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# **Strategic Use of Merger Control – Chicanery Mischievous or Justified Cry for Help?**

**Antitrust Commission**

**THE EXPERIENCE DOWN-UNDER**

**A NEW ZEALAND AND AUSTRALIAN PERSPECTIVE**

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## 1. INTRODUCTION

Australia and New Zealand are similar countries in many respects. For example, the vast majority of inhabitants from both are infatuated with sport, usually involving an oval shaped ball. There are significant differences however. For example, one country is vastly superior in the sporting arena. The authors of this paper are at odds in their respective views on this point.

There are also similarities between the law relevant to businesses in Australia and New Zealand such that much of the corporate and commercial laws in each country are “similar, but not the same”. In August 2006 the regulators in New Zealand and Australia agreed a Cooperation Protocol for Merger Review designed to assist merger control in the New Zealand/Australian business environment.

This paper outlines merger control law and the manner in which those laws are applied in both countries and goes on to consider how third parties to a proposed merger transaction (and their lawyers!) can become involved in the merger control process.

The extent of potential third party involvement is illustrated by reference to a recent merger control case in the aviation industry involving the major commercial airline from each country. The proposed strategic alliance<sup>1</sup> between Air New Zealand Limited (“AirNZ”) and Qantas Airways Limited (“Qantas”) was blocked by the Commission in New Zealand but subsequently approved by the Australian Competition Tribunal. The proposed transaction attracted significant public scrutiny at the time and the process involved numerous third parties with various different perspectives and agendas.

## 2. MERGER CONTROL LAWS

Merger control laws in New Zealand and Australia are both based on the “substantial lessening of competition” threshold, such that a merger which has, or is likely to have, such an effect, is prohibited. Both jurisdictions have a voluntary notification regime whereby participants in a merger transaction may seek approval from the relevant regulator (or tribunal) before proceeding with completing the transaction, but need not do so.

### 2.1 New Zealand Merger Control Law

The law in New Zealand prohibits a merger that “*would have, or would be likely to have, the effect of substantially lessening competition in a market*”<sup>2</sup>. It applies to off-shore transactions where the participants have a market presence in New Zealand (e.g. the Adidas/Reebok merger) and there is no “*de-minimus*” rule that excludes or exempts small entities or transactions. Participants in a merger transaction (usually the purchaser) may seek either clearance or authorisation from the Commerce Commission.<sup>3</sup> The consequence of a successful application for clearance or authorisation is, in effect, immunity from a claim for a breach of the “substantial lessening competition” prohibition. Depending on the factual

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<sup>1</sup> Which also provided for Qantas subscribing for up to 22.5% of voting equity in AirNZ

<sup>2</sup> Section 47, Commerce Act 1986 (New Zealand)

<sup>3</sup> Sections 66 and 67, Commerce Act 1986 (New Zealand)

circumstances surrounding a particular merger transaction a lawyer might recommend to his or her client one of four alternative approaches, namely –

- to seek clearance from the Commission;
- to seek authorisation from the Commission;
- to proceed without any formal application to the Commission;<sup>4</sup> or
- to abandon the merger transaction altogether.

### 2.1.1 Clearance

A clearance application will often be appropriate where it can be established that the proposed merger will not result in a substantial lessening of competition even though the entity's market share exceeds the Commission's safe harbour guidelines.<sup>5</sup> Typically, such an application will involve establishing that the relevant market has low barriers of entry or that there are effective competitors or potential competitors that will constrain the market power of the merged entity. The Commission will conduct an investigation of the relevant market and market participants before determining whether clearance ought to be granted. All determinations are documented with reasoning and are available on the Commission's website.<sup>6</sup>

### 2.1.2 Authorisation

An application for authorisation may be appropriate where a clearance application is unlikely to succeed but where it can be shown that "*the acquisition will result, or will be likely to result, in such a benefit to the public that it should be permitted*".<sup>7</sup> The Commission will typically undertake an investigation, carry out research and economic modelling and hold a conference to determine whether an authorisation should be granted or not. This was the process followed by the Commission when considering the AirNZ/Qantas transaction.

### 2.1.3 No application

Because the notification regime is voluntary there is no obligation to seek approval from the Commission. It is inevitably part of the lawyers role to determine whether an application for approval is appropriate or not. The approval process can take up to 15 weeks or longer to complete so there are almost always conflicting objectives from the clients perspective, making the lawyers recommendation a critical part of the deal structure and timeframe. Proceeding to complete a merger transaction without approval from the Commission enables the Commission, or any other third party, to take legal action where they believe a substantial lessening of competition may occur.

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<sup>4</sup> Often it is appropriate, as a courtesy, to advise the Commission of the fact of a proposed merger and the reasons why any application is considered unnecessary.

<sup>5</sup> The safe harbours are as follows: 1) where the three firm concentration ratio (post acquisition) is below 70% and the market share of the combined entity is less than in the order of 40%; or 2) where the three firm concentration ratio (post acquisition) is greater than 70% and the market share of the combined entity is less than in the order of 20%.

<sup>6</sup> See [www.comcom.govt.nz](http://www.comcom.govt.nz) Commercially sensitive information is deleted from publicly available material.

<sup>7</sup> Section 67, Commerce Act 1986 (New Zealand)

## 2.2 Australia Merger Control Law

The law in Australia prohibits anti competitive mergers in a similar fashion to that in New Zealand. That is not surprising given that the Australian *Trade Practices Act* ("TPA") was one of the primary models used by the New Zealand legislature when drafting the *Commerce Act*. Under section 50 of the TPA, any acquisition of shares or assets is unlawful if it has the effect or likely effect of substantially lessening competition in a market in Australia. For the prohibition to apply, that market must be a "substantial" market; having said that, no case has ever turned on whether the market is substantial or insubstantial, whether that be in court or before the Australian Competition and Consumer Commission ("ACCC"), the competition regulator.

The prohibition in section 50 applies to acquisitions made overseas, provided:

- (a) the purchaser is an Australian company; or
- (b) if a foreign company, it "carries on business in Australia"<sup>8</sup>; and
- (c) the overseas acquisition will have the prohibited impact in Australia.

Foreign acquisitions are also governed by section 50A of the TPA. That involves a company referred to in paragraphs (a) or (b) above acquiring a controlling interest in an overseas company (Company 1), which, in turn, gives the purchaser a controlling interest in a further company or companies in Australia (Company 2). Section 50A is triggered where the indirect interest in Company 2 has the effect or likely effect of substantially lessening competition in a market in Australia and there is no compensating public benefit. In those circumstances, it is open to the Australian Competition Tribunal ("Tribunal") to make a declaration. Either the purchaser divests itself of Company 2 or Company 2 has six months to cease operation. There is no other penalty for breaching section 50A.

Leaving section 50A aside, as in the case in New Zealand, a lawyer generally recommends any one of the four alternative approaches mentioned above:

- to seek clearance from the ACCC;
- to seek authorisation from the ACCC;
- to proceed without application to the ACCC; or
- to abandon the merger transaction altogether.

Since 1 January 2007, there are two clearance options in Australia.

### 2.2.1 Clearance

The clearance procedure introduced on 1 January 2007 is provided for under section 95AC of the TPA. It is not dissimilar to the existing clearance procedure in New

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<sup>8</sup> Section 5(1) of the TPA

Zealand. We can call it a "formal clearance" system. If granted, a formal clearance gives the applicant immunity from prosecution and any other suit if it proceeds with the acquisition. The advantage of the new procedure is the ability to seek a review before the Tribunal.

Most clearances provided in Australia are and will remain informal. An informal clearance simply involves the ACCC indicating in writing that it will not intervene in the transaction prior to completion. It is nothing more than a "comfort letter". Generally, Australian businesses are content to rely on this "letter of comfort" even though the ACCC is not prevented from changing its position, nor does an informal clearance provide impunity from private action.

Having said that, the ACCC rarely changes its position from acquiescence to opposition once it commits itself to writing. There have been one or two cases, but they are some time ago. In addition, even though an informal clearance gives no immunity to private action, the structure of the law creates its own disincentive. Under section 80(1A), only the ACCC is able to institute proceedings in respect of potentially anti competitive mergers and seek injunctive relief. It is certainly possible for private actions to commence, but private parties would only be able to seek damages and declarations. This makes private action unlikely, as does the fact that any private litigant would be aware that the ACCC has considered the matter and, itself, decided to take no action.

Both in informal and formal clearances, the ACCC assesses mergers on the same criteria. As is the case in New Zealand, the ACCC has set out an investigative threshold. Where acquisitions meet or exceed the following, the ACCC has indicated that it would wish to investigate these transactions further:

- (a) post acquisition, the 4 largest suppliers account for 75% or more of the relevant market and the merged entity accounts for 15% or more of the relevant market; or
- (b) post acquisition, the merged entity will account for 40% or more of the market, irrespective of the market share of the largest suppliers in the market.<sup>9</sup>

There is a further "safe harbour" where imports competition constitute 10% or more of the market and has done so for the last three years. In these cases, the ACCC notes that it has never opposed an acquisition.<sup>10</sup>

Where its investigative threshold is met, the ACCC will conduct market inquiries to examine issues of the market, competition and prospective competition. These inquiries are directed towards customers, competitors, regulators, industry peak bodies and relevant government departments. It is certainly possible for applicants to meet with the ACCC during its consideration of an informal clearance application. Pre-determination conferences are specifically provided for in formal clearances.<sup>11</sup>

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<sup>9</sup> Para 5.95 of the ACCC Merger Guidelines, June 1999

<sup>10</sup> Para 5.111 of the ACCC Merger Guidelines, June 1999

<sup>11</sup> Paras 3.79 to 3.86 of the Formal Merger Review Process Guidelines, January 2007

Finally, determinations in both the formal clearance and informal clearance procedures are made public. They are entered in electronic public registers, accessible over the internet at the ACCC website.<sup>12</sup>

### 2.2.2 *Authorisation*

Again, as in New Zealand, it is possible to seek an authorisation for an anti-competitive merger. Under section 95AT, the Australian Competition Tribunal has the power to grant an authorisation to an otherwise unlawful acquisition where there is an overwhelming public benefit outweighing the public detriment.

Merger authorisations are, however, extremely rare, largely because of the commercial practicalities of an acquisition. Not only are authorisations public, they are costly and take a considerable period. An authorisation would only ever be contemplated if it is clear that the acquisition will substantially lessen competition.

One of the disincentives for a party seeking an authorisation for an acquisition has traditionally been the ability of third parties to "hijack" the agenda by appealing. Prior to 1 January 2007, authorisations were granted by the ACCC. Any person "dissatisfied with a determination" could apply to the Tribunal for review of that determination. That occurred in the case of *Re Queensland Independent Wholesalers Ltd* (1995) ATPR 41-438.

Dauids Limited was a large independent grocery wholesaler. It sought to acquire Composite Buyers Limited, another independent grocery wholesaler. The ACCC granted authorisation for the acquisition to proceed. A competitor, Queensland Independent Wholesalers Limited (QIW), applied to the Tribunal to review the ACCC authorisation. QIW had, itself, announced an intention to acquire 90% of Composite Buyers' issued capital. The QIW application appears entirely strategic, as part of that company's overall commercial strategy to acquire Composite Buyers. It failed, but not without delaying Davids' acquisition considerably.

On 1 January 2007, the TPA was amended so that the ACCC no longer grants merger authorisations. That is a task now discharged by the Tribunal. Moreover, there is no right of appeal against a Tribunal determination on the merits. This should curtail third party rights.

### 2.2.3 *No Application*

As is the case in New Zealand, the clearance and authorisation procedures are entirely voluntary. Under Australian law, there is no mandatory notification requirement. However, failing to notify the ACCC and seek at least an informal clearance is generally inadvisable where the ACCC's investigative threshold is met.

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Detection – which is likely - is likely to lead to an independent ACCC investigation and the delays described in section 2.1.3.

### **3. THIRD PARTY RIGHTS AND STRATEGIES**

The respective regulators in New Zealand and Australia are the primary enforcement agency in respect of competition law generally in each country. Where a merger transaction is potentially anti-competitive the relevant regulator will typically investigate upon receipt of a genuine complaint from a member of the public or on their own initiative. Incidents of private enforcement are uncommon in both countries although the opportunity to do so is certainly available under the respective legislation.

#### **3.1 New Zealand**

Where an application to the Commission for approval is not made, a third party objecting to a transaction will typically notify the Commission of their concerns in an attempt to encourage the regulator to instigate an investigation and possibly legal action. Other strategies include approaching customers, suppliers and/or competitors of the target company or purchaser in order to place commercial pressure on the parties not to proceed with the transaction.

Of greater interest from the legal perspective, where approval is sought from the Commission a third party will have various means of becoming involved in the process adopted by the Commission in order to make its determination.

Where an application to the Commission seeking approval is made, the Commission will announce that fact by way of media release.<sup>13</sup> This will often be how third parties first learn about the proposed merger transaction and enables them to notify their interest to the Commission so as to ensure they are involved in the investigation procedure. Third party involvement from this point on will largely depend on the nature of the application.

##### *3.1.1 Clearance applications*

A clearance application is handled by executives from the Commission who review the application, seek additional information from the applicant where necessary, verify information provided with independent sources and test the analysis of the likely effect on competition should the proposed merger transaction proceed.

A third party can engage with the Commission either through correspondence or meeting in person. Where the third party is a key customer, supplier or competitor, it is likely that the Commission executive will make contact in order to gather further information and test assertions made by the applicant. Because the application for approval is a matter of public record (excluding commercially sensitive information), the facts relied upon by the applicant in establishing why the proposed merger transaction will not substantially lessen competition

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<sup>13</sup> In general, the Commission will not begin the investigation process in response to an application for clearance unless the fact of the application has been made public. This means applications which are confidential as to fact are not often made.

can be tested against “independent sources”. Third parties are usually in the best position to be able to test these facts due to their knowledge of the relevant markets and what impacts on competition.

### 3.1.2 Authorisation applications

Where an application for authorisation is made on the grounds of “*benefit to the public*” the Commission will adopt a similar approach to that described above in relation to clearance applications. In addition, the Commission will usually hold a conference. The New Zealand legislation specifically provides for a conference to be held at the discretion of the Commission.<sup>14</sup>

The legislation provides that notice of any conference must be given to “persons entitled to be present”.<sup>15</sup> Entitled persons are the applicant and “*any other person whose presence at the conference is considered by the Commission to be desirable*”<sup>16</sup>.

## 3.2 Australia

As noted above, third parties no longer have a right to appeal against merger authorisation determinations and the law does not allow them to seek injunctive relief against mergers proceeding. Accordingly, the only real involvement third parties have and can have in Australian mergers is as follows:

- (a) providing an unsolicited submission to the ACCC when it is considering either a formal or informal clearance application; and
- (b) responding to ACCC enquiries in the course of formal or informal clearances.

The ACCC will invariably undertake market inquiries when considering either a formal or informal clearance application. This often proceeds by way of a written questionnaire, but third parties are free to express any views and provide any evidence or documentation relevant to the application. In many circumstances, independent solicitors are engaged to assist with the preparation of such submissions and, then, in liaising with the ACCC. An example of this involved ITW's acquisition of the Pryda Reid business from Austrim Nylex Ltd in 2003. A rival bidder for this business was MiTek Australia Limited. The writers of this paper were both engaged by ITW to oppose MiTek's application for informal clearance to the ACCC and the formal clearance application in New Zealand. This opposition was successful in both countries.

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<sup>14</sup> A conference may also be held by the Commission in the course of determining an application for clearance although in practice this has only been utilised on one occasion by the Commission.

<sup>15</sup> Section 69B(1), Commerce Act 1986 (New Zealand)

<sup>16</sup> Section 64(1)(b), Commerce Act 1986 (New Zealand) which is incorporated by reference into section 69B(2)

