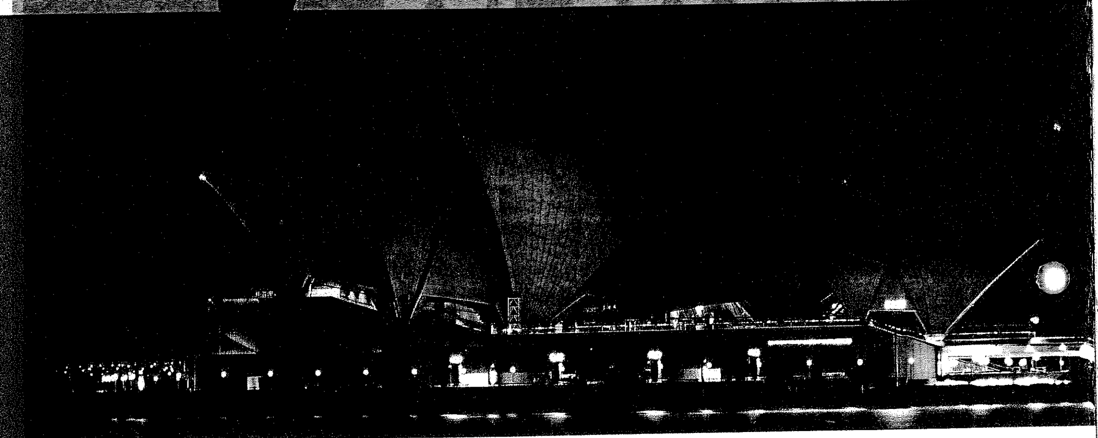


16th Inter-Pacific Bar Association Conference 2006

30 April - 3 May 2006 Hilton Hotel, Sydney Australia

www.ipba2006.com

Hosted by: The Inter-Pacific Bar Association

Conference Theme: Free Trade Agreement

The 16th Inter-Pacific Bar Association Conference is coming to Sydney in 2006, to be held right in the vibrant heart of the Sydney CBD at the Hilton Hotel. The Hilton is one of Sydney's premier venues for conferences and exhibitions.

Free Trade Agreements are becoming an ever greater part of the landscape throughout Asia and the rest of the world and it is ever more crucial to be able to understand the effect they are having.

The IPBA conference in Sydney in 2006 will focus on the effect of free trade agreements across a wide range of committee topics from intellectual property to international trade and transport, banking and finance to telecommunications.

The IPBA Corporate Counsel Forum will provide a background on the effects of free trade agreements on international business and the intensely interesting question of the cross jurisdictional application of legal professional privilege doctrines.

The Inter-Pacific Bar Association Conference is highly regarded and is sure to be an exceptional event. If you are interested in participating in the IPBA 2006 Conference please complete the on-line expression of interest form at www.ipba2006.com

Contact Details: IPBA 2006 Conference Managers
GPO Box 128, Sydney NSW 2001 Australia **Tel:** + 61 2 9265 0700 **Fax:** + 61 2 9267 5443 **Email:** ipba2006@tourhosts.com.au

Please visit the Conference website to register your interest **www.ipba2006.com**

LexisNexis
(a division of Reed Elsevier (Greater China) Ltd)

Publishing Manager
Paul Davis

Editor
Candice Ling

Editorial
Wong Yuk Yin

Design
Zoe Yau

Advertising Sales
Jennifer Luk
Tel: 852-2965-1432
Fax: 852-2976-0840
Email: jennifer.luk@lexisnexis.com

An imprint of
LexisNexis
(a division of Reed Elsevier (Greater China) Ltd)
Unit 3011, 30/F, The Center,
99 Queen's Road C, Central,
Hong Kong
Tel: 852-2965-1400
Fax: 852-2976-0840

Internet:
www.lexisnexis.com.hk

Email address:
candice.ling@lexisnexis.com

ISSN 1469-6495

IPBA Journal is the official journal of the Inter-Pacific Bar Association. Copyright in all material published in the journal is retained by LexisNexis (a division of Reed Elsevier (Singapore) Pte Ltd). No part of this journal may be reproduced or transmitted in any form or by any means, including recording and photocopying without the written permission of the copyright holder, application for which should be addressed to the publisher. Written permission must also be obtained before any part of this publication is stored in a retrieval system of any nature. The journal does not accept liability for any views, opinions, or advice given in the journal. Further, the contents of the journal do not necessarily reflect the views or opinions of the publisher and no liability is accepted in relation thereto.

IPBA JOURNAL

The Official Publication of the Inter-Pacific Bar Association

No 40 December 2005

IPBA News

4 **The President's Message**

5 **Report of the Secretary-General**

7 **Announcement by the Publications Committee**

Legal Update

8 **The Recent Development of the Potential Competition Doctrine in the United States**
This article reviews the basic framework of the guidelines and recent developments in the judicial treatment of the potential competition doctrine

14 **The Impact of the Capetown Convention Implementation Act and Bill C-55 on the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act**
This paper outlines some of the most significant commercial insolvency-related amendments to the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act that will result from Bill C-55, and describes the changes that will be made to these two Acts by the Capetown Convention Implementation Act

22 **Transfer Pricing—A Tax, Corporate and Securities Perspective**
This article examines the legal framework governing transfer pricing and highlights how in addition to satisfying the tax authorities, a transfer pricing policy must satisfy the regulatory authorities

28 **Revisiting the Philippine BOT Law**
Sixteen years after its enactment, the Philippine BOT Law remains a viable option for private sector participation in national growth and development

32 **When the Party is Over: Unwinding a Joint Venture in China**
This article identifies nine common problems that may arise when a Chinese joint venture does not succeed

Colombo Special

36 **IPBA Mid-Year Council Meeting in Colombo**

The Recent Development of the Potential Competition Doctrine in the United States

This article reviews the basic framework of the guidelines and recent developments in the judicial treatment of the potential competition doctrine

Akira Inoue
Attorney at law,
Anderson Mori & Tomotsune, Japan

Introduction

Potential competition exists when a firm, though not active in a given market, is 'so situated as to be a potential competitor and likely to exercise substantial influence on market behavior.'[1] When an incumbent firm, an active player in a market, merges with or acquires a firm that is outside the relevant market but is or is viewed by incumbents as a plausible entrant (the role may be reversed, that is, the situation includes where such a non-incumbent firm merges with or acquires an incumbent firm, an active player in a market), and its entry or perceived threat of entry greatly strengthens competition in a given market, potential competition concerns could arise.[2] In the US, these concerns will be screened by the Department of Justice ('DOJ') and the Federal Trade Commission ('FTC') (the 'antitrust agencies') under Section 7 of the Clayton Act, which prohibits mergers and acquisitions 'in any line of commerce ... in any section of the country ... the effect of [which] may be substantially to lessen competition.'

The elimination of threatening competitors could relax the constraints on existing firms in much the same manner as the elimination of current competitors. The antitrust concerns arising out of the elimination of potential competitors are encompassed in the Potential Competition Doctrine, which has long been recognized in the US.[3]

For various reasons, however, in spite of the Supreme Court's recognition that the Clayton Act seeks to preserve 'potential competition,'[4] which means present competition or probable competition stemming from those businesses that are not active in a market but are in a position to enter and compete in that market, the potential competition doctrine has been given a hostile reception by the lower federal courts.[5]

In addition, both of the antitrust agencies have become reluctant to bring actions which depend solely on the court's consideration of non-incumbents as potential competitors, as they are faced with a high evidentiary standard to meet.[6] Instead, it has been said that the agencies have responded either by not challenging some mergers that might have had anti-competitive potential, or by emphasizing other competitive concerns instead of potential competition in order to avoid quick rejection by courts.[7]

The recent antitrust practices in the US outlined above seem to indicate that the potential competition doctrine will not apply anymore. In order to examine this practical trend, this article reviews the basic framework of the guidelines and recent developments in the judicial treatment of the potential competition doctrine.

Guidelines Regarding the Potential Competition Doctrine

Potential competition concerns are governed by the substantive standard articulated in the US Department of Justice Merger Guidelines, issued on 14 June 1984, Section 4 of which has been transformed into the 'Non-Horizontal Merger Guidelines' by the DOJ'.[8]

Section 4.11 of the Non-Horizontal Merger Guidelines articulates explicitly 'The Theory of Potential Competition,'[9] mentioning that a merger removing a firm at the edge of the market could harm competition in either of two ways, namely by: (i) harming perceived potential competition through the elimination of a significant present competitive threat that constrains the behavior of the firms already in the market;[10] or (ii) harming actual potential competition through eliminating the possibility of entry by the acquiring firm in a more pro-competitive manner.[11]

The first branch of the potential competition theory encompasses the competitive benefits that would be lost given that the competitive threat by the acquiring firm, having been considered by those in the oligopolistic target market as a potential independent entrant and that its existence on the fringe of the target market has had a tempering effect on their non-competitive conduct, could be eliminated by the merger.

Demonstrating that the target market is less than wholly competitive will not be difficult for the agencies and courts because the evidence of oligopolistic market structure, showing that the target market is highly concentrated, has generally been satisfied by making out a *prima facie* case that the target market is non-competitive.[12]

Proof of the high market concentration alone could invoke the presumption of potential competition[13] in spite of the fact that defendants in that case would be free to rebut such a presumption by demonstrating: (i) that the relevant market is broader than alleged by the agencies and therefore less concentrated; (ii) that market shares of the leading firms in the market have not been stable or are not increasing;[14] and (iii) that there are few barriers preventing entry into the market.[15]

Evidence that firms in the target market perceive the acquiring firm as a potential entrant might be more difficult to adduce than the evidence giving rise to the presumption that the market is non-competitive. For that purpose, objective evidence that the acquiring firm is in fact a potential entrant has been held to be sufficient to determine existing firms' perception of its potential for entry.[16]

The second branch of the potential competition theory purports to protect the competitive benefits that would be lost if a potential competitor, instead of entering the target market independently or by a toehold acquisition, acquired one of the leading firms in the given concentrated market.

The elimination of threatening competitors could relax the constraints on existing firms in much the same manner as the elimination of current competitors.

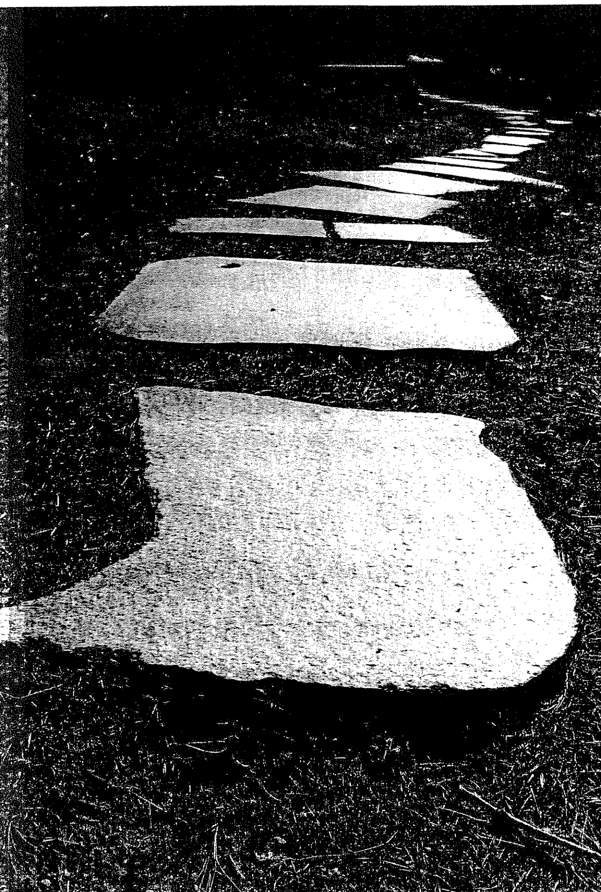
The actual potential competition theory considers losses of competitive benefits from actual entry into the given market by potential competitors that would probably be realized in the future.[17] In other words, the potential competition theory should aim to invalidate, under Section 7 of the Clayton Act, mergers that could prevent probable future increases in competition in a given market by treating a merger's preclusion of that probable future increase in competition as a lessening of competition.[18]

Under the actual potential competition theory, the plaintiffs are required to show not only that the relevant market is oligopolistic but also that absent the merger in question, the acquiring firm was likely to have entered the market in the near future, either on its own or through a toehold acquisition.[19]

Further, under this theory, the plaintiffs have to demonstrate that such an entry was reasonably likely to have significant pro-competitive effects in

---

* Mr Inoue is an attorney at law in Japan, working with Anderson Mori & Tomotsune. During his professional career, he has been involved in numerous complex dispute resolutions including Supreme Court cases. He obtained his LLB in 1996 and LLM in 1998 at the Chuo University in Japan as a Chuo University Scholarship Student. He passed the Japanese Bar Examination in 1997 and was admitted as a member of the Tokyo Bar Association in 2000. From 1998 to 2000, he was a trainee at the Legal Training and Research Institute of Supreme Court of Japan. In addition, he passed the Chuo University Faculty of Law Assistant Professor Examination in 1999. In 2005, he was conferred the LLM at the University of Virginia School of Law, upon completion of his master's thesis, 'Antitrust Analysis of B2B Transaction' under the supervision of Dr Charles C Goetz.



the relevant market.[20] In this regard, in addition to the fact that a lower court held that the government must prove that the putative entry would have lasting pro-competitive effects on the given market,[21] the Supreme Court articulated that a significant enhancement of competition from the defendant's putative *de novo* entry was neither demonstrated by evidence presented nor possible given the regulatory restriction which the acquiring firm would have faced,[22] and that thereby alluded to the fact that the mere addition of another participant to the given market was insufficient to invalidate the merger in question.[23]

With regard to the two kinds of potential competition theories outlined above, the Non-Horizontal Merger Guidelines clearly state that mergers raising either concern would be evaluated with a single structural analysis analogous to that applied to horizontal mergers.[24] Regarding the relationship between perceived and actual competition, these guidelines provide:

> If it were always profit-maximizing for incumbent firms to set price in such a way that all entry was deterred and if information and coordination were sufficient to implement this strategy, harm to perceived potential competition would be the only competitive problem to address. In practice, however, actual potential competition has independent importance. Firms already in the market may not find it optimal to set price low enough to deter all entry.[25]

With regard to determining whether or not potential competition concerns should be included by the antitrust agencies in the review of mergers and acquisitions, the Non-Horizontal Guidelines enumerates several factors, such as market concentration,[26] conditions of entry generally,[27] the acquiring firm's entry advantage,[28] the market share of the acquired firm,[29] and efficiencies.[30]

Based upon the Non-Horizontal Guidelines, a challenge by the antitrust agencies is not likely to be made if entry into the market is generally easy or if it is shown that a few firms have the same or comparable advantages in entering.[31]

Judicial Treatment of the Potential Competition Doctrine in the US

One of the earliest cases in the US which dealt with antitrust concerns arising out of potential competition in an important way was *United States v El Paso Gas Co.*[32] El Paso Gas Co ('El Paso') was a supplier of natural gas to customers in California. It sought to acquire Pacific North West Company ('Pacific North West'), which had a substantial amount of reserves of natural gas outside of California and repeatedly tried to enter the market by participating in the bidding to supply utilities there although it had sold no natural gas in that area before. After examining evidence demonstrating that Pacific Northwest's participation in the biddings in fact altered the price of gas provided by El Paso, the Supreme Court concluded that '[W]e would have to wear blinders not to see that the mere efforts of Pacific Northwest to get into the California market, though unsuccessful, had a powerful influence on El Paso's business attitudes within the State'[33] and that '[U]nsuccessful bidders are no less competitors than the successful one. The presence of two or more suppliers gives buyers a choice. Pacific Northwest was no feeble, failing company; nor was it inexperienced and lacking in resourcefulness.'[34] In conclusion, the Supreme Court upheld the government's challenge to the acquisition attempted by El Paso.[35]

The Supreme Court sharpened the potential competition analysis in *FTC v Proctor & Gamble Co.*[36] In this case, the issue in question was the attempted acquisition of Clorox by Proctor & Gamble ('P&G'). P&G's argument was that it had never intended to enter the liquid bleach market by itself. Although no evidence had been introduced to prove that P&G had undertaken efforts to enter the liquid bleach market, the Supreme Court prohibited the merger on the ground that '[I]f Procter had actually entered, Clorox's dominant position would have been eroded and the concentration of the industry reduced.'[37] In conclusion, the Supreme Court held that the acquisition was illegal because, by eliminating a plausible entrant, the merger would hinder the prospective deconcentration of the industry.[38] The theory adopted in this case was the 'actual potential competition' approach, reflecting the belief that absent the merger, a market would have become more competitive by the actual entry of a non-incumbent to that market.

The Supreme Court in *United States v Falstaff Brewing Corp*[39] further clarified that the perception by the incumbent participants of a given market as competitors should be emphasized as well. In this case, Falstaff Brewing Corp ('Falstaff') acquired Narragansett to expand its marketing into New England. Although Falstaff successfully defended its acquisition by arguing that it had never intended to enter that region by building a new brewery, the Supreme Court reversed the lower court decision by concluding that 'the specific question is not what Falstaff's internal company decisions were but whether, given its financial capabilities and conditions in the New England market, it would be reasonable to consider it a potential entrant into that market.'[40] Further, the Supreme Court stated that Falstaff's presence on the fringe of the market should likely have influenced the behavior of other New England firms in such a product market, and its entry by the acquisition would eliminate the competitive restraint in that market.[41] As explained earlier in this article, the theory adopted in this case came to be known as 'perceived potential competition,' which assumes that because the non-incumbent firm is considered a threat to enter by incumbents of a market, its elimination would reduce the competition among the incumbent firms.

In *United States v Marine Bancorporation, Inc*,[42] the Supreme Court articulated its overall approach to the potential competition doctrine. In this case, Marine Bancorporation, Inc ('Marine Bancorporation'), a large Seattle bank, sought to acquire a midsize bank in Spokane. The government successfully challenged the acquisition in the district court. The Supreme Court reversed the lower court decision by concluding that Marine Bancorporation could not have been considered as a likely entrant into Spokane because state banking laws prohibited *de novo* entry into another region.[43] The court in this case used the following language:

In practice, however, actual potential competition has independent importance.

> Unequivocal proof that an acquiring firm actually would have entered *de novo* but for a merger is rarely available ... . Thus, as Falstaff indicates, the principal focus of the doctrine is on the likely effects of the premerger position of the acquiring firm on the fringe of the target market. In developing and applying the doctrine, the Court has recognized that a market extension merger may be unlawful if the target market is substantially concentrated, if the acquiring firm has the characteristics, capabilities, and economic incentive to render it a perceived potential *de novo* entrant, and if the acquiring firm's premerger presence on the fringe of the target market in fact tempered oligopolistic behavior on the part of existing participants in that market. *United States v Marine Bancorporation, Inc*, 418 US 602, 624–625 (1974).

Although the first sentence of the excerpt could suggest the acknowledgement of a non-incumbent firm that is a prospective entrant (an actual

potential competitor), at the same time, the Supreme Court made clear how difficult it is to meet the burden of proof to its satisfaction, which has been said to cause the decrease of cases challenged by the antitrust agencies based solely upon the potential competition doctrine.[44] With regard to perceived potential competition, the Supreme Court articulated the test, which involves the proof of three elements: (i) the market in question must be concentrated;[45] (ii) the non-incumbent firm must have the 'characteristics, capabilities, and economic incentive to render it a perceived potential *de novo* entrant;'[46] and (iii) the non-incumbent firm must have 'in fact tempered oligopolistic behavior on the part of existing participants.'[47]

The high evidential standard for perceived potential competition created in *United States v Marine Bancorporation, Inc* and reinforced in the lower court decisions[48] has led to fewer cases involving potential competition concerns being brought in the federal court.[49]

Seemingly affected by the courts' reluctance to accept the potential competition doctrine, the FTC had raised the already-substantial evidentiary burdens needed to effectively apply the potential competition doctrine.[50]

In the *BAT Industries Ltd* ('*BAT*') case,[51] the FTC considered whether or not BAT would have entered the US market for chemical carbonless paper had it not acquired Appleton Papers, Inc, the leading US producer in this industry. The FTC mentioned that the argument in relation to entry into the market required 'clear proof of internal plans for independent entry that have been at least tacitly approved at the government levels of corporate management.'[52] This language appears to have created an enormous evidentiary hurdle as well.[53]

At the same time the *BAT* case was pending, the FTC ruled on the attempted establishment of joint venture between General Motors ('GM') and Toyota Co ('Toyota') to manufacture a small car in California for the US market.[54] The issue in question during the course of investigation was whether or not either GM or Toyota would otherwise have undertaken a similar project outside of the joint venture. In this regard, although it can be said that the certainty of new entry by joint venture would be preferred to the merely probable entry of the parents,[55] in this case there was substantial evidence that GM had considered an alternative venture with Isuzu, a much less important rival than Toyota. In addition, since Toyota was known to be the lowest-cost Japanese car producer, its elimination as a possible independent entrant could significantly raise the constraint on existing market participants' prices. In spite of these facts, the FTC approved this joint venture with the reservation that the output from the joint venture between GM and Toyota should be limited to no more than 250,000 subcompact cars per year for a period of 12 years, ending no later than 31 Dec 1997.[56]

Recently, the DOJ has cited the potential competition doctrine in the case of the merger of United Airlines and US Airways. The outcome was that United Airlines abandoned its plan to acquire US Airways for multiple reasons, including the DOJ's threat to bring a lawsuit.[57] Although the DOJ seemed to find the potential competition doctrine useful in formulating the objection to the proposed merger, it was very cautious in the manner in which it raised it and sought to resolve the case by a consent order rather than initiating litigation.[58]

Conclusion

As outlined above, the judicial treatment of the potential competition doctrine in the US reveals that deep skepticism has developed about this doctrine. The courts and the FTC have come to establish high evidentiary hurdles for successfully challenging mergers and acquisitions where the only antitrust concerns are the elimination of potential competition. In turn, this trend has caused the DOJ to adopt a more cautious approach in cases involving potential competition concerns.

Based upon the judicial treatment in the US and the practical trend taken by the antitrust agencies, it can be said that it will be less likely that the antitrust agencies will challenge mergers and acquisitions whose only antitrust concerns are elimination of potential, non-incumbent competitors.

Notes:

1. See *eg*, *United States v Falstaff Brewing Corp*, 410 US 526, 531–532 (1973).
2. See *eg*, William Allen Alper, 'The Second Circuit Review—1982–1983 Term: Antitrust: Commentary: Potential Competition: An Idea Whose Times Has Passed,' 50 *Brooklyn L Rev* 407, 410 (1984).
3. One of the earliest Supreme Court cases that mentioned this doctrine is *United States v Penn-Olin Chem Co* 378 US 158 (1964).
4. See *United States v Marine Bancorporation, Inc*, 418 US 602, 624–625 (1974). See also *United States v Falstaff Brewing Corp*, 410 US 526, 531–532 (1973). See also *Ford Motor Co v United States*, 405 US 562, 567–568 (1972). See also *FTC v Procter & Gamble Co*, 386 US 568, 581 (1967). In these decisions, the Supreme Court part relied on the legislative history of the 1950 amendment of the Section 7 of the Clayton Act. See *eg*, *Ford Motor Co*, 405 US, at 569. With regard to the development of the potential competition doctrine in connection with the legislative history, see *eg*, Joseph F Brodly, 'Potential Competition Mergers: A Structural Analysis,' 87 *Yale L J* 1, 43 (1977).
5. See *Tenneco, Inc v FTC*, 689 F2d 346 (2d Cir 1982); *United States v Siemens Corp*, 621 F 2d 499 (2d Cir 1980); *BOD International v FTC*, 577 F2d 24 (2d Cir 1977).
6. See *eg*, John E Kwoka, 'New Economy, New Regime Second Annual Symposium The American Antitrust Institute: Non-Incumbent Competition: Mergers Involving Constraining And Prospective Competitors,' 52 *Case W Res* 173, 174 (2001).
7. *Id.*
8. The US Department of Justice, 'Non-Horizontal Merger Guidelines,' (1984), available at http://www.usdoj.gov/atr/public/guidelines/2614.htm (last visited 28 Feb 2005).
9. *Id* at Section 4.11.
10. *Id* at Section 4.111.
11. *Id* at Section 4.112.
12. See *eg*, *Marine Bancorporation, Inc*, 418 US at 630–631.
13. See *eg*, *Tenneco, Inc*, 689 F2d at 352–353.
14. See *eg*, *Falstaff Brewing Corp*, 410 US at 527.
15. See *eg*, *United States v Baker Hughes, Inc*, 908 F2d 981, 987–988 (1990); *United States v Ford Motor Co*, 286 F Supp 407, 422–426 (ED Mich 1968).
16. See *United States v Wilson Sporting Goods Co*, 288 F Supp 543, 562–564 (ND Ill 1968).
17. See *Procter & Gamble Co*, 386 US at 573.
18. *Id* at 577.
19. *Marine Bancorporation, Inc*, 418 US at 633.
20. *Id.*
21. *Mercantile Texas Corp v Board of Governors of Federal Reserve System*, 638 F2d 1255, 1270 (5th Cir 1981).
22. *Marine Bancorporation, Inc*, 418 US at 638–639.
23. *Id.*
24. Non-Horizontal Merger Guidelines, *supra* note 8, at Section 4.13.
25. *Id* at Section 4.12.
26. *Id* at Section 4.131.
27. *Id* at Section 4.132.
28. *Id* at Section 4.133.
29. *Id* at Section 4.134.
30. *Id* at Section 4.135.
31. See *eg*, Kwoka, *supra* note 6, at 181.
32. *United States v El Paso Gas Co*, 376 US 651 (1974).
33. *Id* at 659.
34. *Id* at 661.
35. *Id.*
36. *Procter & Gamble Co*, 386 US at 568.
37. *Id* at 575.
38. *Id* at 603.
39. *Falstaff Brewing Corp*, 410 US at 526.
40. *Id* at 533.
41. *Id.*
42. *Marine Bancorporation, Inc*, 418 US at 602.
43. *Id* at 636.
44. See *eg*, Kwoka, *supra* note 6, at 178.
45. *Marine Bancorporation, Inc*, 418 US at 624–625.
46. *Id.*
47. *Id.*
48. See *eg*, *Tenneco, Inc*, 689 F2d, at 351–352.
49. See *eg*, Joseph F Brodly, 'Potential Competition Under the Merger Guideline,' 71 *Calif L Rev* 376, 390–391 (1983).
50. See *eg*, Kwoka, *supra* note 6, at 179.
51. 104 FTC 852.
52. *Id* at 930.
53. See Robert Pitofsky, 'Competition Policy in Communication Industries: New Antitrust Approaches,' Address to the Glasser Legal/Works Seminar on Competitive Policy in Communication Industries at the Washington DC (10 Mar 1997), in http://www.ftc.gov/speeches/pitofsky/newcomm.htm (last visited 1 Mar 2005).
54. 103 FTC 374 (1984).
55. See generally Joseph F Brodly, 'Joint Ventures and Antitrust Policy,' 95 *Harv L Rev* 1521, 1532 (1982).
56. 103 FTC at 383–384.
57. The US Department of Justice, 'Department of Justice and Several State Will Sue to Stop United Airlines from Acquiring US Airways,' (2001), available at http://www.usdoj.gov/opa/pr/2001/July/361at.htm (last visited 6 Mar 2005).
58. *Id.*

LEGAL UPDATE