MERGER CONTROL IN SMALL MARKET ECONOMIES

Most jurisdictions with new competition policies adopt the competition laws and policies modelled on those of the European Union ("EU"). However, this article argues that optimal merger control design should accommodate the features unique to small market economies. Merger control laws are accordingly not "one-size fits all", and laws transplanted from large market economies, such as the EU, require adaptation to the conditions of small market economies. This article suggests some methods and tools that small market economies can employ to achieve optimal benefits from merger control laws.

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I. Introduction

1 There have been concerns expressed that if one should accept that "size does matter", this could imply a less stringent application of competition law. As stated by the European Commission, it sees:[1]

> … no reason to modify competition laws or their application according to the size of the relevant geographic market, and consider[s] as counter-productive and dangerous arguments that competition laws should be diluted or [misapplied] in order to allow 'national champions' to develop, regardless of the size of the jurisdiction or market.

2 This article argues that for small market economies to achieve optimal benefits from merger control laws, merger control design should accommodate the unique features of small market economies. As will be discussed in this article, it is important to remain aware of the implications of "smallness". "Smallness" leads to a tendency for high concentration and high entry barriers in many industries, so that small market economies face different welfare maximisation issues, amongst other regulatory challenges, compared with large market economies. In particular, competition authorities in small market economies more

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1 International Competition Network ("ICN") Special Project for the 8th Annual Conference, *Competition Law in Small Economies*, Prepared by the Swiss Competition Commission and Israel Antitrust Authority <http://www.internationalcompetitionnetwork.org/uploads/library/doc385.pdf> (accessed 15 July 2015).

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regularly face the challenge of achieving a right balance between allowing firms to be large and integrated enough to achieve scale economies, and at the same time, numerous enough to ensure effective rivalry in the market.[2] Thus, merger control laws are not "one-size fits all", and laws transplanted from large market economies such as the European Union ("EU") require adaptation to the conditions of small market economies. This is an issue that competition authorities of small market economies should not take lightly, as it determines the extent to which their economic goals can be achieved through the adoption of competition laws.

3 A separate but related issue on merger control is whether small market economies should even have merger control laws at all. Indeed, merger control laws are relevant to all economies. Firstly, mergers leading to consolidation within an industry can result in allocative and productive inefficiencies, due to weakened competition and hence incentives for cost control. Although "national champions" may be beneficial to the economy in limited circumstances, such as in economies highly dependent on exports for revenue, monopolies can enjoy "monopoly rent" without becoming more competitive abroad or passing on any benefits, at the expense of domestic consumers and eventually of the development of the economy as a whole. Secondly, merger control laws enable economies to challenge foreign mergers that might have adverse effects on local markets. Thirdly, sole reliance on *ex-ante* provisions akin to Arts 101 and 102 of the Treaty on the Functioning of the European Union will be limited in scope and effectiveness. The prohibition of cartels, while having no enforcement powers against cartel members if they merge, is unwarranted. Investigations into abuses of dominance are often lengthy, cumbersome and complex, and competition authorities in small market economies may lack the resources to police every alleged infringement.

4 For small market economies looking at implementing new merger control laws, this article suggests some methods and tools that can be considered to ensure that optimal benefits are derived from the adoption of a merger control regime.

5 Part II of this article will set out the definition and essential characteristics of a small market economy.[3] Part III will describe issues faced by small market economies in the application of merger control laws.[4] Part IV will consider aspects of EU merger control laws that may

2 Michal S Gal, "Size Does Matter: The Effects of Market Size on Optimal Competition Policy" (2001) 74 *South California Law Review* 1437 at 1441.

3 See paras 5–10 below.

4 See paras 11–27 below.

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be adapted and in some respects followed for optimal merger control design in small market economies.[5]

II. Definition of a small market economy

6 Before delving into the main issues, it is essential to first define the concept of a "small market economy" which forms the focus of this article's analysis. Small market economies, as the name suggests, are states, countries or political units where domestic demand is small relative to the minimum efficient scale of production or distribution, *ie*, the scale at which average cost is minimised.[6] According to Michal Gal, three main economic characteristics arise from the large size of minimum efficient scales relative to demand: high industrial concentration levels, high entry barriers and suboptimal levels of production.[7] Such economies can support only a small number of competitors in most of their industries when catering to demand.[8] This can be attributed to some or all of the following elements that are generally present in small market economies – limited natural resource endowments; insularity and transport costs; small population pool, which determines the number of firms that can efficiently serve the market; population dispersion, which may create market regionalisation through several small local markets within a larger jurisdiction; small domestic markets; high reliance on import and export markets; high government participation in many sectors, with public undertakings advocating for exclusion from competition law provisions due to the "social role" of such entities; and the presence of state aid to permit some form of level playing field.[9]

7 Therefore, it is based on the above characteristics underlying a "small market economy" that this article will carry out its analysis. Examples of small market economies would include Australia, New Zealand, Israel, Singapore, Sweden, the Hong Kong Special Administrative Region ("Hong Kong"), Malta and the Baltic states.

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5 See paras 28–76 below.
6 Organisation for Economic Co-operation and Development ("OECD") Global Forum on Competition, *Small Economies and Competition Policy: A Background Paper* (CCNM/GF/COMP(2003)4) at p 4.
7 Michal S Gal, "Merger Policy for Small and Micro Jurisdictions" in *More Pros & Cons of Merger Control 2012* (Konjurrensverket – Swedish Competition Authority) at p 70.
8 Michal S Gal, "Size Does Matter: The Effects of Market Size on Optimal Competition Policy" (2001) 74 *South California Law Review* 1437 at 1439.
9 This is especially where the economy's small size and insularity has a bearing on costs of production.

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8 However, some qualifications to this definition must be made.[10] Firstly, not all industries in the economy will be highly concentrated even where an economy is considered to be small. Some industries such as the retail industry are highly competitive even in small economies. These are industries where scale economies are of less importance, as costs do not decrease significantly as output expands. Secondly, where firms located in small economies compete in international markets, the size of the domestic market may not constrain the scale and scope of production. Nonetheless, such firms tend to form the exception rather than the rule in small market economies. Thirdly, some independent sovereign economies can be classified as small market economies based on the relative concentration of market structures within most of their industries rather than on geographic size. Australia, in particular, is much larger geographically but can still qualify as a small economy because of market regionalisation where the population is dispersed over large geographic areas but concentrated around several urban centres. Therefore, although the above definition suffices to sketch out the basic elements of a "small market economy", it is important to note that these are not immutable characteristics.

9 A further objection to this definition also needs to be addressed. While this concept of a "small market economy" has been widely accepted, it has been criticised in an Organisation for Economic Co-operation and Development ("OECD") background paper for not addressing the concerns of other economies that may be "small" in other senses, such as (a) population and GDP; and (b) level of development.[11] Whether recommendations made on the premise of Michal Gal's interpretation of a small market economy would be useful is therefore questioned, as it is observed that policy recommendations derived from this approach did not appear to differ significantly from best practices of developed economies.[12] Nevertheless, the importance of defining a small market economy lies primarily in its function of distinguishing its qualities from large economies rather than in its descriptive principles. Crucially, Michal Gal's interpretation serves to highlight that economies falling within the definition possess characteristics that justify a need for systematic differences in "rules of thumb" being applied in large market economies. This is exemplified by criticisms of the European Commission's decision in the *Volvo/Scania* merger,[13] where the application of EU merger control laws has been viewed as placing

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10 Michal S Gal, "Size Does Matter: The Effects of Market Size on Optimal Competition Policy" (2001) 74 *South California Law Review* 1437 at 1441.

11 OECD Global Forum on Competition, *Small Economies and Competition Policy: A Background Paper* (CCNM/GF/COMP(2003)4) at p 15.

12 OECD Global Forum on Competition, *Small Economies and Competition Policy: A Background Paper* (CCNM/GF/COMP(2003)4) at p 15.

13 COMP/M 1672 *Volvo/Scania* [2001] OJ L 143/74.

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merging parties located within small Member States at a disadvantage.[14] The *Volvo/Scania* merger showed that asymmetry in the application of EU merger control laws stemmed from the use of market definition as an easily available proxy for the measurement of the market power enjoyed by firms, which in turn was dependent on the size of the relevant markets within each Member State. Potential discrepancies in developmental or GDP levels of the EU Member States in question were not seen as relevant to the issue of market definition. Accordingly, a similarly sized company active in either a small or large Member State would thus find its possibilities to merge in a small Member State more limited, as a dominance finding would be more likely in a smaller than larger Member State. This therefore serves to illustrate the abiding value of Michal Gal's conception of a "small market economy" in competition law analysis, which OECD's objection fails to diminish.

10 Based on this definition, the next part of this article will turn to describing the issues faced by small market economies in the application of merger control laws.

III. Issues faced by small market economies in merger control

11 With a growing number of countries adopting competition policies worldwide, the tension between regulatory consistency across jurisdictions and the need for policies that are tailored to each jurisdiction's needs is thrown into sharp relief. The main driving force has been the proliferation of bilateral and multilateral trade agreements since the 1990s, which required parties to adopt and enforce competition legislation.[15] Correspondingly, more jurisdictions have, or are at least in the process of adopting, merger control policies. Newer competition agencies tend to look to developments in more mature jurisdictions like the US, the UK and the EU for case law developments and best practices. Nonetheless, to date, most of the 100 or so jurisdictions that have adopted competition laws have based their laws on an administrative enforcement model that resembles the EU regime, as opposed to the adversarial prosecution model of the US.[16] Examples of small market economies that

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14 See, *eg*, Henrik Horn & Johan Stennek, "The Political Economy of EU Merger Control: Small vs Large Member States" in *The Political Economy of Antitrust (Contributions to Economic Analysis, Volume 282)* (Vivek Ghosal & Johan Stennek eds) (Emerald Group Publishing Ltd, 2007) at pp 259–285.

15 See, *eg*, United Nations Conference on Trade and Development, *Implementing Competition-Related Provisions in Regional Trade Agreements: Is it Possible to Obtain Developmental Gains?* <http://unctad.org/en/Docs/ditcclp20064_en.pdf> (accessed 15 July 2015).

16 *Research Handbook on International Competition Law* (Ariel Ezrachi ed) (Edward Elgar Publishing, 2012) at p 238. Jurisdictions that have adopted the European Union's competition laws, in whole or in part, include Luxembourg, Switzerland, Sweden, Finland, Malta, Jamaica, Ireland, Cyprus, Denmark, Israel and Singapore.

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have adopted, whether in full or in part, EU merger control laws include Sweden, Malta, Ireland, Israel and Singapore.

12 On the one hand, consistency in the development of competition law principles under EU merger control laws and the adoption of best practices of the Commission helps provide legal certainty to local firms and foreign investors in the conduct of their businesses. Here, they allow firms to better assess their legal risks based on accepted practices and to adjust their behaviour accordingly. Moreover, EU merger control laws also provide a well-established body of law and jurisprudence, which helps reduce uncertainties and resulting costs of administering competition policy in small market economies. On the other hand, given that small market economies have distinct considerations for achieving effective competition domestically, transplanted laws that do not deal effectively with such considerations may do more harm than good to the economy.

13 Thus, for small market economies to conceive an effective merger policy balancing this tension, it is crucial to first understand the regulatory challenges that small market economies commonly face in the implementation and enforcement of merger control laws.

A. Higher occurrence of concentrated market structures

14 Small market economies face regulatory challenges that arise from concentrated market structures more frequently than large market economies. Given the small size and isolation of markets within small market economies,[17] a larger fraction of domestic markets can be expected to be concentrated even though competitive industries (*eg*, retail) may also exist.[18]

15 Many businesses within small market economies face the problem of achieving efficient scales of production as a result of the characteristics listed in Part II[19] of this article, leading to high industrial concentration levels, high entry barriers and suboptimal levels of production within small market economies.[20] Efficiency imperatives often require industrial concentration in small economies to be high enough in some industries to allow some market power to be realised.

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17 Even in small market economies that impose few restrictions on international trade, distance to trade can also impact on the level of competitiveness of many of its markets. New Zealand is an exemplification of this problem.

18 Lewis Evans & Patrick Hughes, *Competition Policy in Small Distant Open Economies: Some Lessons from Economics Literature* (New Zealand Treasury Working Paper 03/31December 2003) at p 28.

19 See paras 5–10 above.

20 Michal S Gal, "Size Does Matter: The Effects of Market Size on Optimal Competition Policy" (2001) 74 *South California Law Review* 1437 at 1445.

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16 Regulatory authorities in small market economies therefore face on a more regular basis the following dilemma in implementing merger control laws. On the one hand, mergers are an important way for firms to grow to such efficient sizes that, in turn, serve to reduce productive and dynamic inefficiencies. The implementation of merger control laws in such economies could lead to a much higher frequency of blocking business concentrations that could potentially benefit the local economy if based on comparable thresholds, presumptions and enforcement policies as those applied by the European Commission. This could especially lead to a higher frequency of "type I errors" in merger assessments involving companies residing in small market economies. On the other hand, potential efficiencies created by mergers can be adversely affected by monopolistic market behaviours, which tend to be engaged by producers in highly concentrated industries and in market conditions where "everyone knows each other". Hence, competition authorities in small market economies more frequently encounter conflicts between ensuring market efficiency on the one hand, and competitive conditions in domestic markets on the other. The latent risk of misapplying competition law, and the impact of such mistakes on the small economy, also tend to be greater, especially if this can lead to a loss of investor confidence in the small economy's approach to the rule of law.

B. An over-reliance on structural measures can be counter-productive

17 Small market economies have to exercise caution in the wholesale adoption of EU merger control policy, which places heavy reliance on structural measures that may be inappropriate to merger analysis in their particular context. In small market economies, relatively large firm size may be required to achieve minimum efficient scale ("MES"). High levels of industrial concentration may be required to achieve productive efficiency, which should be assessed for anti-competitive effects on a case-by-case basis. As such, pursuing a merger control policy which is premised on the view that high concentration levels are undesirable may not be optimal, especially in conditions where markets are so small in relation to MES that the presence of oligopolies are inevitable. In this respect, EU merger control laws place emphasis on structural measures in merger assessment, which imply elimination of potential efficiency-enhancing merger activity. For instance, at para 27 of the European Commission's *Guidelines on the Assessment of Horizontal Mergers*,[21] it states that "[although] market shares and additions of market

21 Official Journal C 31 of 05.02.2004.

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shares only provide first indications of market power and increases in market power, they are normally important factors in the assessment".[22]

18 Where merger analysis is premised on a heavy reliance on structural indicators of market power, the resulting policy may be unsuitable for small market economies for several reasons. For one, insufficient value may be placed on efficiencies in mergers and trade practices. For example, mergers can lead to benefits for the firms and society involved through efficiencies arising from scale economies or integration of operations. As the World Bank observed, the application of structural measures to ensure competition in mergers and acquisitions may prevent domestic firms from achieving the minimum size needed to compete in international markets.[23] Indeed, even the potential threat of hostile takeovers can keep management on its toes.[24] For another, *de facto* market definition may be seen to determine the outcome of a case. This is particularly problematic in small market economies where it is natural, given the size and vulnerability of domestic markets, for several economic sectors to develop monopolistic or oligopolistic structures in order for investment to be feasible and forthcoming in such sectors. In these ways, the nature of small market economies could pose additional challenges in adopting EU merger control policy.

19 By extension, regulation that is premised to a large extent on EU merger control policy could be ill-suited to small market economies. For one, EU merger control has been criticised as making it impossible for companies in small countries to merge and obtain a leading global position. Although this criticism has been often cited as a "national champion"-type argument put forth by small market economies to protect domestic enterprises, the fact that relevant markets in small market economies are smaller justifies a fuller consideration of the impact of size on the merger review process. For instance, the *Volvo/Scania* merger[25] cited above has been observed by commentators to reflect the EU Merger Regulation's ("EUMR")[26] inherent discrimination against large domestic companies residing in small EU Member States. For

22 See also para 17 of the European Commission's *Guidelines on the Assessment of Horizontal Mergers* (Official Journal C 31 of 05.02.2004), which shows an almost *de facto* approach based on the firms' market shares, when considering if a merger leads to the creation or the strengthening of a dominant position.

23 "What are the Typical Structural Provisions in Competition Law?" (The World Bank Group, www.worldbank.org), cited through U Bernitz & I Gutu, "The Effect of EU Merger Policy on Large Multinationals Based in Sweden and Other Smaller EU Member States: Is the Policy Discriminatory?" [2003] ECLR 19 at 20.

24 Mats A Bergman, Maria Jakobsson & Carlos Razo, *An Econometric Analysis of the European Commission's Merger Decisions* (Working Paper Series 2003:6) (Uppsala University, Department of Economics).

25 Case COMP/M 1672 *Volvo/Scania* [2001] OJ L 143/74.

26 Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings.

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another, merger control laws in small market economies may lead to firms, which find it harder to merge, preferring to place their headquarters, or in the extreme circumstance conducting their business activities wholly, in larger market economies where mergers with other firms, a typical corporate expansion strategy, would not face as high a likelihood of prohibition under merger control laws with comparable structural thresholds. A strict application of EU merger control laws in small market economies may therefore have the unhappy consequence of causing companies to leave the small economy altogether, rendering consumers worse off.

C. Market failures and externalities

20 In regulating small domestic markets, especially in small island economies such as Singapore and Malta, it is more likely that one will find market failures, where the allocation of goods and services by a free market is not efficient due to the existence of markets that can support only a limited number of competing players. As a result, businesses are less likely to take into account the broader social and environmental effects generated by their actions, and there is a need for policy space to recalibrate negative effects that arise from business activity within the free market. For instance, Malta views certain business activity to have a tendency to impact the environment in terms of emissions, noise, transport activity and unsightly structures.[27] In such cases, market forces cannot be relied upon to ration supply and demand, and it may be necessary in small states to limit the number of producers on environmental grounds, permitting existing producers to enjoy dominance even if the market can take more suppliers.[28]

21 Nevertheless, while there may be scope for intervention by the State in market failures, such interventions are also at risk of setting off economic distortions and wasteful rent-seeking behaviour. In this way, small market economies are hard-pressed to ensure the applicability of competition possibilities in a small country.

D. Susceptibility of domestic firms to international prices/producers

22 Domestic firms in small market economies are more susceptible to the pressures of the international market. Small market economies have very limited ability to influence the prices of exports and tend to be price takers to a higher extent due to the relatively small volume of trade

27 OECD Global Forum on Competition, *Competition Policy in Small Economies – Malta* (CCNM/GF/COMP/WD(2003)32) at p 10.

28 OECD Global Forum on Competition, *Competition Policy in Small Economies – Malta* (CCNM/GF/COMP/WD(2003)32) at p 10.

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in products they export or import internationally. Where trade barriers are significantly lowered, such pressures faced at the international level will also be felt within the domestic market, such that domestic players face the full pressures of an open (and liberalised) market. This was one of the considerations underlying the Israeli Competition Authority's approval of a merger between two domestic firms in *Kelet/Taal*,[29] which was determined to be essential to allow the merging parties to compete with imports. A proposed merger in the same market several years before, when trade barriers were higher, had not been approved.[30] Indeed, due to limited domestic demand, domestic players commonly argue for a need to achieve a critical size to be able to compete on the international market. In this regard, mergers may be efficient counter-strategies available to domestic firms in the face of reduction of trade barriers and entry of foreign firms into their markets through imports or local subsidiaries.

23 To be sure, although the "national champion" argument should be viewed with caution by competition authorities, as benefits deriving from a large domestic firm's ability to compete may not be passed down to consumers,[31] some academics have argued that large enterprises are better suited to compete in international markets where they have a strong home market that is able to support them with the critical mass to become world players.[32]

24 Accordingly, small market economies may face pressures from domestic enterprises to treat mergers that increase the competitiveness of domestic firms in the domestic and export markets more favourably, even if they increase the level of concentration within the relevant industries. Inflexible application of policies premised on EU merger control laws could lead to large costs in terms of competitiveness of large-sized firms residing in small market economies.

E. Limited resources

25 On account of the greater role of trade in small market economies relative to large market economies, small market economies are likely to be more affected by merger activity taking place outside their jurisdiction

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29 Approval of a Merger between Kelet [1991] Ltd and Taal Taasiot Etz Lavud Kvutzat Mishmarot Ltd (Director of Israeli Competition Authority, unpublished, 2 February 2002).

30 Non-approval of a merger between Taal and Levidei Ashkelon, Inc (Director of Israeli Competition Authority, unpublished, 4 October 1998).

31 For instance, due to lack of international price discrimination measures.

32 Examples of the "national champion" argument have been cited in Henrik Horn & Johan Stennek, "EU Merger Control and Small Member State Interests" in *The Pros and Cons of Merger Control* (report commissioned by the Swedish Competition Board, 2002) at p 100; and Michal S Gal, *Competition Policy for Small Market Economies* (Harvard University Press, 2003) at p 201.

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than large market economies. Small size often implies poor natural resource endowment and a relatively high import content in relation to GDP, with little possibilities of import substitution.[33] In the case of Singapore, its high dependence on foreign demand (apart from actual small geographic and population size and limited natural resources) is significant.[34] For the period 2010 to 2012, Singapore's trade to GDP ratio for the period 2010 to 2012 was 400.2% compared to the US's ratio of 29.5%.[35] Hong Kong has a similarly high trade to GDP ratio of 419.1%.[36]

26 However, whilst extraterritoriality is an efficient tool for large jurisdictions that possess sufficient power over foreign firms to command obedience, the capacity of small market economies to enforce competition law regimes is severely constrained by their relative size in the international economic sphere. Small market economies often lack the requisite power or resources to discipline foreign entities, especially where the main merging activities take place in a foreign jurisdiction, even if such mergers significantly affect their economies. In these ways, as a comparatively minor player in the international domain, small market economies may be ill-equipped to enforce domestic merger control laws.

27 Moreover, the ability of small market economies to implement effective competition law regimes may be restricted due to a comparative lack of resources. In the first place, limited financial resources allocated to competition enforcement, including merger control, is exacerbated by the observation that small market economies may also face higher administrative costs *per* capita relative to large ones. In an International Competition Network ("ICN") report, some jurisdictions including Japan, Mexico, New Zealand and Singapore highlight the fact that small market economies face higher expenses relative to large ones.[37] For instance, the Competition Commission of Singapore's ("CCS") budget ratio is 3 times greater than that of Japan relative to the latter's GDP, and

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33 Lino Briguglio & Eugene Buttigieg, "Competition Constraints in Small Jurisdictions" *Bank of Valletta Review* (No 30, Autumn 2004) at p 4.

34 ICN Special Project for the 8th Annual Conference, *Competition Law in Small Economies* <http://www.internationalcompetitionnetwork.org/uploads/library/doc385.pdf> at p 12 (accessed 15 July 2015).

35 Trade profiles culled from the World Health Organization's statistics database <http://stat.wto.org/CountryProfile/WSDBCountryPFView.aspx?Language=E&Country=SG%2cUS> (accessed 15 July 2015).

36 Trade profiles culled from the World Health Organization's statistics database <http://stat.wto.org/CountryProfile/WSDBCountryPFView.aspx?Language=E&Country=SG,US,HK> (accessed 15 July 2015).

37 ICN Special Project for the 8th Annual Conference, *Competition Law in Small Economies* <http://www.internationalcompetitionnetwork.org/uploads/library/doc385.pdf> at p 11 (accessed 15 July 2015).

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2.5 times the ratio of the UK budget relative to the UK's GDP.[38] Additionally, expertise in specific areas of law such as competition law might be scarce in small market economies, where there exists a need to prioritise resources.

IV. Optimal merger control design in small market economies

28 Taken together, the issues highlighted in Part III of this article[39] indicate that the option of mirroring EU merger control laws to achieve regulatory consistency may be lost on small market economies due to the latter's distinctive characteristics. As a result, a wholesale transplant of EU merger control laws would be innately unsuitable for small market economies and, if adopted, would need to be modified to some extent.

29 In this part, the author suggests aspects of EU merger control laws that should be adapted and/or followed for optimal merger control design by small market economies that are considering the adoption of models based on EU competition law.

A. Notification

30 A vast majority of merger control regimes in the world, including the EU, employ mandatory notification. On the other hand, only a handful of jurisdictions employ voluntary notification, and these include Australia, New Zealand, Singapore and the UK.

31 A mandatory system has its advantages for small market economies, namely, in the acquisition of all information necessary to conduct a merger assessment. This has particular importance in the case of international mergers where the relevant information may be located outside of the small economy's territory, and the merging firms concerned refuse to comply with requests for information by the competition authority of the small market economy.

32 Another benefit of mandatory notification systems is that parties in cross-border mergers often focus their efforts on those with mandatory, rather than voluntary, notification. This lowers the potential of late or non-notification of problematic mergers, especially in small market economies where revenues derived from domestic markets by merging parties operating internationally may be small or otherwise insignificant.

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38 ICN Special Project for the 8th Annual Conference, *Competition Law in Small Economies* <http://www.internationalcompetitionnetwork.org/uploads/library/doc385.pdf> at p 11 (accessed 15 July 2015).

39 See paras 11–27 above.

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33 Additionally, mandatory notification systems tend to benefit businesses in the assessment of a need to notify, and less developed competition authorities, as relatively simple and objective parameters such as turnover are employed. Voluntary notification systems on the other hand tend to rely on parameters that are of lesser clarity, for instance whether a merger would lead to a substantial lessening of competition, which would in turn require the parties to make a preliminary assessment of, amongst other things, the relevant market(s) and market shares. The difference in clarity of the rule for notification by merging parties can make it easier for authorities to prove illegal action for failing to notify in a mandatory notification jurisdiction.

34 However, mandatory notification in small market economies may undermine trade and investment activities within the small market economies and prove costly for businesses. Due to their high dependence on trade, small market economies need to weigh the costs of trade against the costs for compliance with national merger control laws. A fundamental element of the mandatory notification system under the EUMR, the "standstill obligation" that prevents parties to a transaction from implementing a transaction before EC approval is granted, can impose additional costs associated with notifying merger activity, in particular where a significant portion of the merger takes place outside of the small market economy's territory.

35 In addition, the need for allocating resources efficiently in small market economies warrants the application of a voluntary, as opposed to a mandatory, notification system. As discussed above, competition law enforcement in small market economies is relatively more costly than in large economies. Competition authorities within small market economies are thus generally required to optimise the use of their scarce resources and to focus their enforcement activities only on activities that are most likely to have an adverse effect on competition. As put by the New Zealand Commerce Commission ("NZCC"), "a mandatory regime would create unnecessary additional work, both for the business community and the [NZCC]". In the case of Singapore, as a small and open economy with a strong presence of multinational corporations and sizeable external trade, Singapore's economic activities are highly sensitive to international merger activities. A voluntary notification regime was put in place in recognition of the limited resources of the competition authority in a small economy, while most merger transactions in Singapore's open markets involve tradable goods that do not typically raise competition concerns.[40] A small competition authority forced to review too many transactions would then have little or no resources left

40 OECD Global Forum on Competition, *Cross-border Merger Control: Challenges for Developing and Emerging Economies – Contribution from Singapore* (DAF/COMP/GF/WD(2010)71).

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to pursue other important enforcement priorities, including cartel enforcement[41] and mergers that are most likely to raise competition issues. This also contributes to reducing business costs related to unwarranted notifications of international mergers.

36 To address concerns on lesser clarity under a voluntary system of notification, small market economies that adopt voluntary systems can consider implementing measures that enable firms to obtain legal certainty on whether a transaction should be notified to the relevant authorities. For instance, in the UK, the Office of Fair Trading (now the Competition and Markets Authority or "CMA") provides a number of opportunities through which the parties may obtain informal advice. A similar confidential advice process has also been adopted in Singapore, where parties to a merger may approach CCS for confidential advice on whether the merger could result in a substantial lessening of competition in Singapore and therefore could require a formal notification.[42]

37 Therefore, given the issues faced by small market economies in implementing merger control policy, small market economies should not rule out the possibility of employing voluntary, as opposed to mandatory, notification under their merger control laws. The shortcomings of a voluntary notification system should be weighed against its inherent benefits, particularly, a reduced administrative and regulatory burden on competition authorities of small market economies in assessing notifications for mergers that have little or insignificant impact on domestic markets. Furthermore, some of the shortcomings associated with voluntary notification systems are not insurmountable. For instance, to address problems of failure to notify by merging parties, voluntary systems in the UK, Singapore and Australia have been supplemented with powers of the competition authorities to initiate a review of mergers where there may be anti-competitive effects in the economy. Such review can arise following a complaint from a third party, or through intelligence-gathering and market-monitoring activities for non-notified merger activity.[43] Competition authorities in voluntary jurisdictions

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41 Report to the ICN Annual Conference, *Setting Notification Thresholds for Merger Review* (April 2008) at p 6.

42 In order for confidential advice to be available, certain conditions need to be met, namely: (a) the merger must not be completed but there must be a good faith intention to proceed with the transaction; (b) the merger must not be in the public domain; and (c) there must be some doubt on whether the merger raises concerns such that notification may be appropriate: *CCS Guidelines on Merger Procedures 2012* at paras 3.20–3.22.

43 For instance, in Singapore, as part of its statutory powers under merger control, the Competition Commission of Singapore keeps markets under review to ascertain which mergers and acquisitions are taking place, and will approach merging parties and third parties to gather further information on the transaction and its effects on competition for identified transactions that may potentially raise concerns under the Competition Act (Cap 50B, 2006 Rev Ed).

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also attach particular importance to bilateral and/or international co-operation agreements with other competition authorities to assist and exchange information between authorities of relevant jurisdictions.[44]

B. Market definition/market concentration

38 Current case law suggests that much emphasis is placed on market definition in EU merger control laws.[45] However, the smallness of an economy, whilst having little impact on the definition of the relevant *product* market, can have implications on the definition of the relevant *geographic* market. A merger between firms of a given size (in terms of turnover) would hence more likely lead to a finding of dominance in a small rather than a large market economy. In the *Volvo/Scania* merger, the European Commission concluded that the markets for trucks and buses were national, rather than pan-European. This led to the European Commission's prohibition of the merger as it determined that dominant positions would be created in the markets for heavy trucks in Sweden, Norway, Finland and Ireland, for touring coaches in Finland and the UK, for inter-city buses in Sweden, Finland, Norway and Denmark, and for city buses in Sweden, Finland, Norway, Denmark and Ireland.[46] The decision was followed by extensive debate on how large companies domiciled within small markets such as Sweden could develop and compete within the European market, and outside the EU.[47] The tendency for small market economies to support fewer firms, and for firms residing within such economies to reach a dominant position before they attain minimum viable scale is also reflected in the *Substantive Guidance on Merger Control* of The Bahamas. The Guidance states that "[the competition authority] is aware that a relatively small jurisdiction such as The Bahamas may not support a large number of operators and therefore higher market concentrations than larger jurisdictions are possible in The Bahamas".[48]

39 To address the issue of inherent bias against large companies domiciled in small market economies under the current approach to market definition, one proposal could be to allow discretion for

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44 See, *eg*, the protocol on co-operation between Australia and New Zealand.

45 The European Court of Justice in *France v Commission* held that a proper definition of the relevant market is a necessary precondition for any assessment of the effect of a concentration on competition under the European Union Merger Regulation, Cases C-68/94 and C-30/95 *etc* [1998] ECR I-1375, [1998] 4 CMLR 829 at para 143. See also subsequent cases, *eg*, Case T-151/05 *Nederlandse Vakbond Varkenshouders (NVV) etc v Commission* [2009] ECR II-1219, [2009] 5 CMLR 1613 at para 51.

46 Case COMP/M 1672 *Volvo/Scania* [2001] OJ L 143/74 at para 363.

47 See, *eg*, U Bernitz & I Gutu, "The Effect of EU Merger Policy on Large Multinationals Based in Sweden and Other Smaller EU Member States: Is the Policy Discriminatory?" [2003] ECLR 19.

48 ECS COMP 2 (18 September 2009) at para 57.

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competition authorities to define the relevant geographic market more widely, *ie*, EU-wide (in the case of smaller Member States of the EU) or regional/international. At the least, given the relatively higher reliance on imports in most small market economies, the importance of imports should be prioritised as a relevant consideration when defining geographic markets for tradable goods, such that geographic market definitions may extend beyond national borders on a case-by-case basis. Imports should thus have a greater role in the calculation of market shares or market concentration, for instance, through the use of import-corrected market concentration indexes, and high domestic concentration levels should not be assumed to indicate the presence of market power.

40 Another proposal to address concerns on potential discrimination against small market companies could be for competition authorities of small market economies to steer away from the emphasis on market definition and to employ more sophisticated economic indicators to assess the potential for anti-competitive effects arising from a merger. The trend in the UK and the US has been to recognise that market definition and market concentration should not be an end in itself in merger assessment, but that these should be considered alongside other quantitative econometric tools for assessment of anti-competitive effects. For instance, techniques have been developed by CMA to assess closeness of competition and predict merger effects without having to explicitly define the market. Techniques include the use of metrics such as Generalised Upwards Pricing Pressure Indicator, Upward Pricing Pressure and Illustrative Price Rises. The latter two are consistent with the practice of the US Federal Trade Commission ("FTC") and the US Department of Justice ("DOJ"). On the other hand, the European Commission has not yet shown willingness to adopt the techniques employed by the UK CMA and the US FTC and DOJ, although it has been observed to increasingly employ economic models to estimate the effects of a merger.[49]

41 Although the use of metrics to assess the competitive effects of a merger may be administratively more expensive, and the various assumptions employed in the use of such indicators potentially subject to challenge or error, these alternative economic indicators can provide competition authorities in small market economies with more precise tools for assessing anti-competitive effects arising from a merger. The use of metrics, coupled with a consideration of total welfare effects, discussed later in this article, can also provide scope for recognising that high

49 See, *eg*, Case COMP/M.5658 *Unilever/Sara Lee Body Care*, where the European Commission objected to the proposed merger on the basis of, among other pieces of evidence, a merger simulation.

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concentration does not necessarily lead to anti-competitive effects in the relevant market.

42 Alternatively, competition authorities in small market economies can adopt merger policies that shift emphasis away from strict thresholds indicative of market power, towards a more dynamic analysis of markets. Snapshots of competition measured by market shares at any one point in time can lead to inaccurate conclusions on the effects of a merger on competition. Market shares and concentration levels in small market economies should thus be simply indicators of potential competition concerns but not give rise to a presumption that a merger should be prohibited.[50] In the example of another small market economy, Canada, s 92(2) of the Canadian Competition Act expressly forbids the Competition Tribunal from finding that a merger is anti-competitive "solely on the basis of evidence of concentration or market shares".

43 The adoption of a dynamic analysis in merger assessment has allowed competition authorities operating in small market economies to clear mergers that tend to create monopolies or very high market concentration levels, so long as conditions reveal sufficiently low or moderate barriers to entry and other factors that will ensure competition *for the market*, despite a lack of competition *in the market*.[51] For instance, in NZCC's decision in *South Pacific Seeds Pty Ltd and Yates Ltd*,[52] NZCC cleared the merger despite the merging parties having a 100% market share in the seed distribution market. NZCC defined separate markets for capsicum, tomato and cucumber seeds, and concluded that the degree of existing competition in the market, the long and short-term entry of potential competitors and the countervailing power of large suppliers would be sufficient to make a substantial lessening of competition, in any of the markets, unlikely as a result of the acquisition. In a separate example, CCS cleared the proposed merger between Nippon Steel Corporation and Sumitomo Metal Industries, Ltd in December 2011.[53] A dynamic analysis showed that despite high joint market shares in several product markets in Singapore, competition in finished steel product markets was regional in nature and barriers to entry and expansion were low.

44 As potential changes in the economic climate of a small market economy can have their impact felt quicker and, arguably, greater than in

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50 See, *eg*, the *CCS Guidelines on the Substantive Assessment of Mergers* <https://www.ccs.gov.sg/legislation/~/media/custom/ccs/files/legislation/ccs%20guidelines/substantiveassessmergerjul07final.ashx> (accessed 15 July 2015).

51 Michal S Gal, "Merger Policy for Small and Micro Jurisdictions" in *More Pros & Cons of Merger Control 2012* (Konjurrensverket – Swedish Competition Authority) at p 86.

52 NZCC decision 508, 25 September 2003.

53 CCS Case No 400/010/11, decision dated 10 February 2012.

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a large market economy, dynamic factors that can alter the merging parties' position in relevant markets should play a bigger role when assessing the competitive effects of a merger in small market economies. For instance, in Singapore, CCS has showed that it is prepared to consider developments in the industry occurring after a notification has been filed, and even after a provisional decision blocking the merger has been issued. In the proposed joint venture between Greif International Holding BV and GEP Asia Holdings Pte Ltd, CCS issued a provisional statement of decision in April 2010, after completion of its Phase 2 review subsequent to receiving a notification on the merger in July 2009. The merging parties then applied to the Minister seeking an exemption on the grounds of public interest, but this was declined in December 2010. However, in April 2011, when CCS issued its final decision on the merger, it cleared the merger unconditionally.[54] In its clearance decision, CCS highlighted that key developments in the Singapore market that took place after the issuance of the provisional statement of decision in April 2010 were considered, including (a) one of only two bitumen drum users in Singapore, ExxonMobil's, intention to cease the use of bitumen drums in 2011, and subsequent feedback from the merged entity's remaining customer, Shell, that it had the necessary countervailing buyer power so it did not view the merger as a threat to its supply of bitumen drums in Singapore; and (b) the next largest competitor of the parties in the steel drum market, the Mauser group's, announcement in November 2010 of plans to triple its steel drum production in Singapore by constructing a new plant to be completed in 2012. Relevant changes in market conditions can thus be considered when assessing the potential competitive effects of a merger in small market economies.

C. Substantive test

45 Before delving into detail on this topic, it is observed that there is little substantive difference between the application of the significant impediment to effective competition ("SIEC") test and the substantial lessening of competition ("SLC") test, despite a difference in wording. Nonetheless, due to reference to dominance under the SIEC test,[55] the following discussion will, for purposes of clarity, be focused on considering whether the SLC test or the dominance test would be more suitable for small market economies.

54 CCS Case No 400/003/09, decision dated 14 April 2011.

55 This was a result of a creative solution in re-defining the old dominance test, thus achieving two aims, (a) upholding the established practice and case law of the European Commission and European Union courts regarding the dominance test, whilst (b) explicitly enabling the European Commission to take a more effects-based approach when assessing mergers: see Bogdan Getzich (Gecić), "The Significance of the New SIEC Test in Merger Control" *Pravo i Privreda* (Law and Economy Journal) 2010.

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46 Comparing the SLC test and the dominance test, the SLC test is observed to be better suited for small market economies that are characterised by a relatively high number of oligopolistic markets. Firstly, the more effects-based approach under the SLC test shifts the focus of merger assessment away from market structure.[56] Even where structural considerations such as turnover or other market share indicators are applied to facilitate merging parties in the notification process, under the SLC test, these only serve as first indications of market power and do not create a presumption of illegality. Secondly, the test is sufficiently wide to capture both unilateral and co-operative anti-competitive effects that might be created by mergers, closing the non-collusive oligopoly gap seen in the *Airtours* line of cases.[57] Thirdly, the SLC test can allow a merger to be blocked where it would lead to the acquisition of a small but vigorous competitor, which may not be achievable under a dominance threshold. In the context of oligopolistic markets with few existing players in small market economies, the ability to prevent mergers leading to a potential loss of a maverick player can be essential to safeguarding the competitiveness of domestic markets. An interesting illustration can be observed in the *Progressive/Woolworths* merger in New Zealand.[58] The initial clearance of the three to two merger[59] had been made under the dominance test which had been interpreted narrowly in New Zealand to the extent that only mergers resulting in a monopoly could be blocked, *ie*, the "single dominance" test. As a precautionary measure, Progressive Enterprises Ltd ("Progressive") had also applied to NZCC for clearance under the new SLC test. Under the SLC test, NZCC was able to determine that the merger would lead to an elimination of a key competitor in the market, and in the presence of other factors seen to facilitate collusion and discipline, would lead to an SLC. Nonetheless, NZCC found its hands tied on the final outcome of the merger. Progressive won on final appeal and was permitted to merge based on the application of the old dominance test. A similar problem surfaced in Australia under its old dominance test, in the merger between Ansett Airlines and East West Airlines that reduced the number of interstate competitors in the national domestic aviation market from three to two. Whilst the remaining competitor, Qantas, was substantially larger than the merged entity, the Australian Competition and Consumer Commission ("ACCC") believed

56 The role of market share proxies under the dominance test was repeated in Case T-210/01 *General Electric v Commission* [2005] ECR II-5527 at para 115: "very large shares are in themselves, save in exceptional circumstances, evidence of a dominant position".

57 There is also a level of uncertainty as to whether tacit co-ordination is the minimum condition necessary for finding collective dominance.

58 Commerce Commission Decision No 448, Progressive Enterprises Ltd and Woolworths (NZ) Ltd, 14/12/01.

59 The deal was controversially approved by the Commerce Commission under the dominance test because the application was lodged on 25 May 2001, just before the amendments to the New Zealand Commerce Act 1986, which introduced the new substantial lessening of competition provisions, came into force on 26 May 2001.

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that the merger resulted in the removal of a vigorous and effective competitor on the relevant routes. However, ACCC was unable to prohibit the merger under the previous dominance test, which had been interpreted to be the narrower single dominance standard.

47 The dominance test in merger assessment, on the other hand, can be seen to be less suited for small market economies for a number of reasons. Firstly, it is harder to frame an efficiency defence under a dominance test, as the dominance test is not directly related to the assessment of economic effects of a merger. Efficiencies are thus rarely considered under the dominance test, if at all. European Commission officials under the old dominance test enunciated that: "There is no real possibility of justifying an efficiency defence under the Merger Regulation. Efficiencies are assumed for all mergers up to a limit of dominance."[60] As will also be discussed later in this article, merger assessments in small market economies should take into consideration potential efficiencies that can arise from mergers, as some mergers may be effective solutions to the realisation of scale economies by existing firms, thus leading to overall welfare gains to the small market economy.

48 Secondly, the dominance test, especially in jurisdictions that have interpreted this to be the narrower single firm dominance standard, can lead to a too-lenient merger policy not capable of prohibiting many mergers that significantly affect competition in relevant markets. When interpreted narrowly, the dominance test can be seen as a facilitative tool, allowing more mergers to take place where governments may be concerned about the need for domestic firms to achieve economies of scale and improve international competitiveness.[61] However, competition authorities may then find serious limitations in their ability to prohibit mergers where mergers may increase the likelihood of co-ordinated effects in domestic markets, as seen in the earlier examples of the *Progressive/Woolworths* and the *Ansett/East West Airlines* mergers. This is a particular problem in small market economies where oligopolistic markets are a common occurrence, and was one of the key reasons for Australia and New Zealand's switch from the dominance test to the SLC test, in 1992 and in 2001 respectively.[62] Furthermore, where higher levels of concentration are allowed to develop in oligopolistic markets through a lenient merger control policy to increase international competitiveness

60 OECD Policy Roundtable, *Efficiency Claims in Mergers and Other Horizontal Agreements – Contribution from the Commission of the European Union* (OECD/GD [96]65, 1996) at p 53.

61 This was the case of Australia, where the substantial lessening of competition test under s 50 of the Trade Practices Act was amended to the dominance test in July 1977, such that only mergers which would lead to a corporation being able to dominate or control a substantial part of the relevant market were proscribed.

62 OECD Policy Roundtables, *Substantive Criteria used for Merger Assessment 2002* (DAFFE/COMP/ (2003)5) at pp 144 and 253.

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of merged entities, significant harm can occur to domestic firms upstream or downstream to these merged entities, themselves subject to import competition, thus undermining the competitiveness of entities upstream or downstream.

49 The SLC test (or the SIEC test) can therefore be seen as a better test for assessing mergers in small market economies. Although the more effects-based standard under the SLC test can also present problems in practice due to a higher potential for legal uncertainty in the application of the test, this can be alleviated through the adoption of supplementing guidelines and notices. Such guidance will assist merging parties in understanding issues relating to the competition authority's approach towards its assessment of mergers, such as how the notions of "substantial", unilateral effects and co-ordinated effects will be applied in practice.

D. Consideration of efficiencies

50 In the context of small market economies, merger policy should recognise that concentration might be a necessary evil in order to achieve scale and scope economies. Competition authorities of small economies should thus be accorded sufficient flexibility to allow mergers that can promote efficiencies and place less reliance on limiting structural presumptions, even where mergers involve an increase in market power.

51 Mergers can play an important role in the promotion of economic growth and development. In particular, mergers can serve as the most realistic way to realise efficiencies in oligopolistic markets that would otherwise remain unexploited. In many cases, an increase in capacity can result in a potential loss of profits if no corresponding or significant reduction in production costs arises from purely internal growth. This will lead to a lack of incentive for domestic firms to individually seek to achieve minimum efficient scale. Instead, existing players in domestic markets may adopt co-operative profit maximising strategies through limitation of output. On the other hand, mergers in oligopolistic industries can generate efficiencies where lowered costs are derived from consolidated operations. This then increases the overall welfare of the economy due to the ability of the merged firm to provide its products or services at lower prices or better quality. In such circumstances, significant cost savings from achieving scale economies can result in lower prices, despite a lessening of competition. As concluded in the 2000 working paper co-authored by Lars Hendrik Röller and Joseph Stennek, even though there was no support for a general presumption that all mergers create efficiency gains, some mergers do create efficiencies that benefit consumers through lower prices, with

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some achieving the pass on of 30–70% of cost savings.[63] A merger may also create dynamic efficiencies through the creation of innovative products or services, and increased capacity for research and development, important for the creation of long-term economic growth and welfare in a small economy. Additionally, to reflect their reliance on international trade, the small market economies of Australia and Canada have in their merger control laws a specific instruction that a significant increase in the real value of exports should be considered as an efficiency gain.[64]

52 On the other hand, an over-accommodative merger policy may entrench monopolistic elements in the small market economy where many of its industries are characterised by high entry barriers. Market structures resulting from merger activity can subsequently be difficult to alter. This is a key reason for the general disinterest in efficiency arguments put forth by merging parties in mergers leading to monopoly or near-monopoly in large market economies. For instance, in the EU, the Commission's Horizontal Merger Guidelines still consider that a merger leading to a monopoly or similar level of market power is highly unlikely to be declared compatible with the common market on the ground that efficiency gains counteract its potential anti-competitive effects.[65]

53 However, while disregard for efficiency arguments under structural assumptions of anti-competitiveness may have created overall efficient results in large market economies, the adoption of such a policy in small market economies can result in false positive errors. An implicit presumption that all mergers within certain structural thresholds can create net positive effects, and those outside of such thresholds, *ie*, mergers that create very high degrees of market power, should be proscribed will lead to two types of errors, namely: (a) some mergers creating or strengthening a dominant position may generate higher than average efficiency gains, thereby ultimately benefiting consumers; and (b) some mergers that do not lead to dominance may produce insignificant or negative efficiency gains, thereby hurting consumers. Given that error costs are generally higher in small market economies due to the limited ability of and/or longer duration required for domestic

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63 L H Röller, J Stennek & F Verboven, *Efficiency Gains from Mergers* (The Research Institute of Industrial Economics, Working Paper No 543, 2000) at pp 35, 42 and 53 <http://ec.europa.eu/competition/speeches/text/sp2005_013_en.pdf> (accessed 15 July 2015).

64 Australian Competition and Consumer Act 2010 s 90(9A); Canadian Competition Act 1985 s 96(2).

65 Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings (2004/C 31/03) ("Horizontal Merger Guidelines") at para 84; also see the General Court's judgments in Cases T-342/07 and T-411/07, *Ryanair Holdings plc v Commission* and *Aer Lingus Group plc v Commission*.

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markets to correct such errors, competition authorities should have the discretion to examine merger-specific efficiency claims on a case-by-case basis.

54 A further alternative of opting for no merger control, and leaving anti-competitive conduct in the market to *ex post* conduct regulatory measures such as control of abuse of dominance provisions, is less viable, as this leaves little room for intervention by the small economy in redistributive effects that can be associated with some mergers.

55 In the consideration of efficiencies, a total welfare standard, as opposed to the consumer welfare standard, should be adopted, especially in small market economies where exports constitute a large fraction of output. Even though the total welfare standard may, in some cases, subordinate the interests of consumers in terms of lower prices to the long-run productivity of the entire economy,[66] productivity growth determines long-term consumer welfare.[67] Cases where prices may rise after the merger, with the lowering of consumer benefit "compensated" by an increase in producer benefit, and in the longer term, benefits to overall welfare through investment growth, tax revenues and employment, should be permitted in small market economies. Whilst giving rise to concerns of potential negative effects on consumer welfare in the short term, these concerns may to an extent be addressed by requiring, as a condition for approval of mergers, the merging firms to commit to charging prices in domestic markets not exceeding those charged in foreign markets.

56 The consideration of efficiencies in merger assessment can also give rise to issues in practical application. Firstly, the need for consideration of efficiencies may raise concerns of lack of resources available, as a case-by-case analysis would require more resources and more time on the part of competition authorities due to additional factors that need to be considered in the merger assessment. Nonetheless, given that firms have the best access to the necessary information and have stronger incentives to determine the existence of efficiencies due to the likely larger impact on their profits than on consumers' welfare,[68] concerns about lack of sufficient resources can be addressed by allocating the burden of proof on firms to show the existence of submitted efficiency gains.

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66 See, *eg*, ss 6.42 and 6.43 of the Australian Competition and Consumer Commission Merger Guidelines (1999).

67 Michael Porter, "Competition and Antitrust: Towards a Policy-based Approach to Evaluating Mergers and Joint Ventures" (2001) 46 *Antitrust Bulletin* 919 at 934–935.

68 Johan Stennek & Frank Verboven, *Efficiency Defence and Consumers' Interests in European Merger Control* (Report for EC Contract No B5-1000/02/000518, 25 March 2003) at p 4.

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57 Secondly, the need for consideration of efficiencies may also raise concerns on the verifiability of efficiencies submitted by merging parties. To address these concerns, competition authorities of small market economies may decide to rank information provided by the merging firms on efficiency gains. In particular, emphasis should be placed on (a) internal documents used by firms when deciding on the merger; (b) management briefs to owners and financial markets about the expected efficiencies where they will be held accountable for their claims; (c) historical examples of similar mergers producing similar efficiencies; and (d) external expert reports.[69] Additionally, where it is unclear if efficiencies submitted by the merging parties will materialise, clearances can be granted on a temporary basis, for instance, for a period of three years. Competition authorities can then further evaluate if the submitted efficiencies have in fact been realised at the end of the period.

58 Thirdly, the consideration of efficiencies by competition authorities may raise concerns that decisions will lack transparency and legal certainty due to the increase in factors that are considered. However, the alternative can be stated, that having a formal system for consideration of efficiencies may in fact increase transparency and certainty by making explicit in decisions all factors considered in merger assessments. As observed in the European Commission's practice prior to the adoption of the EUMR in 2004, the Commission was likely to have considered efficiencies in some cases but did not openly account for how that was done.[70] With the formal introduction of efficiencies, firms considering mergers will have the benefit of clearer guidelines and decisions on how efficiencies will be taken into consideration in merger assessments. Further, and to increase transparency of the assessment process, small market economies may consider adopting pre-merger consultation procedures that can allow firms to better evaluate difficult issues involved in balancing between efficiencies and anti-competitive conduct in the small market economy. This can provide the merging parties with more certainty regarding their transaction prior to committing too many resources to the proposed merger.

E. Extraterritorial application of merger control laws

59 A large proportion of foreign-produced products traded in small market economies and reduced ability of domestic market forces to

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69 OECD Policy Roundtables, *Dynamic Efficiencies in Merger Analysis 2007* (DAF/COMP(2007)41) <http://www.oecd.org/competition/mergers/40623561.pdf> at p 228 (accessed 15 July 2015).

70 Commentators have observed that some favourable assessments of dominance hide concerns for efficiency, *eg*, Peter D Camesasca, "The Explicit Efficiency Defence in Merger Control: Does it Make the Difference?" (1999) *European Competition Law Review* 1 at 14–28.

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effectively regulate foreign importers, often imply that anti-competitive merger activity of foreign importers can have strong negative effects on the small market economies with which they trade. To combat the anti-competitive effects of foreign merger activity, it is essential for competition authorities of small market economies to be granted sufficient powers to apply their merger control laws extraterritorially against conduct that has an impact on their domestic markets, despite their size relative to the global markets.

60 Extraterritoriality can be a useful tool in regulating international merger activities that have anti-competitive effects in domestic markets, especially for enforcement authorities that possess sufficient power over foreign firms to ensure the effective enforcement of extraterritorial laws. For instance, the EUMR confers upon the European Commission wide extraterritorial powers to review mergers between global companies, with the ability to review mergers that bear little or no nexus to the EU, on the basis of turnover thresholds of the merging entities.[71]

61 However, small market economies often face problems with the practical enforcement of merger control laws against foreign merging entities, and/or may find themselves spending a large part of their resources on reviewing mergers with no effective remedies at hand. Firstly, firms that are trading in small market economies may not have significant assets in the jurisdiction. Their products may be sold through local distributors and it would be difficult to enforce a remedy against firms domiciled outside of the small market economy.[72] Secondly, considering the portion of international revenues derived from the small market economy, competition authorities of small market economies might not create a credible threat to blocking an international merger. A firm might instead choose to exit the small market economy if the latter were to attempt to impose significant regulatory burdens on the merger, and the negative welfare effects arising from the firm's exit might be greater than the welfare effects arising from continued operations of the merged entity within the small market economy.[73]

62 To overcome the problem of weak or ineffective enforcement of merger control laws against foreign merger activity, one option often

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71 Response to European Commission public consultation, *EU Merger Control – Draft Revision of Simplified Procedure and Merger Implementing Regulation* (19 June 2013) <http://ec.europa.eu/competition/consultations/2013_merger_regulation/allen_overy_en.pdf> (accessed 15 July 2015).

72 Michal S Gal, "Merger Policy for Small and Micro Jurisdictions" in *More Pros & Cons of Merger Control 2012* (Konjurrensverket – Swedish Competition Authority) at p 115.

73 Michal S Gal, "Merger Policy for Small and Micro Jurisdictions" in *More Pros & Cons of Merger Control 2012* (Konjurrensverket – Swedish Competition Authority) at p 115.

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adopted by small market economies is the practice of "free-riding", where authorities rely on the enforcement actions of large market economies to limit the anti-competitive effects of mergers on the small economy's local markets. This can be done through having no extraterritorial powers in merger policy, or having extraterritorial powers but at the same time deferring to decisions of foreign authorities. To some extent, free-riding can be a practical way to address common competition issues. For instance, in the *Thomson/Reuters* merger,[74] CCS determined the relevant product to be fairly homogeneous and competition issues stemming from the merger to be global in nature, such that the competition concerns in Singapore could be sufficiently mitigated by the commitments offered to the European Commission and the US DOJ. In addition, free-riding can result in benefits to both large and small market economies, with the former benefiting from a reduction in the burden and costs on merging parties when notifying international mergers, and the latter economising on scarce resources in the assessment of international mergers.

63 Whilst free-riding can be useful in situations where mergers create similar anti-competitive effects across various global markets, decisions of overseas authorities on a merger can create sub-optimal effects on domestic markets of small economies where merger assessments by different competition authorities may give rise to opposing or conflicting views. As mergers are assessed on the premise of competitive effects accorded to each jurisdiction's own local markets, positive or negative externalities generated by a merger on foreign markets are rarely, if at all, considered in the assessment. One example is the proposed merger of Boeing and McDonnell Douglas, the two largest commercial aircraft manufacturers in the US. The US FTC cleared the merger as it assessed that the merger could enhance efficiencies while at the same time prevent large-scale layoffs in the industry. However, the European Commission objected to the merger and expressed concerns that Boeing would have an increased customer base from 60% to 84% of planes currently in worldwide service.[75] This divergence of views between the US FTC and the European Commission captures many of the controversies regarding the application of competition laws by foreign competition authorities. Depending on domestic concerns, differing enforcement agencies may (a) define markets differently; (b) weigh anti-competitive effects against efficiency gains from a merger differently; (c) view the competitive effects of a merger differently; and (d) disagree with regard to appropriate remedies. In this case, the US had the incentive to approve the merger, even if it had substantial anti-competitive effects on a global scale because the costs imposed by these anti-competitive effects would mostly be realised outside of the US. Hence, the merger could be approved in favour of national welfare gains

74 CCS Case No 400/007/07, decision dated 23 May 2008.
75 Case No IV/M 877 *Boeing/McDonnell Douglas*.

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for the US.[76] In other words, higher prices borne by consumers would be paid for somewhat by customers outside the US, whereas some of the benefits accompanying a monopolist residing within the US would only be realised within the US, such as increased tax revenues and employment.[77] On the other hand, by blocking the merger, the EU can not only be observed to be (a) placing heavy reliance on strict structural indications of anti-competitive effects, and (b) protecting Airbus' business interests, thereby protecting its local tax revenue and employment base.

64 The *Boeing/McDonnell Douglas* merger justifies the need for extraterritorial application of domestic merger control laws, and illustrates the potential for disagreement on the competitive effects even amongst large market economies. Given the differing features of large *versus* small market economies, this creates a greater potential for conflicting views on effects of international mergers on local markets. It is thus essential for competition authorities of small market economies to be given discretionary powers to assess international mergers that may have an impact on domestic markets. At the same time, two additional solutions can be considered to address weak or ineffective enforcement of extraterritorial powers in small market economies, namely: (a) ramping up *ex post* regulation of merged entities' conduct through enforcement of cartel and abuse of dominance provisions; and (b) strengthening positive comity between regional and international competition authorities to help circumvent the problems faced by small market economies in initiating unilateral action.

F. Remedies

(1) Structural versus *behavioural remedies*

65 Most competition authorities have expressed a preference for structural remedies over behavioural remedies as structural remedies are viewed to be more effective in addressing competitive concerns, and impose a lesser burden on competition authorities by removing the need for constant regulatory oversight. Indeed, various small market economies have shown a preference for structural remedies, including New Zealand, where NZCC is statutorily restricted to accepting only structural commitments, and not behavioural commitments. This inability to impose behavioural remedies has not been problematic as

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76 David Snyder, "Mergers and Acquisitions in the European Community and the United States: A Movement toward a Uniform Enforcement Body" (1997) 29 Law & Pol'y Int'l Bus 115 at 137.

77 David Snyder, "Mergers and Acquisitions in the European Community and the United States: A Movement toward a Uniform Enforcement Body" (1997) 29 Law & Pol'y Int'l Bus 115 at 137.

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NZCC favours structural over behavioural remedies, given its view that behavioural remedies are difficult to formulate, monitor and enforce.[78] In Singapore, CCS has indicated in its guidelines that it generally prefers structural commitments to behavioural commitments as these remedies are seen to address competition concerns created by the merger more directly and also require less monitoring.[79] Similarly, the European Commission's notice on acceptable remedies[80] states a preference for structural remedies, "inasmuch as such [remedies] prevent, durably, the competition concerns which would be raised by the merger as notified, and do not, moreover, require medium or long-term monitoring measures".

66 However, structural remedies do not provide a perfect solution for small market economies. Firstly, pure reliance on structural remedies such as requiring divestment by a merged entity to achieve competition can impose large costs on efficiency, and a behavioural solution could, on balance, provide a better result in certain cases. When divestitures are required in a small market economy, this often requires a trade-off between competition and exploiting potential efficiencies through achieving, or nearing, minimum efficient scales of production. Notably, market demand within small market economies may limit the number of efficient units of production such that high concentration levels may ultimately prevail despite an earlier divestiture by a merged entity. Pure structural remedies may therefore have limited benefits to the domestic markets of small market economies.

67 Secondly, the efficient functioning of domestic markets may require competition authorities of small market economies to employ remedies other than divestiture. For instance, in the *Telia/Sonera* merger,[81] the Latvian Competition Authority[82] determined that the merger would create a monopoly in the market for international telecom services. The authority first considered a divestment of a stand-alone business, but later noted that independent service providers required access to Telia's global telecommunications network in order to stay competitive. It therefore abstained from imposing structural remedies, preferring instead to impose only behavioural remedies, which included

78 OECD Policy Roundtables, *Remedies in Merger Cases* (DAF/COMP(2011)13) at p 292.

79 *CCS Guidelines on the Substantive Assessment of Mergers* (2007) at para 9.12.

80 European Commission Notice on remedies acceptable under Council Regulation (EC) No 139/2004 and under Commission Regulation (EC) No 802/2004 at p 6.

81 Cleared by the European Commission in Case COMP/M 2803 *Telia/Sonera*, conditional upon, *inter alia*, full compliance with the divestments of Telia Mobile Finland branch of Telia Mobile AB, and of Telia Product Oy as well as equipment owned by Telia relating to the wireless LAN business in Finland, and upon the divestiture of cable TV network and related distribution business in Sweden owned and operated by Telia Mobile AB's wholly owned subsidiary, ComHem AB.

82 Latvia was not a member of the European Union at the time.

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requiring the merged entity to grant network access to assure access by independent providers.

68 Thirdly, structural remedies may be limited in a small market economy due to a lack of suitable prospective purchasers in the market. As a result of the consolidated nature of many of its industries, there may be few suitable purchasers having no significant relationships with the merging parties, and having the necessary resources and expertise to acquire the assets to be divested. Divested assets also need to be complementary to the potential purchaser's existing range of brands and businesses in its portfolio before it becomes sufficiently attractive as a target for acquisition. For instance, in the *Valio/Kainuu, Maito-Pirkka, Aito Maito* case,[83] the Finnish Competition Authority cleared the acquisition by Valio, a major dairy processor, of the dairy and marketing businesses of the co-operatives Maito-Pirkka and Kainuu, and of the company Aito Maito Fin Oy. The clearance was made subject to an extensive package of remedies, including the need for Valio to divest some of the acquired brands and production plants. It was later shown that these structural remedies could not be realised, as no competitor was willing to acquire the brands or equipment to be divested.[84] However, behavioural remedies, namely through Valio's commitment to sell raw milk at its own purchase price to its actual and potential competitors, were found to be sufficient in ensuring that Valio's competitors in the domestic market continued to have access to raw milk.[85]

69 Fourthly, competition authorities of small market economies face limited enforcement powers in foreign-to-foreign mergers. As discussed above,[86] there is limited recourse should merging firms, especially multinational firms that do not maintain substantial assets in the small market economy, fail to comply with the conditions and obligations under the imposed remedies. Conversely, tough sanctions imposed on merging parties active in small market economies could risk merging parties leaving the jurisdiction altogether, thus leaving the domestic market worse off. Practically, therefore, competition authorities in small market economies may need to consider the alternative option of imposing behavioural remedies in circumstances where they struggle to effectively implement structural remedies.

83 Case No 1151/81/1999 of 20.06.2000, cited through Katri Paas, "Implications of the Smallness of an Economy for Merger Remedies" (2008) *Juridica International*, No 2 at pp 100–101.

84 ICN Merger Working Group: Analytical Framework Subgroup, *Merger Remedies Review Project* (Report for the fourth ICN annual conference) (Bonn – June 2005) <http://www.internationalcompetitionnetwork.org/uploads/library/doc323.pdf> at p 37 (accessed 15 July 2015).

85 The decision of the Finnish Competition Authority is available at <www.kilpailuvirasto.fi> (accessed 15 July 2015).

86 See paras 59–64 above.

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70 Fifthly, mistakes made in the process of imposing structural remedies (namely, divestitures) have a higher risk of creating greater detrimental effects on the economy, given that most structural remedies involving divestitures are irrevocable. As described succinctly by Michal Gal, "the effect of small size is similar to that of a magnifying glass".[87] Where remedies are applied with detrimental effects, such effects become more significant in small markets.

71 With the above considerations, small market economies should not have to place an over-reliance on structural remedies. Instead, small market economies should be able to adopt more wide-ranging measures, with a flexibility to impose both structural and/or behavioural remedies where appropriate.

72 As behavioural remedies are typically less burdensome, and therefore more willingly accepted by merging parties, competition authorities in small market economies may even decide to opt for pure behavioural remedies in some cases. For instance, in Unilever's proposed acquisition of Ben & Jerry's in Israel, anti-competitive concerns were raised in the Israeli ice cream market. The Israeli Competition Authority nonetheless cleared the merger, conditional on Ben & Jerry's use of an independent distributor that was free to determine its prices charged for the products, and that all new products were to be made available to this independent distributor.[88] The remedies imposed in this instance are arguably limited remedies since they would not have been able to completely mitigate the effects arising from the combined market shares of the merging parties, or the fact that both entities were now controlled by the same entity. Nonetheless, the remedies would ensure that pricing and strategic decisions of the combined entity were subject to monitoring, thereby limiting any future decisions to raise prices or reduce competition in the Israeli ice cream market.

73 Another benefit of behavioural remedies is that these remedies can be "rectified" through further review if later market conditions or market studies show that the extent of remedies imposed at the time of the conditional clearance decision had been excessive. For instance, in *A Le Coq/OÜ Finelin*, the Estonian competition authority cleared the merger, but clearance was made conditional upon the merging parties' compliance with production volume restrictions for a period of two

87 Michal S Gal, *Competition Policy for Small Market Economies* (Harvard University Press, 2003) at p viii.

88 Director of Israeli Competition Authority, Conditions for Approval of a Merger between Ben & Jerry's Homemade Inc and Unilever NV (16 December 2001), cited through Michal S Gal, *Competition Policy for Small Market Economies* (Harvard University Press, 2003) at p 246.

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years.[89] Developments in market conditions, namely, rapid and unexpected growth in the Estonian cider market following the merger, showed that such harsh restriction was unnecessary, and the competition authority increased the limit to production volumes subsequent to request by the parties.[90]

74 On concerns that behavioural remedies may be excessively burdensome on small market economies due to the need for constant monitoring, the small size of small market economies arguably makes monitoring of behavioural remedies easier as the number of players in the market would be smaller, and deviations from imposed remedies more easily detected. The stated concerns can further be addressed by ensuring that the authorities enable constant feedback from competitors and consumers through an open process for comments from interested third parties after the issuance of conditional clearance decisions. Transparent decisions containing details of the remedies imposed on the merging parties, and the motivation behind requiring these remedies, can also assist interested third parties in the feedback gathering process.

(2) Free-riding

75 As discussed above,[91] reliance on foreign action may not always be appropriate. The effects on competition may in some cases be jurisdiction-specific, in which case appropriate remedies would be required to address effects specific to domestic markets. The merger of Unilever and Best Foods ("*Unilever/Best Foods* merger") provides one such example. The EU and the US cleared the merger as it did not raise anti-competitive concerns in their markets, but the same merger was determined to substantially lessen competition in Israel's markets.[92] Unilever and Best Foods had each merged with a dominant competitor in some of Israel's food markets prior to the *Unilever/Best Foods* merger, with the result that the latter raised concerns of a strengthening of a food conglomerate and the lessening of competition in several of Israel's food markets, such as in chocolate and snacks. Also in the case of the attempt by the British American Tobacco company (trading in Australia as WD &

89 Decision No 38-KO of 11.11.2003, cited through Katri Paas, "Implications of the Smallness of an Economy for Merger Remedies" (2008) *Juridica International*, No 2 at p 101.

90 Decision No 27-KO, 24.08.2004, cited through Katri Paas, "Implications of the Smallness of an Economy for Merger Remedies" (2008) *Juridica International*, No 2 at p 101. See also further developments in the *Valio/Kainuu, Maito-Pirkka, Aito Maito* case, where the Finnish Competition Authority amended conditions pertaining to the pricing of raw milk, which took effect on 1 January 2010, available at <www.kilpailuvirasto.fi> (accessed 15 July 2015).

91 See paras 59–64 above.

92 Conditioned approval of the Director of the Merger between Tozeret Mazon Israelit Baam and Unilever NV (M/4006) (Director of Israeli Competition Authority, 27 September 2000, not published).

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HO Wills) to take over Rothmans,[93] the acquisition by British American Tobacco did not create competition concerns in the major jurisdictions in which the firm operated, but created significant concerns in Australia. There were only three companies – WD & HO Wills, Rothmans and Philip Morris – where the market share of the merged entities would have been approximately 65%, and imports accounted for less than 1%. ACCC considered that a merger of two of three big players would lead to a substantial lessening of competition, and opposed the merger. ACCC agreed to approve the merger only after the merging parties agreed to divest brands and production facilities amounting to approximately 17% of the total brands of cigarettes on the domestic market. These were later acquired by Imperial Tobacco, a major international tobacco company, which became a new entrant to the Australian market and went towards preserving competition domestically, aided by an initial 17% market share and the introduction of its own well-established brands into Australia. As a result of ACCC's imposed remedies, competition in the domestic markets in Australia was preserved, and there remain three strong credible players in the Australian market.

76 Competition authorities in small market economies should therefore exercise caution when assessing whether to grant clearance of a merger on the basis of remedies or commitments accepted by large market economies including the EU.

V. Conclusion

77 Whilst the above proposals on merger control design will need to be refined depending on the specific conditions of the small market economy in question, this article serves to highlight that merger control laws are not "one-size fits all", and laws transplanted from large market economies such as the EU need to be adapted to the unique features of small market economies. As "smallness" leads to a tendency for high concentration and high entry barriers in many industries, small market economies face different welfare maximisation issues compared with large market economies. The higher occurrence of concentrated market structures within industries of small market economies have resulted in concerns that larger firms may find it harder to undertake merger activity if merger control laws place over-reliance on structural indicators. In addition, characteristics of small market economies such as the inefficient functioning of free markets, susceptibility of domestic firms to import pricing pressures, and higher administrative costs per capita relative to

93 Australian Competition and Consumer Commission, unpublished, 3 June 1999; also see the Australian Competition and Consumer Commission's media release which can be found at <https://www.accc.gov.au/media-release/accc-accepts-cigarettes-divestiture> (accessed 15 July 2015).

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large market economies, can result in further challenges when adopting merger control laws.

78 Having considered the experiences of competition authorities that have implemented merger control laws in small market economies, small market economies looking at modelling their competition laws and policies after the EU's should explore how certain aspects of EU merger control laws may be adapted or in some respects followed for optimal merger control design. In this respect, firstly, small market economies should not rule out the possibility of employing voluntary, as opposed to mandatory, notification under their merger control laws. There are inherent benefits to a voluntary notification system, particularly, a reduced administrative and regulatory burden on competition authorities of small market economies in assessing notifications for mergers that have little or insignificant impact on domestic markets. Secondly, small market economies can adopt merger policies that shift emphasis away from strict thresholds indicative of market power, for instance, through a more dynamic analysis of markets or the use of more sophisticated economic indicators when assessing the anti-competitive effects arising from a merger. Thirdly, the SLC test (or the SIEC test) can be seen as a better test for assessing mergers in small market economies. Amongst other reasons discussed in this article, the more effects-based approach under the SLC (or SIEC) test shifts the focus of merger assessment away from presumptions premised on market structure, and further allows merger assessments in small market economies to take into consideration potential efficiencies that can arise from mergers. Fourthly, small market economies should retain sufficient flexibility to allow mergers that can promote efficiencies, as some mergers may be effective solutions to the realisation of scale economies by existing firms. Fifthly, despite the foreseeable problems of weak or ineffective enforcement against foreign merging parties, small market economies should be given extraterritorial powers to assess international mergers that may have an impact on domestic markets as free-riding on decisions of overseas authorities can create sub-optimal effects. Lastly, competition authorities of small market economies should have the flexibility to impose both structural and/or behavioural remedies where appropriate. Structural remedies, in particular divestments, do not provide a perfect solution due to, amongst other reasons, the large costs that divestments can impose on efficiency in small market economies. Additionally, in the case of remedies, reliance on foreign action may not always be appropriate, as particular remedies may be required by small market economies to address effects specific to local markets.

79 The proliferation of regional and international trade agreements has resulted in an increasing number of jurisdictions that are adopting competition laws. Small market economies that intend to implement new competition laws can benefit from a common and consistent approach to

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merger review in line with large market economies such as the EU, including a reduction in uncertainties and resulting costs in the administration of competition laws and policy in small market economies. Nonetheless, as mentioned above, there are important differences between small and large market economies. Merger control design should therefore accommodate the unique features of small market economies in order to achieve optimal benefits from the adoption of a merger control regime.

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