SIDLEY AUSTIN LLP RESPONSE TO THE COMPETITION COMMISSION'S DRAFT GUIDANCE CONSULTATION DOCUMENT

MERGER REMEDIES: COMPETITION COMMISSION GUIDELINES CONSULTATION DRAFT –MAY 2008

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INTRODUCTION

We welcome the opportunity to respond to the draft guidance consultation document "Merger Remedies: Competition Commission Guidelines Consultation Draft" (the "Consultation" or "Guidance") published by the Competition Commission (the "CC") in May 2008.

Over the past five years since the introduction of the UK's new merger control regime, the CC has gained a considerable amount of experience in dealing with remedies through both its case work and its research into the outcomes of merger remedies. We believe that the CC's decision to update its merger remedies guidance based on this experience and research is both timely and opportune, and represents an important means of providing clarity, transparency, and legal certainty to the business and adviser community. We also commend the CC for taking into account the principles of the Merger Remedies Review Project (the "Review Project") of the International Competition Network (the "ICN"), the framework of merger control policy within the European Community, and UK judicial precedent.

In responding to the Consultation, we have not endeavoured to comment exhaustively on each and every point, but have instead focused on a number of the key issues raised by the Consultation. Our main comments may be summarised as follows:

1. ***Proportionality***. We consider that paragraphs 1.9 to 1.13 (dealing with the cost of remedies and proportionality) should contain a clear statement to the effect that the scope of the remedy should typically not go beyond the ambit of addressing the substantial lessening of competition ("SLC"). The CC appears to accept this elsewhere and it would be consistent with the European Commission's approach.

2. ***Differences in treatment between anticipated and completed mergers***. Although the CC states that it will follow similar principles for anticipated and completed mergers, there is a separate discussion of full and partial prohibition for anticipated mergers in paragraphs 2.3 and 2.4 of the Guidance, indicating that the CC may seek to treat anticipated and completed mergers differently. We nevertheless believe that there should be no fundamental difference of treatment between anticipated and completed mergers when formulating appropriate remedies. We are especially concerned that full prohibition is mentioned at the outset as being an effective remedy in the case of anticipated mergers, while partial prohibition is mentioned afterwards as being appropriate "if feasible" where the merger parties carry out activities in markets other than those that are expected to give rise to an SLC. This seems unnecessarily to bias the remedy in favour of full prohibition for anticipated mergers.

In addition, this part of the Guidance dealing with the prohibition of anticipated mergers mentions that an appropriate remedy may be requiring a notifying party to decrease a pre-existing minority shareholding in the third party in which the notifying party now intends to acquire a material or controlling interest, although it is clear that the CC would not have jurisdiction to impose such a remedy in the case of an anticipated merger (*i.e.*, where the acquiring party had not yet acquired control or material influence).

3. ***More consistent treatment of intellectual property remedies***. It seems to us that the Guidance is not sufficiently consistent in the treatment of intellectual property ("IP") remedies. In particular, we believe that all remedies providing access to IP should be treated as structural remedies and not merely those that result in the assignment or irrevocable exclusive licence of IP to a particular third party.

4. ***Less bias against remedies aimed at controlling outcomes***. Paragraph 1.8(a) of the Guidance states that structural remedies are normally preferable to measures that seek to regulate the ongoing behaviour of the notifying parties as the latter are unlikely to deal with an SLC and its adverse effects as comprehensively as structural remedies and may result in distortions compared with a competitive market outcome. While we believe that this statement may be appropriate with respect to what the CC has termed "controlling outcomes", we would question its appropriateness in relation to what the CC has termed "enabling measures" and in particular access remedies.

5. ***Access remedies should be treated as structural remedies***. The Guidance proposes to treat access remedies as behavioural. We would suggest that access remedies (whether access to IP or infrastructure) should generally be viewed as structural rather than behavioural. This would be consistent with the approach of the European Commission, as well as with the approach of the CC elsewhere in the Guidance. It would also be closer to reality.

6. ***Sunset clause period should be set at 10 years***. Consistent with European Commission practice, we believe that the sunset period for not re-acquiring a divested business should be set at 10, rather than 15, years. Further, we believe that, as in the case of behavioural remedies, merging parties that have divested businesses should have a right to apply to extinguish the sunset clause where there has been a significant change in market circumstances.

PROPORTIONALITY – PARAGRAPHS 1.9 TO 1.13

Paragraph 1.9 of the Guidance states that, after identifying remedies that are effective, the CC will select the least costly remedy in order to be reasonable and proportionate. Where there are two equally effective remedies, the CC will select the one that "imposes the least cost or that is least restrictive." The CC will generally attribute less significance to the costs of a remedy incurred by the merging parties as compared with costs imposed on third parties and, absent exceptional circumstances, will not consider the cost of divestiture in completed mergers.

We have a number of comments on this section of the Guidance as follows:

- First, the Guidance appears to equate proportionality with achieving the least costly remedy. We believe, however, that proportionality should not be measured merely according to the cost of the remedy, but also according to the scope of the remedy as compared with the ambit of the SLC. In this circumstance, we consider that this section of the Guidance should contain a clear statement that, based on the principle of proportionality, the remedy should not ordinarily go beyond the ambit of the SLC except where the effectiveness of the remedy would otherwise be impaired. This is particularly important given the CC's position that it will attribute less significance to the costs of a remedy incurred by the merging parties.

  The notion that the remedy should be proportionate to the ambit of the SLC seems to be implicit in a statement later in the Guidance that the CC will normally seek to identify the smallest viable, stand-alone business that can compete successfully on an ongoing basis and that includes all the relevant operations pertinent to the area of competitive overlap.[1] This notion is also clear from past CC decisions as highlighted in the following selected quotations:

  – "[A]ny structural undertakings would, at their minimum, be likely to involve divestment of a package of routes and flows significantly wider than those on which competition issues have been identified … [S]tructural remedies would in our view be disproportionate in this case."[2]

  – "A divestment of either party's assets involved in the production of raw CO_2 would also require the divestment of assets used in the production of ammonia

[1] The Guidance, para. 3.7.

[2] *Firstgroup plc/ Scotrail*, Competition Commission decision, June 2004, para. 6.5.

which would extend far beyond the area of competitive overlap and would not be, in our view, proportionate to the SLC identified."[3]

– Divestiture would be "either disproportionate (in the sense of being more intrusive or costly than prohibiting the merger) or would not effectively address the SLC."[4] At the CC Merger Remedies Guidance Launch Seminar, the CC also linked proportionality to the notion of "intrusiveness."[5]

At present, any explicit elaboration on the concept of proportionality is limited to paragraph 1.12 where it is stated that, in exceptional circumstances, the CC will not seek to impose the least costly but effective remedy where the costs incurred would still be disproportionate to the scale of the SLC. However, this paragraph is focused on the proportionality of the costs of any remedy relative to the scale of the SLC (typically placing less weight on the costs to be incurred by the merging parties) and not more broadly on the proportionality of the scope of any remedy relative to the ambit of the SLC. We would therefore recommend that the Guidance include an explicit discussion of the concept of proportionality vis-à-vis the ambit of the SLC.

- Second, the Guidance does not elaborate on what is meant by "or that is the least restrictive" in the last sentence of paragraph 1.10. This nevertheless seems to be an important concept if, by itself, it can influence the selection of the ultimate remedy. For purposes of legal certainty, we would therefore invite the CC to explain what it means in this context by the "least restrictive."

- Third, as mentioned, paragraph 1.10 states that, when opting for the least costly remedy, the CC will generally attribute less significance to costs incurred by the merging parties. Further, this paragraph says that, since the cost of divestiture is in essence avoidable (*i.e.*, the notifying parties could have chosen not to close the transaction pending the outcome of the merger control process), the CC will only in exceptional circumstances consider the cost of divestiture in the case of completed mergers. Given that the UK operates a voluntary merger control, it is not clear to us that merging parties which choose to close their transaction pending the outcome of the merger control review process should be treated more unfavourably as compared with merging parties which choose to condition closing on approval from the UK

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[3] *Kemira GrowHow Oyj / Terra Industries Inc.*, Competition Commission decision, 11 July 2007, para. 15.82.

[4] *Knauf Insulation Limited / Superglass Insulation Limited*, Competition Commission decision, November 2004, para. 9.9.

[5] Competition Commission Merger Remedies Guidance Launch Seminar – Notes of a Seminar held at the Competition Commission on May 27, 2008, Cathryn Ross, line 11, page 24.

authorities. At the very least, we believe that the CC should be willing to take into account, in completed mergers, the merging parties' costs of divestiture that would in any event have arisen even if the parties had not closed the transaction prior to clearance (in the same way that the CC would take into account the costs of divestiture for non-completed transactions).

DIFFERENCES BETWEEN ANTICIPATED AND COMPLETED MERGERS – PARAGRAPHS 1.29 AND 2.3 TO 2.4

Paragraphs 2.3 and 2.4 of the Guidance discuss full and partial prohibition of anticipated mergers, while paragraphs 2.5 and 2.6 and then later paragraph 3.1 onwards discuss divestiture. Although paragraph 1.29 states that the CC will follow similar principles for anticipated and completed mergers, the separate discussion of full and partial prohibition in paragraphs 2.3 and 2.4 suggests that there may be a difference of treatment as between anticipated and completed mergers. We have three principal comments on this part of the Guidance:

- First, paragraph 2.3 suggests a bias in favour of full over partial prohibition of anticipated mergers. The first sentence of paragraph 2.3 says that full prohibition will generally be an effective remedy,[6] while the second sentence says that partial prohibition may be appropriate "if feasible" where the merger parties carry out activities in markets other than those that are expected to give rise to an SLC. As mentioned, we consider that the starting point should be that the scope of any remedy should not go beyond the ambit of the SLC and therefore the CC should seek to impose the least intrusive remedy possible. Moreover, as there is no similar discussion in relation to completed mergers, this suggests a difference of treatment as between anticipated and completed mergers.

- Second, we believe that it should be made clear that the discussion of divestitures in paragraph 3.1 onwards equally applies to anticipated mergers.

- Third, paragraph 2.4 in the context of prohibition of anticipated mergers notes that the CC may need to require a party to reduce a minority shareholding in the party to be acquired. This paragraph appears to presume that the acquiring party has notified an intention to acquire an increased shareholding in a company in which it has already built up a minority shareholding and that it is the proposed acquisition of the increased shareholding that will lead to a relevant merger situation arising (*i.e.*, the notification relates to an anticipated merger). However, if the minority shareholding

[6] Interestingly, the Review Project did not regard prohibition as a remedy but an alternative outcome to a merger decision. See ICN Merger Working Group: Analytical Framework Subgroup, Merger Remedies Review Project, Report for the fourth ICN annual conference, Bonn – June 2005, para. 1.5.

> already acquired prior to notification does not already confer material influence or control, it is clear that the CC does not have any power under its merger control powers to order a reduction in the minority shareholding already held. Conversely, if the minority shareholding does confer material influence or control, then the transaction should previously have been classed as a completed merger and not be included in this section dealing with anticipated mergers.

Finally, the second sentence of paragraph 1.29 states that, in completed merger cases, there are circumstances which "increase the risks of achieving an effective solution." Given the statement in paragraph 1.30 that the CC will take action to limit these risks, we presume that there is a "not" missing from the second sentence of paragraph 1.29 (*i.e.*, it should read "which increase the risk of not achieving an effective solution").

TREATMENT OF IP REMEDIES – PARAGRAPHS 2.7 AND 3.28

It seems to us that the Guidance is not sufficiently consistent in the treatment of IP remedies. At paragraph 2.7, the Guidance states that the licensing or assignment of IP may in general be viewed as a specialised form of asset divestiture (and can therefore be treated as a structural remedy). It also states that where an IP remedy results in a material ongoing link between the merger parties and the parties gaining the IP (*e.g.*, providing access to new releases or upgrades of technology), the measure may take on some of the characteristics of a behavioural commitment. Paragraph 3.28, on the other hand, states that a licence that requires a licensee to rely on the licensor for updates of the technology or continuing access to specialist inputs or know how will be regarded as a behavioural commitment which is subject to significant risks of not being an effective remedy.

We consider that the position adopted in paragraph 2.7, *i.e.*, that the IP remedy takes on some of the characteristics of a behavioural remedy, as opposed to classifying the entire remedy as a behavioural remedy, is preferable. An assignment or exclusive and irrevocable licence of IP to a third party appears to satisfy the test of being a structural remedy. While any ongoing relationship between the merging parties and the assignee or licensee might in certain circumstances detract from the effectiveness of the remedy, it does not deprive the remedy of its structural effect. Indeed, it is no different, for example, from the situation in which a business is divested but the merging parties continue to have a relationship (*e.g.*, the supply of an input) with the acquirer of the divested business.[7]

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[7] The following are examples of cases in which a divestiture also involved ongoing relations: (1) *Stericycle International LLC / Sterile Technologies Group Limited* (supply of hospital waste to the purchaser of the target's incinerator business for a short transitional period; (2) *EWS Railway Holdings / Marcroft Engineering inquiry* (provision of support services to the purchaser of part of the target's outstation business, including administrative and engineering supervision and guaranteed access rights to transferred sites owned or controlled by EWS); (3) *Stagecoach/Scottish Citylink* (interim provision of services to the purchaser of the relevant coach business, such as

Important, but not essential, in the analysis of this type of IP remedy (*i.e.*, an IP licensing or assignment remedy involving an ongoing relationship with the licensee or assignee) is whether the ongoing relationship is for a transitional period or more long term. If only for a transitional period (for example, while the assignee or licensee builds up the relevant R&D capability), then this should be acceptable in the same way that it can be acceptable to have a supply relationship between the merging parties and a divested business for a transitional period following the sale.

TREATMENT OF BEHAVIOURAL REMEDIES – PARAGRAPHS 1.8, 2.16, AND 2.2

Paragraph 1.8(a) of the Guidance states that structural remedies are normally preferable to measures that seek to regulate the ongoing behaviour of the notifying parties as the latter are unlikely to deal with an SLC and its adverse effects as comprehensively as structural remedies and may result in distortions compared with a competitive market outcome. While we believe that this statement may be appropriate with respect to what the CC has termed "controlling outcomes", we would question its appropriateness in relation to what the CC has termed "enabling measures" and in particular access remedies.

Where a vertical merger results in foreclosure concerns, access remedies can be equally effective in resolving such concerns as compared with divestiture. Access remedies may also have the advantage of preserving important efficiencies resulting from the merger or acquisition for the benefit of the merging parties and third parties equally. Access remedies can also result in a competitive market outcome (as opposed to "controlling outcome" remedies that merely regulate the merged entity's conduct on the market). For example, access remedies can create new entrants, thereby re-establishing essential features of the market expected in the absence of the merger.

Paragraph 2.16 of the Consultation states that it is only in "unusual circumstances" that the CC would select behavioural remedies. In fact, the CC has accepted behavioural remedies as the primary remedy in six[8] of the 21 cases involving remedies since the start of the new UK merger control regime under the Enterprise Act 2002. Given that behavioural remedies have been applied in around a quarter of remedies cases, we do not believe that "unusual circumstances" correctly describes the situation.[9] More generally, the CC recognised in its report on past remedy cases that "…although [behavioural remedies] may not be appropriate for every

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operating through ticketing arrangements, providing coaches and drivers, and allowing customers of the divested business to acquire tickets through the vendors' web-based ticketing arrangements and agency sales arrangements at ticket offices).

[8] This includes the *Mid-Kent Water/South-East Water* decision which was a water merger reference.

[9] By contrast, paragraph 3.26 of the Consultation states that the use of divestiture trustees at the outset of the divestiture process would be "unusual" and this seems the appropriate adjective here.

situation, if designed carefully and monitored well, they can be effective."[10] We suggest that in paragraph 2.16 the CC replace "unusual circumstances where the CC selects behavioural remedies" with "circumstances where it is appropriate for the CC to select behavioural remedies."

Treatment of Access Remedies – Paragraph 2.2

Paragraph 2.2 of the Guidance states that some remedies "such as those relating to access to intellectual property rights may have features of structural or behavioural remedies depending on their particular formulation." We believe that this statement should apply more generally to access remedies and not be limited to remedies aimed at access to IP. Indeed, we would propose that access remedies generally (whether access to IP or infrastructure) be viewed as structural rather than behavioural remedies – access remedies are currently treated as behavioural remedies, and in particular enabling measures, in the Guidance. Treating all access remedies as structural would be consistent with the approach of the European Commission. The European Commission states, for example, in its draft Notice on remedies:

> "[A] general distinction can be made between divestitures, other structural remedies, such as granting access to key infrastructure or inputs on non-discriminatory terms, and commitments relating to the future behaviour of the merged entity. … Other structural commitments may be suitable to resolve all types of concerns if those remedies are equivalent to divestitures in their effects"[11]

This approach would also seem to be consistent with the notion of structural remedies developed by the CC elsewhere in the Guidance. Remedies that provide third parties with access to IP or infrastructure can give rise to new entrants or at least decrease entry barriers, thereby effecting a clear structural change to the market. It is also pertinent to note that the Guidance is willing to treat a "virtual divestiture" (*e.g.*, divestiture of production capacity for a specified period) as a structural remedy, although there are similarities between such a remedy and a remedy providing access to a product. Indeed, the Guidance notes at paragraph 4.19 that access remedies can be a form of "virtual divestiture." Moreover, there does not seem to us to be any good justification for treating a remedy granting an exclusive irrevocable IP licence to a particular third party as structural (as the Guidance does), while treating a remedy licensing IP to any third party on a non-discriminatory irrevocable basis as behavioural. Both remedies have the potential to effect a structural change to the market.

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[10] Understanding past merger remedies: report on case study research, Competition Commission, January 2007, para. 66.

[11] Draft revised Commission Notice on remedies acceptable under the Council Regulation (EEC) No 139/2004 and under Commission Regulation (EC) No 802/2004, April 24, 2007, para. 17.

SUNSET CLAUSES – PARAGRAPH 3.8

Paragraph 3.8 of the Guidance states that there will be a prohibition on merging parties from re-acquiring divested assets for a sunset clause period of 15 years. We consider that the CC should adopt the sunset clause period of 10 years proposed by the European Commission in its draft Commission Notice on remedies in order to be consistent with the framework of merger control policy within the European Community. Moreover, we consider that the merging parties should have the ability to apply to extinguish the sunset clause where there has been a significant change in market circumstances. An ability to apply to vary or cancel behavioural remedies before the end of the sunset clause period is explicitly acknowledged in paragraph 47 of the Guidance with respect to behavioural remedies.

CONCLUSION

The authors of this response – David Went (based in Sidley's London office) and Stephen Kinsella (based in Sidley's Brussels office) – would be pleased to discuss any matters raised in this paper either in a meeting or otherwise.

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