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Dennis DeMelto

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ADDRESS

Problems in Transnational Acquisitions and Mergers: Specialization and Export Agreements

*by Dennis DeMelto**

I. TRANSNATIONAL MERGERS

I SHOULD MENTION AT the outset that the views I express below are my own and not necessarily those of the Bureau of Competition Policy. I should also stress that I am looking at these issues strictly from a broad competition policy viewpoint, even though I recognize other public policy considerations may also be relevant to the issue under discussion. Nevertheless, competition policy concerns are themselves very broad, in that they relate to questions concerning market power and the competitiveness, innovativeness, efficiency and vigour of Canadian industries.

In order to understand what Canada's competition policy concerns should or should not be in situations where transnational mergers affect the Canadian economy, the costs and benefits of such mergers have to be understood. Judgments on the competition policy implications of the extraterritorial application of relevant United States antitrust laws should be made within such a framework. The issue of how Canada should evaluate transnational mergers from a competition policy viewpoint raises very complex issues, and it is worth stressing that the basic issues are essentially the same as those relating to the analysis of the costs and benefits which the operations of multinational enterprises bestow on our national economy.

No attempt will be made here to even set out these issues in any detail. Mr. Fugate has set out the sort of concerns which are looked at when these issues are addressed under the United States antitrust laws. But it is still worthwhile to set these issues out briefly from a Canadian viewpoint because the Canadian economy differs in some important respects from the United States economy and I think the difference, at least in emphasis, between the issues I stress and those stressed by Mr. Fugate, reflect the fact that the two national economies are not in many respects comparable. An acquisition by a foreign firm of a Canadian firm may confer benefits on Canadian industry in terms of new technology, access to research, to advanced organizational techniques, to distribution and marketing techniques, etc. The entry or potential entry of a multinational enterprise (MNE) into a concentrated industry can play an important role in placing competitive pressures on domestic firms in such an

* Director, Manufacturing Branch, Bureau of Competition Policy, Ottawa. This paper was drafted from notes taken of the author's oral remarks made at the Canada-United States Law Institute's Antitrust Conference, held September 30, 1977, at the University of Western Ontario, London.

industry. On the other hand, the firm which is acquired by a large multinational enterprise may find itself in a differentially favourable position *vis-à-vis* its competitors, because it can draw on the resources of its foreign parent to engage, for example, in monopolizing activity. This raises the possibility that such an acquisition may over time further increase concentration in the industry (and MNE's have shown a tendency to enter highly concentrated industries in Canada) and raise entry barriers.

Furthermore, world trade is becoming increasingly highly concentrated as MNE's continue to grow in size and importance and this phenomenon directs attention to the presence of oligopoly in transnational markets. The development of dominant firms in transnational markets, making decisions as to where they will produce, where they will export, where they will licence others to produce, what prices they will charge in national markets, etc., presents opportunities for such firms to coordinate their international activities, somewhat as is done in a domestic oligopoly. Because the operations of MNE's, by definition, crossover national jurisdictions, it is difficult to either monitor or control their operations. The well-known problems relating to the setting of transfer prices by these enterprises are a good example, and one which illustrates how intractable such problems can be.

The important point is that transnational mergers clearly raise the same sort of issues that are raised in making judgments with respect to domestic mergers and, if anything, even more complex issues. As a general rule, it would clearly be preferred, from a competition policy viewpoint, if MNE's entered a domestic industry by a so-called toehold acquisition or by setting up a new business rather than by acquiring an existing large firm in the industry. As another example, transnational mergers raise difficult problems relating to determining what will be the probable effects of the merger on Canada's foreign trade. Canada's current merger law (section 33 of the Combines Investigation Act) within the criminal law framework, has not been an effective policy instrument, but the proposed merger law in the Stage II reform of competition law will deal with mergers within a civil law framework. The considerations which the proposed Competition Board can take into account in judging the effect of the merger on competition and efficiency are broad and sophisticated. Under the proposed Canadian law, mergers which give rise to efficiency gains will be treated in a more permissive manner than is the case under United States merger law, a difference which reflects the recognition of the problems arising from the smaller, more regionalized Canadian markets.

Within this context, the issue then becomes what might be the implications for Canadian competition policy concerns of the extraterritorial application of United States antitrust laws. Canadian concerns in this area will arise most directly when such application appears likely to affect the structure or performance of Canadian industries. For example, where two American firms merge, both of which have subsidiaries operating in Canada, we would certainly review the merger occurring in Canada to determine whether or not it should be allowed (or allowed subject to conditions), and in appropriate cir-

cumstances we would expect an order to issue from the Board. Under the proposed merger legislation in Canada, there may be more of a tendency to review such mergers than in the past to determine their benefit to Canada. The sort of considerations outlined above would be taken into account in making judgments and framing orders in such situations.

The United States might well attack an acquisition by an American firm of a Canadian firm in circumstances where Canada might see some benefit to such a merger but where the United States believed the acquisition would have adverse effects on exports to the United States or where it was believed the Canadian firm was a likely entrant into the United States industry. However, in the past, Canada might well have been of the view that American action to block such a takeover was beneficial, where the takeover was viewed to be contrary to the Canadian public interest. The attempted takeover of Labatt's by Schlitz would be an example. This is no longer the case today because under present laws, Canada can block such acquisitions directly (under the Foreign Investment Review Act) if the view is that the Canadian acquisition will not be of significant benefit to Canada.

The United States might also in the future take antitrust action with respect to the merger of two Canadian firms because such a merger was judged to have detrimental effects either directly on competition in the United States or, if the Canadian firms were significant exporters to the United States, because they believed the acquisition would have adverse effects on the strength of foreign competition facing United States firms. In the former case, it might be that Canadian firms have plants operating in the United States (a not unlikely scenario). In such a case, a remedial order affecting the ownership of the plants in the United States might issue. In the latter case, it is more difficult to see what sort of reasonable remedial order might issue from the United States courts. There tends to be a flavour of sabre-rattling involved in discussions of possible extraterritorial application of antitrust laws, but on a case-by-case basis this posturing can be cut through by taking a hard look at whether or not in fact there is any kind of reasonable remedial order that could issue, and in many cases, I think, it will be found there is not much scope for action. It is one thing to take jurisdiction, it is quite another to come up with a remedy.

Divestiture orders in the United States, under antitrust laws, may significantly affect the structure of Canadian industries where Canadian firms are affected. I am not intending to review the specific cases, of which there are a small number, where the application of United States antitrust laws have affected firms operating in Canada, either positively or negatively. Mr. Fugate has already referred to most of these. I would also refer you, however, to the recent *ITT v. GTE* case in the United States, not only because it dealt with a divestiture order which would have affected firms operating in Canada, but also because the United States Court of Appeals ruled that the remedy of divestiture is not available in private antitrust actions under section 16 of the Clayton Act.

Canada's position in cases involving foreign divestiture orders is fairly

clearly stated in the Combines Investigation Act. Such situations would be broadly reviewable under section 31.5, which would prevent the implementation of such orders in Canada where they would adversely affect competition or efficiency in Canada or the foreign trade of Canada. The breadth of the considerations which can be taken into account under that section should be noted. Canada's maneuverability in such areas may not be all that great, however. For example, it may be that many Canadian subsidiaries are not so structured that they can stand alone. Additional problems arise where shareholders are not within Canadian jurisdiction. I raise this point particularly to indicate further the difficulties in devising remedial orders in specific cases. For example, it might have been possible in the *ICI-Dupont* case, years ago, to implement section 31.5 had it been in force at the time. Perhaps a very clever order, from a legal viewpoint, could have been drafted which would have prevented the dissolution in Canada of the joint venture incorporated in Canada. But afterwards, would the joint venture have been a vigorous and viable operation given the implementation of the orders in the rest of the world? The point is, a really effective order would have had to be directed to the parents of the joint venture, and these were outside our jurisdiction. Finally, in retrospect, from a competition policy viewpoint, the divestiture would appear to have been consistent with Canadian public interest concerns.

The principle, in any event, is clear—Canada should have the ability to review the above sort of situations and make appropriate orders when feasible. The prospects for this would appear to be brighter under the Stage II proposals, where the civil powers of the proposed Competition Board will be broadened as to subject matter. However, it should be stressed that in many cases where the application of United States antitrust law affects Canada, it is possible and even likely that the effects in Canada from the viewpoint of competition and efficiency may well be judged to be positive. On the other hand, I would certainly not deny that on rare occasions, conflicts could arise in this area. Very special circumstances would have to apply. For example, a significant merger between two Canadian firms might be proposed which held the prospect of substantial gains in efficiency. The United States authorities might oppose the merger because both firms had plants in the United States and the effect in the United States was judged to be anticompetitive. Thus, the subsidiaries in the United States might be prevented from merging and would have to be sold. But the operations of these plants might be essential to the operations of the parents because they were vertically related. In such a case the merger might be prevented altogether as a result of United States antitrust action. It would be in this kind of case that cooperation between the two countries would seem reasonable, to determine where the net benefit lay.

II. SPECIALIZATION AGREEMENTS

The theoretical issues relating to horizontal mergers and to specialization agreements are to a large extent related. Similar considerations will apply, *i.e.*, the proposed Competition Board will review those specialization

agreements among firms in Canada which embrace a large enough proportion of the market that they would, in the absence of approval by the Board, constitute an illegal agreement. The important test, in deciding whether or not to approve such agreements, is whether or not the agreements will result in significant efficiency gains. There are cases where there is scope for significant efficiency improvements as a result of specialization agreements in some industries in Canada. There are also obstacles to the development of such agreements relating to the high degree of foreign ownership in many Canadian industries, the existence of foreign tariffs, customer preferences in some industries toward firms offering a full line, etc. For one example, Canadian subsidiaries of foreign firms may be less willing to enter into specialization agreements in Canadian industries than might domestic firms because the subsidiaries have other options relating to specialization within the multinational enterprise.

In addition, subsidiaries of American firms in Canada might be unwilling to enter into specialization agreements because of a concern that such activity might expose them or their parents to United States antitrust attack. The possibility of conflict may not be as great as might at first sight appear. In most cases major specialization agreements entered into in Canada would have for an important objective the possibility of stimulating exports to the United States, and United States antitrust policy should look favourably on such an expected result. It is unlikely that participants in major specialization agreements would already be significant exporters of the products in question, since if they were serving world markets, they would have sufficient scope for specializing their production, absent any agreements with domestic competitors. Nevertheless, it is possible participants in such agreements may be exporting other lines to the United States and thus no doubt some American antitrust scrutiny of such agreements could occur. If an application for such an agreement does go forward to the Board, the above issues (efficiency, stimulation of export possibilities, etc.) will be reviewed and United States authorities will have the benefit of the record and decision of the Board and it is hoped they will be influenced accordingly.

Another possible problem in this area might arise where a Canadian subsidiary of an American firm is subject to a possible United States antitrust order affecting its parent and prohibiting the entry into any such agreements. Here too, it is possible that section 31.5 of the Combines Investigation Act might be brought into play. Again, however, it should be pointed out that with respect to all the issues raised above concerning specialization agreements, the development of such agreements requires a sensitive bargaining process prior to the issue even arising before the proposed Competition Board, and uncertainty with respect to the possible extraterritorial application of United States antitrust laws could considerably impair the outlook for the development of such agreements in specific cases. This consideration also would apply with some force to mergers. These represent supporting arguments for avoiding the development of a confrontationist atmosphere respecting extraterritorial application of antitrust laws and for encouraging international cooperation.

III. EXPORT AGREEMENTS

I do not believe Canadians have serious concerns that export promotion agreements involving small Canadian firms will come under United States antitrust scrutiny. In discussing such agreements it is helpful to distinguish export agreements involving firms which are price-takers in the world market and those involving firms which are price-makers in the world market. Few Canadian industries would fall into the latter category, though some, particularly in the resource area, would. It is the latter types which might be subjected to United States antitrust attack. Of course, where such agreements are extended into international cartels and/or include predatory aspects, they can be attacked under antitrust laws of affected countries, including those of the host country. For Canada to encourage such developments in the few areas where Canadian firms might be in a position to affect world prices would be folly because the dangers of retaliation would be great and the costs to Canada of dealing with internationally cartelized United States industries would be enormous as are the costs to Canada of dealing, for example, with the OPEC cartel. Given the obvious "beggar thy neighbor" aspects which seem export agreements can raise, it is difficult to complain if such agreements are attacked by countries which feel they are being harmed. The sensible position for Canada to take is that in cases where foreign export agreements are harming competition in Canada, competition law action will be taken where it appears it is feasible to do so.

IV. SUMMARY

In summary, in administering its competition law, Canada will probably go as far as possible to ensure that any negative effects of extraterritorial applications of United States antitrust laws are minimized. I believe there is some scope to do this in the present law and that there will be greater scope to do this under the Stage II proposals. On the other hand, I am not all that optimistic that many of the problems isolated can be effectively solved for the many reasons set out above. To put the matter another way, clearly in the background are the issues relating to the effect on national economies of the operations of multinational enterprises. Attempts to solve the sorts of problems raised by the growing importance of the operations of MNE's on an *ad hoc*, unilateral basis, do not, I think, have bright prospects for success. The attempts to deal with these problems by extraterritorial applications of antitrust laws are just that—*ad hoc* and unilateral actions. Another problem with the pragmatic, *ad hoc*, approach to these problems is that it leaves the firms exposed to uncertainty and, as Mr. Baker mentioned this morning, perhaps faced with the *choice* of whether or not they wanted to be criminals in the United States or in Canada. From a public policy viewpoint this is surely an undesirable situation.

Many of the speakers today stressed the need for stronger, more pragmatic cooperation on specific cases involving extraterritorial application of antitrust laws. I certainly agree with such approaches. Countries ought to

have some scope and willingness to be sensitive to situations where solving a perhaps marginal antitrust problem domestically affects the economic interests of another country much more significantly in a negative fashion. But it has often been claimed, and with a great deal of truth, that the really basic problems discussed above can only be dealt with in a fully satisfactory manner if they are dealt with within the context of greatly improved international cooperation on enforcement issues in the antitrust area. The Stage II proposals provide for the introduction into Canadian competition law of a provision allowing the Minister, with Cabinet approval, to enter into agreements with governments of other countries providing for the elimination of private restrictions on international trade and assistance in the administration and enforcement of laws relating to the safeguarding of competition or the exchange of information. If other countries take a similar stance and in the future follow through on such an approach, significant progress may be made in dealing in a more sensible and sophisticated manner with many of the issues raised. If such developments do occur in the future it is likely that the problems relating to the extraterritorial application of antitrust laws may be significantly reduced.