For Information

Legislative Council Bills Committee on Telecommunications (Amendment) Bill 2002

Overseas Experience in Interpreting "Substantially Lessening Competition" in Regulation of Merger and Acquisition Activities

Introduction

Under the proposed section 7P in the Telecommunications (Amendment) Bill 2002, the Telecommunications Authority (TA) may regulate a merger and acquisition (M&A) if it has, or is likely to have, the effect of substantially lessening competition in a telecommunications market. At the Bills Committee meeting of 19 March 2003, Members requested the Administration to provide information on cases in which overseas authorities interpreted "substantially lessening competition" when assessing the effect of M&A. The words "substantially lessening competition" have been interpreted in a number of overseas jurisdictions in the context of merger control and in other situations, in various sectors of the economy (not confined to telecommunications). At Members' request, we have conducted some research. The result is set out below for Members' information.

US

2. The US legislation prohibits M&A that may "substantially lessen competition". According to the Horizontal Merger Guidelines, the ultimate inquiry in a merger analysis is "whether the merger is likely to create or enhance market power or to facilitate its exercise". In *International Shoe Company v Federal Trade Commission* 280 US291, the court held that this meant acquisitions which probably will result in lessening competition to a "substantial" degree, i.e. to such a degree as will injuriously affect the public, and is inapplicable where there was no pre-existing substantial competition to be affected; for the public interest is not concerned in the lessening of competition, which, to begin with, is itself without real substance.

3. The same "substantial lessening of competition" test is used in assessing other anti-competitive practices. This case law is also helpful in

interpreting the meaning of “substantial”. In the case of *Standard Oil Company of California Et Al. v United States*, 337 US 293, a quantitative analysis was adopted. In this case, The Standard Oil Company of California entered into exclusive supply contracts with independent dealers in petroleum products and automobile accessories. There was statistical evidence which suggested that the contracts covered “a substantial number of outlets and a substantial amount of products whether considered comparatively or not”. Given the quantitative substantiality (in terms of the market and product), the Court reasoned that “substantial” lessening of competition is an “automatic” result. It should be noted that the Court was not saying that it is not necessary to look at all the relevant factors in determining whether a merger is objectionable. What the Court was saying is that in a case where quantitative assessment generates an overriding conclusion of substantiality, “substantial” lessening of competition is an irresistible conclusion.

4. The quantitative approach may not be applicable for some industries where the market concentration is already great. In the recent case of *United States v General Dynamics Corp. Et Al, 415 US 486*, it was held that the market structure, market behaviour and probable anti-competitive effects would be taken into account in the “substantiality” (of lessening competition) test. In this case, the Court considered that a merger which results in a significant increase in the concentration of firms in that market, is so inherently likely to lessen competition “substantially” that it must be enjoined in the absence of evidence.

Australia

5. In Australia, the test of "substantially lessen competition" is used in assessing both M&A and anti-competitive conduct of a company. Some interpretation of the courts on such test are set out below.

6. In *Cool & Sons Pty Ltd v O’Brien Glass Industries Ltd*, the Australian Federal Court described “substantially” in “substantially lessening competition” in the following terms:-

> *“It must be capable of being fairly described as a lessening of competition that is real, or of substance as distinct from a lessening that is insubstantial, insignificant or minimal.”*

7. In the case of *Radio 2UE Sydney Pty Ltd v Stereo FM Pty Ltd (1982) 62 FLR 437*, Lockhart J in trying to define “substantial” said:

> *The word “substantial” is imprecise and ambiguous … it can mean considerable or big … it can also mean not merely nominal, ephemeral or minimal … In the context of S.45 the word “substantial” is used in a relative sense. The very notion of competition imports relativity. One needs to know something of the business carried on in the relevant market and the nature and extent of the market before one can say that any particular lessening of competition is substantial.*

8. In *Dandy Power Equipment Pty Ltd v Mercury Marine Pty Ltd* (1982) 64 FLR 238, Smithers J said:

> *“To apply the concept of substantially lessening competition in a market, it is necessary to assess the nature and extent of the market, the probable nature and extent of competition which would exist therein but for the conduct in question, the way the market operates and the nature and extent of the contemplated lessening. To my mind one must look at the relevant significant portion of the market, ask oneself how and to what extent there would have been competition therein but for the conduct, assess what is left and determine whether what has been lost in relation to what would have been, is seen to be a substantial lessening of competition…”*

9. In the explanatory memorandum to the Trade Practices Legislation Amendment Act 1992, the use of the word “substantially” in the M&A test of “substantially lessening competition” is said to refer to an effect on competition which is real or of substance, not one which must be large or weighty.

UK

10. Under the Enterprise Act 2002, in assessing whether a M&A should be allowed to proceed, the Office of Fair Trading and the Competition Commission will apply a “substantial lessening of competition” test.

11. It is expected that the competition and consumer provisions of the Enterprise Act 2002 will come into force in spring/summer 2003. Hence, there are not yet any cases on the definition of “substantial lessening of competition” under the Enterprise Act 2002. However, it is instructive to consider the test adopted by the UK court for the purposes of the merger control provisions of the Fair Trading Act 1973.

12. The House of Lords found in *R v Monopolies & Mergers Commission ex p. South Yorkshire Transport Ltd* [1993] 1 WLR 23 that the word “substantial” accommodates a wide range of meaning. In considering whether South Yorkshire constituted a “substantial part” of the UK for the purposes of the merger control provisions of the Fair Trading Act 1973, the House of Lords found that “substantial” meant that the effect must be of such size, character and importance as to make it “worthy of consideration for the purpose of the Act” and on that basis concluded that South Yorkshire was indeed a substantial part of the UK.

Conclusion

13. Members may note that the interpretation of “substantiality” is generally not based on a set of definite quantitative criteria or formula, but is assessed by the competition authorities, tribunals or courts based on the facts of individual cases and widely accepted economic principles.

14. With the proposed committee stage amendments, the factors for consideration which TA will take into account in assessing an M&A will be set out in the Bill. The detailed methodology of the analysis will also be set out in TA's guidelines. An explanation of such matters is already set out in the "Explanatory Note on the Guidelines on the Competition Analysis of Mergers and Acquisitions in Telecommunications Markets" which was issued in December 2002.

Office of the Telecommunications Authority
April 2003