1965, s. 6 (2) empowers the Monopolies Commission to consider whether mergers "operate or may be expected to operate against the public interest".

32 Sir Garfield Barwick adopted a similar attitude, 37 PARL. DEB. p. 3108.

33 See KORAH, *The Commonwealth Proposals for Legislation Controlling Monopolies and Restrictive Trade Practices,* 38 A.L.J. 190 at 191.

prevention of any particular merger causes no irreparable harm.[34] The acquiring company is not precluded from expanding its existing facilities, nor is its position worsened by maintenance of the *status quo*. Only where the company to be taken over is (a) a failing company or (b) a proprietary company whose owners wish to provide liquidity for their estates or other purposes by selling their interest in the company, will anybody suffer specific harm. Specific exemption must be provided for case (a). In case (b) a balance must be struck between protecting the right of free alienation of property and preventing mergers which unduly restrict competition or create monopolies. The difficult case occurs where the owners of a company enjoying a strong position in the market desire to merge or sell for a wholly defensible reason, but the only offer comes from a competitor or company in a vertical relationship (supplier or customer) and the merger appears likely to create a monopoly. It is submitted that the owner's *private* interest should be deferred to the *public* interest in preventing monopolies.[35]

On further analysis, however, it may be established that the fear of being unable to realize on such investments when a favourable offer is presented, tends to prevent independent entrepreneurs entering certain markets, thereby extinguishing one means of enhancing competition. The adoption of specific criteria to the exclusion of a general dragnet clause would make it far easier to predict whether a particular merger was permissible or not. No doubt the companies concerned would arrange their relevant statistics and present their evidence in such a way that the merger appeared to avoid the statutory provisions. The Commissioner would have to prepare his own statistics. His administrative task would be less onerous in the majority of cases because the presentation of specific economic data will either condemn the merger or at least cast the burden of proof on the companies. The task of the Trade Practices Tribunal would be simplified to the same extent.

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34 Compare BOK, supra at p. 273: "In merger cases, however, no personal freedoms are in jeopardy, nor do we ponder the dissolution of a going concern. The impact of the law is merely preventive, and there are generally other available methods of expansion available to the defendant if the merger is blocked . . ."

35 Brecher, supra at p. 572: ". . . such itmes as the welfare of a particular firm and the stability of a particular group of firms will normally have no place in the public policy scheme of things."

PROCEDURES

The next task is to evolve procedural techniques for speedy and certain disposal of merger challenges. In his second reading speech the Attorney-General referred to the great difference of opinion as to the merits of two alternative courses: (i) to hold up a proposed merger pending a determination of its compatibility with the public interest, or (ii) to permit the merger to proceed at the risk that divestiture may have to be ordered later on. The obvious possibility of wastage inherent in the second alternative inclines the writer to the view that every effort should be made to adopt the first procedure in some form which causes a minimum of delay to the companies concerned. The Commissioner's task of investigating proposed mergers may be reduced by purchasing frank disclosure of authentic data by offering a final clearance for those who register a proposed merger which is then not challenged within a limited period.[36]

In addition a concurrent scheme of immediate and final clearances should be introduced for mergers which are demonstrably unobjectionable. Such clearance should be automatically granted to applicants who frankly disclose all relevant data and whose combined market shares fall below a prescribed minimum. A further extension of this proposal would allow other companies whose market shares exceeded the prescribed minimum to apply to the Tribunal for an expedited clearance. To preclude an excess of groundless applications the following would be mandatory: (1) sworn statements as to estimated market shares of the companies, and (2) proof that the benefits to be achieved from the merger would be lost unless the merger were allowed to proceed immediately. All clearances would be conditional upon the truth of the statements contained in the companies' declarations regarding the proposed merger. This would avoid the Commissioner or the Tribunal having to check the accuracy of these declarations. Any period of delay would be a hindrance to the proposed merger, and the prescribed waiting periods should be kept to a minimum. If a merger is challenged and found to be contrary to the public interest, the companies have no complaint. However, if the parties to a merger which is ultimately approved, are hampered by the required waiting period, their complaint is clear, since it is cold comfort to know that the merger is lawful after the opportunity

[36] The general principle of clearance certificates has already been adopted in ss. 59-61 of the Trade Practices Act 1965 in relation to examinable agreements and practices.

presented by the amalgamation has been utilized by a competitor. The expedited clearance is designed to meet this situation.

The determination of contested mergers could be expedited by rules requiring the merging companies and the Commissioner to file particulars of their grounds for and against the proposed merger within strictly enforced time limits. The companies should also file particulars of their sales in the relevant market. It may be argued that such requirements cast an unnecessary burden on the companies; however, this information is peculiarly within the companies' knowledge and would have been collated by the acquiring company in making the business decision to take over the other company. However, a criterion or set of criteria which can be applied directly to a proposed merger would, more than anything else, enable companies considering merger to predict whether the merger is permissible. Such specific criteria cannot account for every fact situation or differences between one industry and another. Even a test based on a limited number of factors necessarily precludes consideration of other factors which deserve consideration in particular cases.[37] Yet the alternative is a statment of broad principle which gives the Tribunal and companies little assistance. The most difficult problem in American merger cases is the application of the general criteria of section 7 of the Clayton Act, to proven economic statistics. Proof of the economic statistics themselves is comparatively simple.[38] Most commentators agree that "existing knowledge does not permit prediction concerning the probable effects of most mergers" and "little is presently known of the relative importance of the separate factors involved."[39]

FACTORS RELEVANT TO MERGERS

(1) *Market Definition*

The first element in any merger test is the definition of the relevant

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37 In its Report on Corporate Mergers and Acquisitions (1955) p. 171, the Federal Trade Commission stated: "The meaning and relative importance of competitive activities varies from industry to industry and from market to market. Since competition cannot be directly measured, no single standard is applicable to the whole range of American industries and markets."

38 "Economic analysis . . . cannot produce such conclusive evidence on the effects of merger.... [E]conomic "analysis" may reveal with absolute precision that a given merger reduces the number of independent sellers in a market from 11 to 10.... However, economic theory cannot predict "a priori how much" this affects competition, or even whether it affects competition substantially." MARKHAM, *Merger Policy Under the New Section 7: A Six-year Appraisal* (1957) 43 VA. L. REV. 489, 491.

39 BOK, supra at p. 288.

market which requires an examination of the market from at least two viewpoints:

(a) The *product* dimension is "determined by the reasonable interchangeability of use or the cross-elasticity of demand between the product itself and substitutes for it".[40] For example, in considering a merger between two companies which respectively previously produced glass bottles and cardboard cartons it would be necessary to decide whether the relevant product market should be confined to glass and cardboard containers or should extend to all containers, glass, paper, metal, plastic and so on. When faced with this question American courts have given primary attention to the end use to which the products are put.[41]

(b) The *geographic* dimension requires consideration not only of areas in which actual sales are made, but also of *potential* sales areas. The latter are particularly important in Australia because of expansion in secondary industries, widening market horizons at home and overseas, and the lowering of freight barriers. In the past, Australia's secondary industries have centred on the capital cities, each separated by huge distances. Historically, the trading activities of each state have flowed through the state capital, which in each case has been the central outlet for sea and air transport. More recently, increased awareness of the potentialities of interstate trade, and greater use of road and air transportation, have lowered freight barriers and increased interstate trade and competition. Hence the definition of market areas will require consideration of actual and potential markets throughout the nation.

Another factor is the effect of foreclosure of a source of supply or sales outlet where a vertical merger is proposed between manufacturer and retailer. For example, the company being taken over, say an integrated shoe manufacturer-retailer, may not only have competed in the same horizontal retail market as the acquiring retail company, but may also have supplied retailers in a different geographic market. The result of the merger is that these retailers are foreclosed from a source of supply. Although the retailers are not competing in the horizontal retail market with the acquiring company, the vertical aspects of the merger should be tested in the market which includes the alternative sources available to the retailers foreclosed, as well as

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40 Brown Shoe Co. v. United States (1962) 370 U.S. 294, 325.

41 This aspect may be regarded as a separate "functional" dimension. See, e.g. the Cellophane Case, United States v. E. I. Du Pont de Nomours & Co., (1956) 351, U.S. 377, 395-96.

in the market in which the acquiring company purchases its supplies.

(c) The *time* dimension may be considered to be a separate element in market definition. While the effects of a merger on the subsequent market structure and behaviour have occasionally been important in the United States,[42] the original Australian proposals were concerned only with the pre-merger situation, since they envisaged only prevention of *prospective* harmful mergers, and not fragmentation of completed mergers. In this context it seems clear that the market structure must be viewed at the date of the hearing. However this data would be evaluated against the history of prior mergers and new entries into the market, stretching back as far as necessary to obtain perspective and facilitate predictions of the post-merger effects on market structure and competition.

This brief discussion of market definition has demonstrated that the relevant factors are numerous and complex. The problem cannot be avoided, since the determination of the relevant market is an essential prerequisite to *any* merger test. It might therefore be feared that all merger proceedings would be lengthy and unpredictable, and involve conflicts of economic testimony. However American experience suggests that "satisfactory evidence is usually available in business records, and with proper focus it can be gathered and presented without inordinate delay. Moreover there are many mergers, perhaps most, where the market problem is not much of a problem."[43] Unless a strict test of percentage market share or degree of concentration is applied to mergers, absolute accuracy in market definition is not essential, since it is only one element—albeit an essential and important one—in estimating the probable effects of a merger. American courts have been satisfied with rough approximations of the relevant market since they are only required to measure the general overall effects of a number of factors on competition in the market.

(2) *Market Shares*

Having defined the relevant market, as many as *six* other factors may be treated as pertinent to the enquiry whether the probable effect of the merger is to lessen competition substantially or tend to create a monopoly. The first of these is the respective market shares

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42 e.g., Reynolds Metals Co. v. FTC, 309 F.2d 223, 229 (D. C. Cir. 1962); "The truer picture of anti-competitive effect emerges from . . . consideration of the post-acquisition competitive postures of the eight previously independent florist foil converters *vis-à-vis* one another."

43 KAYSEN & TURNER, ANTITRUST POLICY, 1959, p. 134. See also BOK, supra at p. 274.

of the merging companies in the case of horizontal mergers and the degree of foreclosure of sources of supply or outlets in the case of wholly or partially vertical mergers. Since vertical mergers require separate and different treatment, I shall defer consideration of them to a later point in this article.

The market share criterion taken alone is not necessarily a good one. Depending upon the nature of the industry, a company whose market share might indicate monopoly power may in fact have little market power. Market power is subject to the case with which competitors can enter the market once the monopolist starts to exploit his position by extracting a monopolist's profit. Much of the traditional theory of monopoly was based upon the concept of companies specialising in the production of particular products. The emergence of the modern conglomerate or multi-product corporation has emphasized the case with which a company can switch its manufacturing activity from one product to another which offers a higher profit margin. Provided there is adequate *potential* competition the degree of *actual* competition or the *present* market share of a particular company is not critical.

The concept of market shares itself involves several facets. Should the Trade Practices Tribunal be concerned with sales figures or production capacity? present or potential sales or capacity? Should the Tribunal give greater weight to the present market share of the acquiring company or the prospective aggregate share of the two companies after merger? To illustrate the different result which may follow from these alternative approaches it is interesting to consider the suggestion of Professors Kaysen and Turner that the application of section 7 of the Clayton Act, would be facilitated by the adoption of benchmarks such as the following:

"(a) Any acquisition of a competitor by a firm with 20 per cent or more of its market is prima facie illegal.

(b) Any merger of competitors who together constitute 20 per cent or more of a market is prima facie illegal."[44]

Although these percentages are a guide to the inherent monopoly power of the aggregate firm, it is virtually impossible to pinpoint the percentage at which the market power endangers competition or becomes monopolistic. Even assuming that the adoption of some form of legislative or judicial benchmark is acceptable, these particular

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44 KAYSEN & TURNER, supra at p. 133. Benchmark (b) is the same as Stigler's suggested Rule (2). STIGLER, *Mergers and Preventive Antitrust Policy*, (1955) 104 U. PA. L. REV. 176 at 182.

formulations are open to specific criticisms. First, there is necessarily some overlap between these two criteria. Benchmark (a) is unnecessary in its present form since any merger which falls within its limits is necessarily prescribed under benchmark (b). On the other hand, by reducing the percentage share of the acquiring firm under benchmark (a) to, say 15 per cent, the area covered by the benchmarks could be increased. Thus, a firm with 16 per cent would be precluded from acquiring one with 3 per cent, even though their aggregate share did not violate the 20 per cent barrier of benchmark (b). A more damaging criticism of the aggregate market share test is that it fails to take cognizance of the degree to which concentration has increased in the industry.[45] Benchmark (b) would preclude a company with 19 per cent of the market acquiring a company with 1 per cent, although the degree of market concentration is little affected. However a merger of two firms with 10 per cent and 9 per cent respectively would escape prohibition, although the degree of concentration would increase markedly.

Finally, the market share test has no relation to the margin of superiority which the acquiring firm enjoys over another firm or over its competitors generally. To illustrate, suppose that two firms X and Y with 9 and 8 per cent of their market respectively, enjoyed first and second position in the market and their nearest competitor, Z, had 2 per cent. If X acquired Y, X's market leadership over Z would increase from 7 percentage points to 15 points. On the other hand, if X and Y ranked fourth and fifth in the market behind firms with market shares of 30, 25 and 23 per cent, though the acquisition would increase concentration, there is no necessary reason to suppose that X would increase its market power or leadership. Yet a simple market share test fails to take account of the distinction between the two cases.

(3) *Increases in Concentration*

Because of the inadequacies of the market share test, a further criterion deserves consideration, namely, the increase in aggregate share of the leading companies in the market, including the acquiring company by, say, 15 per cent over the previous aggregate share computed at a base year within the past 5 to 10 years.[46] This formula

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[45] BOK, supra at p. 310.

[46] The suggested 20 per cent is a purely hypothetical figure. Such a test is advocated by BOK, supra, at pp. 308-316, where he suggests 7 or 8 per cent as applicable in the American context. Compare the similar approach to sections 2 and 32 of the Canadian Combines Investigation Act R.S.C., 1952, c. 314 advocated by BRECHER, supra at p. 561.

takes account of aggregate market shares, relative standing in the market and increased concentration in the market structure. Application of this formula would prevent undue accretions in total concentration by means of a number of mergers even though each in itself was of relatively small proportions. It might be argued that this test fails to distinguish between the situations where the prior trend towards concentration was due to internal expansion, company failures or previous mergers. However, it is submitted that there is no logical reason why any such distinction should be made since the Tribunal should assess the effect of the merger on market structure and competition as it finds it, regardless of which factors or parties have previously influenced that structure.

Market shares "can have no meaning apart from some analysis of the patterns of competition in a particular industry or market . . .".[47] Mergers should be evaluated in relation to their likely effect on competition in the existing market, and not in the abstract. While a particular merger may only increase the power of the acquiring company or the degree of concentration by a small amount, that merger may be the straw which breaks active or potential competition. While it is conceded that indices of concentration increase can never be a direct and complete measure of the state of competition, they do have the advantage of indicating not only the increased power of the acquiring company but also the effect of the merger on that market structure and hence the likelihood of a substantial lessening of competition. Such indices represent the most advanced attempt to combine the essential elements of the merger problem into a simple formula with explicit exceptions, directly applicable to proven economic data.

However, such a test can only afford *prima facie* evidence of the likely effect of the merger. Since it does not necessarily reflect the degree of potential competition or the ease or difficulty of entry into the market, this test suffers from the same deficiency as a simple market share test.

In any event the formula would require qualification to take account of the following situations:

(a) Where the acquiring company's market share after merger would not exceed the share which it held in the base year, the merger should not be prohibited automatically, even though the degree of concentration in the industry as a whole or amongst the market leaders has exceeded the permissible limits. The argument for this

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[47] BARNES, *Competitive Mores and Legal Tests in Merger Cases. The Du Pont-General Motors Decision,* (1958) 46 GEO L.J. 564 at 628.

exception is that the purpose of an anti-merger statute should be to arrest the overall trend towards concentration and reduced competition. In this example, the acquiring company has not really contributed to the concentration increase in the long term. On the other hand it may be argued that the statute should require consideration of the likely effects of the merger on competition at the time of its consummation, and therefore the only useful comparison is between the degree of concentration immediately before and after the merger.

(b) In the converse situation, a particular merger may increase substantially the concentration among the leading companies themselves, but because of the expanding nature of the market or new entrants, the aggregate market share of the leading firms may have decreased since the base year, so that the merger would escape under the original formula. Therefore the formula should be broadened to cover an increase of, say, 15 per cent in the market share of the acquiring company.

(c) A further addition suggested by Professor Bok is that acquisition of a competitor by the leading company in the market should be prohibited where the margin of superiority of that company over its strongest competitor would be increased by more than 2 or 3 per cent over the margin in the base year.[48] Without entering upon a discussion of the validity of the percentage margin suggested by Bok either in the United States or Australia, the writer approves the general policy inherent in this stricter test for acquisitions by market leaders. The policy is to prevent mergers which tend to create monopoly. It would take account of the problem posed in the example of companies X, Y and Z above.[49] Bushnell has demonstrated that by the medium of mergers, the structure of Australian industries which previously enjoyed widespread competition has been changed to oligopoly. In the period 1947-1956 such changes were effected in department and chain stores, Melbourne milk distribution, container manufacture and tanning.[50] He lists a much greater number of industries in which oligopoly was intensified to even greater concentration among fewer companies by means of mergers in the period 1947-1959.[51] His commentary on the Australian textile industry is typical:

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48 BOK, supra at p. 308. Compare BRECHER, supra at p. 585: "[T]here is need to impose especially strict standards of conduct on dominant or leading firms, . . ."

49 See p. 493 supra.

50 BUSHNELL, supra at p. 163, Table VI.

51 Id. at p. 163, at p. 210, Table IX.

> Basic textile production was concentrated in a few firms at the start of the period [1946] and there was little scope for mergers. . . . Despite this initial concentration, all three leading companies engaged in merger activity to add even further to the concentration in the basic textile industry. . . . Since the medium-size firms did not participate in merger activity during this period, the gap between the giants and their competitors grew wider.[52]

A curb upon this type of merger activity will be necessary if the gap between market leaders and their smaller competitors is not to be further widened.

(d) Professor Bok also suggests that special protection should be afforded to prevent the acquisition of companies which make a substantial contribution to competition.[53] Difficulties will arise in determining which companies should qualify for this protection and what impact the merger is likely to have on the competitive vigour of the market. The acquired company will not compete with its new parent. No *a priori* inference can be drawn that the merged companies will be more or less competitive than before the merger. The acquired company was by definition a substantial competitive force before the merger. If it was only a small company stimulating competition through innovation, vigorous selling or price cutting, the merger will enable it to continue this policy vis-à-vis the rest of the market provided this coincides with the acquiring company's policy. Everything depends on the purpose of the merger. If the acquiring company desired the merger so that it too could avail itself of the competitive management of its new partner, competition will be stimulated. On the one hand, where it can be shown by overt acts or statements that the purpose of the merger was to eliminate "a disturbing force from the market"[54] the merger is clearly undesirable. Since it is the acquiring company's purpose which is determinative here, admission of evidence on this point would not be contrary to the policy of requiring clear criteria so that the businessman can predict with certainty the legality of the merger. At the other end of the spectrum, where the acquired company is on the verge of being forced out of business, the solution is again clear, since the failing company defence, whose limitations are discussed hereunder,[55] will probably sanction the merger.

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52 Id. at pp. 144-145.
53 BOK, supra, at 321-29.
54 Id. at p. 323.
55 See pp. 528-532 infra.

Neither of these polar cases brings us nearer the solution of defining just when an acquired company which is in the middle ground should be deemed to make a distinctive contribution to competition. Since qualitative considerations of the competitiveness of the acquired company are necessarily vague, Professor Bok has suggested a quantitative benchmark of about five per cent market share, which he considers is a reasonable compromise[56] between (a) companies which lack economies of scale or are so small that their disappearance does not matter, and (b) companies approximating ten per cent of the market, whose acquisition would result in aggregations controlling at least one-fifth of the market.

There is no direct relationship between the size of an acquired company and the contribution which it makes to competition. Hence any benchmark such as Bok suggests must be arbitrarily chosen and can only be tested pragmatically by trial and error. Bok himself admits that "these suggestions do not purport to reflect certain knowledge" but he does cite "competent opinion" in their support. For example, one of Bok's justifications for the five per cent benchmark is that "firms of this size will usually be large enough at least to take advantage of available economies of large-scale production".[57] While it has generally been assumed that the concentrated market structure of many Australian industries is justified by the need for economies of scale in a limited market[58] there have been no empirical studies of the minimum size that companies must achieve in particular industries in order to achieve these economies.[59] Bok's generalization cannot, therefore, be automatically applied to Australian conditions. Where the purpose and effect of a proposed merger is to enable the companies to achieve the minimum optimum size to meet competition, for example, from overseas competitors there would be a strong justification for the merger.

Assuming for the moment that such a quantitative correlation could be made between market shares and the contribution which a company makes to competition, the writer considers that such a benchmark is still objectionable for another reason. Let us take the example of a company with a five per cent market share faced with increased competition from larger companies enjoying economies of scale, yet

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56 Bok, supra at p. 328.
57 Id. at p. 329.
58 Karmel & Brunt, supra at p. 5.
59 Id. at p. 88.

unable to finance the internal expansion[60] necessary to achieve optimum capacity. Even if that expansion is achieved, the necessary share of the limited market may not be captured in order to absorb the increased capacity and capital outlay. The remaining alternatives are:
(1) to remain in business and continue the losing battle against the larger companies, perhaps trying to gain an advantage through technical innovation;
(2) to merge or sell out.

The inevitable result of the first alternative is eventual business failure and a substantial loss of resources to the economy. If a merger is prohibited because the company has a five per cent market share, the opportunity for a favourable take-over offer may pass. If the company reduces its prices to meet competition, it will retain its market share for a longer period and no merger will be permitted until the market share drops below five per cent or the company reaches the brink of bankruptcy and qualifies as merger material under the failing company defence. A strict five per cent rule may therefore induce a company in this position to retain its higher prices and lose the requisite market share quickly in the hope of attracting a better take-over offer before profits fall too far. Yet this non-competitive attitude is exactly what the government hopes to avoid. Therefore, on the available evidence, there is no justification for attempting to quantify the criteria of substantial contribution to competition.

(4) *Companies with peculiar talents or facilities*

The possession of special managerial or research talents, or of unique facilities can obviously provide a company with a competitive advantage. Whilst the development of these skills and facilities is therefore to be encouraged, the accumulation by merger of such skills and facilities at the expense of competitors may create or enhance monopoly power. The issue here is whether these talents or facilities are more or less likely to be utilized in the interests of healthy competition if they come under the control of the acquiring company.

In the United States, Professor Bok has argued that the impact on competition of the acquisition of companies possessing peculiar talents or facilities is unpredictable.[61] He concludes that no restrictive standards should be imposed on such mergers at the present time. In

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60 The difficulties of raising new funds for expansion and the effect on merger activity are discussed by BUCHNELL, supra at p. 50 et seq.

61 BOK, supra at pp. 329-332.

Australia, there has been an acute shortage of capable management.[62] However, "mergers have been instrumental in replacing the managements of conservative family enterprises. They have spread the available supply of well-qualified managers over a wider area of industry and at the same time have introduced a higher level of specialist technology and marketing technique in the amalgamated firms".[63] Arguments based upon this type of evidence would carry much weight in the Australian context. Where it can be demonstrated that the utilization of particular talents, facilities or resources is restricted by lack of finance or other necessary resources, there is obvious benefit in their reallocation to another company possessing the resources of capital or materials for their maximum utilization. To substantiate the argument, however, it would be necessary to show that there was no feasible alternative source of these resources, that internal expansion or greater efficiency could not produce the same results and that the benefit flowing from the reallocation was reasonably certain of fruition.

(5) *The Nature of Competition*

American experience has shown that giving evidence as to the nature of competition in a merger case is most often both expensive and inconclusive.[64] In Australia, the time and expense likely to be absorbed in trade practices litigation have been the predominant concerns of both the Government and business leaders. It is pointless to permit both sides to introduce opinion evidence of doubtful value which only reflects their own bias, is largely self-cancelling, and fails to assist the Tribunal towards an accurate assessment of market behaviour. Evidence that competition is already restricted by the concentrated structure of the market, amounting to oligopoly or dominated by price leadership, is really equivocal because the merging companies can argue with equal plausibility that the merger can have no further effect on prices. On the other hand, the existence of effective price competition prior to the merger is also inconclusive. A multiplicity of factors will determine the effects of the merger. These include whether the industry is stable or expanding, its record of innovation and progress, the durability of the product, channels of distribution, price-cost relationships, price discrimination and excess capacity.[65]

62 BUSHNELL, supra at p. 47.

63 THE ECONOMICS OF AUSTRALIAN INDUSTRY, 1962, (ed. A. Hunter), Introduction, by A. Hunter, p. 9.

64 BOK, supra at p. 333.

65 See ADELMAN, *Economic Analysis and Critique of the Factors Considered in Judging the Legality of Mergers* (1954) 21 Current Bus. Studies 21, 26.

All of these factors have received attention in United States merger cases, but no single one of these factors can determine of itself the outcome. In many cases the nature of competition will be reflected in the increase of concentration since the base year. It is submitted that the adoption of a rebuttable benchmark of the kind discussed earlier would tend to minimize the giving of opinion evidence on the nature of competition while leaving the way open for the merging companies to rebut the presumption by any evidence which they thought sufficiently convincing.

(6) *Growth and other dynamic factors*

The argument has been advanced that more generous treatment should be given mergers which take place in an expanding market because the increased market power of the acquiring company may be quickly eroded by new entrants or expansion of rivals.[66] In assessing the importance of this factor in Australia, it should first be noted that Australian markets have expanded almost continuously since World War II. On the other hand, conditions have not always favoured new entrants or expansion of rival companies following a merger.[67] As mentioned earlier in this article it is a relatively simple matter for a conglomerate company to switch part of its production activity to a new field of manufacture if this is offering high profit margins. The position is similar in many service industries. However, in certain major industries such as iron and steel, motor vehicle and heavy industrial manufacture where the equipment is both specific to the industry and long-lived, such changes cannot be made without major capital expenditure. Unless the intending entrant is large enough to achieve fairly quickly the minimum optimum capacity in the field concerned, entry will not be worth-while. Professor Adelman points out that it is "not the abstract ease or difficulty of entry, but the *likelihood* of new entry"[68] which is relevant. Adelman enumerates five sub-factors which should be considered in assessing the likelihood

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66 For a general discussion see BOK at pp. 334-35.

67 See e.g., statement in *Company Takeovers,* 25 Current Affairs Bulletin 179, 191, April 18, 1960 (Published by Dept. of Tutorial Classes, University of Sydney, Australia): "None of [the company acquisitions] would have been the cause for so much concern if there had been a compensating flow of new entrant companies in larger scale production. But such a flow is conspicuous by its absence . . ."

68 ADELMAN, supra at p. 27. Brecher makes the point that "the relevance of entry is [not] confined to obstacles caused directly by the merger: the key issue is whether all entry barriers, taken in the aggregate, are sufficiently high to negate the forces of competition . . ." Brecher, supra at p. 564.

of new entry into a market. Of these,[69] the financial barrier is likely to be of most importance in Australia where the lack of new capital has been a barrier to independent entry into new markets, and a contributing factor in the growing merger movement.[70]

It might be argued that an Australian anti-merger statute would itself reduce the likelihood of existing companies expanding into diverse product markets. Support could be found in the fact that due to the above-mentioned lack of funds, the risks of entering a new field and the advantages of acquiring a going concern instead of building facilities, distribution lines and goodwill, mergers have been the most popular method of entering new industries in Australia.[71] This type of conglomerate merger is likely to play an increasingly important role as companies adopt the now popular policy of diversification. A separate section has been devoted to conglomerate mergers.

The expansion of rival companies to take advantage of expansion in a market which they already supply, or to sell their existing products in new geographic markets is not subject to the same degree of limitation in raising additional capital as a new competitor would be, who was entering this industry or product market for the first time. Where good returns are assured without attendant risks, capital is not difficult to raise. It may therefore be forecast that the ability of rival companies to expand in a growing market and thereby to erode the advantages of a competitor acquired by merger will be one argument used to support Australian mergers in appropriate cases. On the other hand, a showing that it was not economically feasible for outsiders to enter a market would tend to work against approval of horizontal mergers within that market. Thus, while it may be conceded as a generalization that a merger deserves more leniency in an expanding market than in a declining market, difficulty arises in determining what diluting effect, if any, the expanding nature of the market will have on a particular merger. Since power often begets power, there remains the danger that a merger may even give the acquiring company a sufficient headstart over its rivals to enable it to

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69 The other four sub-factors are: the relation of the necessary capital investment to the present and anticipated size of the market; the past history of entry; the presence of patents or other legal barriers to entry; and the need for elaborate and expensive distribution systems or advertising, or specialized know-how.

70 BUSHNELL, supra at pp. 50-57. There was less demand for new capital during the period of restrained prosperity, 1957-59, and this factor was of less importance as a reason for mergers. Id. at pp. 184-86.

71 Id. at pp. 63-72.

capture the bulk of the incremental market and thus obtain a dominant position in a previously competitive market.

Quite distinct from the last issue is the growth factor in the economy as a whole. One of the objectives of the Australian government in introducing the Trade Practices Act was to stimulate the economy by removing practices which would restrict competition. Businessmen and others have criticized the means directed to achieve this objective, claiming that undue restraint of certain business practices would arrest the continued growth of the economy.[72] The same criticism would no doubt be made of any attempt to regulate mergers. However, the objective of national economic growth is quite compatible with that of restricting anti-competitive practices and mergers. It is important to distinguish between (a) provisions directed to removing restraints on competition, which may incidentally restrict the growth of some companies in the effort to expand national growth; and (b) arguments for the right of a particular company to grow, possibly at the expense of others and of national productivity and efficiency.

Where the capital market is liquid, a company desirous of expanding will have the alternative of internal expansion if merger is prohibited. However, due to the difficulty of raising new funds for expansion, mergers have played a major part in Australian post-war expansion. Finding a strong correlation between Australian merger activity and economic growth, Bushnell inquired whether mergers were a prerequisite to exceptional corporate growth. He concluded that, "although mergers are not a prerequisite of especially rapid growth, they are a usual characteristic of exceptional growth".[73] In other words, exceptional growth—and *a fortiori* normal growth—is possible in Australia without mergers, though mergers greatly facilitate expansion.[74] In order to justify an exception to the normal merger rules on the grounds of national growth, it would be necessary to show, for example: that there was a wastage of peculiar facilities or

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72 The same type of arguments have been accepted by the French and German Governments, and the European Economic Community. See France: Price Ordinance No. 45—1483, Article 59 ter (2) (June 30, 1945); Germany: Act against Restraints of Competition, Section 5 (2) (July 27, 1957); Treaty of Rome, Article 85 (3) (March 25, 1957).

73 BUSHNELL, supra at p. 120.

74 As a practical matter, this argument is weakened by the fact that if a large proportion of prospective mergers are foreclosed by statute, the demand for new funds will rise correspondingly. Competition for new capital may be good antitrust policy, but it cannot be carried so far that national growth is frustrated.

talents which could not be rectified by other less restrictive means; or that a desirable trade opportunity would be lost, not only by the merger applicants, but by the nation. It would not be sufficient to show that a particular company was prevented from expanding when the only result would be to increase its market share and power at the expense of domestic competitors.

(7) *Prior Acquisitions by Merging Companies*

This factor has been used in American cases[75] to support the government's argument that although the merger only increases the market share or concentration by a small percentage, it follows in the wake of a series of similar acquisitions, the overall effect of which may be a substantial increase in market power and concentration with consequent reduction in competition. It has been shown earlier in this article that existing size and market power are relevant to the effects of a merger. However the means by which size and power were acquired are generally irrelevant to the question of a merger's effects. Of course, where previous mergers indicate a systematic attempt to restrain competition, an inference will be raised that the purpose of the present merger is also to restrain competition or acquire a monopoly. In that case, the evidence is relevant in the same way as express declarations of purpose. While such evidence would be very damning, it should not of itself make a merger unlawful.

Section 7 of the Clayton Act and the original Australian proposals look to the probable effects of the merger, not its express or implied purpose. Moreover, the formula for measuring concentration increase, specifically proposed to guard against this type of creeping concentration, would make consideration of prior acquisitions redundant in most cases. As previously mentioned, a merger should be judged in the market as it exists and it should make no logical difference whether concentration has been increased by the parties to the present merger or by other companies; nor whether it was brought about by internal expansion, failure of some other companies, or merger.

One objection to taking past acquisitions into account in deciding merger cases in the years immediately following introduction of new legislation, would be that those decisions would be based partly on merger activity which occurred prior to the statute. It could be argued that this amounts to penalizing the merging companies for conduct

[75] E.g. United States v. Bethlehem Steel Corp., (1958) 168 F. Supp. 576 (S.D. N.Y.).

which was neither unlawful nor a preliminary step to unlawful conduct at the time it was performed. On the other hand, it is the present merger which is being challenged, not the prior acquisitions. A formula measuring concentration increase is open to the same objection since it uses as its basing point, concentration data which in the early years of the statute's administration would reach back to periods prior to the statute. However, under this formula, parties to a merger would not be prejudiced by their acquisitions prior to the statute, except insofar as their size was considered dangerous in itself or the percentage increase in concentration of the leading companies approached the benchmark. These factors would apply equally to other companies in the same market which had attained the same size *without* previous mergers and were prevented from merging by the concentration increase of the market as a whole.

The formula would not positively discriminate against mergers between companies with a history of pre-statute acquisitions, while favouring mergers between companies without such a history. On the other hand, equitable considerations require that absence of prior merger activity should be admitted as affirmative evidence in support of a merger. This may be particularly important to the merging companies in a situation where market concentration has increased sharply because companies have rushed to merge before the statute became effective. It is noteworthy that the first qualification[76] upon the formula will specifically cover this situation provided the acquiring company has not increased its own market share since the base year.

(8) *Vertical Mergers*

The above analysis is not directly applicable to vertical mergers or the vertical aspects of horizontal mergers. Within the scope of this inquiry, it is not intended to focus as much attention on vertical mergers as they demand, but only to indicate the relevant issues. The relatively low incidence of vertical mergers in Australia indicates that the need for restrictions on horizontal mergers is more immediate.[77] Nevertheless, vertical mergers have contributed to the market power of leading companies in some Australian industries, notably iron and

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[76] See p. 494 supra.

[77] BUSHNELL, supra at pp. 73, 85. One of the reasons given by Bushnell for the smaller proportion of vertical mergers in Australia compared to the United States is that the Australian economy is not as specialized as the American. "When a firm wishes to manufacture a new product in Australia, most of the components usually must be imported or manufactured by the firm itself." Id. at 83.

steel,[78] timber[79] and textiles.[80] Vertical mergers are potentially more dangerous to competition in Australia than horizontal mergers. There are two reasons.

First, once a substantial percentage of a market for raw materials or distribution outlets is foreclosed by vertical merger, this market is *permanently* precluded from competitors.[81] They cannot regain the lost ground by greater efficiency or innovation as the competitors of two companies who have entered a horizontal merger may do. The competitors of a company which acquires access to a substantial share of available supplies by backward vertical merger can only hope that supplies will increase until they exceed demand; and competitors faced by a forward vertical merger are dependent upon market demand exceeding supply.[82] Although *a priori* there is no reason to suppose that backward vertical mergers will have greater effects than forward ones, the foreclosure of sources of supply seems likely to be the more serious and far-reaching in Australia. Of course, the competitors who have been foreclosed from a source of supply can either produce or extract their own raw materials or buy them in some other market. While this is theoretically correct, there may well be situations where it would not be feasible for the competitors to produce their own raw materials, perhaps because they do not have the capital to meet the initial establishment costs. In the case of extractive industries the new sources of supply will be inferior—if only in terms of

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78 Id. at p. 73.

79 Id. at pp. 129-30.

80 Id. at p. 144.

81 MARKHAM, *Merger Policy Under the New Section 7: A Six-Year Appraisal* (1957) 43 VA. L. REV. 489, 497: "The most persuasive economic argument for imposing legal limitations on vertical mergers is that they considerably reduce the possible number of independently reached prices at which final goods will be offered for sale." Compare less permanent exclusive dealing, requirements and tying contracts for a set period of time. Typical examples include: FTC v. Motion Picture Advertising Service Co. (1952) 344 U.S. 392—exclusive dealing contracts for advertising films restricted to one year under Federal Trade Commission Act s. 5 (a); Tampa Electric Co. v. Nashville Coal Co. (1961) 365 U.S. 323—full requirements contract for supply of coal for twenty years held not to infringe Clayton Act s. 3; International Business Machines Corp. v. United States (1936) 298 U.S. 131—agreement tying tabulating cards to lease of machines infringed Clayton Act s. 3.

82 The trend in the structure of the Australian economy has been from backward vertical mergers in the first decade after World War II when materials and components were scarce to forward mergers during the period of restrained prosperity in 1957-59. During this latter period many manufacturers' supplies exceeded demand and hence the incentive to obtain control of distribution outlets. BUSHNELL, supra at pp. 73, 184-86.

location. Where domestic supplies are foreclosed, Australia's geographical isolation from major world markets coupled with protective import tariffs could result in delay in obtaining and increased cost of, substitute production materials from overseas sources. A manufacturer cut off from essential supply-lines cannot manufacture. The result may be unemployment;[83] it certainly will be a reduction of competition in the primary market. On the other hand, a manufacturer, who finds some or all of his customary distribution outlets closed, can still manufacture and stockpile until he finds alternative outlets or markets, possibly overseas; or, depending on his resources and the nature of the product and market, he may be able to extend his activities to marketing his own product. Nonetheless, closure of distribution outlets is equally damaging to competitors and consumers, though its effects may not be felt so quickly.

Second, "vertical integration is one of the best ways of preventing the entry of competitors into an industry,"[84] and this alone is a very strong reason for prohibiting mergers which are likely to preclude potentionl competition. For both these reasons, it is important that the Australian Government recognize and guard against the effects of undesirable vertical mergers. Such provision should at least refer explicitly to vertical mergers and indicate that they require a different type of analysis from horizontal mergers.[85] One of the most important indicia of the effect of a vertical merger on competition is the extent to which the market, which the acquired company supplies or in which it furnishes an outlet, is foreclosed to competitors.[86] Professors

83 Depending on the nature of the industry and the degree of automation, some of these unemployed may be hired by the acquiring company in the merger, which presumably will increase its capacity to supply its enlarged market.

84 BUSHNELL, *supra* at p. 74. Compare STIGLER, *Mergers and Preventative Antitrust Policy,* 104 U. PA. L. REV. 176, 183 and n. 13, and Hand J. in the famous Alcoa case, United States v. Aluminium Co. of America, 148 F.2d 416, 431 (2d Cir. 1945).

85 The Supreme Court of *United States v. E. I. Du Pont de Nemours & Co.,* (1957) 353 U.S. 586 "overturned forty years of administrative practice and lower court decisions [and professional advice] which had interpreted original section 7 of the Clayton Act as not applicable to vertical acquisitions." BODNER, *Vertical Mergers Under Section Seven,* (1963) 22 A.B.A. Antitrust Section 106, 109.

86 United States v. E. I. Du Pont de Nemours & Co. (1957) 353 U.S. 586 at at p. 595; BODNER, supra at pp. 108-10. See also BOK, supra at pp. 335-36 and n. 322. Compare Brown Shoe Co. v. United States (1962) 370 U.S. 294, 328: "[A]n important consideration . . . is the size of the share of the market foreclosed. However, this factor will seldom be determinative."

Kaysen and Turner have quantified this concept in their benchmark: "An acquisition of a relatively substantial customer or supplier by a firm with 20 per cent of its primary market is *prima facie* illegal."[87] This benchmark recognises the obvious factors of the size and relative standing of the acquiring company in its own market and the degree of foreclosure of the secondary market, both of which will be relevant to any assessment of the effects of a vertical merger on competition. Yet it leaves unanswered the question, "What constitutes 'a relatively substantial' customer or supplier?" Having set up a presumptive benchmark for the market share of the acquiring company, is there any reason why a quantitative benchmark should not be applied to the customer or supplier?

In answering this question, it is immediately obvious that absolute percentages of market shares or concentration increases cannot alone be determinative in every case.[88] They will indicate the market foreclosed by the merger and the trend towards concentration in that market. However, they do not take account of the following factors,[89] all or any one of which may be very relevant in an appropriate case:

(a) the nature and purpose of the merger;
(b) the competitive advantage which the integrated company may obtain over its rivals, enabling it to manipulate prices and otherwise "squeeze" competitors;
(c) the barriers to entry;
(d) the availability of alternative sources of supply or market outlets;
(e) the general condition of the industry.

The relevance of these factors need not necessarily forbid the adoption of a quantitative test but indicates that the percentages in a quantitative test should be set reasonably high and that the test should be presumptive only. In order to test this proposition, the following test is suggested as a working model:

Where the acquiring company has, say, 20 per cent or more of its primary market, and, as the result of a proposed acquisiion by it of a customer or supplier, the aggregate share of the secondary market controlled by the acquiring company and other companies in the

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[87] KAYSEN & TURNER, ANTITRUST POLICY, 1959, p. 133.

[88] BODNER, supra at p. 116: "By themselves, absolute dollar or percentage figures are of little significance except as they tend to get very small or very large."

[89] Id. at pp. 108, 116.

primary market would be increased by more than say 10 per cent[90] in the last five years, the acquisition shall be presumed to substantially restrain competition or tend towards a monopoly unless the merging companies prove that the merger would not have this effect.[91] One qualification, corresponding to that suggested for the horizontal merger formula,[92] would be that where the share of the secondary market controlled by the acquiring company after the merger did not exceed its share in the base year, the presumption should not apply because the acquiring company had not really contributed to the foreclosure of that market. Likewise, where the acquiring company is the leader in the primary market, there are grounds for either prohibiting a vertical merger absolutely or confining the company to control of a limited percentage of the secondary market.

It is conceded that this working model disguises the complexity of the problem. It is the restraint on competition in the primary market which is the chief concern in vertical mergers. Yet it is by foreclosure of the secondary market that this is achieved. It may be argued that the market share of the acquiring company in its primary market should be reduced or deleted from the formula since it is the percentage of the secondary market foreclosed by any one or more suppliers or customers which is paramount. This argument recognizes the interest of any other single competitor or potential competitor in the primary market since a series of vertical acquisitions by companies with less than twenty per cent of the primary market could foreclose the secondary market entirely. On the other hand, this would prevent desirable mergers by small companies in the primary market which have no anti-competitive effects.

Of factors (a) to (e) above which are not reflected in this formula, it is very unlikely that evidence under factors (a) to (c) would support a merger which was prescribed under the presumption. It is also unlikely that any evidence under factors (d) or (e) would outweigh

90 The suggested percentages are purely hypothetical figures. It is conceded that a quantitative test which is too lenient may be worthless, and that the task of setting the appropriate percentage may be very difficult. On the other hand, the hope of avoiding the otherwise inevitably complex balancing of conflicting considerations in every case makes the attempt worthwhile.

91 Compare the rule proposed by STIGLER: "Where a firm has a fifth or more of an industry's output, its acquisition of more than five to ten per cent of the output capacity of industries to which it sells or from which it buys in appreciable quantities shall be presumed to violate the statute." STIGLER, supra at p. 183.

92 See p. 494 supra.

the factors which the quantitative formula reflects, even absent any burden of proof which the presumption casts on the merging companies. Within its obvious limits, the formula would work fairly and achieve the objectives of more efficient administration and certainty of the law. Where the presumption did not apply, all the above factors would be weighed in even scales.

(9) *Conglomerate Mergers*

In recent years the so-called "conglomerate" merger has presented economists and lawyers with a new field for analysis and enquiry.[93] A conglomerate merger is most easily defined in a negative way as any merger other than (a) one between companies producing or selling the same product or a close substitute for it in the same geographic market—i.e. a horizontal merger; or (b) one between companies one of which supplies a product which is bought by the other—i.e. a vertical merger; or (c) one which involves features of both (a) and (b). Conglomerate mergers can be subdivided into *pure* and *mixed* conglomerates. In a pure conglomerate there is no discernible economic relationship between the manufacturing or selling activities of the merging companies, other than the purely financial one. In a mixed conglomerate, there is a relationship between the products of the two companies, but it is not such that the merger qualifies as a simple horizontal or vertical merger. For example, the two companies may manufacture or sell the identical or substitutable products, but in distinct geographic markets; or they may deal in products which are distinct but are related to each other because they "can be produced with much the same facilities, sold through the same distribution channels, or made a part of the same research and development efforts".[94] The latter are termed "product extension mergers" and are illustrated by the acquisition of a manufacturer of household steel wool pads by General Foods Corporation, one of the largest U.S. producers and distributors of packaged food. The Court of Appeals agreed with the characterization of the merger as one "that may enable significant integration in the production, distribution or marketing activities of the merging firms".[95]

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93 See Harlan J. in F.T.C. v. Proctor & Gamble Co. (1967, U.S. Supreme Court) 1967 Trade Cases, para. 72, 061, at p. 83, 804; BLAIR, *The Conglomerate Merger in Economics and Law,* (1958) 46 Geo L.J. 672; and TURNER, *Conglomerate Mergers and Section 7 of the Clayton Act,* (1965) 78 HARV. L.R. 1313.

94 TURNER, op. cit. supra at p. 1315.

95 General Foods Corp. v. F.T.C. (1967 3rd Cir.) 1967 Trade Cases, para. 72, 268 at p. 84, 636.

The motive and purpose of a pure conglomerate merger would normally be (a) financial—for example, where a company with liquid assets discerns an opportunity to acquire a profitable investment, even though the acquired company operates in a market unrelated to that of the acquiring company; or (b) to diversify its operations, as a hedge against fluctuations in the economy. Pure conglomerate mergers for these commendable purposes are unlikely to have any adverse effects on competition.

Mixed conglomerate mergers present an opportunity to rationalize the operations of the merging companies, and as such they bear a closer resemblance to horizontal and vertical mergers.[96] Attention will therefore be concentrated upon this type of conglomerate merger. Professor Turner, former head of the U.S. Anti-Trust Division, has suggested the following possible consequences of conglomerate mergers.

(1) Economies of scale may be achieved.[97] If this is so, it should be regarded as a reason for approving the merger. While the conglomerate may have acquired the power to drive smaller competitors out of business, it is hardly a justification for attacking the merger as such. Predatory practices following a merger should be restrained by other provisions, such as those directed to monopolization. The merger itself will not have increased the market share of the conglomerate nor the degree of concentration in the industry.

(2) The conglomerate will be able to adopt predatory pricing techniques because it can subsidize temporary losses in one line by profits from another, with a view to eventually extracting monopoly profits when other competitors have been excluded from the market. However, the anti-monopolization provisions are again available to deal with this situation. In addition, provided the product is one in

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96 A survey and analysis of the types of, and motives for, conglomerate mergers in the 1960's is a fruitful field for economic research.

97 Economies may also result from a pure conglomerate merger, for example in the raising of capital, in management services such as accounting and legal advice, and in advertising, provided similar media are appropriate, or a trade mark is readily transferable to the other products. Professor Turner draws the distinction between true distribution economies and promotional economies. Whilst the former represent a saving in actual resources the latter are of a private nature. "Economies in promotional expenditures . . . may not lower average costs at all, since total promotional efforts may increase; and if promotional efforts are intensified, they will raise the barriers to entry. Promotional economies, generally speaking, are not as procompetitive as other kinds of economies." Op. cit. supra at p. 1361. See also In re Proctor & Gamble Co., C.C.H., Trade Reg. Rep., (1963 F.T.C. Cases) para 16, 673 at p. 21585 aff'd, on appeal to Supreme Court, 1967 Trade Cases, para. 72, 061.

which continuity of production and research is not essential, the conglomerate is unlikely to be able to exclude competitors permanently. Former large competitors, and smaller ones also provided the capital barrier to entry is not too high, will re-enter the market as soon as the conglomerate commences to charge monopolistic prices.

(3) Other competitors may compete less vigorously through fear of the power of the conglomerate. This is only likely to be important where the pre-merger nature of the market was highly competitive, and entry comparatively difficult.

(4) A decrease in the entry of new small companies is the most likely and important consequence of a conglomerate merger. Whereas existing competitors are already committed to the industry, would-be competitors are likely to be deterred from entering a particular market because of the existence of a giant.[98] Larger companies may also be deterred, but equally, they are just as likely to be provoked into seizing the same opportunity to diversify.[99]

(5) Where the market is oligopolistic, the threat of the possible entry of the outsider by means of internal expansion may have exercised a competitive influence on prices which would otherwise have been above the competitive level.[100] Once the outsider has entered by means of the conglomerate merger, the external pressure is removed, yet the number of actual competitors remains unchanged. Where the acquired company already held one of the largest shares of the market the merger would be unlikely to stimulate competition. If, however, it was a smaller company, the merger could well assist it to compete more vigorously with the market leaders, especially if its previous failure to improve its market position was due to a lack of capital

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98 It is not possible to prove the reaction upon other possible entrants, but the Reynolds Metals case is a good example of a situation where potential entry of small competitors into the florist foil market was probably discouraged. Reynolds Metals Co. (1960) 56 F.T.C. 743, aff'd (1962, D.C., Cir.) 309 F. 2d 223.

99 Kaiser Aluminium entered the florist foil industry following the Reynolds Metals acquisition. On the Australian scene, the acquisition by William Arnotts of Swallows (contested by the U.S. National Biscuit Co.) has not prevented the latter entering the Australian biscuit industry by internal expansion of its subsidiary Nabisco Pty. Ltd.

100 It is anticipated that the difficulties of establishing whether the acquiring company would have been likely to enter the market, except by means of the instant conglomerate merger, or whether there are other potential entrants waiting on the sidelines, will be considerable. See, e.g. U.S. v. Penn-Olin Chem. Co., (1963 D. Del) 217 F. Supp. 110; rev'd and remanded on this point, 378 U.S. 158 at pp. 175-76. See discussion by TURNER, op. cit. supra at pp. 1372-9.

rather than lack of efficiency. If the outsider had in fact entered the market by means of internal expansion, rather than conglomerate merger, there would have been an additional competitor, and therefore the possibility of increased competition. However, it may be argued that there are conceptual difficulties in basing an alleged reduction of competition upon what might have been the case if the outsider had chosen to enter the market, and furthermore, had chosen to do so by internal expansion.

(6) A conglomerate merger may enable the conglomerate substantially to increase the market share of the acquired company by means of reciprocal selling and buying arrangements if the acquiring company already uses products sold by producers who purchase from the industry into which it has merged. This type of situation could lead to requirements contracts and tying agreements with resulting foreclosure of markets. Again this factor should not be accorded too great a weight in assessing the effects of a merger, since, if and when such requirements contracts eventuate, they should be dealt with as examinable agreements or monopolization. However, the anti-competitive effects of reciprocity can materialize without express agreement or pressure merely because present or potential suppliers will purchase from a large conglomerate in order to curry favour and win reciprocal contracts to supply it. A recent example was the acquisition of Gentry Inc., a producer of dehydrated onion and garlic by the U.S. giant food wholesaler, Consolidated Foods Corporation. The merger was held to be unlawful under Clayton Act, s. 7, by the U.S. Supreme Court,[101] primarily on the grounds that it conferred upon Consolidated Foods reciprocal power to require food processors, who supplied Consolidated Foods, to purchase their onion and garlic needs from Gentry.

This brief discussion illustrates that it is not easy to assess the exact implications of conglomerate mergers upon competition, and that their effect will vary according to a multiplicity of factors. Even American economists and courts, faced with the specific problem of applying the Clayton Act to these mergers, admit they can only reach tentative conclusions at this point of time.[102] Further information as to the percentage of conglomerate mergers which fall within the situations outlined above, together with analysis of the economic effects of each type of merger are necessary before any conclusions can be

101 F.T.C. v. Consolidated Corp. (1965) 380 U.S. 592; 1965 Trade Cases, para. 71, 432; and U.S. v. General Dynamics Corp. (1966, D.C. S.D.N.Y.), 1966 Trade Cases, para. 71, 870.

102 TURNER, op. cit. supra at p. 1394.

reached. The only general suggestions which the writer can make are that, since bigness as such is not viewed with the same concern in Australia as in the United States, it appears unlikely that conglomerate mergers will be restricted in this country, especially since they probably afford the best opportunity to obtain economies of scale without entailing the likely anti-competitive effects of horizontal and vertical mergers. The only clear case for restriction upon conglomerate mergers is where there is a manifest intention to monopolize a particular market or markets.

DEFENCES AND EXCEPTIONS

From the above it is obvious that whether a specific formula is adopted or not, provision must be made for certain specific exceptions or defences. Under the Trade Practices Act 1965, the grounds upon which a restriction or practice, other than monopolization, may be justified are contained in section 50. The structure of this section is designed to assist the tribunal in determining whether a restriction or practice is in the public interest. The section is not directly appropriate to the criteria by which a merger should be judged and it is unlikely that many mergers would be treated as examinable agreements or practices under the existing Act. If the Government decides to regulate mergers, a completely new enactment would be requisite rather than engrafting merger provisions on to the existing statute. Despite the last statement it would be beneficial to analyse mergers in the context of section 50 for the following reasons:

(i) Section 50 requires the effect of a restriction or practice upon a number of matters to be taken into account in assessing whether it is in the public interest. Whatever test is adopted for mergers, presumably a merger will be permitted where its likely effect is to enhance the public interest.

(ii) Such an examination should assist in determining which (if any) of the matters requiring consideration under section 50 is likely to prove an important justification for mergers.

(iii) Conversely such an examination may also shed light upon the correct method of applying section 50 in its present role as the yardstick for judging examinable restrictions and practices under the Act.

Section 50 requires the Tribunal to take "the principle that the preservation and encouragement of competition are desirable in the public interest" as the basis of its consideration of such practices. However, the Tribunal is required to weigh against the detriment constituted by the practice any beneficial effect of the practice on the matters listed in section 50(2) and to strike a balance between the anti-competitive practice and these other matters. Unlike the *per se* prohibitions upon price-fixing and division of markets under the U.S. Sherman Act,[103] there is no *per se* condemnation of restraints upon competition in the Australian legislation.

The structure of section 50(2) makes it clear that its purpose is only to indicate the type of matters to which the Tribunal should direct itself without stipulating that priority is to be accorded to any particular factor. There may be a considerable overlapping in the scope of the various matters listed.[104] Thus facts relevant under paragraph (d) may also be relevant under (e). Again a consideration of these facts may indicate that a practice will fulfil the needs of achieving "a full and efficient use and distribution of labour, capital, materials, industrial capacity, industrial know-how and other resources" [para. (d)] and of achieving "the production, provision, treatment and distribution, by efficient and economical means, of goods and services of such quality, quantity and price as will best meet the requirements of domestic and overseas markets" [para. (e)]. Yet consideration of the same facts may indicate that the practice will be contrary to "the needs and interests of small businesses" [para. (b)], and would stultify "the promotion of new enterprises" [para. (c)].

Section 50(2)(a) contains within itself the seeds of a further conflict which requires a balance to be struck before the conclusion is weighed in the balance with the matters listed in the other sub-paragraphs, and with the general principle of preservation and encouragement of competition. Thus section 50(2)(a) requires "the needs and interests of consumers, employees, producers, distributors, importers, exporters, proprietors and investors" to be taken into account. It is tautologous to state that the interests of consumers, employees and producers are constantly in potential conflict, and yet the Act suggests no guide to the manner in which such conflicting interests are to be reconciled. The same comment may be made in relation to sub-paragraphs (d) and (e), although in these instances the conflict is likely to be less pronounced. The general effect of section 50 may be summarized thus: it requires the Tribunal to conduct a balancing operation at three levels: first, between conflicting interests grouped

103 The Sherman Act, 1890, s. 1. The case for *per se* rules in the Australian legislation is argued by DR. WALKER in AUSTRALIAN MONOPOLY LAW, 1967 (Cheshire) p. 289 et seq.

104 For a general discussion of s. 50, see MASTERMAN & SOLOMON, AUSTRALIAN TRADE PRACTICES LAW, 1967 (Butterworths) Chapter 6.

together within each sub-paragraph taken separately; second, between the matters listed in section 50(2) as a whole;[105] third, between the matters listed in section 50(2) and the detriments constituted by any proved restriction of, or tendency to restrict, competition.

Application of Public Interest Criteria to Mergers

It may be assumed that a merger which contravenes any statutory test or formula should still be permitted if its likely effect is to be on balance "in the public interest". On the basis of this assumption, one may ask to what extent the above-mentioned discussion of "the public interest" under section 50 would be relevant to mergers. At the same time a further question should be considered, namely: assuming that proof of particular facts is considered material to the effects of a merger on competition, should those facts be taken as conclusive, or merely treated as one factor to be weighed in the balance? Each of the sub-paragraphs of section 50(2) will be dealt with in turn.

(a) *The needs and interests of consumers*[106] are obviously benefited by any merger which helps to achieve lasting reductions in prices or improvements in quality or choice. It is unlikely that the merging companies would be able to demonstrate conclusively that the merger would definitely lead to price reductions, although they may be able to show that production costs would be reduced, which is a question involving an overlap with sub-paragraph (e). A merger will usually result in a reduction of the number of choices open to the consumer. Even if the amalgamated companies continue to market the same range of products as before the merger, the choice of sources of supply is still reduced. It has been pointed out that since the interests of

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105 MASTERMAN & SOLOMON suggest that the Tribunal is only required to consider the effects of a practice upon the particular interests referred to in s. 50 (2) (a) if the Commissioner or defendants adduce appropriate evidence. *Id.* at p. 223, n. 39.

106 In other contexts the phrases "detriment to the 'public'" and "detrimental to the 'public'" have been construed as referring not only to the "consuming" public but as "contemplating the interests of any person engaged in the production or distribution of articles of consumption" and as bearing the ordinary meaning of the phrase—i.e. "the community as an aggregate". See A.-G. of the Commonwealth of Australia v. Adelaide Steamship Co. Ltd. (Coal Vend Case), 1913 A.C. 781 at p. 801 per Lord Parker, Interpreting Australian Industries Preservation Act, 1906, ss. 4 and 7, and criticism by D. J. STALLEY, *"Federal Control of Monopoly in Australia"* in University of Queensland Law Journal, Vol. 3, No. 3, December 1958, p. 271 et seq. See also the report of Cook J. under the Monopolies Act 1923 (N.S.W.) s. 8 (2) on the woolbuyers' ban on Goulburn trading. Wool Trade Report (1959) N.S.W. Government Printer, No. 41/1959.

consumers have not been given any special emphasis in section 50, English decisions upon section 21(1) of the Restrictive Trade Practices Act 1956 which have tended to be concerned primarily with the protection of consumers under gateways (a) and (b) of section 21(1) may be of less importance in Australia.[107] The dislocation of employees is a likely result of a merger, but this matter may receive less attention from the Australian Tribunal because of the labour shortage in many Australian industries. On the other hand the removal of one individual employer reduces to some degree the employee's freedom of choice of available positions.

The interests of *producers, distributors and importers* will usually be considered in the context of the general state of product competition in the market. Under this heading, for example, two small companies desirous of merging would argue that they as producers and/or distributors would be more capable of competing with the existing market leaders. Another example is that of a giant overseas competitor entering the Australian market, and acquiring a large segment of the market. This will often be achieved by virtue of lower costs resulting from economies of scale, and improved patented techniques. Although the Australian consumer would be benefited initially by the greater efficiency of the foreign company, there will be those who will still maintain, on political and sociological grounds, that it is not in the public interest for smaller domestic companies to be forced out of business, even if they are less efficient. This question is discussed under sub-paragraph (b), but it should be pointed out here that protagonists of this view must recognize that the needs and interests of small businesses must be considered in relation to the other interests referred to in section 50(2), and in particular that the interests of small businesses and consumers will often conflict. Possible solutions to the problem include:

(i) permitting defensive mergers amongst smaller Australian companies to enable them to compete more effectively, on the theory that the resulting oligopoly of two or three large Australian companies and the foreign company is preferable to the foreign company acquiring a complete monopoly;

(ii) encouraging other overseas companies to enter the Australian market either in their own right, or by promoting the expansion of an existing Australian company in a joint venture. A

107 See paper delivered by C. C. Trumble to the Australian Law Convention, 1967 in 41 A.L.J. 310 at pp. 324-5.

recent illustration was the unsuccessful attempt by the U.S. National Biscuit Co. to enter the biscuit market by acquiring Swallow's Biscuits. When that attempt failed, Nabisco Pty. Ltd., the Australian subsidiary of the National Biscuit Co. built its own biscuit plant and has recently entered the market;

(iii) the Government entering the private sector of the economy in an attempt to stimulate competition and efficiency. This might be achieved by creating a statutory corporation to actively compete in the industry;

(iv) introducing a system of government subsidies to smaller Australian companies where they were able to demonstrate that they were operating efficiently.

Of course the problem with this alternative is devising a satisfactory means of proving or testing efficiency. Up to the present time the purpose of government subsidies, whether in the form of cash grants or achieved by means of a regulated price scheme, has not been to reward small producers for their efficiency. On the contrary, such subsidies have tended to assist struggling and less efficient industries. In the dairy industry, for example, those farmers whose production is channelled into butter and cheese receive a government cash subsidy, whether they are efficient or not. The arrangement is supported by an embargo on imports, and State statutory limitations on the local production of table margarine. The result is higher prices to Australian consumers. Those farmers within a Milk Zone receive government protection from external price competition because dairymen outside the zone are prohibited from selling milk for consumption within the zone. The result of course is higher consumer prices than in a free market.[108]

The interests of *exporters and producers who produce for export* would presumably be subsumed in sub-paragraph (f) and will be dealt with under that heading.

The interests of *proprietors and investors* are entitled to consideration provided they do not conflict with competition. These interests have already received recognition in the suggestion that proprietors of small proprietary companies must be enabled to dispose of their businesses for legitimate purposes, such as retirement, and to provide against death duties.[109] Similarly the right of a company in financial diffi-

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108 See generally, THE AUSTRALIAN DAIRY INDUSTRY, 1960 (ed. by DRANE AND EDWARDS) Ch. 7 and 8.

109 See p. 487 supra.

culties to seek a take-over offer or merger is recognized in the failing company defence.[110] Companies should also be permitted to acquire shares in other companies solely for investment provided their shareholdings are not used for the purpose of reducing competition. The prohibition of anti-competitive mergers under section 7 of the Clayton Act, hinges upon whether the effect of the merger will be to substantially lessen competition or tend to create a monopoly. The terms of the section do not refer to the intention of the merging companies, although if their intention is to reduce competition or create a monopoly this will be strong evidence of the likely effect of the merger. On the other hand, the Clayton Act does not apply to acquisitions of share capital, or assets[111] purely for investment, nor to the creation of subsidiaries for legitimate purposes.

There would appear to be an administrative problem for the Commissioner in determining when a *de facto* merger has taken place. Obviously he cannot investigate every share acquisition to determine whether the shareholder-company has acquired sufficient shares to exercise control over its competitor. There is no specific minimum percentage of the issued share capital of a company which carries control. Twenty per cent or even ten per cent may suffice if the remainder of the shares is widely dispersed. Thus a company which gradually accumulates a competitor's shares may be able to achieve a merger in all but name, even though its holding is substantially less than fifty per cent of the issued capital. It was for the purpose of combatting this very kind of secret control, which is an effective substitute for a restrictive agreement, that section 7 of the Clayton Act was originally enacted.[112]

The proposal for final advance clearances suggested earlier in this article would only apply where due notice of the merger had been given to the Commissioner. It should therefore remain open to the Commissioner to challenge at any time[113] the exercise of actual con-

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110 See pp. 528-532 infra.

111 The Celler-Kefauver Act, 1950 closed the loophole previously available of achieving a merger by acquistion of assets rather than of shares.

112 NEALE, THE ANTITRUST LAWS OF THE U.S.A. 208 (1960). See e.g. American Crystal Sugar Co. v. Cuban-American Sugar Co. 152 F. Supp. 387, 393-94 D.C. N.Y. 1957) aff'd 259 F.2d 524 (2d Cir. 1958).

113 Clayton Act, s. 7 does not prevent an acquisition being challenged even years after it is made. The more important issue in the United States is whether the probable effects of the acquisition are to be tested as of the date of the acquisition or as of the date of the suit. The majority of the Supreme Court held in the Du Pont-General Motors case that the acquisition should be tested as of the time of the suit and that s. 7 applies to

trol by a company over a competitor, customer or supplier, unless the parties had fully disclosed that a *de facto* merger had been achieved and a formal clearance had been obtained.

Brief mention should also be made of the related problem of interlocking directorates. An anti-merger law will be frustrated if competing companies can achieve the same anti-competitive results by electing common or interlocking directorates as they might otherwise have achieved by merger. The difficulties[114] encountered by the United States government in enforcing section 8 of the Clayton Act[115] should act as a warning for the Australian authorities. An equivalent provision should be inserted in the Australian law to close an obvious opportunity for abuse. To be really effective, power must be given to grant injunctive relief against the continuation of an offence, even where there is no showing of danger of recurrent violations. This kind of broad injunctive power would avoid the defence[116] that once a director resigns from the board of one of the competing companies, the charge is moot, irrespective of whether the director may be re-elected to both boards in the future. Neale points out[117] a further deficiency in section 8 in that it permits an attorney, secretary or other executive of one company to be a director of a competing company. This loophole should be closed in the Australian legislation.

(b) The *needs and interests of small businesses* would be furthered by a merger of two or more small companies which enabled the combined company to compete more effectively with the market leaders. However, it would not necessarily follow that the result would be improved competition and efficiency. Where the advantage of the large companies has been achieved or maintained by anti-competitive

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the holding and subsequent use of stock as well as its acquisition. United States v. E. I. Du Pont de Nemours & Co. (1957) 353 U.S. 586, 589. The Court later stated: "Even when the purchase is solely for investment, the plain language of s. 7 contemplates an action at any time the stock is used to bring about or in attempting to bring about, the substantial lessening of competition." Id. at 597-98. Note the strong dissent of Mr Justice Burton who argued that as a matter of statutory construction s. 7 applies only to acquisitions. Any subsequent violations arising from the use of the stock should be attacked under the Sherman Act. *Id.* at 619-26. See generally BARNES, *Competitive Mores and Legal Tests in Merger Cases: The Du Pont-General Motors Decision* (1958) 46 Geo L.J. 564 at 575-79.

114 See summary statement in NEALE, supra at p. 215.

115 38 Stat. 732 (as amended) 15 U.S.C. s. 19. Cf. U.K. Monopolies and Mergers Act, 1965, ss. 7 and 9.

116 This defence was raised in United States v. W. T. Grant & Co. (1953) 345 U.S. 629.

117 NEALE, supra at p. 215.

means and is being used to restrict competition, it is the province of the Commissioner to prevent or curtail this activity. It follows that it would be a misapplication of basic principles to sanction a merger of smaller companies for the single or major reason that their larger competitors were engaging in anti-competitive practices. Adoption of such a policy would ultimately lead to a plethora of oligopolistic industries.[118] On the other hand mergers between small companies can be justified where it can be demonstrated that the reason for the previous inability of the small companies to compete effectively was neither their own poor management or inefficiency nor predatory conduct on the part of competitors, but the fact that they were considerably below the minimum optimum size necessary to achieve economies of scale.

There are certainly other political and sociological grounds for preserving small businesses,[119] although they may involve a conflict with the interests of consumers. The Government may find it expedient to evolve other methods of protecting small businesses. Dr Walker has suggested that "the best kind of public support is direct help in raising capital, in making available the results of government technological research".[120] The advantage of this type of assistance is that it benefits the small business directly. Such assistance is preferable to cash subsidies which sometimes lead to inefficiency. As a general policy it does not seem necessary or wise to encourage small businesses to seek protection from competition itself by merging, especially where the foreseeable result is increased market concentration and oligopoly.

(c) The *promotion of new enterprises*[121] is a matter closely related to the needs and interests of small businesses, since most new enterprises will start in a small way. Dr Walker has also pointed to the problem of determining when a business is small or an enterprise

118 While the writer recognizes that an oligopolistic industry may be as competitive or more competitive than a fragmented one, there seems to be no reason why the Tribunal should itself encourage oligopoly by sanctioning mergers which will clearly create this type of market structure.

119 See Report of the White House Committee on Small Business (June 1962) and MASTERMAN & SOLOMON, AUSTRALIAN TRADE PRACTICES LAW, 1967, pp. 226-7.

120 WALKER, AUSTRALIAN MONOPOLY LAW, 1967, p. 169. Small businesses should obtain some indirect protection from the implementation of 36 (1) of the Trade Practices Act against discriminatory practices of their larger competitors.

121 Cf. Gateway (9) in Sir Garfield Barwick's 1962 proposals, 37 PARL. DEB. 3107 (6th December 1962).

new.[122] Obviously these terms involve questions of degree requiring for their solution an exercise of a value-judgment based upon the underlying principle that "the preservation and encouragement of competition are desirable in the public interest".[123] Paragraph (c) of section 50(2) demonstrates a legislative intention to promote new enterprises, which are of particular importance in a young industrial country such as Australia, where the difficulties of raising capital and matching overseas technology are acute. In many instances paragraphs (b) and (c) will be argued together. However, it would appear that it will be an advantage to companies wishing to merge to demonstrate that they are not only small but also new. Paragraph (c) is not primarily directed to protecting new enterprises already in existence. It calls for consideration of the welfare of the as yet unborn enterprise and requires the Tribunal to try to preserve a climate within the industry which can accommodate new entrants. The only situation where it could be argued that a merger would promote new enterprises in the industry is where that merger resulted in a reduction of competition in the industry and increased profits.[124] It is therefore hard to see how this paragraph can be of assistance to merging companies. Where one of the merging companies was new to the industry it might be argued that the merger was justified by assisting this company and also by encouraging others to promote new enterprises with a view to negotiating a favourable merger[125] at an early date. Such an argument is self-defeating because it assumes that the end-result will involve approximately the same market structure as originally existed.

(d) Paragraph (d) requires account to be taken of "the need to achieve the full and efficient use and distribution of labour, capital, materials, industrial capacity, industrial knowhow and other resources". It is inspired by a similar gateway in the Barwick proposals of 1962.[126] The desirability of including laymen with business experience on the

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122 Id. at pp. 177-8. Relevant factors are the size of the company in relation to its competitors in the industry, rather than in absolute terms; lack of monopoly power, and the security of its competitors in the market.

123 Trade Practices Act, 1965, s. 50(1).

124 The power to extract increased profits would indicate that competition had been substantially reduced.

125 Any person entering an industry with a view to obtaining a favourable offer to merge will generally be looking for a take-over offer from one of the larger well-established competitors.

126 Gateway (10) 37 PARL. DEB. 3107.

Tribunal[127] is obvious when it is noted that they will be required to assess the effect of a business practice upon such needs as those included in this and the succeeding paragraph (e). An interesting question arises as to whether all of the interests which require consideration under paragraphs (d) and (e) will be allowed full representation before the Tribunal. For example, employees may often claim to have an interest in the outcome of such proceedings, especially where unemployment is likely to be caused by re-allocation of plants and factories as the result of a merger. The Tribunal is empowered by the Trade Practices Act to permit a person to intervene in proceedings,[128] and any party or intervener is entitled to legal or other representation.[129]

The economic justification for the application of paragraph (d) in a merger situation is that "mergers which change the use of fixed assets or labour are almost always beneficial to the economy as a whole. They represent a re-allocation of resources to production on which the community places a higher value".[130] It is also necessary to distinguish between: (i) the acquisition of a failing company, or one which had completely closed down while the acquiring company had built additional capacity to take up this slack; and (ii) the merger of two or more competing firms.[131] In the first case, the assets of the acquired company are justifiably restored to profitable use, and the economy avoids a loss of real resources. In the second, the gain through re-allocation of resources must be balanced against the possible harm caused by increased concentration and reduced competition. Since World War II, the second situation has been more common in Australia than the first.[132] However, it is clear that the failing company defence must be recognized as a powerful justification for a merger, whether under this paragraph, or by separate statutory provision.

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127 The first lay members include three retired businessmen and a grazier with executive experience on the Australian Wool Industry Conference.

128 s. 77 (3). In any event the interests of employees are specifically referred to in sec. 50 (2) (a).

129 s. 76.

130 BUSHNELL, supra at pp. 76-77.

131 Ibid.

132 "[B]ecause of the almost continually prosperous business conditions, few firms have been threatened with the possibility of liquidation in postwar Australia." Id. at p. 77. Since Bushnell wrote in 1960, there was a general economic decline in 1960-61 which contributed to the failure of a number of firms.

(e) Paragraph (e),[133] which is also based upon a gateway in the Barwick proposals,[134] appears to cover two distinct arguments based upon efficiency of operation and economies of scale respectively. There are four main arguments[135] against allowing a merger to be justified on the grounds that it will increase efficiency of operations:

(i) There is no proof that greater cost reductions could *not* be achieved by internal expansion. In Australia however, this argument may receive a less sympathetic hearing than in the United States, especially since the Australian Tribunal is partly composed of laymen. The reason is that funds for internal expansion as an alternative to merger have been relatively scarce in the post-war period.[136]

(ii) The second argument is that companies can frequently acquire stocks of second-hand assets more cheaply than they can reproduce them. To the extent that the lower price of the second-hand assets reflects the monopoly power of the buyer, or lack of bargaining ability on the part of the seller, its result is merely a transfer between private parties and not a social economy attributable to the acquisition. This argument can be partially countered by showing that under Australian conditions the merger achieves a different social benefit since it is often the only way rapid expansion can be achieved, for example in an industry providing opportunities for export trade, but requiring increased capital investment.

(iii) The third argument is that by acquiring existing assets, a company will grow without making a net addition to an industry's capacity which would intensify competition for existing demand. This argument is particularly applicable to Australian conditions since the Government's objectives are a rapid increase in production while maintaining competition. The only counter-argument is that although Australia needs competition it should be open to the Tribunal to conclude that in all the circumstances the degree of competition in a particular industry will still be adequate after the merger which will bring other advantages including increased efficiency which outweigh the failure to increase the intensity of competition.

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133 s. 50 (2) (1) reads: "the need to achieve the production, provision, treatment and distribution, by efficient and economical means, of goods and services of such quality, quantity and price as will best meet the requirements of domestic and overseas markets."

134 Gateway (8). 37 Parl. Deb. 3107.

135 The first three are discussed in MARKHAM, *Merger Policy Under the New Section 7: A Six-year Appraisal* (1957) 43 Va. L. Rev. 489 at 494.

136 BUSHNELL, supra at pp. 50-57.

Such a conclusion may be indicated where a company shows that it must integrate vertically to keep up with its competitors. Whether such vertical integration should be permitted to take place by merger rather than by internal expansion will depend on the relationship of capacity to demand. Where vertical integration is essential to survival but internal expansion would only create such a degree of excess capacity in the industry that other firms would be forced out of business, a vertical merger seems justifiable. This argument is really only an extension of the failing company defence to cover the situation of a company whose survival is threatened though it is not yet in failing condition.

In relation to the defence of economies of scale, Bushnell has concluded that

> from the buyer's [acquiring company] point of view a merger is not a good way to achieve economies of scale in production processes. . . . The main importance of mergers in lowering production costs per unit of output is in fields where a technical breakthrough suddenly makes the minimum scale of production with new machines considerably greater than the size of most firms operating in the industry. These technical breakthroughs are rare; in postwar Australia the only clear example involving numerous mergers was in the Melbourne milk distribution industry.[137]

However, two situations in particular would appear to present opportunities for lowering production costs. First, where plant obsolescence is pronounced, it will be advantageous to ensure that each item of plant receives maximum use before it is superseded. Second, where the merging companies produce joint products, each plant can specialize in products. The resulting longer production runs would yield significant cost economies. Examples can be found in the textile and motor vehicle industries.

In the fields of management, overhead, research and selling costs, large savings can be achieved as a result of a merger,[138] but they will not automatically follow. Hence the burden of proving the reality of the economies expected from the merger should be upon the companies. American experience suggests that this will be a difficult burden to discharge.

(iv) The fourth argument against the efficiency defence is that there are alternative less restrictive methods of obtaining the benefits

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137 Id. at p. 60.
138 Id. at pp. 61-62.

expected to flow from the merger. An argument often advanced in support of restrictive agreements or mergers is that competition and low profit margins preclude research and innovation. Dr Walker has demonstrated that "there is no basis for an inference that a restriction on price or other terms promotes industrial efficiency when the only evidence is that it promotes collaboration".[139] It is submitted that a merger of itself will not promote increased efficiency, research or innovation. Even where a clear case for sharing of technical information, research or other overhead costs can be established, it does not follow that a merger is the only or even the best means of sharing these benefits. In some cases a merger may be the means of achieving what could not be achieved by agreement. For example, the merger of cast-iron pipe producers in the United States, following the previous condemnation of a cartel agreement,[140] enabled excess capacity to be reduced in the industry. This was not possible under the pre-merger conditions. The problem will remain of ensuring that the merger is in fact used to achieve the desired result rather than to reduce competition or acquire monopoly power. It may be possible in some circumstances for the Tribunal to approve a merger subject to compliance with conditions.

Nor is it a necessary conclusion that a merger for reasons of efficiency or economies of scale will lead to the "distribution . . . of goods and services of such quality, quantity and price as will best meet the requirements of domestic and overseas markets" as required under paragraph (e). The savings in cost may be retained in the business, distributed by way of dividend or used to eliminate competitors, and never reach the consumer in the form of lower prices or improved quality. For example, in the *Clorox Case,* Commissioner Elman pointed out that "economic efficiency or any other social benefit resulting from a merger is pertinent only insofar as it may tend to promote or retard the vigour of competition".[141] He concluded that

> the kind of 'efficiency' and 'economy' produced by this merger [chiefly savings in advertising and sales promotions] is precisely the kind that—in the short as well as the long run—hurts, not helps, a competitive economy and burdens, not benefits, the consuming public.[142]

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139 WALKER, supra at p. 193.

140 United States v. Addyston Pipe and Steel Co. (1898) 80 Fed. 271, and see WALKER, supra at pp. 162-3.

141 In re Proctor & Gamble Co. CCR Trade Reg. Rep. (1963 F.T.C. Cas.) para. 16,673 at p. 21, 585.

142 Id. at 21, 586.

Professors Kaysen and Turner[143] would require a showing that the economies of scale or of resource utilization will be substantial and cannot be achieved in any other way. The alternative ways would be (i) internal expansion, which has been dealt with above, or (ii) agreements to share certain limited facilities or information, such as the fruits of research, or (iii) the acquisition of the assets from a source other than a competitor, customer or supplier, the implications of which are considered under the failing company exception hereunder.

Despite the above criticisms and limitations on the efficiency and economies of scale justifications, they cannot be ruled out altogether. Even in the United States, a merger between companies which are sufficiently small in absolute size to justify a merger on these grounds is not immune from challenge if the merging firms are themselves giants in their own geographic market. The Australian Tribunal, faced with mergers between companies of even smaller absolute size possessing large shares of insulated markets, will have to balance the economies of scale argument against prospective restrictions on competition. While possible advantages such as standardization of production, sharing of technical and research costs, and the preservation of excess capacity to meet changes of demand will be argued under section 50(2)(e) as justifications for restrictive practices[144] and agreements, they do not appear relevant to mergers since these results can be achieved by less drastic and far-reaching means.

(f) The final paragraph provides that *"the ability of Australian producers and exporters to compete in overseas markets"* shall be taken into account in the balancing process under section 50.[145] It should also be noted that the interests of exporters are to be considered under paragraph (a), and the need to produce goods for overseas markets is relevant under paragraph (e). On the other hand none of these paragraphs envisages a consideration of the balance of the payments.[146]

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143 KAYSEN & TURNER, ANTITRUST POLICY, 1959 at p. 133.

144 See MASTERMAN & SOLOMON, supra at pp. 228, 243-6.

145 Although Gateway (6) in the Barwick proposals provided that a practice might be justified if "the abandonment of the practice would be likely to affect adversely the export trade", it is not clear whether it was intended that this gateway should be applicable to prospective mergers, since its terms appear to permit justification of "existing practices" on the grounds that their "abandonment" would adversely affect exports. 37 Parl. Deb. 3107

146 Cf. The English Restrictive Practices Act, 1956 s. 21 (1) (f) which refers to "the volume or earnings of the export business". Dr. Walker suggests that this omission from the Australian Act is probably wise. WALKER, supra at p. 205.

Because of the relative smallness of Australian producers, any step which will enable them to compete more effectively with their larger overseas competitors is welcomed by the Australian Government and is likely to receive favourable consideration by the Tribunal.[147] A merger proposed for the ostensible purpose of enabling the participating companies to compete more effectively in overseas markets may eventually facilitate domination of the domestic market. One of the characteristics of a merger, in contrast to a restrictive agreement or practice, is its virtual irrevocability once it has been sanctioned by the Tribunal, which would then have little, if any, power to control its methods of operation unless they amounted to monopolization. Whereas an agreement between two competitors allocating overseas markets could be restricted by the Tribunal to areas outside Australia, once two erstwhile domestic competitors have merged, it would be more difficult to control the policies of the new combination in the domestic market. If exploitation of the domestic market is a likely, or possible, result of such a merger, it should not be justified on the grounds that it would promote exports.[148]

A merger may conceivably facilitate export promotion in several ways:

(a) by enabling the new combination to extract higher profits at home and thus subsidize lower prices for its exports;

(b) by reducing marketing overheads overseas and thus enabling it to sell its goods more competitively in foreign markets.

In case (a) domestic consumers subsidize export sales but receive no direct[149] benefit from the merger. If the higher profit from domestic sales were achieved by lowering costs rather than raising prices above the pre-merger level the consumer would suffer no detriment. However if the merger enabled domestic prices to be raised because of reduced competition, consumers would be adversely affected and the merger would not be in the public interest. In case (b) the benefits of increased foreign sales may or may not be passed back to the Australian consumers. Experience would indicate that increased profits will be distributed by way of dividend to shareholders, retained in reserves, or employed in research, development or expansion. They rarely result in reduced retail prices. Thus the effects of a merger upon consumer prices and the state of competition in the domestic

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147 WALKER, supra at pp. 204-6.

148 See A. HUNTER, COMPETITION AND THE LAW, (London, 1966) at pp. 150-1.

149 There may be an indirect benefit to the economy as a whole through improved balance of payments.

market will depend upon the policy of the new combination after merger, over which policy the Tribunal could exercise little control.

THE FAILING COMPANY DEFENCE

It has already been stated[150] that, in addition to the provisions of section 50(2), the failing company defence must be recognized as a powerful justification for merger. This justification may be available within the framework of the matters to be taken into account under section 50(2), particularly paragraphs (d) and (e), but the question of company failures is of such great importance that it warrants individual attention in this article, and, it is submitted, in any proposed legislation dealing with mergers. Although the United States Congress has indicated by its approving references[151] to the *International Shoe* decision[152] that acquisitions of companies in failing circumstances require special consideration, Congress has not indicated clearly what criteria determine when a company is deemed to be failing, what interests are involved, or the measure of the special consideration required.

The interests which would support the recognition of this defence in Australia are:

(i) the re-allocation of resources to more productive use, thereby increasing overall efficiency.[153] In permitting the acquisition of a failing company for this reason, one recognizes that free competition alone cannot be the sole determinant of the allocation of resources;[154]

(ii) the avoidance of harm to creditors, employees and the locality of the failing company in the event of its eventual liquidation;

(iii) the right of owners of companies to freely alienate their businesses to the highest bidder. As indicated earlier, the motives of the owners in selling are quite often unrelated to the structure of competitiveness in the industry. They may be concerned with providing liquidity for their estates, avoiding undistributed profits tax or personal income tax, or relieving themselves of the burdens of management;

(iv) the expansion of industries where demand has increased, but capital for internal expansion is difficult to obtain.

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150 See discussion of s. 50 (2) (d) supra.

151 H.R. Rep. No. 1191, 81st Cong., 1st Sess. 6 (1949); S. Rep. No. 1775 81st Cong., 2d Sess. 7 (1950).

152 International Shoe Co. v. FTC (1930) 280 U.S. 291.

153 Compare Trade Practices Act, 1965, s. 50(2) (d).

154 Similarly, in the area of public utilities and in certain agricultural industries, free competition does not provide a workable solution.

The second and third interests deserve particular recognition in Australia just as they have received most attention in the United States.[155] Another justification which has been advanced in favour of this defence is that the absorption of a failing or weak company cannot threaten competition.[156] This is too broad a generalization because although the failing company may be unable to compete vigorously, its acquisition by a large competitor may enable the acquiring company to exert anti-competitive pressures on the remainder of the industry through the additional customers and market share acquired. Where a company is failing, its greatest asset is likely to be its market outlets which will be of much greater value to an acquiring competitor than plant and machinery. Therefore, it may be relevant in defining the limits of this defence to take account of the market power and position of the acquiring company, and, in particular, whether that company has contributed to the failure of the acquired company by predatory practices.[157]

It will be equally important to carefully designate the circumstances in which the acquired company will be recognized as in a failing condition. Existing descriptions of these circumstances include "a corporation with resources so depleted and the prospect of rehabilitation so remote that it faced the grave possibility of a business failure",[158] or a firm on the verge of bankruptcy.[159] The second description would appear to give effect to interest (ii) above since eventual bankruptcy will harm creditors and employees. Yet the concept of bankruptcy has technical connotations[160] which are not relevant to whether the failing company remains a competitive force or

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155 See generally BOK, supra at pp. 339-47.

156 *Comment,* (1959) 68 Yale L.J. 1627 at pp. 1663-64.

157 BRECHER, *Combines and Competition: A Re-appraisal of Canadian Public Policy,* 38 Can. B. Rev. 523 at 564 and especially at 584 where he warns "[P]ermissible categories of merger—such as the 'bankruptcy' group— . . . must be narrowly circumscribed in the interests of competition; . . . laxity in the early enforcement stages of merger policy might well provide a green light to the pursuit of restrictive merger conduct throughout the Canadian economy."

158 International Shoe Co. v. FTC (1930) 280 U.S. 291, 302.

159 BOK, supra at p. 341 and n. 341 referring to S. Rep. No. 1775, 81st Cong., 2d Sess. 7 (1950).

160 For example, a firm may be declared bankrupt because it *does not* pay its debts rather than because it is unable to pay them. Bankruptcy Act, 1966, s. 40(1) (g). Similarly, a company may be ordered to be wound up on purely formal grounds. See, e.g., Companies Act 1961, s. 222 (N.S.W.). These provisions show that the Commissioner and Tribunal would need to be wary of the possibility of two companies deciding to merge, one voluntarily going into liquidation and being bought up by the second.

whether its acquisition by a competitor, customer or supplier will enable it to monopolize the market. The first description taken from the *International Shoe* case has a closer relation to the situation where the failing company would no longer be expected to be an effective competitor. Yet both descriptions presume that bankruptcy or company failure necessitate the physical liquidation[161] of the business as a going concern. This is not the case in Australia since creditors may in their own interests prefer and therefore permit a bankrupt firm or company to continue to operate under a receiver, composition or deed of arrangement,[162] or may arrange for the complete recapitalization of the enterprise.

There may, therefore, be instances where a company faces the grave possibility of business failure or is on the verge of bankruptcy, and may still be expected to compete vigorously. If such a "failing company" is acquired by a large competitor, the effect could be a substantial reduction of competition. On the other hand, it seems harsh to require the failing company to actually cease to function before allowing it to sell out. The effects would be analogous to requiring the assets to be sold for scrap, since all remaining goodwill would be dissipated and any previous attractive sale opportunities irretrievable. The suggestion of extending the failing company defence to cover cases of a threat to survival where the alternative of internal expansion would increase excess capacity has already been noted in relation to paragraph (e) of section 50(2) above.

The difficulty of the problem can be appreciated by conceiving of a very large company which has incurred losses for several years and which now desires to sell out.[163] Because of its very size, the company necessarily remains at least a *potential* competitive force until it ceases

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161 The acceptance in the International Shoe case of the failing company defence is predicated in part on a finding "that at the time of the acquisition the financial condition of the [acquired company] . . . was such as to necessitate "liquidation" or sale, and therefore the prospect for future competition or restraint was entirely eliminated." (Emphasis added.) International Shoe Co. v. FTC (1930) 280 U.S. 291, 294. This finding can only be read as referring to a liquidation of physical assets and the cessation of the business entity as a going concern. See also Note (1959) 45 Va. L. Rev., 421, 424.

162 See Bankruptcy Act, 1966, Part X, and Companies Act, 1961, Parts VII, VIII and IX.

163 Compare Bok, supra at p. 343: "When the acquired firm is large, for example, it becomes more important in the interest of competition not to permit the acquisition if in fact the company can be rehabilitated in some way . . . [a]s the magnitude of the acquisition increases, a graver likelihood of business failure seems necessary to justify the exception . . ."

to operate. There is no middle or neutral ground between the point when it is a competitive force and when it closes down. Yet, once the company closes down, the opportunities for an advantageous merger are irrevocably prejudiced. The use of the description "grave possibility of business failure" or verging on bankruptcy tends to conceal the real issue, namely, cessation as a competitive force. On the other hand, the former test is more easily applied to factual situations.[164] This will be especially true in Australia since any doubts as to the ability of lawyers to predict the probability of a business failure should be compensated for by the presence of businessmen as lay members of the Tribunal.

The above considerations indicate that the next question involves the relationship between a finding that the failing company defence has been established and other factors which normally indicate a reduction of competition. It has already been shown that the defence should not be an absolute one since the market power of the acquiring company remains relevant. Where, in the absence of the failing company defence, the acquisition would be prohibited, a showing that reasonable attempts had been made to find a permissible purchaser should be required before the defence prevails. This accords with the general anti-trust principle that if a lawful purpose can be achieved in several ways, the means which are least restrictive to competition should be adopted. No general rules can be laid down in advance to determine what is a reasonable attempt to find an alternative purchaser.[165] The Tribunal should consider the nature of the industry,[166] whether the price offered by another buyer is adequate even though not as great as the offer of the competitor,[167] whether the alternative buyers would maintain the failing company in its present market.[168]

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164 Id. at p. 342. Reasons suggested by Bok include the continuing attention given to the art of forecasting business prospects, the fact that previous estimates can be checked against experience, and the relatively shorter time that is involved than in assessing effects on concentration and competition.

165 Id. at p. 346.

166 E.g., the machinery may be unique to this industry, and the range of potential purchasers thereby limited. Note (1959) 45 Va. L. Rev. 421, 425.

167 Ibid. This raises the question why a competitor would offer more to acquire the failing company than non-competitors unless in anticipation of substantially expanding its market.

168 Bok suggests that where the acquiring company intends to scrap the facilities or devote them to a different market, the advantages of compelling such a sale are impaired because "a substantial portion of the failing firm's business may well accrue in any event to these larger companies." BOK, supra at p. 345.

If future Australian legislation compelled advance clearance for proposed mergers the question of whether a failing company had made a reasonable attempt to find an alternative purchaser would be clarified since the merger would not have been consummated at the time of this inquiry. Thus, the Tribunal could give directions as to the steps it considered necessary to constitute a *bona fide* attempt to find an alternative purchaser.

On the other hand, the Tribunal must still attempt to balance conflicting interests involving the assessment of the future effects of the merger. For example, where a high bid is received from a large competitor and a considerably lower bid from a non-competitor or smaller competitor, the Tribunal would have to balance the considerations outlined above which indicate that the failing company should be permitted to accept the best offer, against the probability of the anti-competitive effects of such a merger. A further complication is presented by the need to compare the relative values of several bids where they involve exchanges of shares. Once the failing nature of the acquired company is established and the Tribunal is satisfied that in an appropriate case reasonable efforts have been made to find an alternative purchaser, the merging companies would have discharged the burden cast upon them. The failing company defence should not be treated merely as one factor to be weighed in the balance with such other factors as market shares, concentration increase, growth and prior acquisitions discussed earlier in this article.[169] Since the failing company defence is designed to protect specific interests in a positive manner, once that defence has been established it should override any presumptions or inferences of reduced competition.

CONCLUSION

If the basic principle is accepted that the Australian government should legislate against anti-competitive and monopolistic activities, as it has done, logic would require that merger activity which would result in reduced competition should also be curbed. However, the question whether such legislation should be introduced involves other questions of national economic goals and policies which cannot be resolved by purely logical means. The mechanical difficulties of for-

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169 See pp. 491-504 supra. Compare Standard Oil Co. v. FTC (1951) 340 U.S. 231 where the Supreme Court held that where a seller sustains the burden of proving the "good faith meeting of competition" defence under Clayton Act, s. 2 (b) that defence is absolute and should not be destroyed indirectly by the counter-balance of other factors.

mulating a satisfactory test are no excuse for declining to regulate merger activity. Assuming a policy decision to regulate mergers, the following submissions are made:

(a) There are obvious problems in drafting a merger provision, which could achieve the desired economic purposes and at the same time be capable of reasonably simple interpretation and implementation. While a general formula, such as section 7 of the Clayton Act, would permit flexibility, it would require many years of interpretation before its effect became clear, and the costs of implementation would be very heavy.

(b) It is impossible to embrace within a specific formula all relevant factors. These number at least seven including market definition, market shares, increases in concentration, peculiar talents and facilities, the nature of competition in the industry, growth and other dynamic factors, and the prior history of acquisitions.

(c) If a specific quantitative formula is desired, a presumptive test based upon increases in concentration appears the most appropriate to take account of a majority of the above factors.

(d) Special provision is necessary for vertical mergers and the vertical aspects of horizontal mergers. It is even more difficult to devise a satisfactory quantitative formula for vertical mergers.

(e) Any formula should be presumptive only, and permit justification of the proposed merger by reference in appropriate cases to at least some of the matters referred to in section 50(2) of the Trade Practices Act.

(f) In addition mergers should be permitted where the necessary elements of the failing company defence have been established.

(g) A system of advance clearances appears essential to the practical operation of any merger statute. Where all relevant information relating to a proposed merger has been disclosed to the Commissioner, the clearance should be automatic unless the Commissioner challenges the merger within a specified but comparatively short period.

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