

MERGERS AND MARKET DOMINANCE: CASES AND COUNTRY EXPERIENCES ¹

1. Introduction:

The competition/ anti-monopoly laws generally cover three areas: abuse of market dominance, mergers/ acquisitions, and collusive agreements. In this presentation, I will cover the first two categories.

Taking mergers first, the enterprises/firms can combine in several ways: however, established practice has been to label any transaction in which two independent firms are combined into one as a merger. Result is strengthening of one enterprise into existing or new economic activities; and of course elimination of the other. This aspect essentially raises the concern about controlling mergers leading to market dominance.

Mergers may lead to economic efficiency but of concern to us is the exercise of market power that can harm consumers and other producers, through higher rather than competitive prices, and at times it may be reduced output or a compromise over product quality. The rationale for merger control is simple: it is far better and easier to prevent firms from gaining market power than to attempt to control market power once it exists. Care must be taken, however that most mergers pose little or no threat to competition in any market. Many are simply investments to utilize available cash or fuller use of an under-used enterprise resource (e.g., expertise in the marketing of some products, use of a new technology, etc, etc. Some mergers, on the other hand may not be so harmless because they significantly increase the probability of exercising market power. Competition agencies (CAs) seek to identify and prevent such acquisitions and mergers which may increase the possibility of abusing a dominant position by a single enterprise and certain restrictive agreements by two or more market players. Horizontal mergers are the most suspect in this regard, since by definition, they reduce the number of independent competitors in a particular market.

Whatever, is the type of merger: horizontal, vertical or conglomerate, the foremost step is to analyse and determine whether the merger raises any competition concerns. In case, the possibility of competitive harm is identified, a more complete examination is required with respect to the:

- Market definition and description;

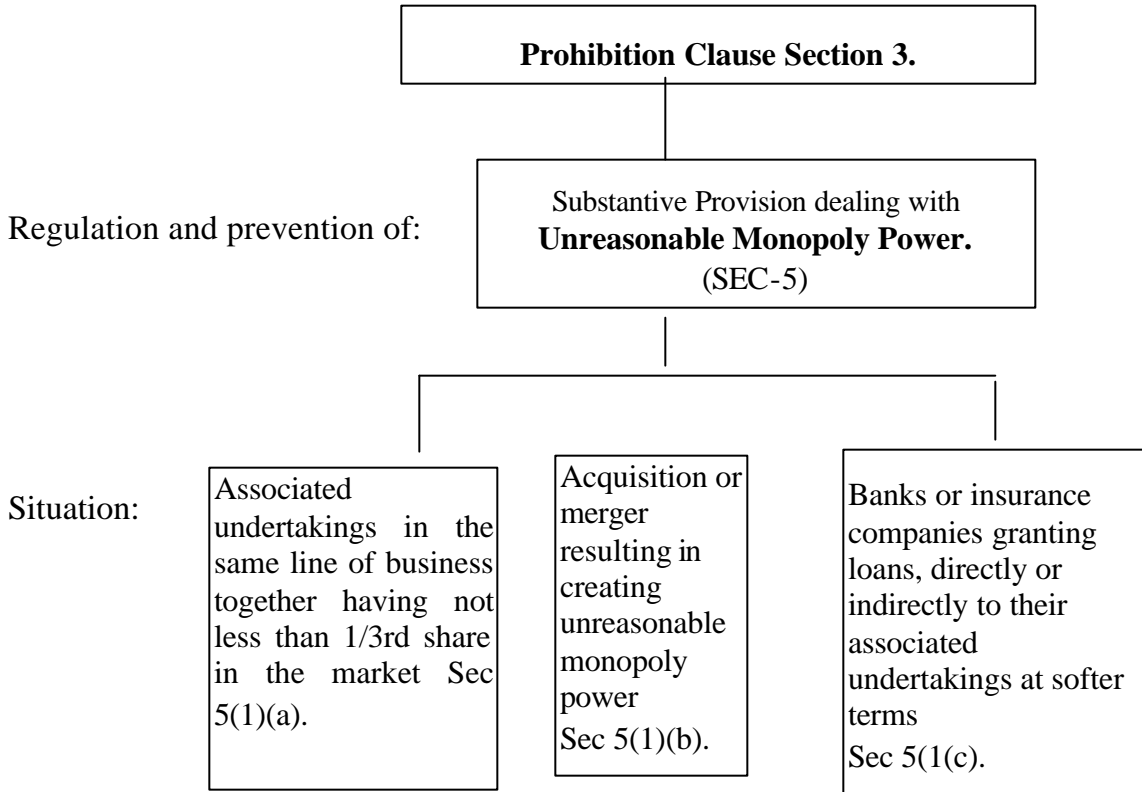
¹Regional Conference on 'Competition Policy, Competitiveness and Investment in a Global Economy: The Asian Experience', Colombo, Sri Lanka, May 19-21, 2004.
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- Identification of enterprises/firms that participate in the relevant market alongwith their market shares; and
- Identification of potential adverse effects from the merger/ market dominance including entry barriers.

2. The Law in Pakistan:

Now I will turn towards Pakistan's Law about merger and market dominance.

Schematic of Monopolies And Restrictive Trade Practices Ordinance, 1970



In case of violation: _____ **Show Cause Notice (Sec. 11)** _____

Remedies:

Undo the merger/acquisition,
divestment of shares.
Sec. 12(1)(b).

Limit the total loans and
investment in any
undertaking.
Sec. 12(1)(b)

Non compliance _____ **1.Show Cause Notice u/s 19**
or misleading **2. Penalty upto Rs.100,000 and**
information: **additional Rs.10,000 per day.**

3. Explanation of Schematic: Law in Pakistan for mergers and market dominance cases - the Unreasonable Monopoly Power.

Following points are noted with reference to above schematic:

- Merger and market dominance cases are dealt within the Monopolies and Restrictive Trade Practices (control and prevention) Ordinance, 1970 (MRTPO) under section 5;
- For situations of mergers/ acquisitions of associated undertakings, two-fold criteria is used, firstly, the threshold level of 1/3rd market share is specified - with reference to production, supply or distribution of goods/ services; and secondly, the situation where the effect of the acquisition or merger is likely to create monopoly power or to substantially lessen competition in any market;
- Only horizontal mergers are covered in the MRTPO, 1970;
- There is no mandatory pre-merger notification provision in the MRTPO;
- 'Single firm' monopoly cases are not covered in the substantive provisions i.e., only associated undertakings having more than threshold market share are covered.

4. Processing of a case and investigation

Examination of a case starts on these grounds, firstly *suo moto* by the MCA after getting information from some source (e.g., media) and secondly, if concerned undertakings ask for advice as per Section 10. Thirdly upon receipt of a reference from the Government or complaint from at least 25 persons under Section 14.

4.1 Suo-moto action: Important is the task to determine if the transaction falls in the purview of MRTPO, for this purpose, threshold market share is used to determine if further processing of the case is required. MCA calls for relevant information under section 21 from various data sources as prescribed under the law i.e., companies, manufacturer's groups/ associations, board of revenue, bureaus of statistics, etc.

In the next stage, effects of a particular transaction are evaluated with respect to market share, product availability, etc. Though in cases of mergers, whole Pakistan is considered to be a market but for specific cases, regional markets can also be considered (Section 2 (f)). If a case *prima facie* falls in the purview of MRTPO, the MCA decides to involve other stakeholders in the investigations, e.g., competitors - these may be in the form of informal discussions.

Side by side, legal requirements are fulfilled i.e., show cause notice is issued to the concerned parties under section 11, opportunity of hearing is provided to submit record, evidence and any facts to support the contention of parties. MCA decides, in the final stage, if a particular transaction falls in section 5 (1) i.e., contravening situation (Annex - I) or else in section 5 (2) i.e., when a particular transaction is not objected to - keeping in view its particular plus points. In the first category of cases MCA can pass an order of divestment from ownership/ shares and prohibition from acquisition as the case may be. Such orders are passed under section 12 of the MRTPO.

4.2 Advice: MRTPO provides a formal confidential guidance procedure, by which the merging parties can seek preliminary guidance by the Authority on the likely assessment of a proposed merger or market dominance case - under section 10 (d) read with Rule 13 of the MCA's Rules, 1971, on payment of prescribed fee.

In each case, MCA's staff in the Research and Investigation Branch initiates preliminary investigation, necessary information is called for as and when required (Section 21). Once, MCA's research staff finds a *prima facie* contravention of the law (Section 3), and the MCA considers that it is necessary in the public interest to do so, it can initiate proceedings under Section 11 i.e., show cause notice is issued. MCA has powers of a civil court (Section 15) all the proceedings are, therefore, quasi judicial in nature. The undertakings are provided with full opportunity to present evidence - showing advantages/ lesser anti-competitive nature of their transaction (Rule 5 of the MCA's Rules, 1971) in the 'hearings'. Though these hearings are to be public but depending on specific nature of a case, confidentiality is maintained. Finally, the decisions of the MCA are expressed in terms of opinion of the majority of Members (Rule 7). Decisions are published in the forms of Orders of the Authority. These are appealable before the High Courts of the country on point of law.

5. General problems in processing a case

5.1 Insufficient Information from parties: An attempt is made to gather all possible information supportive to process a case. As far as formal ways to call for information are concerned, these are useful as evidence. However, the problem, often faced is that the required information at times is not readily available from the undertakings themselves. Infact, easy accessibility of information may lead to swift processing and hence an early decision by the MCA.

5.2 Under-developed/ inadequate data sources: Since data sources in Pakistan are not yet developed to the extent that comparable, consistent (both internally and external) data is readily available, therefore MCA, at times have to rely on the data provided by the relevant parties. An attempt, of course, is made to cross-check the same from other sources, as is a practice in other competition regimes - this may be in the form of discussions with 'whistle blowers', competitors, major customers, etc. This sort of oral evidence, however, could only serve as a guideline/basis to move in a particular direction, rather than solid evidence.

5.3 Institutional limitations: Though the MCA can conduct enquiries for the purposes of the Law including those on general economic conditions and impact of any merger, etc. under section 10(b). But most effective tools such as use of on-site visits or econometric data are rarely used by the MCA. Reason being institutional limitations such as non-availability of specialized staff and lack of resources like many other developing countries.

5.4 Exemptions from Provisions of Section 5 (1) - the 'gateways'

The Ordinance "exempts" situations of unreasonable monopoly power provided certain specified conditions are met. The conditions may be seen as catering to situations which on balance are advantageous in terms of promoting national economic well being.

The conditions are three-fold and are set out in Sections 5(2) of the Law. First, the *prima facie* prohibited outcome - prohibited in terms of Sections 5(1) should also result in efficiency gains, or technical development, or export achievement. Second, it needs to be established that any such benefits could not be gained through means that would be less restrictive of competition. Third is the proviso that any such benefits clearly outweigh the adverse effects of the absence or lessening of competition (Annex - II).

6. Remedial orders in the Law

Seven different orders are provided for in the Law to redress situations of unreasonable monopoly power. Three of these orders relate to ordering the sale, or prohibiting the purchase of shares or stock or assets. More precisely, the person/undertaking may be required to disinvest itself of the ownership of any stocks or shares in any undertaking or of assets under specified conditions, including the time permitted for such disinvestment. MCA may also prohibit the person or undertaking concerned from acquiring the stock or assets of, or the undertaking from merging with, any other undertaking (Annex - III).

The general effect of these orders would be to undo or prevent such combinations of businesses that may constitute or are likely to constitute a situation of unreasonable monopoly power, and to thus ensure relatively greater competition in the market.

7. Case studies

Here I would like to point out that the MCA was created in 1971 and by the time it became operative in 1972, the 'phenomenon' that this organization was to regulate, entered a state of fundamental change. Beginning early in 1972, there followed the widespread nationalization of the 1970s. These developments considerably reduced the scope of the private sector. However, in the late 1980s, a pro-market shift led to privatization, deregulation and liberalization. These policies gave boost to the private sector and in recognition thereof the Government separated the MCA from Corporate Law Authority in 1994 (of which it was working as a Wing). In this background, the case law is not so rich in Pakistan, however, a review of selected cases is presented in the paragraphs to follow.

7.1 Pencils manufacturer's case

7.1.1 *Facts of the case:* Crescent Pencils Limited and Indus Pencils Limited both had market share exceeding the threshold limit.

7.1.2 *Analysis of the facts:* *Prima facie* it was suspected that associated undertakings had more than threshold market share. Upon deep probe, the undertakings were able to establish that the legal requirements for dominance were not met.

7.1.3 *MCA's Order:* MCA agreed in its Order that the Directors of the two companies, though were related to each other but were not the same 'persons' as required in the definition of the associated undertakings in the MRTPO, 1970. The case was thus cleared.

7.2 Acquisition of the Polka Group of Companies by Lever Brothers Pakistan Limited

7.2.1 Facts of the case: On request of relevant parties, the MCA gave its advice in June 1996 about their proposed transaction. By that time MCA has prescribed only one data source to determine market share namely the Statistical Bulletin of the Federal Government but it did not cover the ice-cream sector. therefore, the applicant got conducted a market survey. According to the results, the market share of the subsidiary of Unilever, using brand name Walls, together with the other Group, using brand name Polka, would have to increase to 65.45% in the organised sector producing ice-cream.

7.2.2 Analysis of the facts: The undertaking argued the case under gateways i.e., the efficiency grounds, prospective decrease in cost, availability of technical expertise, usage of international standards, etc. upon fulfillment of certain conditions, the case was cleared.

7.2.3 MCA's Order: Merger was allowed on fulfillment of certain conditions and efficiency grounds, etc.

7.3 Merger of tea marketing companies

7.3.1 Facts of the case: Unilever, UK had majority shares in Lipton Pakistan Ltd. and 40% shares in the equity of Brooke Bond Pakistan Ltd. The merger was to create a dominant undertaking with more than 80% of the market share.

7.3.2 Analysis of the facts: Issue raised and examined included: computation of market share, unorganized sector tea supplies, smuggled tea, other substitutes of tea, etc.

7.3.3 MCA's Order: MCA allowed the merger subject to certain conditions: the company will develop tea cultivation at 600 hectares by the year 2004 in areas identified in Mansehra District – as a first step towards indigenous tea production.

MCA monitored the implementation of its Order during the stipulated time period for implementation. Last year the company approached the MCA with a revised plan of developing tea gardens and sought extension in timeframe due to unforeseen draught/floods over last few years, therefore, the targets envisaged initially could not be achieved. The MCA felt it difficult to allow the extension as it would amount to revision of its own order, as under the Law, Authority has no powers to review its own Order.

7.4 Merger in cigarette industry

7.4.1 Facts of the case: In another case, the Premier Tobacco Industries Ltd. was merged into Lakson Tobacco.

7.4.2 Analysis of the facts: MCA took *suo-moto* action and issued a show cause notice. During the merger proceedings, Lakson raised the following points:

Firstly, as a result of the merger, the competition in the cigarette industry has considerably improved which was earlier dominated by the Pakistan Tobacco Company Limited (PTCL). This would not have happened without merger, now with its strengthening, the Lakson is competing a big giant i.e. the (PTCL).

Secondly, in cigarette industry, the consumer is brand captive and do not bother as to who is the manufacturer. Therefore, the brands compete with each other even produced by the same manufacturer. Therefore market of each brand is separate one and should not be added together to compute the market dominance of an undertaking producing a number of brands. They also raised the issue of smuggled cigarettes, counterfeits and cigarettes produced by unorganized sector.

7.4.3 MCA's Order: MCA cleared the case while looking into the competition conditions in the market and considering the above mentioned arguments of the undertaking.

7.5 Banking sector case

7.5.1 Facts of the case: The undertaking, Indus Bank made loans and advances amounting to Rs.526.89 million to its associated companies in 1994 on favourable terms i.e., less than the prevalent market rate of interest, than those made available to other undertakings in the comparable situation. This attracted section 5(1)(c).

7.5.2 Analysis of the facts: MCA took *suo-moto* action and issued a show cause notice. In response, the undertaking raised the issue relating to common directorship and that the dealings were as per regulations set by the State Bank of Pakistan.

7.5.3 MCA's Order: MCA concluded in its Order that the undertakings are not associated undertakings as per MRTPO and also that it would be an over regulation of loans and advances and rate of interest which are already subject to regulation by the central Bank of the country.

7.6 Batteries' case

7.6.1 Facts of the case: Exide Pakistan Limited acquired the business of the Automotive Battery Company Limited in 1992. This acquisition raised its market share to 58%. The provisions of section 5 of MRTPO, 1970 were, accordingly, attracted,

7.6.2 Analysis of the facts: MCA took a *suo moto* action and the company was called for hearing. The case was discussed with reference to the determination of market/ market share and gateways as provided under MRTPO, 1970. The undertaking raised the issue of determining market size while considering usage of second hand batteries, presence of large unorganized sector and smuggling.

7.6.3 MCA's Order: MCA kept on monitoring the case particularly the financial health of the acquired entity, which was infact a 'failing' unit earlier and price pattern over a period of time. It was established that the acquisition has brought about advantages that were not possible without it.

7.7 Aminoplast Moulding compound manufacturer's case

7.7.1 Facts of the case: Dyno Pak Limited and Visionite (Pvt) Limited both associated undertakings had a market share of 50-60% in the aminoplast moulding compound.

7.7.2 Analysis of facts: A *suo-moto* show cause notice was issued and in response, the undertakings established that they are not enjoying unreasonable monopoly power due to several reasons such as dumping of imported products below international market price by 30-40% from China. In this situation they are not in a position to charge monopoly prices. Moreover, they set up the associated undertaking in the area of Gadoon Amazai to reap benefits as announced by the Govt. for the said area. The undertakings were facing both domestic and international competition as well as were also involved in the exports.

7.7.3 MCA's Order: MCA agreed with the submissions and cleared the case.

7.8 Engineering Industry

7.8.1 Facts of the case: During the year 1999, the market share of the Abbas Engineering Industries Limited and Abbas Steel Industries (Pvt) Limited exceeded the threshold in the production of wire rods.

7.8.2 Analysis of facts: A *suo moto* show cause notice was issued and in response the undertakings submitted that their earlier estimates of market share were based on self collected data and infact it did not cover the entire country. They also raised the issue of un-organized sector, in the presence of which real market size can not be determined.

7.8.3 MCA's Order: In its Order, the MCA disposed of the show cause notice on the grounds that it was not a horizontal merger and that the undertakings were producing different types of wire rods which cater to the needs of different customers, hence they were not competing in the same line of business.

8. On going Polyester staple fibre case

8.1 Facts of the case: MCA has under consideration, a merger case of companies namely Dewan Salman and Dhan Fibre (PSF), both producing polyester staple fibre. With that merger a dominant undertaking having around 60% market share has emerged.

8.1.2 Analysis of the facts: MCA took a *suo-moto* action and issued a show cause notice. In response, the undertakings raised two issues: first was about the 'product' which formed the basis of computing market share. They argued that all types of man made fibres and the natural fibre i.e. cotton should be accounted for to serve as a denominator for working out the market share.

The second issue was that of the 'market' itself. They argued that while working out the market share, whole of the regional market i.e. South Asian market should be taken into account, because they are not only competing in the local PSF manufacturers but also the PSF manufacturers of the region namely Indians, South Koreans, Malaysians, etc. The matter is under adjudication.

Section 5. Circumstances constituting unreasonable monopoly power.—(1)
Unreasonable monopoly power shall be deemed to have been brought about, maintained and continued if -

- (a) there has been created or maintained any such relationship between two or more undertakings as makes them associated undertakings where they are competitors in the same market and together produce, supply, distribute or provide not less than ¹ [one third] of the total goods or services in such market;
- (b) there has been any acquisition by one person or undertaking of the stock or assets of any other person or undertaking, or any merger of undertakings, where the effect of the acquisition or merger is likely to create monopoly power or to substantially lessen competition in any market, including any acquisition which creates any such relationship as is referred to in clause (a);
- (c) any loan is granted by a bank or insurance company to any of the associated undertakings of amounts greater or on terms more favourable than for loans made available to other undertakings in comparable situations, or any loan is granted by a bank or insurance company to a person or undertaking not associated with it on the condition or understanding that the borrower or any of its associated undertakings will make any loan to a person or undertaking associated with the lender.

¹ Substituted for the words "twenty" percent by MARTP (Amend) Ordinance XXVI of 1980.
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The Gateways

Section 5(2): No such relationship, acquisition, merger or loan as is referred to in sub-section (1) shall be deemed to have the effect of bringing about, maintaining or continuing unreasonable monopoly power if it is shown -

- (a) that it contributes substantially to the efficiency of the production or distribution of goods or of the provision of services or to the promotion of technical progress or export of goods;
- (b) that such efficiency or promotion could not reasonably have been achieved by means less restrictive of competition; and
- (c) that the benefits of such efficiency or promotion clearly outweigh the adverse effect of the absence or lessening of competition.

Orders of the Authority under Section 12(1)(b)

In the case of unreasonable monopoly power--

- (i) require the person or undertaking concerned to divest himself or itself of the ownership of any stock or shares or other beneficial interest in any undertaking or of assets within such time and under such conditions as may be specified in the order;
- (ii) require the person concerned to divest himself of any position held by him as an officer, director or partner in any undertaking within such time and under such conditions as may be specified in the order;
- (iii) require the person or undertaking concerned to divest himself or itself of the management or control of any undertaking within such time and under such conditions as may be specified in the order;
- (iv) prohibit the person or undertaking concerned from acquiring the stock or assets of, or the undertaking from merging with, any other undertaking;
- (v) limit the total loans which may be made by any bank or insurance company to any single individual or undertaking, or to any undertaking associated with such bank or insurance company;
- (vi) limit the investments of any undertaking engaged in the banking, investment or insurance business;
- (vii) require the person or undertaking concerned to take such actions specified in the order as may be necessary to restore competitive prices and eliminate restrictions on output or entry of competitors in the market;