

ADDLESHAW GODDARD

Our reference FEAST/KXP

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BY EMAIL

David Roberts
Director of Remedies
Competition Commission
Victoria House
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London
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Dear Mr Roberts

Consultation on Divestiture Remedies

Further to the letter from Paul Geroski to Adam Aldred of Addleshaw Goddard dated 21 June 2004, please find below our comments on the proposed Competition Commission guidelines on divestiture remedies in merger inquiries. We do not object to these comments being made public.

General Comment

We would make a general comment regarding the overall tenure of the guidelines. These are focussed very much on protecting the business to be divested and ensuring the divestment occurs. On the other hand, it should be recalled that the merging parties are not generally acting, nor seeking to act, anti-competitively in the manner of activities regulated under Articles 81 and 82 EC Treaty/Chapter I and Chapter II Competition Act 1998. They are seeking to operate profitably and to maximise business and competitive opportunities, which will generally be to the overall advantage of the domestic economy and consumers. In this light, we suggest below with respect to various stages of the divestiture process that a "check" be performed to ensure assessment of any significant burden or harm to the retained businesses of the merging parties. We also consider that divestiture should be treated as a remedy of last resort and used only when less invasive contractual arrangements are insufficient to remedy the substantial lessening of competition.

The following sections of this letter refer to paragraph numbers of the proposed guidelines, unless otherwise stated.

The comments we make below are largely aimed at a situation in which a party is ordered to dispose of an integral part of its business or a significant income stream.

Categories of risk that may impair the effectiveness of divestiture remedies

Paragraph 2.4 identifies three broad categories of risk that may possibly impair the effectiveness of divestiture remedies. We consider that the Competition Commission ought to address also a fourth category, being the risk of tangible damage to the retained businesses of the merging parties, notably where key personnel or assets will be transferred through divestment. For instance, research and development facilities may be used jointly by various divisions within a company. Manufacturing facilities may be operated as one production line which is re-tooled on a weekly basis to allow

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production of other products supplied by the corporate group. Loss of these facilities can seriously harm the retained businesses. Even where the facilities can be replicated at a cost, there may be a delay whilst suitable land, planning permissions etc. are obtained. There can be numerous complications arising from a divestment, such as when the funding structure for the retained businesses has to be re-negotiated with the banks and other financial institutions because a significant income stream has been sold, or when direct access to background intellectual property rights is lost through the disposal, the retained businesses may be placed in a weak negotiating position when seeking a replacement licence.

It is not clear to us at what stage(s) of the process the Competition Commission specifically addresses these issues.

In addition to any on-going adverse impact on the retained business, it is often the case that where there is forced divestiture, there is a risk that the vendor has to bear a greater burden (in the form of compensation to the purchaser – eg regarding employment costs such as TUPE transfer obligations and pensions - or a lower purchase price) in order to "sweeten" the deal and conclude the forced disposal. There are also considerable costs for all the companies involved in a business disposal in terms of diverted management time and transaction costs.

We would therefore welcome the introduction of an identified stage in the Competition Commission's procedures when such concerns are expressly assessed.

We recognise that paragraph 4.9 of the Competition Commission's merger reference guidelines provides for the Commission to have regard to the reasonableness of any remedy and that this will include the costs of any action it may decide is appropriate. However, paragraph 4.10 of the merger reference guidelines continues: "the Commission will not normally consider the costs of divestment to the parties as it is open to the parties to make the merger proposals conditional on competition authorities' approval ... the Commission will normally expect this risk to be reflected already in the acquisition price ... the Commission will not, in the absence of exceptional circumstances, accept that the cost of divestment should be considered in the setting of remedies".

We also note at paragraph 4.11 of the merger reference guidelines that it is stated that normally the costs to the companies of foregone economies will only be considered in the context of relevant customer benefits.

We consider that this approach, which is reflected in the proposed guidelines on divestiture remedies, does not take sufficient account of the impact of a forced sale on a business in terms of both the impact on the value of the business transferred and impact on the business retained. During a regular business sale, the balance will have been freely negotiated by the parties in the light of commercial considerations determined by market forces. The balance on each of these potentially may be adversely affected by forced divestiture. Indeed, the merging parties may lose out twice in the circumstances, and therefore greater consideration ought to be given to the harm which they may suffer.

For clarity, we would say that we are not opposed to forced divestiture as a remedy in cases where it is truly appropriate and a proportionate remedy, but we do emphasise that forced divestiture should be treated generally as a remedy of last resort.

Protective Measures

With respect to paragraph 2.7 of the proposed guidelines, we would require further information in order to comment on the Competition Commission's position that protective measures may be needed to a greater extent in the case of completed mergers than anticipated mergers. Perhaps the Competition Commission could expand on its position.

Crown Jewel Divestiture Packages

Paragraph 3.6 of the proposed guidelines deals with Crown Jewel divestiture packages, forcing the merging parties to dispose of a broader, more valuable group of assets if a proposed divestiture is not completed within a specified period. We do question whether the Competition Commission have the

statutory power to impose Crown Jewel divestment orders when, by definition, those orders go further than is necessary to remedy any substantial lessening of competition.

We welcome the comment of the Competition Commission that it will only consider using Crown Jewel packages in circumstances where other options are not available.

We would make two points here. The first relates to the timing of any Crown Jewel divestment proposal or order and the legitimate expectations of the parties. We believe that the Competition Commission must make the proposal or order at the same time as the original divestment plan is agreed. If it does not do so, the parties may find themselves, some way down the line if the original divestment plan fails, in the position of being forced to divest Crown Jewel assets which they would never have agreed to divest. It is only equitable that they be permitted to evaluate the risks and, in the case of an anticipated merger, to enter into the merger with full appreciation of the divestment orders they potentially face.

Secondly, we would emphasise that forcing divestment of Crown Jewels is highly draconian with significant potential to cause serious damage to the retained businesses and consumers. The original proposed divestiture might not have been concluded owing to lack of buyer interest rather than a lack of willingness on the part of the vendor to conclude a sale. As mentioned, if the original divestiture package would have been adequate to remedy a substantial lessening of competition, forcing disposal of additional, Crown Jewel assets of the parties goes further than required to remedy the potential harm to competition.

On balance, we would not rule out the possibility for the Competition Commission to order a Crown Jewel divestiture, but this remedy must be reserved for truly exceptional circumstances and following full appraisal of the impact of such a divestiture package on the merging parties' retained business and its continuing viability as an attractive business proposition.

Operation of Core Assets

In paragraph 3.6 of the proposed guidelines, the Competition Commission states that it would wish to be satisfied that a purchaser of a Crown Jewel package would truly be committed to the operation of the assets in the package and not just the ancillary (Crown Jewel) assets. What powers does the Competition Commission have in this respect to regulate the activities of the purchaser? The Competition Commission places the onus on the merging parties to secure a suitable purchaser (see paragraph 4.3 of the proposed guidelines). How are the merging parties to ensure that the purchaser is truly committed to operation of the core assets? We anticipate that it could be restrictive of competition for the vendor to require the purchaser to operate the core assets for a minimum period of time, as the market may change and competition may be stifled if the purchaser cannot adapt to changing circumstances. We would appreciate clarification of the scope of the responsibility imposed upon the merging parties in this respect.

Protecting the divestiture package/use of monitoring trustees

Should the Competition Commission require "hold separate" undertakings from the merging parties during the divestiture process, the Competition Commission should have regard to the cost and other implications for the merging parties of fulfilling that undertaking. For example, in practical terms it can be extremely difficult to separate out the IT systems within a company. Does the Competition Commission also envisage physical separation in terms of separate premises, separate logistical support etc? The financial impact on the merging parties of duplicating such resources may be considerable.

We note that the proposed guidelines state at paragraph 5.3 that "hold separate" undertakings will be used where asset risk is perceived to be significant. Nonetheless, we believe that the focus of the Competition Commission must be wider than protection of the divested business, and once again we would like to see in the proposed guidelines an express reference to consideration of the impact of such undertakings on the merging parties.

Continuing Financial Links between the purchaser and the merging parties

It is stated in paragraph 5.7 of the proposed guidelines that continuing financial links between the purchaser and the merging parties may undermine competitive incentives. Divestiture may comprise part of a business or specified assets such as intellectual property ("IP") rights (see paragraph 3.4 of the proposed guidelines). What is the Competition Commission's approach to ordering disposal of IP rights or forcing the grant of licences as part of a divestiture? In the latter case, what is the Competition Commission's view of on-going links in the form of royalty payments, whether from the purchaser to the vendor or vice versa in the case of forced disposal and licence back to the vendor?

We note that under Article 82/Chapter II Prohibition, it is comparatively rare for a dominant company to be forced to dispose of IP rights or to grant a licence of rights, and we would anticipate that a similarly cautious approach should be taken by the Competition Commission in ordering divestiture of IP rights.

Practical Guidance

Finally, it would be very helpful if the divestiture remedies guidelines incorporated a practical section giving examples of situations in which the Competition Commission would consider that divestiture were appropriate as a remedy. The European Commission has been prepared to provide practical, hypothetical examples in guidance which it has provided e.g. regarding the application of Article 81 to horizontal co-operation agreements. Alternatively or in addition, inclusion of a summary of the Competition Commission's current practice in decided cases would be very useful.

If you have any questions regarding the above comments, please contact Trudy Feaster in the first instance (direct telephone: 0113 209 2566; email: trudy.feaster@addleshawgoddard.com).

Yours sincerely

Addleshaw Goddard