Convergence: a call to arms

by Tefft Smith and Catherine Fazio, Kirkland & Ellis

Businesses must clear the hurdles set by antitrust enforcement agencies around the world to consummate cross-border mergers. Regrettably, competition regulators sometimes work at cross-purposes, diluting the benefits of undertakings and hindering the evolution of global markets.

The solution to the problems posed by multilateral merger regulation – convergence – is at once obvious and elusive. The world's antitrust enforcement authorities must, through co-operation and communication, reach consensus on objectives for competition policy, substantive standards by which international mergers should be judged and streamlined procedures for pre-merger notification.

If all the world's antitrust enforcement authorities work from the same competition toolkit, each should reach transparent and consistent results when reviewing the same transaction, making cross-border mergers more efficient and less costly to consummate.

Many antitrust enforcement regimes have worked diligently over the last five-10 years to achieve convergence. Still, from the perspective of international businesses, their progress has been frustratingly slow, outpaced by the continued proliferation of new merger control laws. Only recently have the world's antitrust authorities recognised that, to be effective, the convergence dialogue must include all governments as well as representatives from the private sector.

Further, although the newly formed International Competition Network (ICN) has issued guiding principles upon which world antitrust enforcement authorities may draw, there remains a wide gulf between issuance and implementation. Strong leadership will be required to bridge this gulf, leadership that may now be lacking in light of turnover and turmoil at the world's leading antitrust enforcement authorities.

For the most part, businesses have been content to stand on the sidelines of the convergence debate. With convergence efforts now at a crossroads between talk and action, it is time for international businesses to take a more active role. Without convergence, the most restrictive regime will always determine the outcome of multi-jurisdictional merger review, frustrating pro-competitive deals. The end result is that consumers suffer; ill-advised competition regulation may hamper businesses' ability to exploit global efficiencies.

Businesses must develop both short and long-term strategies to tackle the risks posed by multilateral merger control. In the short-run, firms contemplating cross-border undertakings must rely on private advocates to navigate the maze of overlapping merger regulations. Over the long run, firms should actively participate in the convergence debate, influencing sovereign antitrust enforcers to implement best practices to help ensure that competition laws operate as they should – to free markets for global competition.

Drivers of convergence

The initial push for convergence arose out of the globalisation of world economies, the contemporaneous proliferation of overlapping competition laws and the growing recognition of the costs and risks of divergence. Convergence continues to be driven by antitrust enforcement authorities' collective need to both police global marketplaces and avoid the dangers inherent in multiple, simultaneous and complex merger investigations.

Over the past decade, globalisation has emerged as perhaps the most important opportunity for long-term productivity enhancements. From heavy manufacturing to high technology services, the ability to draw upon resources from around the world and compete efficiently across multiple international markets has become the hallmark of those companies able to deliver value to customers and profits to shareholders. It is no coincidence that national and regional merger control laws proliferated at the same time. With globalisation, scores of nations became interested in regulating world-wide transactions that affected their local economies.

More than 100 countries have now enacted antitrust laws; roughly 67 of those impose merger control regulation. Each jurisdiction establishes different pre-merger notification thresholds, waiting periods, filing fees, submission requirements, and formal clearance procedures. Each local review employs a local lens, focusing primarily, if not towards convergence. At the now famous Ditchley Park Conference in February 2001, international consensus was finally achieved that the convergence dialogue must be multilateral and all-inclusive. The United States and European antitrust authorities answered ICPAC's calls for a Global Competition initiative. They launched the International Competition Network (ICN), a virtual forum for encouraging discussion, co-operation and consensus among government antitrust authorities, consumer groups and business leaders. The ICN has already surpassed expectations, issuing best practices guidelines for both pre-merger notification and substantive merger investigations.

Still, convergence is far from a *fait accompli.* Governments cannot and will not surrender control over their local economies to a central authority in the name of convergence. Any consensus reached must both defer to sovereign authority and account for the possibility of intra-jurisdictional political change; the ICN best practices are no exception. Indeed, the following recent developments make clear that complete harmonisation of divergent antitrust law will remain difficult to realise.

First, countries continue to enact new antitrust laws and merger control regulations that deviate substantially from established standards and practices. For example, in November 2002, Egypt passed antitrust regulation defining monopolies to include any firm with market shares exceeding 30%, a threshold roughly half that imposed by the United States and significantly more stringent than that applied by the EU. Egypt may prohibit undertakings that the United States and the EU would peremptorily clear.

Second, established antitrust authorities continue to resist formally converging on a single substantive standard for merger review. After completing a wholesale re-evaluation of the EU merger control laws, including the difficulties presented by applying a different substantive standard than the United States to cross-border mergers, the EU's Competition Commissioner, Mario Monti, recently recommended against adopting the United States' substantial lessening of competition test. Monti encouraged the EU to maintain the abuse of a dominant position test, the standard that led to a divergent outcome in GE/Honeywell.

Third, political turnover continues, with the potential to destabilise convergence momentum. The current chief of the Antitrust Division of the United States Department of Justice, Charles James, and his top deputy, William Kolasky, both announced their resignations from public office. James, as a key leader of ICN efforts, and Kolasky, as the director of its merger working group, each have been instrumental in driving recent convergence achievements. Their departures create a leadership void just when their leadership is most crucial to persuade world antitrust authorities to implement ICN best practices guidelines.

Finally, political turmoil also continues, threatening to distract key leaders from convergence efforts. After not reversing a single determination of the EC Merger Task Force for more than a decade, an EU appeals court struck down three Merger Task Force decisions in the last six months. The EU court took issue with the Merger Task Force's procedures as lacking adequate due process and their substantive analysis as wrought with "errors, omissions and contradictions". A fourth reversal may be on the way, as the EU court prepares to hear the GE/Honeywell appeal. On the defensive, Commissioner Monti recently urged the European Commission not to let "these setbacks distort our view of the Community's merger control policy [but instead] transform them into an opportunity for even deeper reform than originally envisaged."[1] Monti will no doubt dedicate significant effort to rebuild the reputation of his Merger Task Force. One might query whether Monti will have the time or attention necessary to fill the void left by James and Kolasky.

Convergence is at a crossroads between talk and action. There remains much room for optimism that convergence will ultimately be achieved. However, the proliferation and maintenance of divergent merger control laws, along with turnover and turmoil at the world's leading antitrust authorities, may prevent the notable consensus achieved through the Ditchley Park conference and the ICN from being widely implemented any time soon.

A proposal for international businesses: short-term solutions and a long-term call to arms

Where does that leave businesses? At least in the near term, international businesses cannot rely on convergence efforts to alleviate the risks presented by multi-jurisdictional merger control. Over the long run, international businesses should take a more active role to foster convergence, lobbying for the adoption and implementation of best practices and streamlined procedures.

Short term reality

Companies planning cross-border undertakings must internalise the cost, complexity and uncertainty inherent in the present systems of antitrust review. On a deal by deal basis, international firms must rely on exclusively, on domestic competitive effects. Moreover, substantive standards used to evaluate cross-border transactions vary. Three approaches predominate:

- The United States Model: Antitrust authorities ask whether the contemplated transaction is likely to substantially lessen competition unilaterally via monopolisation or price leadership, or by facilitating collusion among a limited number (usually three or fewer) of major players.
- The European Union (EU) Model: Antitrust authorities ask whether the contemplated undertaking will enable the merged firm to achieve or strengthen a dominant position.
- The Public Interest Model: Antitrust authorities consider all elements of the public interest, including effects on local competitors, employment, export promotion or international comparative advantage.

Compliance with these merger control regulations is costly, complex and fraught with uncertainty. Dozens of different countries' merger control laws often apply to any single cross-border undertaking. Moreover, the delay in getting clearance is substantial – up to four months for undertakings that pose no competitive concerns, and more than a year for those that do pose such concerns. At the end of the day, there are no guarantees for a consistent, positive outcome. Absent consensus among world enforcement authorities on the purpose of merger control regulation, conflict is inevitable. While diverse decisions grounded in different local competitive conditions are not problematic, the same cannot be said for fundamental disagreements over the purpose of competition policy or application of economic principles. Such divergence could engender a loss of public confidence in competition policy, spark trade wars among sovereign nations, and possibly deter pro-competitive transactions from being attempted.

Consider the proposed merger of General Electric and Honeywell. The United States Department of Justice and the EU's Competition Commission (EC) closely scrutinised the transaction and agreed on the basic facts. However, after applying their different standards of substantive review, the United States and EC disagreed on the undertaking's likely competitive effects.

The EC believed that the merged entity, through leading market positions in credit financing and avionics, would have an unfair advantage over smaller competitors in specific market sectors. The United States considered and rejected this theory as overly dependent on competitor concerns and lacking adequate economic foundation.

The United States elected to clear the transaction and the EC chose to block it. The conflict was elevated beyond antitrust authorities, nearly sparking a trade war. Thankfully, cooler heads prevailed. After a bout of transatlantic finger-pointing, the world's two leading antitrust regimes elected to reinvigorate their convergence dialogue in opted to prevent future conflicts and to reassure the public trust in existing competition enforcement systems. The fact remains, however, that the most restrictive regime won. The EC blocked the proposed merger.

The GE/Honeywell incident highlights the importance of convergence. Convergence complements globalisation by harmonising the efforts of world antitrust enforcers. Without it, divergence could undermine both global markets and the legitimacy of competition regulation.

The convergence two-step: can consensus be translated into action?

It has taken 10 years for the world's antitrust authorities to agree on how best to approach convergence. At first invitations to the convergence dialogue were limited to key players. Only later did world authorities come to realise that effective consensus depended on participation by all interested parties. Even now, the road to convergence remains long as governments struggle to balance the drive towards convergence against their need to maintain authority over local marketplaces and flexibility to adapt to political change.

Early attempts at convergence were limited in scope. Many countries, including the United States, believed bilateral co-operation would be sufficient. Those multilateral working groups that did exist (namely those organised by the Organisation for Economic Co-operation and Development, the World Trade Organisation and the United Nations) were open only to member nations. By construction, any consensus reached could, at best, be only a partial solution.

However, there was a growing awareness that such endeavours would not be sufficient to resolve problems posed by multi-jurisdictional merger review. In 2000, for example, the United States International Competition Policy Advisory Committee (ICPAC) called for the formation of a Global Competition Initiative that would provide a comprehensive forum for convergence efforts. ICPAC stressed that, to be effective, the membership for the Initiative would have to include developed and developing nations, as well as private sector and non-governmental organisations.

2001 and 2002 marked landmark progress

private advocacy by lawyers and economists to identify the jurisdictions where they must file and design a strategy which minimises the likelihood of multi-jurisdictional scrutiny and bolsters clearance arguments in the event that multiple investigations are launched.

Early involvement of antitrust counsel is essential to help businesses:

- Determine which jurisdictions are likely to scrutinise closely the transaction and how they are likely to view it.
- Design and describe the transaction in a way that will be palatable to concerned jurisdictions so as to increase the chances of expedited review and clearance.
- Explore possible remedies to test the economics of various deal structures and enable informed negotiations with antitrust enforcement agencies.
- Preserve viable exit strategies to manage downside risk effectively.
- Co-ordinate with the other merging party's counsel to ensure cohesive and complementary advocacy efforts.

Counsel can also be instrumental in evaluating whether and how to encourage the co-ordination of merger investigations by different jurisdictions. To a great extent, merging parties control the degree to which different antitrust authorities may co-operate by determining what level of communication of confidential information to allow. Depending on the specifics of the deal contemplated, and the relevant markets impacted, it may not be advantageous for firms to encourage different jurisdictions to co-ordinate their efforts. For example, if a proposed merger is subject to pre-merger notification requirements in 12 jurisdictions, but only poses competitive issues in one, encouraging co-ordination among all regimes may unnecessarily slow down the clearance process. However, securing expedited clearance in all but one jurisdiction may provide the parties with a strong platform from which to advocate that the last remaining jurisdiction should clear the transaction as well.

Long term strategy

Over the long run, international businesses should actively support efforts to achieve convergence. International companies need freedom to run their businesses without unnecessary, or worse, irrational regulatory intrusion; they have a vested interest in ensuring that convergence initiatives succeed.

Antitrust authorities may not be able to get the job done on their own. Far from an exact science, competition laws leave great room for interpretation based on political mores. It may not be possible for jurisdictions to maintain consistency in the application of antitrust laws across administrations, let alone to harmonise laws across national and regional borders. Constituent pressure will force countries to make convergence a priority, possibly tipping the balance between success and failure.

Concluding thoughts

Multilateral merger control has the potential to deter pro-competitive deals and stunt global markets, but it need not. If the world's overlapping antitrust enforcement regimes are harmonised through convergence, their policies and procedures can serve the interests of both businesses and governments.

Convergence will not guarantee uniform outcomes to multi-jurisdictional merger reviews, nor will it prevent antitrust authorities from evaluating every deal through a local lens. What it will do is help to teach world antitrust authorities sound economic principles and the benefits of markets free from protectionist trade barriers. If world antitrust enforcement regimes employ the same building blocks, even when acting to preserve competition in local or regional markets, they will be doing global markets a great service. By requiring companies to be competitive at home, these antitrust authorities will enhance firms' ability to compete abroad and promote, albeit indirectly, the continued evolution of global markets. Thus, antitrust enforcement regimes and global businesses share the same goal for multilateral merger enforcement – competitive global markets. Firms should do their part to help governments achieve this important, consumer welfare enhancing policy objective.

Note:

[1] Mario Monti, "Merger Control in the European Union, a Radical Reform", speech before the European Commission/International Bar Association Conference on EU Merger Control, November 7, 2002.

Authors:
Tefft Smith (Attorney of Counsel)
Catherine Fazio (Attorney of Counsel)
Kirkland & Ellis
655 Fifteenth Street, N.W.
Washington, D.C. 20005-5793
US
Tel: +1 202 879 5212
Tel: +44 20 7816 8700
Fax: +1 202 879 5200
E-mail: tsmith@kirkland.com
Web site: www.kirkland.com