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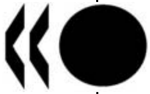

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Global Forum on Competition

ROUNDTABLE ON CROSS-BORDER MERGER CONTROL: CHALLENGES FOR DEVELOPING AND EMERGING ECONOMIES

Contribution from UNCTAD

-- Session I --

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CROSS-BORDER MERGER CONTROL: CHALLENGES FOR DEVELOPING AND EMERGING ECONOMIES

-- UNCTAD --

1. Introduction

1. Over the last 30 years, countries have liberalised and reduced policy impediments on foreign direct investment (FDI) and trade, speeding up the rate of globalization. This has resulted in the increased propagation of cross-border mergers, acquisitions and concentrations that impact multiple markets around the world.

2. FDI in developing countries has largely taken the form of M&A activity and is closely linked to efforts by developing states to privatize industry and create viable and competitive market economies. Unfortunately, in most developing nations this liberalization has not necessarily been coupled with appropriate and complementary regulatory measures to curb potential anticompetitive and other activities that harm markets. As the primary tool available to mitigate potential anticompetitive effects of mergers on both domestic and cross-border levels, competition law and policy (including merger control) is more important than ever before.

3. The domestic nature of merger control presents significant challenges for enforcement on cross-border transactions, particularly for developing countries and emerging economies. Increased cooperation between competition authorities in different jurisdictions has proved useful to tackle these challenges and further such cooperation should be encouraged, both among competition authorities in developing countries and between competition authorities in developed and developing countries.

2. Challenges arising from cross-border mergers

4. Merger control regimes of developing countries and economies in transition should have the capacity to deal with the following two kinds of cross-border mergers:

- Mergers directly involving local firms; and
- Mergers between major foreign Transnational Companies (TNCs) that have a bearing on the domestic market of a third country.

2.1 Cross-border mergers involving local firms

5. Cross-border mergers involving local firms may have a positive effect on competition if, for example, the target domestic firm is ailing and would otherwise exit the market; a very welcome state of affairs for developing countries particularly during or in the wake of a recession. Furthermore, they may challenge established domestic oligopolies by strengthening smaller domestic firms, thereby introducing more effective rivals to the market. Cross-border mergers may also increase competitive pressure on domestic firms leading to an increase in product quality, variety and innovation in host economies (UNCTAD, 2000).

6. On the other hand, cross-border mergers of this sort may reduce competition and increase market concentration and have an adverse social impact. Such circumstances include, inter alia:

- Where the acquiring firm was exporting substantially to a market before it acquires a competing firm in that market, thus reducing import competition;
- Where a foreign firm with an affiliate already in the market acquires another, thereby acquiring a dominant market position;
- Where an investing foreign firm acquires a market leader with which it has previously competed;
- Where the acquisition is intended to suppress rather than develop the competitive potential of the acquired firm; and
- Where parent firms of foreign affiliates located in a host country merge, increasing concentration and reducing local competition (UNCTAD, 2000).

7. Analytically, this type of cross-border merger should not present competition authorities of developing countries with any further challenges than those posed for the regulation of domestic mergers. This is because in relation to such mergers national laws apply as there is a clear nexus between the transaction's effects and the domestic jurisdiction. However, various other considerations unique to developing countries make the regulation of mergers challenging in this context.

8. In the first instance, merger control regimes do not always exist in developing and transitioning countries, even where there are laws regulating other forms of anticompetitive behaviors. This clearly makes regulation of anticompetitive effects of cross-border and any other mergers nearly impossible. Mergers affect market composition and structure and thus have a significant impact on policy areas beyond competition. As mentioned above, cross-border mergers make up a large proportion of FDI and are often encouraged by governments, particularly in developing countries seeking growth and stability. As such, merger control is often not prioritised despite the potential long-term detriments arising from anticompetitive mergers to growth and development.

9. The challenge for developing countries is to examine and reform their broader regulatory frameworks in such a way that complements the principles of competition and merger control. This involves the creation of a competition culture, whereby the benefits of competition are well known and accepted in government and policy making circles and the perils of excessive State intervention are understood. This is particularly pertinent in the context of mergers which have a long term effect on market structure and are difficult to reverse. Increased consciousness of potential anticompetitive effects of a merger in political and government circles will ensure that long-term and permanent positions are not applied to short-term problems in a manner that limits future options.

10. That being said, it is important to recognize the valid and unique needs of developing countries in relation to mergers. It may be appropriate for developing countries in relation to specific sectors for example, to tailor merger rules in such a way that they are able to co-exist with other policy objectives without compromising fundamental competition principles. Public interest exceptions resorted to in relation to the banking sector during the recent financial crisis such as the UK's Lloyd's TSB/HBOS merger, present useful examples of limited and sector specific exceptions to merger rules. The open and transparent manner in which the Lloyds'/HBOS exception was carried out should not go unnoticed (See UNCTAD, 2010).

11. Where merger control regimes do exist in developing countries and economies in transition, there are often difficulties with effective enforcement of the merger rules. This is due in part to substantial power asymmetries existent between small economies and large TNCs. Developing economies, which usually present a small part of foreign TNCs' total world operations, cannot always make a credible threat to prohibit such mergers. Attempts by competition authorities of developing economies to place significant restrictions on the mergers of TNCs could result in their exit from the market altogether potentially causing significant detrimental effects to the developing country's welfare (UNCTAD, 2007). Such considerations only compound the existing comparatively weak internal systems of protection of competition in many developing countries and transitioning economies usually due to social, political and financial restraints. Furthermore, it should be noted that most of these challenges are not unique to the issue of merger regulation but are faced in relation to almost all other governmental regulation particularly in developing countries.

2.2 Foreign-to-foreign mergers

12. In today's globalized world, mergers involving TNCs (typically from developed nations) may impact competition in numerous jurisdictions. For example, where two foreign suppliers merge, this may result in oligopsony or even monopsony situation in a third country's market whose firms were previously reliant on both suppliers.[1]

13. In order to deal with such cross-border anticompetitive effects, competition law agencies (primarily in the developed world) reach beyond their borders and apply national merger control laws to concentrations between companies based abroad. This position is justified by the "effects doctrine" under public international law, which allows such extraterritorial application of domestic rules when it is foreseeable that a proposed concentration will have a substantial effect in a given State's territory.[2]

14. A recent example of unilateral merger control enforcement on a foreign-to-foreign cross-border merger can be found in Brazil. In its ordinary session of 4 October 2006, CADE (Conselho Administrativo de Defensa Economica) approved with restrictions a merger in pharmaceutical sector between two European companies, Axalto Holding (Netherlands) and Gemplus International (Luxembourg). The companies produce plastic security cards and commercialized software, hardware and related services and the analysis was mainly based on the impact of the dominance of technological resources on competition. CADE imposed commitments upon the companies obliging them to license their patents related to subscriber identity module (SIM) cards that are deposited in Brazil to any interested parties operating in the Brazilian market in a fair, reasonable and non-discriminatory manner (UNCTAD, 2008)(2).

15. However, this seemingly tidy solution to the potential anticompetitive effects of cross-border mergers does not always play out so easily in practice. Competition law agencies of developing countries in particular, struggle to unilaterally enforce their domestic laws on an international scale again owing to their limitations in relation to financial and human resource scarcity, a lack of competition culture, and political economy constraints, amongst other reasons. In fact competition authorities in the developing world are often impotent in the face of global mergers and acquisitions for fear of retaliatory action by some large firms' home country, political interference, and again fear of frightening way FDI (UNCTAD, 2001). This is particularly problematic in light of the often vulnerable status of the markets of developing countries. Given their comparatively small size and limited market diversity, markets in developing countries are more keenly affected by large cross-border mergers; be they positive or negative. Any negative impact, including anti-competitive effects, is therefore compounded by low levels of effective regulation.

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1 The Cocoa industry presents a useful example of this, see UNCTAD 2008 (1).

2 See Judgment of the Court of First Instance of 25.3.1999 in case T-102/96, *Gencor Ltd v Commission*, (1999) E.C.R., page II-0753, at paras. 89-92

3. Possible Solutions

16. As a first priority, developing countries and economies in transition must strive to establish well-functioning competition law and policy regimes as well as credible enforcement institutions, in order to effectively regulate cross-border mergers.

17. Three activities that can contribute to this end are as follows.

- **Implementation of competition laws and policies and creation of competition institutions**

18. There are now over 112 countries with competition laws around the world, many of which are developing countries and economies in transition. However, although fundamental, this is just the first step. Developing countries and countries in transition are at varied levels of actual implementation and effective application of competition rules and merger regulations. This is fundamentally because establishing and maintaining an effective competition authority is not easy. Considerable political, human resources and financial investments are required as well as mechanisms of monitoring and enforcement. In addition, it is essential that competition laws and institutions of developing countries are independent and command the respect of both market and political players at home and abroad if they are to be effective in their enforcement activities. Again, this is not easily achieved.

19. Developing countries must therefore be proactive and seek financial and technical assistance wherever available. Robust domestic advocacy campaigning is also essential in this respect (see point 3 below).

- **Engage in cooperative activities on bilateral, regional and international levels to achieve greater convergence on application of merger rules, share experiences and exchange information**

20. As merger control is implemented at the domestic level, different jurisdictions conduct independent analyses simultaneously leaving room for discrepancies in the quality and standards of merger control enforcement among different jurisdictions in relation to the same cross-border merger. In addition, such duplication of regulatory effort increases costs for both competition authorities and businesses and creates uncertainty for businesses.

21. In the absence of a binding multilaterally agreed framework for competition law and policy, national competition authorities have chosen instead to enter into regional and bilateral cooperation agreements in a bid to achieve convergence on merger control rules. Such agreements often incorporate provisions on the exchange of information and a requirement to consider any anticompetitive impact of a given merger on another jurisdiction. For example, under the Cooperation Protocol for Merger Review between the Australian Competition and Consumer Commission and the New Zealand Commerce Commission, the agencies agree to inform each other of proposed merger transactions that may involve trans-Tasman operations or impact the other country's market.

22. Although a number of regional groups in the developing world, such as Caribbean Community (CARICOM) and East African Community (EAC), have developed regional competition law regimes, they continue to struggle with effective enforcement (Stewart, 2005). On the bilateral level, few bilateral agreements exist either among competition authorities in the developing world or between competition authorities of developed countries and developing countries (Stewart, 2005). In relation to the latter, this is partly due to the focus of developed countries on cooperation with authorities from other developed economies, whose anticompetitive activities have greater potential to cause harm on their domestic markets. A combination of limited resources, low levels of confidence and conflicting political objectives

between countries and competition agencies also dampens incentive to enter cooperation agreements, which require authorities to relinquish a degree of power and autonomy, particularly in the exchange of (sometimes confidential) information.

23. Nonetheless, increased cooperation among competition authorities reduces inefficiencies and inconsistencies, raises the bar on the quality of merger analysis and improves merger control enforcement. Such cooperation should not be limited to official agreements but should include informal interactions and relationships which competition authorities have found to be equally or even more valuable than official agreements (UNCTAD, 2007). Developing countries should also seek capacity building and technical assistance from competition authorities of developed countries and international organizations in order to assess the likely impact of individual mergers on the market structure in their countries.

24. It is also in the interests of developed countries to make efforts to cooperate with competition authorities in developing countries and countries in transition given the changing dynamics of cross-border merger activities. There are an increasing number of mergers originating from larger developing countries and targeting businesses and markets in the developed world. The recently announced joint venture between China's oil and gas producer, PetroChina and INEOS, a leading British chemical company in relation to trading and refining activities at INEOS's refineries in Scotland and France is one example of this.

25. However, it should be noted that cooperation will be most likely and beneficial where national perspectives coincide and where cooperation is well managed. For developing countries therefore, it would be beneficial to focus merger control on shared issues with nearby and like-minded countries.

- **Develop a competition culture by engaging in advocacy (domestically and internationally) and participating in international forums on competition such as the OECD Global Forum, UNCTAD and the ICN to raise awareness and seek technical assistance**

26. The role of advocacy cannot be overemphasised for the effective regulation of cross-border mergers. On the national level, policy makers should be made aware of the potential long term adverse effects on domestic markets if anticompetitive cross-border mergers are not prevented. On the international scale, developing countries should endeavour to apprise more advanced agencies of the effects of cross-border mergers on developing countries' markets and express a need for more cooperation. This will also require greater openness from competition authorities of developed countries. International forums such as UNCTAD, the ICN and the OECD Global Forum present ideal opportunities to facilitate such interaction and dialogue and also allow for exchange of best and relevant practice, encouraging convergence and cooperation even without bilateral or regional agreements.

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