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DIRECT DIAL

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David Roberts  
Director of Remedies  
Competition Commission  
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London  
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Dear Mr Roberts

**Consultation on Application of Divestiture Remedies in Merger Inquiries: Competition Commission Guidelines**

I am writing to set out our response to the above consultation.

We welcome the opportunity to comment on the Guidelines which are likely to be of increasing importance in merger inquiries going forward.

I divide my comments into the general and the particular.

**A. General Comments**

1. Although the Competition Commission is required to have regard to the need to achieve as comprehensive a solution to the SLC, it is equally directed to ensure that its solution is both reasonable and practicable and subject to the overriding requirement that it must be proportionate. Thus, both the Guidelines and their application in practice must meet each of these requirements.
2. Under the Enterprise Act these requirements are of greater importance than under the Fair Trading Act given the review power of the Competition Appeal Tribunal. It is easy for loose drafting to run the risk of successful challenge. For example, the Competition Commission's recommendation in the Safeway mergers that each of Asda, Sainsbury and Tesco be prohibited from acquiring "... any part of Safeway" would, if adopted in fact, almost certainly have led to successful judicial review proceedings against the Secretary of State. That recommendation was plainly both disproportionate and unsupported by the Commission's own conclusions.

3. It is essential that the remedies are sculpted to meet the requirements of the particular case as recognised at paragraph 1.4.
4. I am mildly disappointed that the draft Guidelines do not appear to have benefited from the substantial work done by the staff of the Federal Trade Commission ("FTC") both in its 1999 Study and in the 2003 statement on "Negotiating Merger Remedies". These are perhaps the most substantive studies done and conclusions reached on merger remedies.
5. Equally, there is no mention of the market testing of possible remedies with customers, suppliers, competitors and potential buyers. Although the Commission's procedures give third parties the opportunity to comment on possible remedies during the course of the inquiry and the actual proposed remedies following the Commission's report, this process very much depends on the preparedness of third parties to comment constructively at those stages. In contrast, both the FTC and the European Commission adopt a more proactive approach to market testing possible remedies.
6. An increasing number of mergers will be reviewed by the competition authorities in two or more jurisdictions and thus international cooperation not merely on substantive analysis but on remedies will be of increasing importance. This is particularly evident in the cooperation between the European Commission on the one hand and the FTC and the Department of Justice on the other. This would be of particular importance in those mergers where the parties' activities in the UK are confined to distribution with research and development and production taking place outside the UK - see, for example, *Drager Medical*. It is disappointing to see that there is no reference to such cooperation in the draft Guidelines. Equally in *Drager Medical* there was no detailed explanation of the remedy obtained by the Portuguese competition authorities.
7. Given the longstanding continuing trend towards globalisation and the shrinking of the United Kingdom's manufacturing base, it is anticipated that there will be an increasing number of mergers where the Commission will be unable to impose reasonable, practical and proportionate remedies on its own; indeed insofar as the purchaser is non-UK incorporated and does not carry on business in the UK, the Commission has no power to impose orders which affect its behaviour outside of the UK. In the absence of full and proper international co-operation, the Commission will face significant challenges in seeking to fashion efficacious remedies as regards the UK.
8. It is apparent from the FTC's Study that buyers, and even well resourced buyers, may underestimate the implications of the acquisition of the divested package including whether or not the right set of assets and resources are being sold. Thus, it is quite likely that when potential buyers are conducting due diligence they may realise potential limitations of the divestment package. There should therefore be scope for potential buyers to make appropriate representations to the Commission which might entail the modification or variation of undertakings or orders, subject to the comments in Part 3, paragraphs 2, 3 and 6 below. The FTC expressed its disappointment that potential buyers did not raise and discuss issues which might have led the FTC to modify its proposed divestiture package. It would be helpful for the Commission to flag this as an

issue and indicate its willingness to listen to potential buyers and, if need be, to consider modifying the package to be divested.

**B. Particular Comments**

***Part 2. Effective Divestiture Remedies***

1. Part 2 comes across as, unbalanced, given that its focus is on constraints on effective outcomes or in other words the risks of divestiture remedies proven to be ineffective. For example, paragraph 2.3 implies that merging parties may wish to impair the success of a divestiture in a wide range of cases. Although there are indications from the FTC work in the US that this may be correct in some cases, our experience is that where a purchaser believes there is a genuine risk for divestment it will have significant concerns regarding any financial loss which it may sustain on the forced sale and will wish to conclude an effective sale within the timescale. Indeed, clients are conscious that buyers may complain to the competition authority which they would wish to avoid. I believe it would be helpful if an attempt was made to bring greater balance to this part. This can be done by:

- recognising there may be a limited number of cases where the original purchaser might have the incentive and the means to potentially impair the success for the divestiture
- also pointing out that there are ways in which a competition authority can seek to protect the acquired business through interim "hold separate" undertakings or orders and other measures including the appointment of a monitoring Trustee to oversee the business
- recognising that the composition risk may ultimately be simply the result of the limited divestiture required to cure the SLC being unattractive in its own right but that in such cases the potential damage to competition is likely to be small
- acknowledging that if an asset has to be divested with no minimum price then it is always likely that a purchaser will be found, certainly that is the conclusion reached by the FTC study, and in any event the Commission has the right to approve the purchaser

***Part 3. Scope of Divestiture Packages***

***Package Definition***

2. The Commission's obligation is to take such action as is reasonable and practical to remedy, mitigate or prevent the SLC and any adverse affects which may result therefrom. Therefore, it is right that the Commission's focus should be on the minimum package. However, this section talks about adding other assets or business segments or further assets desired by the parties or required by the Commission. Insofar as these are suggested or agreed to by the seller, I do not have an issue. However, insofar as they are required by the Commission whether as a result of

suggestions by potential buyers or otherwise, then real issues arise. The Commission must ensure that any divested remedy is reasonable, practicable and proportionate, and thus in strict terms it should not go further than is necessary to remedy the SLC and its adverse effects.

3. For example, if it is necessary to add a production facility for the relevant products to the distribution assets, or potentially research and development resource or assets (or licensing rights thereto), to create a business in those products which are the focus of attention that they may well be acceptable. If, however, the buyer for example argues that it is essential that it acquires rights to other products where SLC does not arise to make up a minimum range of products, then I believe serious issues arise as to whether any attempt by the Commission to impose that requirement on the merging parties would be proportionate. This is particularly the case where the buyer is effectively able to set its own price.
4. In other cases where there is only one buyer, and its business plan demonstrates that the purchase of the divestment package would be insufficient to generate a reasonable return on its investment even paying a low price for the package, it is not obvious that the Commission could require the seller to add further assets to the package. The Commission should at that stage assess other alternative remedies. The Commission's role is not to improve the pre-merger market structure.

*Presumption for Divestiture of an Existing Business*

5. Logic indicates that the best solution to remedy the SLC and its adverse effects would be a "mix and match" approach crafted to address the issues of the case. Equally logic indicates that the sale of the existing business, whilst it might be easier in terms of finding a buyer, might well go further than is necessary to address the SLC and its adverse effects. I would suggest that rather than the Commission suggesting that the sale of an existing business will be preferred to indicate that the seller may need to go to greater lengths to demonstrate that its preferred "mix and match" solution will meet the Commission's objectives in contrast to the divestiture of an existing business. This is particularly the case as a great deal will depend upon the identity of the buyer and of its resources. As the Commission point out that where there is a perceived risk that a "mix and match" result may be difficult to achieve or there are doubts as to whether a suitable buyer can be found, then the requirement for an up-front buyer would mitigate that risk.

*Crown Jewels*

6. I suggest that the possible use of a "Crown Jewels" approach will run a significant risk of challenge on the basis that it may neither be reasonable nor proportionate. Crown Jewels remedies have been criticised in the past for constituting some form of punishment on or blackmail over the merging parties. This criticism has greater substance where an agency seeks to impose such a remedy on the buyer in contrast to cases where a buyer having suggested a tailored remedy to address the problem may offer a fall back solution if that proves to be unobtainable.

7. Where the Commission seeks to impose such a remedy it will be operating in a different environment to the FTC or the European Commission. In the USA the FTC is effectively negotiating a settlement achieved through a consent order, and under the EC Merger Regulation it is the responsibility of the acquiring party to propose commitments to the European Commission. Thus in each case the remedy is something offered by the purchaser to address an issue, albeit it may not be offered completely willingly. Moreover, the Commission must be wary of introducing perverse incentives for potential buyers. If there are a limited number of buyers they may seek to hold out from negotiation of the purchase of the initial divestment package hoping that, therefore, the Commission will force the vendor to sell the Crown Jewels. The Commission notes it would wish to be satisfied that the purchaser of a Crown Jewels package was committed to operate the core assets and not primarily attracted by the ancillary assets. It is difficult to see how the Commission could so satisfy itself.

#### *Part 4. Suitable Purchasers*

8. I note the Commission will also wish to satisfy itself that the purchaser has an appropriate business plan for competing in the relevant market. It is only fairly late in the day that the Commission will be able to evaluate a business plan. Thus, the vendor will have to conduct some form of auction process, enable potential buyers to conduct due diligence, select the preferred buyer and give additional access to financial information to enable the third party to finalise the business plan. This may put considerable pressure on the Commission to approve a business plan within a constrained timetable. It also raises the issue of whether the Commission has the appropriate staff to evaluate such a business plan or whether it may have to engage external consultants for that purpose. In any event, is it likely that the Commission would not approve a business plan if the proposed purchaser is a substantial well resourced company?
9. I agree that upfront buyers may be the appropriate approach where there are doubts as to the viability or attractiveness of the package or scepticism as to the identity of the possible purchaser. I would suggest the issues as to the composition of the package could be tackled by a more proactive approach by the Commission during the latter stages of the inquiry after publication of the possible remedies. The upfront buyer requirement can then be used where there are real concerns as to whether in fact there is likely to be a natural buyer for the divestment package. However, the upfront buyer should be used as a last resort as it can lead to greater delays and gives significant bargaining leverage to the preferred buyer.

#### *Part 5. Effective Divestiture Process*

10. One of the important findings to emerge from the FTC Study is that the actual buyers of divestment packages may have failed to accurately assess the requisite resource needed to conduct the business, whether the assets to be divested are sufficient and the financial viability of the divestment package. There is thus a need for an effective process which will enable potential buyers to properly evaluate the divested package, carry out proper due diligence, ensure that they have requisite resources and assets and

the appropriate financial information. The Study indicates that the appropriate way forward is to provide potential purchasers with appropriate time to carry out the requisite evaluation.

*Part 6. Employment of Trustees*

11. One of the findings of the FTC Study of particular relevance in more complex industries is that the employment of appropriately technically qualified trustees may be more valuable both to ensure the protection of the divestment package and also to assist the Commission and potential buyers in ensuring that the buyers have the requisite information to properly evaluate the purchase and ensure the requisite assets and resources form part of the package.

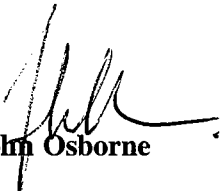
*Part 7. Role of Enquiry Group and Remedies Standing Group*

12. There is a degree of opacity in the legislation as to when the role of the inquiry group comes to an end. Under the FTA the answer was straightforward in that the inquiry group's role ended with the delivery of its report. However, the Enterprise Act is uninformative. The Commission's own Rules of Procedure do not entirely clarify the position. For example, it is envisaged that the Merger Reference Group will continue to function until undertakings have been accepted or orders made, whilst the rules also refer to the Remedies Standing Group functions including the acceptance of undertakings and the making of an order.
13. It would be helpful to have clear confirmation that the role of the Merger Reference Group continues until the acceptance of final undertakings or the making of a final order whereupon the Remedies Standing Group takes over. One of the defects of the old FTA procedure was that the OFT dealt with remedies on the basis of only the Commission's report and DTI instructions having played no part in the inquiry. It is sensible that the Merger Reference Group finalise the remedies leaving subsequent monitoring to the Remedies Standing Group.

Finally, none of these comments are confidential.

Once again, we welcome the opportunity afforded by this consultation exercise.

Yours sincerely

  
John Osborne