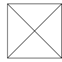

OFFICE OF
REGULATION REVIEW
INDUSTRY COMMISSION

Pre-merger notification and the *Trade Practices Act 1974*

Submission to the Treasury

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1 INTRODUCTION

The *Trade Practices Act* 1974 (Cth) has never required a merging or acquiring firm to provide advance notice to the Trade Practices Commission (TPC), although the parties *may* obtain an authorisation of anti-competitive arrangements after demonstrating a net public benefit — s88(9). The TPC also operates an informal, voluntary clearance procedure.

The mandatory pre-merger notification scheme outlined by Treasury in its discussion paper — *Pre-merger Notification and the Trade Practices Act 1974* — is the latest step in a long process of community consultation about the need for a pre-merger notification scheme.

In 1989 the Griffiths Report (1989, p. 51) recommended against the introduction of a pre-merger notification scheme on two grounds. Firstly, it found limited evidence for the view that the TPC has insufficient information about possible future mergers. Secondly, the Report considered that the

> introduction of mandatory pre-merger notification may involve a number of difficulties, including a substantially increased administrative burden for the TPC, the difficulty of determining an appropriate threshold test and the possibility of unduly delaying and interfering with the merger process (1989, p. 51).

Two years later the Cooney Report (1991) reached the opposite conclusion. The Committee judged that the TPC receives insufficient notice of impending mergers and sometimes has difficulty affording each full consideration. It therefore recommended that parties involved in a substantial merger or acquisition should be obliged to notify the TPC, but in a way that avoids imposing an undue burden on them, or involves information requirements that are too wide, vague, onerous, or vexatious.

As part of a wide-ranging response to the Griffiths and Cooney Reports, the Government in 1992 agreed in principle to adopt an administratively simple pre-merger notification scheme for substantial mergers (Duffy 1992).

On the 22 November 1994 the Assistant Treasurer, the Hon George Gear MP, released for public comment a discussion paper by the Treasury canvassing options for the introduction of a pre-merger notification scheme.

This submission assesses the TPC's need for more, and more timely, information from those parties intending to merge. In this light, the Office of Regulation Review (ORR) considers whether the proposed mandatory pre-merger notification scheme meets the perceived need in a least cost manner.

2 THE TREASURY PRE-MERGER NOTIFICATION PROPOSAL

The Treasury proposal seeks to reduce the cost of merger litigation by:

- providing the TPC with enough time to seek an interim injunction and hence overcome the problems that can arise when attempts are made at divestiture following any anti-competitive midnight mergers — expense, complexity and only partial success;
- providing greater certainty for potential merging parties, so reducing the possibility of litigation by the TPC; and
- bringing Australia into line with other OECD countries.

Under the scheme outlined by the Treasury the *Trade Practices Act* would be amended to require anyone proposing to acquire shares or assets in excess of a threshold to notify the TPC and to wait 21 days before actually making the acquisition.

The Treasury has identified two possible notification thresholds. The Treasury has said that it is not committed to either option and may modify the scheme in light of public comment.

The first proposal (Proposal A) will require notification if:

- the combined value of the target and acquirer is $150 million; and
- the target company has a value in excess $25 million; and
- the acquisition is for 5 percent of voting power; and
- after the acquisition, the acquirer has more than 10 percent of the voting power of the target.

The second proposed scheme (Proposal B) is more demanding. It will require notification if:

- the combined value of the shares and assets to be acquired exceeds $25 million; and
- after the acquisition the acquirer has more than 10 percent of the voting power of the target.

Either of these proposals would require that the TPC be given 21 days notice of major mergers. This advance notice would enable the TPC to assess the competitive effects of all such mergers and allow it time to seek a court injunction or to obtain undertakings from the concerned parties.

3 PROBLEMS WITH MERGER OVERSIGHT

The TPC has apparently proved quite successful in gathering information about potentially anti-competitive mergers. Most mergers that the TPC may wish to challenge are attempted with the TPC’s prior knowledge. Moreover, the TPC is willing to challenge potentially anti-competitive mergers under s50 of the *Trade Practices Act* on short notice:

> The Commission is fully alive to the commercial sensitivities surrounding takeover bids, and has recourse to the Courts only where it sees no alternative. On the other hand, it has a clear obligation under the Act to move where it believes a breach of s. 50 is likely. When it does feel compelled formally to oppose a proposal it does its best to avoid unnecessarily prolonging commercial processes. Unfortunately it is sometimes hampered by the parties’ inability or unwillingness to cooperate — especially where an insistence on confidentiality impedes necessary market inquiries.
>
> The Commission's response to the Rank Commercial/Coles Myer bid for Foodland Associated demonstrated its willingness and ability to move quickly in the Courts where this is necessary. In that particular case it was heartening that the Federal Court proved ready to accommodate the need for speedy resolution (TPC 1994a, p. 7).

A more recent example of the TPC’s willingness and ability to move quickly was its announcement in early February 1995 that it will challenge a proposed merger between Ampol and Caltex (TPC 1995). Despite such apparent capability, several criticisms of the present system have been made.

3.1 Insufficient notice — midnight mergers

The TPC claims that it has insufficient notice of some impending mergers. This is particularly the case with midnight mergers. Midnight mergers are those mergers that occur without the TPC’s prior knowledge — thus presented as an accomplishment rather than a proposal. This makes any attempt to seek an injunction pointless.

The principal example of a midnight merger is the Petersville/General Jones merger:

> In the Petersville Case, the transaction was entered into on Wednesday and by Saturday certain bean processing equipment had either been dismantled and removed to a new location or was in an advanced stage of dismantling and removal. Further, immediately upon the sale of the shares, a significant part of General Jones’ staff was retrenched and others were transferred to the Elders Group. Within seven days of the sale, all General Jones’ sales offices were closed and orders for General Jones’ products were being directed to Edgell Sales Offices. Immediately upon the sale the accounting and financial reporting activities of General Jones were transferred to Edgell. On the first

> hearing date, the TPC sought orders to preserve and keep separate the assets, business undertakings and goodwill of General Jones but by this time Petersville was arguing that irreparable harm would be caused to innocent third parties if the bean processing plant was not re-installed in the Petersville Plant (Goldberg and Shavin 1984, p. 26).

It is important to stress, however, that the Petersville/General Jones merger is the exception rather than the rule.

3.2 Excessive litigation costs

The present system of merger enforcement tends to create excessive litigation costs. Once a merger has taken place it is in the firm's interest to implement a strategy of delay. The longer the time between the merger and the day that a court makes a decision on divestiture, the less likely that the order will be granted. The Hilmer Report acknowledged this point:

> The severity of the remedy is such that firms facing divestiture proceedings could be expected to strenuously oppose the proceedings using every legal means to impede the enforcement agency and try to obtain a political settlement or abandonment of proceedings. In a long case the market situation can undergo fundamental changes and the original reason for bringing the case may be irrelevant (1993, p. 164).

The TPC's litigation costs will be lower if a merger can be stopped before the purchase is consummated. This allows the TPC to channel its resources into areas other than litigation. The then Chairman of the TPC, Professor Baxt, explained the "enormous amount of time and effort [involved] to try to unravel the intricacies of these arrangements — resources that could [be] used much more productively elsewhere (TPC 1989)".

3.3 The inability of a divestment order to restore competition

For a number of reasons, divestiture is an imperfect remedy for an anti-competitive merger. Once a midnight merger is made public and the assets have changed ownership, the merger is difficult, if not impossible, to unravel through a divestiture order. This problem has long been appreciated in the United States, where divestiture has been heavily relied upon.[1]

Even when the assets of an anti-competitive merger are reasonably intact, the divestiture relies on the existence of parties willing to purchase the assets of the target company. This is not always feasible. Furthermore, even when

[1] *Federal Trade Commission v. Dean Foods Co.*, 384 U.S. 596 (1966), at p. 606 per Clark J.

purchasers have been found for the divested assets, they may be 'unsuitable' because the purchase may not greatly facilitate competition in the industry.[2]

This problem is evident in Australia. Many Australian non-traded goods markets are too small, concentrated and regionalised to enable suitable and economically viable purchasers to be found for the divested assets. It is often the case that potential purchaser of divested assets needs to be a large company in order to afford the purchase price (Copp 1994).

For example, in both the *Ansett-East West Case* and the News Ltd/Herald and Weekly Times merger investigation (1987) the TPC sought to use divestiture to overcome perceived anti-competitive outcomes. In both cases there existed insufficient 'suitable' buyers in the relevant markets.

[2] In a study of 114 divestiture cases in the United States only "16 cases resulted in a sale of all or part of the assets ordered divested to a newly formed corporation backed by a group of independent investors or by the former independent owners (Pfunder, Plaine and Wittemore 1972, pp. 37-38)."

4 CONCERNS WITH THE PROPOSED SCHEME

4.1 There are few 'midnight mergers'

The pre-conditions for a successful midnight merger are:

- the company is unlisted, and thus is not subject to the disclosure requirements of the Australian Securities Commission and the Australian Stock Exchange;
- the company's assets are acquired rather than just its shares — it is easier for courts to unwind share transactions than put back together physical assets, organisations and work-forces that may have been dispersed, dismantled or disbanded;
- the proposed acquirer is not foreign, or controlled by foreign interests, so notice to the Treasurer is not required under the *Foreign Takeovers and Acquisitions Act* 1975 (Cth); and
- the acquisition is of such a small scale that it escapes the attention of the electronic and print media, the investment community and the TPC.

Not surprisingly, there appears to have only been one midnight merger that had anti-competitive consequences — the Petersville/General Jones merger.[3] *The Economist* (1995, p. 14) has observed that "competition law is better at remedying actual abuses than fending off hypothetical ones". The rarity of midnight mergers suggests that the existing remedies in the *Act* are having the desired deterrent effect.

4.2 The proposed asset threshold

The Treasury proposal incorporates a threshold based on asset values. The ORR is concerned that reliance on an asset-based test will unfairly discriminate against those firms who own (rather than lease) their equipment. For example, a merger involving an airline that leases its planes and a travel agency may not be required to notify. On the other hand, if the airline owned its planes it might breach the asset threshold and it would be required to notify. In other countries the threshold is most commonly calculated on the basis of annual sales revenue of the target

[3] See discussion in Section 3.1.

(McLaughlin 1994). However, it is not clear that thresholds based on this, or any other criteria, would be any better as they introduce their own distortions.

More importantly, asset-based thresholds will catch many competitively neutral transactions while missing significant anti-competitive mergers. Asset-based thresholds are biased against firms that operate in large markets and conglomerate enterprises are more likely to be scrutinised than small specialised enterprises. Mergers in small strategic or "bottle-neck" markets for transport or infrastructure services may have an important anti-competitive impact in one or more states or territories, but may not require pre-merger notification under the Treasury's current proposals. Sectorally differentiated thresholds would reduce this bias, but would raise a host of new questions concerning the appropriate number and level of different thresholds and the sectoral classification of conglomerate enterprises.[4]

A single asset-based threshold pays no regard to the degree of openness to international competition in particular industries. The application of pre-merger notification to the traded goods sector, where actual and potential competition from imports is typical, may be an unjustified burden on all concerned. Indeed the TPC has not opposed a merger in that sector since at least 1 July 1991 (Fels and Walker 1993, p. 171; TPC 1994a, p. 36).

It is a difficult process to determine the level at which a threshold test should be set. As Chart 1 demonstrates, there is no international norm for a threshold value as a percentage of an economy's gross domestic product;[5] nor should there be. The threshold for the Treasury's Proposal B, while administratively simpler than Proposal A, appears rather close to that of the US, particularly when compared with the majority of European countries.

Australia should, however, be careful not to adopt merger law enforcement standards as stringent as those in operation in the US. The sheer size of the US economy allows antitrust regulators to presume that scale economies are exhausted at modest market shares in most markets.

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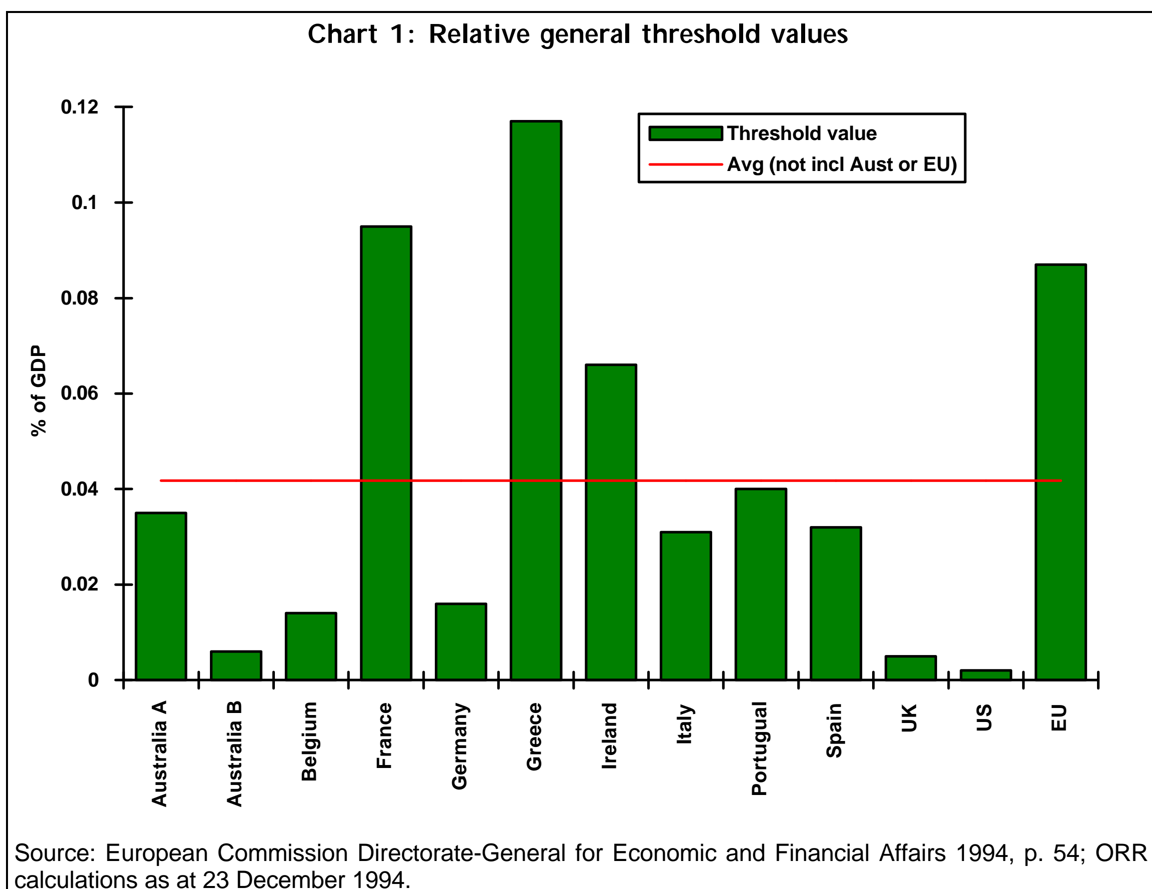
4 One solution is to for the TPC to focus its investigations on those mergers that will have a substantial competitive impact by requiring pre-merger notification only from key infrastructure industries. Such industries could include utilities, transport, communications, media and banking. This approach would appear to provide greater certainty for merging parties. However, the increased certainty created by prescribing industries may be more apparent than real. Technological innovation makes it difficult to draw clear boundaries around industries. The uncertainties of pre-merger notification may simply refocus on the highly subjective issue of defining industry boundaries and debating which should be considered key infrastructure industries.

5 A threshold determined as a percentage of an economy's gross domestic product is a crude (but effective) measure of a merger's impact on an economy.

The size of many Australian markets are such that there is room for only a few efficient producers. Moreover, Australia is undergoing increased international financial and economic integration. A more open Australian economy is likely to lead to an increase in the optimal size of local firms. This should increase the efficiency gains from mergers and reduce the likelihood that they will be opposed by the TPC. Moreover, when new firms are formed, and re-structured markets are developed, market shares are likely to be unstable. Entry is often easier in markets under-going change than in markets having firms with large stable market shares. In conditions of change, the cost of permitting anti-competitive mergers are reduced (Carlton and Bishop 1993, p. 425).

Chart 1: Relative general threshold values



Source: European Commission Directorate-General for Economic and Financial Affairs 1994, p. 54; ORR calculations as at 23 December 1994.

By the same token, the delays involved in pre-merger notification are difficult to justify except for overwhelmingly large or strategic transactions. Thus, one would expect Australia to set a threshold at a level significantly above that of the US because in this country relatively high levels of industrial concentration are required for efficient production.

4.3 Does minority ownership deliver effective corporate control?

What is control?

Since 1993 the *Act* has prohibited mergers and acquisitions that substantially lessen competition. The Chairman of the TPC is of the view that:

> The fact that the test prevents the anti-competitive acquisition of shares or assets means that not only are full mergers and acquisitions covered, but so also can be the acquisition of minority share-holdings interests, where this lessens competition substantially (Fels and Walker 1994, p. 97).

In its discussion paper, the Treasury notes that:

> An acquisition which alters control of the acquired firm has the potential to affect the level of competition in the market, but it is not clear at what point an acquisition of shares gives control (1994, p. 7).

Ford and Austin list eight alternative definitions of what may constitute control:

- total ownership of all classes of shares;
- total ownership of all voting shares of the target;
- entitlement to sufficient shares to implement compulsory acquisition;
- ownership or control of sufficient voting shares to secure the passing of a special resolution
- ownership or control of sufficient voting shares to give the offerer a simple majority of votes at a general meeting
- effective control at a general meeting;
- board room control; or
- control sufficient to require consolidation of accounts of the controlling and controlled entities (1992, pp. 690-691).

Somewhat in contrast, the Treasury's discussion paper suggests that only 10 percent of voting rights constitutes the threshold at which corporate control might be gained in enough cases to require the TPC to scrutinise further acquisitions. While 10 percent of voting power may enable one to place favourable or interlocking[6] members on a board, the ORR considers minority stakes of this proportion to be well short of effective control.

[6] An interlock exists when two companies have one or more common members.

When does a minority interest offer control?

Silent partial equity interests among rivals in oligopolistic markets are said to raise antitrust concerns because they link the fortunes of the companies. Managers of the rival companies have less incentive to compete aggressively because this may adversely impact on the combined returns to those shareholders with cross-holdings (Flath 1991).

The ORR considers that much more than acquiring a silent partial equity interest is required in order to co-ordinate the affairs of rival companies. For example, minority cross-share-holdings between the major firms in a highly concentrated market — the worst case scenario — are, at most, a small part of a much wider anti-competitive arrangement. Successful price fixing requires inter-firm negotiations of great complexity. Moreover, oligopolistic co-ordination may break down owing to conflicts over the most suitable price, heterogeneity of products, the pressure of under-absorbed fixed costs, secret price cutting, simple cussedness on the part of some maverick producer, long-run substitution by buyers and the threat or actuality of new entry (Scherer and Ross 1990). In the great majority of cases, effective legal control of a company — or at least a dominant position on the board of directors — would be necessary to ensure that the multiplicity of hurdles to sustained collusion are overcome.

Actual examples of cross-share-holdings among business rivals are almost non-existent — even in Japan, where share interlocks are common between firms that are not rivals (Flath 1991). For example, some suggest that the shareholding ties within a Japanese *keiretsu*[7] predisposes members to trade with each other on grounds other than competitive merit. Although minority share interlocks are the most tangible link within a *keiretsu*, these ties alone are not enough to co-ordinate the affairs of members. There are many other facets to an effective *keiretsu* — monthly meetings of company presidents, interlocking directorships, common affiliations to one 'main-bank', long term supplier-purchaser ties and, in some instances, shared brand names such as Mitsui and Sumitomo (Flath 1994; Sheard 1993).

The available literature on inter-locking directorships — a much stronger step towards co-ordinated pricing than minority-cross-ownership — suggests that companies will arrange inter-locks only if they have already agreed not to compete (Carroll and Thanos 1994). For example, while 10 percent of shares may enable one to obtain an interlocking member of the board of a competing company, this is not enough to ensure continuous or effective common control. Some minority acquisitions are friendly while others are regarded as hostile by the incumbent

[7] The term *Keiretsu* describes a wide range of affiliations between firms in different markets in Japan involving a variety of structures, purposes and intensities of interaction and control. A *Keiretsu* is never made up of competing firms. *Keiretsu* is sometimes used inter-changeably with the term *kigyo shudan*, meaning 'firm group' but commonly translated as "enterprise group"(Sheard 1993).

management. Moreover, the ability of one inter-linked director to influence the decisions of the remaining directors is often limited and many key corporate decisions are taken by senior management (Carroll and Thanos 1994).

The ORR considers that, as a minimum, minority cross-ownerships must encircle the major sellers in a market before they raise any competitive concerns. Anti-competitive arrangements that are narrower in their compass will be defeated by competition from the non-participating competitors. Moreover, where minority cross-ownerships do raise anti-trust concerns, they will usually be part of a wider agreement to curb competition. Such agreements are already prohibited under s45 of the *Trade Practices Act*.

Control thresholds in other legislation

The ORR is also concerned that the Treasury's proposed thresholds are below comparable thresholds in other Australian laws regulating company ownership. Australian corporate law regards 20 percent as the threshold for a *possible* transfer of corporate control:

> ... the legislature has arbitrarily fixed upon 20 percent as the threshold for the regulation of acquisitions of shares, on the broad ground that a holding of less than 20 percent does not normally constitute control ... but a holding of more than 20 percent *may amount to a controlling parcel where the other shares are widely dispersed* (Ford and Austin 1992, p. 706).

The 20 percent control threshold was reviewed in 1984 and was found to be consistent with other statutory provisions, as well as overseas precedent, as an arbitrary level that fell short of the likelihood of actual control (Companies and Securities Law Review Committee 1984, p. 42).

The Treasury's proposed 10 percent threshold is also at odds with the thresholds in the *Banks (Share-holdings) Act* 1972 (Cth). As a general policy, the Government will allow a shareholder to have a total holding of 15 percent (Dawkins 1993, p. 2). The 15 percent threshold for bank share-holdings is driven by competition considerations and by a broader national interest in ensuring that no single shareholder exercises undue influence on a bank's policies or operations.

Although the potential costs of a failure in prudential supervision regarding minority share holdings are far greater than those from failure to regulate mergers, the Treasury's proposed pre-notification thresholds are much broader in their scope. The relative risks from minority ownership and the costs and benefits of merger policy and prudential supervision do not justify this discrepancy.

The Treasury's proposed thresholds are also stricter that those applying under foreign takeover legislation. The foreign investment thresholds are 15 percent for a single non-resident person or foreign corporation, and 40 percent in aggregate for two or more non-resident unassociated persons or foreign corporations (Treasury

1992, p. 1). Foreign investment thresholds are driven by national interest concerns of a far wider compass than competition policy.

The European Commission regards minority share blocs as substantial when they lie within the range 25 to 40 percent. Under a standard set in the *Phillips Morris* case, the European Commission regards share acquisitions below 25 percent as not tending to lead to control or a decisive influence over the company. However, the European Commission has not been rigid in its application of the *Phillips Morris* standard and its approach is still evolving. It has shown an increased willingness to challenge acquisitions of share bloc smaller than 25 percent where it results in joint control, or “some influence” over a company, particularly where dominant firms are involved (Hawk and Huser 1994).

The ORR acknowledges that control of a company can occur with the ownership of substantially less than 50 percent of voting shares. However, the ORR is concerned that the Treasury’s proposed 10 per cent threshold is much lower than necessary and lacks an empirical basis. For example, the group that is best placed to control a company through a minority share bloc is the incumbent management. However, the available empirical evidence suggests that the share bloc necessary to deliver effective control to management is twice that specified by the Treasury for pre-merger notification. Several studies suggest that a 25 to 30 per cent share bloc is necessary before management can combine this with other insider advantages to secure effective corporate control (Jensen and Warner 1988; Wruck 1989; Stultz, Walking and Song 1990; Belkaoui and Pavlik 1992).

Should the Treasury proceed with a pre-merger notification scheme based upon an asset threshold, then the ORR suggests that the proposed 10 percent threshold is too low. The ORR would recommend a threshold of at least 20 percent to bring together the control thresholds in corporate and trade practices law.

4.4 Costs of pre-merger notification

Costs to merging parties

Merger regulation is designed to target mergers between competitors in concentrated markets. The Treasury’s pre-merger notification proposals apply to mergers by both competitors and non-competitors. It does not distinguish between acquisitions of rival firms, straight-forward takeovers by an outside company, conglomerate mergers and portfolio investments in both concentrated and unconcentrated markets and in the internationally traded and non-traded goods sectors. The wide net cast by the notification threshold means that many companies will be burdened with compliance. Many investors, particularly institutional investors, could be inadvertently caught by the proposed thresholds.

The Treasury's current proposals will impose pre-notification delays, that may be of great commercial sensitivity, to a large number of competitively neutral transactions. This is because the vast majority of mergers in Australia do not infringe the *Trade Practices Act* (Fels and Walker 1994, p. 96).

The efficiency of the market for corporate control

There are always firms that are under-performing and their share price usually reflects this. The low share price provides an incentive for others to mount a takeover bid and run the company better. However, once the intentions of bidders are known, the share price of targets may rise to the point where the takeover is barely worth carrying through. Thus, there is an incentive for potential bidders to buy shares in their targets while their prices are still low. Most of the rewards to bidders accrue while they are quietly building a minority bloc in the target before speculation takes hold (see Box 1).

Notifying the TPC of a proposed merger would not, of itself, make the intention public knowledge. However, markets rapidly discern that a takeover is in the wind from unusually high share trading, and further evidence will become available when a notifying firm must stay its hand for 21 days while the TPC considers its position. The stakes are high in the lead-up to an acquisition. Share prices rise by an average of 30 percent on the announcement of a takeover; and this estimate excludes speculative increases in the period leading up to the announcement (Jarrell, Brickley and Netter 1988; Easterbrook and Fischel 1991).

In vibrant market conditions, even the slightest of head-starts is important to the division of gains from mergers and acquisitions. The size, cost and timing of an acquirer's toe-hold acquisition in the target play a decisive role in the incentives for mergers and takeovers and the probability of eventual success (see Box 1).

Pre-merger notification expands the window of opportunity for speculators and rival bidders to cash-in on the entrepreneurial insights of the notifying firm. This penalises firms with a comparative advantage in discovering undervalued assets because the 21 day delay clouds expected returns (Shughart 1987, 1989). The reduced incentives for entrepreneurship will mean that fewer profitable opportunities will be found and exploited. The result is lower national wealth than would otherwise be the case (Tollison 1986). US studies have found that pre-merger notification — and similar laws that increase the risk of premature disclosure or early market detection — reduce the number of, and social gains from, mergers and takeovers (Eckbo and Wier 1985; Jarrell, Brickley and Netter 1988; Easterbrook and Fischel 1991).

Box 1: Who gains from takeovers and when?

The division of the gains from mergers and acquisition between potential bidders and the existing owners of targets has important incentive effects.

Potential suitors face major costs — research, organising finance and risking exposure to a large bloc of poorly regarded shares if the bid fails. However, once the suitor's entrepreneurial insights and intentions are known, the target's share price may rise in anticipation of improved earnings, perhaps to the point where the takeover may be barely worth carrying-out (Krugman 1990).

Hence, a premature disclosure of a looming takeover — or earlier than expected detection by the market — will increase the share price of the target, reducing both the bidder's gains and the incentive to bid. Potential improvements in corporate performance will go undiscovered unless there are sufficient private rewards for identifying under-performing companies (Krugman 1990).

The probability of a successful takeover increases with the size of the bidder's initial toe-hold in the target. There is less room for others to mount rival bids or put together share blocs that are pivotal to the success of the initial bid and hold-out for more. Delay, disclosure or early detection allow band-wagon effects such as these to take hold. In addition, bidders can also afford to earn less and offer more for the remaining shares they need to acquire the larger are the profits from buying a toe-hold while the target's shares were under-valued (Ferguson 1994; Choi 1991).

It is still necessary for a takeover to succeed before any corporate restructuring can occur. However, a forward looking market will capitalise the discounted net present value of the additional earnings — adjusted for risk and uncertainty — into current share prices.

Numerous studies show that share price changes are very reliable indicators of changes in the value of companies; and that new information about a company is capitalised into its share price within the day that the news is released (Easterbrook and Fischel 1991).

There are two stylised facts about mergers and takeovers:

- the gains from corporate acquisitions, as measured by the takeover premia on shares, are large — to the order of a third to a half of the pre-takeover value of the acquired firm; and
- almost all of the gains typically accrue to the owners of the target (Peltzman 1991; Easterbrook and Fischel 1991; Jensen 1993; Pautler and O'Quinn 1993).

Takeovers are common, in part, because a shrewd bidder buys a substantial part of the target before his intentions are known. These initial purchases will be at a lower price — 30 per cent or more lower — than when the takeover is announced. Most of the bidder's profits

from a takeover come from these surreptitious purchases (Krugman 1990; Easterbrook and Fischel 1991).

The gains from mergers and acquisitions are substantial: the share price of investments as a whole (the combined value of targets and bidders) rise by 7 to 8 percent (Easterbrook and Fischel 1991). Williamson (1977) calculated that a 2 percent cost saving should offset the allocative inefficiencies from almost any increase in market power. Hence, the gains from an effective market for corporate control outweigh the benefits of stopping a few anti-competitive midnight mergers.

Opportunity costs to the TPC's enforcement program

The ORR questions whether an extensive compulsory pre-merger notification scheme is the best use of the TPC's resources given that the vast majority of mergers in Australia do not infringe the *Trade Practices Act* (Fels and Walker 1994, p. 96) and that the TPC already identifies the great majority of mergers in breach of s50. For example, while the TPC considered or investigated 53 percent more mergers in 1993-94 and the majority required a substantial degree of investigation and analysis, it "did not oppose substantively more mergers in 1993-94 than in 1992-93 (TPC 1994a, p. 36)." This suggests that returns from further resources being devoted to merger investigations, particularly in the traded goods sector, are falling.

The low threshold proposed will require the TPC to divert resources to the monitoring of many competitively neutral mergers. It could be expected that more investigations would be commenced under a pre-merger notification scheme.[8] This will result in an increased amount of work for the TPC (and cost) with little probability of a commensurate benefit in the prosecution of anti-competitive mergers. For example, the TPC's resources have been severely stretched since investigations began in 1992 for the Ansett, TNT and Mayne Nickless cases (TPC 1994b, p. 93).

Compulsory pre-merger notification is out of step with international practice in merger law enforcement. A survey of the 25 other OECD countries and 10 other large countries reveals that only 10 have a form of compulsory pre-merger notification (McLaughlin 1994).

[8] The TPC estimated that, under the pre-merger notification scheme it proposed to the Cooney Committee, the number of mergers considered would involve the consideration of 150 to 200 mergers in greater detail (Cooney 1991, p. 59). These figures are probably inflated because the proposed scheme would have supplied more voluminous information to the TPC.

5 SOME LESS BURDENSOME APPROACHES TO PRE-MERGER NOTIFICATION

Given the concerns discussed in Section 4, this section explores some less burdensome approaches to pre-merger notification.

5.1 A shorter notification period

The ORR believes that the 21 day merger delay imposed by the proposed pre-merger notification scheme is excessive. New Zealand experience suggests that a waiting period of far less than the 21 days is feasible.

The New Zealand Commerce Commission presently runs a merger clearance process with a 10 working day deadline.[9] The Commerce Commission recently said, regarding merger clearances, that:

> It will often require extensive investigation before the Commission knows enough about a market to be able to reach a view on this question. The relevant market must be defined, market shares must be assessed, and the state of current and potential competition must be judged. In most cases it is possible to do this within the prescribed 10 working days (Commerce Commission 1995, p. 8).

However, the Commerce Commission believes that even this time-frame can be reduced:

> The Commission favours the introduction of a highly streamlined mandatory pre-merger notification and approval system. It proposes a one page initial notification and a five working day waiting period before mergers can be implemented (New Zealand 1992, p.38).

If the New Zealand Commerce Commission can issue most merger clearances within 10 working days (and probably less) — and go through the much more demanding process of issuing draft determinations on *authorisation* in about 25 working days (Commerce Commission 1995, p. 8) — five working days notice should be sufficient time for the TPC to decide whether a proposed acquisition warrants further attention.

A five day period of notice should allow the TPC to make an initial assessment of the proposed merger and seek undertakings from the parties or an interim

[9] New Zealand law allows the Commerce Commission to issue clearances: these are confirmations that a business acquisition is not prohibited by the *Commerce Act* 1986 (NZ).

injunction. A shorter waiting period would reduce the regulatory burden of pre-merger notification on the market for corporate control.

The TPC has already shown an ability to act decisively on merger matters within time spans comparable to those proposed by the ORR for pre-merger notification. For example, the TPC was informed on 15 June 1994 of arrangements between Rank Commercial Ltd and Coles Myer Limited concerning the assets of Foodland Associated Ltd. The TPC made an application for an ex parte interim injunction on 28 June after fruitless negotiations with the parties over a number of days. Importantly, the TPC (1994b, p. 58) said that “Very early in its consideration of the matter the Commission came to the conclusion that such a takeover would breach the s. 50.”

5.2 A corporate duty to notify

Prior notification imposes costs on all major mergers in the hope of stopping those few mergers that are irregular but otherwise go undetected. However, it is often the case that only a small percentage of given transactions require scrutiny. If so, it is more efficient to detect the irregular transactions after the event and impose high enough penalties to act as a deterrent in the future. This view is consistent with the role of penalties as construed by Australian courts:

> The penalty should constitute a real punishment proportionate to the deliberation with which the defendant contravened the provisions of the Act. It should be sufficiently high to have a deterrent quality, and it should be kept in mind that the Act operates in a commercial environment where deterrence of those minded to contravene its provisions is not likely to be achieved by penalties which are not realistic.[10]

Although deterrence is imperfect, scrutinising every transaction is costly. To encourage relevant parties to disclose their intentions, the ORR recommends that the *Trade Practices Act* be amended to impose monetary penalties (in addition to the already existing risk of penalties and divestment) upon those corporations knowingly involved in a merger who did not notify the TPC where that merger was later found to be in breach of s50.

This notification requirement would be a corporate duty to notify. A corporation can, because of its status as a separate entity, be bound by a duty as any other person can. Courts are already required to consider many duties that may fall upon a board collectively and its directors individually (see Ford 1992, pp. 458-481); there is no conceptual difference for a duty applied to a corporation.

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[10] *TPC v Stihl Chain Saws (Aust) Pty Ltd* (1978) ¶40-091 at 17,896 per Smithers J. See also *TPC v CSR Ltd* (1991) ATPR ¶41-076 per French J.

To reduce the burden of this proposed notification scheme, the *Act* should be amended to provide corporations which failed to notify the TPC with a two-part defence made up of subjective and objective elements:

- the corporation must have judged that the TPC would not challenge the merger — the subjective element[11]; and
- it must have been reasonable for the corporation to make this judgement — the objective element.

Such a defence is clearly capable of judicial enforcement; in the influential case of *AWA Ltd v Daniels (No 2)*,[12] Rogers J successfully applied the directors' duty of care and diligence — s232(4) *Corporations Law* — which contains both subjective and objective elements.

The principal means of identifying mergers that require notification is through the TPC's merger guidelines (TPC 1992). The guidelines should set out the enforcement priorities and methodology of the TPC in a transparent manner. Secondly, the TPC should specify which industries it considers to be somehow special so that corporations can determine whether proposed mergers within those industries will, or will not, be challenged. For example, it would be reasonable for the TPC to state that it would not expect to challenge mergers in the traded goods sector.

The duty to notify (and the attendant defence), in conjunction with transparent merger guidelines, should allow the TPC to focus on mergers that have the potential to substantially lessen competition. The ORR's proposal recognises that in the overwhelming majority of cases, mergers are competitively innocuous, particularly in the traded goods sector.

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[11] In considering the subjective element of the proposed defence, courts would determine the corporation's subjective intent as though the corporation were a real person — the approach adopted is akin to determining the corporation's intent in a criminal case. The courts have shown an ability to do this by focusing on certain categories of people who have power to commit the company to a course of action. Having found them, it is a matter of looking at their acts and their state of mind. The search is for people who, although some are servants or agents for many purposes, are charged with such a degree of responsibility for the management of the company that they can be said to be acting as the corporation rather than *for* the corporation — the directing mind — *Tesco Supermarkets Ltd v Nattrass* [1972] AC 153 at 170 per Lord Reid. The judgement made by the corporation need not be that of one particular individual alone. A company can have made a judgement which is a composite of different items of knowledge each possessed by different individuals, at least where the separate judgements are not contradictory — *Brambles Holdings Ltd v Carey* (1976) 15 SASR 270, 2 ACLR 176.

[12] (1992) 9 ACSR 383; 10 ACLC 1643. In this case Rogers J distinguished between the standard of duties for executive and non-executive directors.

6 CONCLUSION

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