



Competition Law Association

British Group of the
Ligue Internationale du Droit de la Concurrence
(International League for Competition Law)

Mr David Roberts
Director of Remedies
Competition Commission
Victoria House
Southampton Row
London
WC1B 4AD

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Dear Mr Roberts

The Competition Commission consultation document on the Application of Divestiture Remedies in Merger Inquiries

On behalf of the Competition Law Association I attach our submission in connection with the above.

Yours sincerely

Geraldine Tickle

Enc.

CHAIRMAN:	Peter Roth QC	Monckton Chambers, 4 Raymond Buildings, Gray's Inn, London WC1R 5BP Telephone: 020 7405 7211 Fax: 020 7405 2084 DX No. 257 London Email: proth@monckton.com
VICE-CHAIRMAN:	Geraldine Tickle	Martineau Johnson, St. Phillips House, St. Phillips Place, Birmingham B3 2PP Telephone: 0121 200 3300 Fax: 0121 233 3911 DX No. 721090 Birmingham 50 Email: geraldine.tickle@martjohn.com
NATIONAL REPORTER GENERAL:	Anna Carboni	Wilberforce Chambers, 8 New Square, Lincoln's Inn, London WC2A 3QP Telephone: 020 7306 0102 Fax: 020 7306 0095 Email: acarboni@wilberforce.co.uk
TREASURER:	Richard Shaw	Berwin Leighton Paisner, Adelaide House, London Bridge, London EC4R 4HA Telephone: 020 7760 1000 Fax: 020 7760 1111 Email: richard.shaw@bplaw.com
SECRETARY:	Jenny Block	Simmons & Simmons, CityPoint, One Ropemaker Street, London EC2Y 9SS Telephone: 020 7628 2020 Fax: 020 7628 2070 DX No. 12 London Email: jenny.block@simmons-simmons.com
PUBLICITY SECRETARY:	Ashley Roughton	Hogarth Chambers, 5 New Square, Lincoln's Inn, London WC2A 3RJ Telephone: 020 7404 0404 Fax: 020 7404 0405 DX No. 16 LDE Email: ashleyroughton@hogarthchambers.com
OTHER COMMITTEE MEMBERS:		Stuart Davis, James Flynn QC, Guy Leigh, Christopher Morcom QC, John Osborne, Susan Singleton, Kassie Smith, Justin Watts, Irina von Wiese

**COMMENTS ON THE COMPETITION COMMISSION
CONSULTATION DOCUMENT
ON THE APPLICATION OF
DIVESTITURE REMEDIES IN MERGER INQUIRIES**

These comments are submitted by the Competition Law Association and are a response to the Competition Commission Consultation Paper of June 2004 entitled "Application of Divestiture Remedies in Merger Inquiries".

The Competition Law Association is the UK branch of the Ligue Internationale du Droit de la Concurrence. The membership of the Competition Law Association includes barristers, solicitors and in-house lawyers, academics and other professionals including economics, patent and trademark agents. The Competition Law Association's main object is to promote freedom of competition and combat unfair competition.

1. PREFERENCE FOR STRUCTURAL REMEDIES

At paragraph 1.9 of the Consultation Paper it is stated that structural remedies such as divestiture (or prohibition) are likely to be preferable to behavioural remedies, which seek to regulate the behaviour of firms, as structural remedies address the effects of a merger more directly and will usually require less monitoring or enforcement of compliance.

The Competition Law Association welcomes this preference for structural remedies as opposed to behavioural remedies in relation to UK mergers. The European Commission's Notice on remedies acceptable under the European Merger Regulation also indicates a clear preference for structural remedies rather than behavioural remedies. We consider following modernisation in relation to other areas of competition law, that the merger regime in the UK should follow that of the EU where appropriate.

We consider that structural remedies are normally the best corrective measures for potentially anti-competitive mergers and that the Competition Commission is correct to emphasise this in its Consultation Paper. Structural remedies have the advantage of not occupying further the scarce resources of the UK competition authorities after they have been implemented. Once a buyer has been identified and the transaction relative to the divested assets finalised, the competition authorities will not have to monitor further the deal (unless suspected infringements arise). We consider that the most effective way to restore effective competition in a case where outright prohibition is not appropriate is to create the conditions for the emergence of a new competitive entity or for the strengthening of existing competitors via a divestiture.

We agree with the Competition Commission that behavioural remedies should not normally be favoured and consider that there are a number of problems with such remedies. Most behavioural remedies by their very nature require some type of ongoing regulation or monitoring and therefore will probably engage the resources of a competition authority long after the merger has been cleared and implemented. Some measures are also reasonably easy to evade without very careful monitoring and unless the regulator knows the relevant industry very well.

Behavioural remedies, then, are difficult to administer and are not necessarily likely to be successful. Foreclosure or discriminatory behaviour might take many different forms, from the

obvious (blatant refusal to supply etc.) to the more subtle (increasing prices, reducing quality, blaming insufficient capacity for a refusal to supply, delaying supplies etc.). A behavioural remedy that calls for an obligation to supply can be a very difficult obligation to enforce, and even an obligation not to discriminate may not be easily enforceable. Discrimination can occur at many different levels and in many different ways and it is not adequate merely to consider transaction prices.

Behavioural remedies can also be troublesome when they are aimed at facilitating market entry eg by access to a key technology. Implementation of this type of remedy requires a period of collaboration between the merged entity and a third party to which access is to be provided. In such a case, the third party may be an actual or potential competitor and therefore it is difficult to ensure that the merged entity will have sufficient incentive effectively to collaborate to make entry successful.

2. PRESUMPTION FOR DIVESTITURE OF AN EXISTING BUSINESS AND AGAINST "MIX AND MATCH" DIVESTITURES

At paragraphs 3.3 - 3.5 of the Consultation Paper it is made clear that the Competition Commission will normally prefer divestiture of an existing business, which can operate independently of the merger parties, to divestiture of part of a business or a collection of assets because divestiture of such a business is less likely to be subject to purchaser and composition risk.

It is also stated that if nevertheless divestiture of part of a business or certain specified assets is proposed rather than a complete business, it will usually be preferable for all the assets to be provided by one of the merging parties. Divestiture of a mix of assets from both merging parties (a so-called "mix and match" approach) may create additional composition risks such that the divestiture package will not function effectively.

Again, the Competition Law Association welcomes this preference for divestiture of a stand alone business and the presumption against mix and match divestitures. Again, such an approach is consistent with the European Commission's Notice on remedies acceptable under the European Merger Regulation. We welcome this alignment of divestiture remedies under the UK merger regime with those of the EU merger system.

We agree that is normally best if the divested assets can either create a new firm or be acquired by an existing competitor. The divested activities should consist of a viable business that, if operated by a suitable purchaser, can compete effectively with the merged entity on a lasting basis. A viable business is normally an existing one that can operate on a stand-alone basis, which means independently of the merging parties as regards the supply of input materials or other forms of co-operation other than during a transitory period.

We also agree with the presumption against mix and match divestments. A divestiture consisting of a combination of certain assets from both the purchaser and the target can create additional risks as to the viability and efficiency of the resulting business. Mix and match divestments should therefore be treated with great care. We note the results of a divestiture study by the Federal Trade Commission (Parker R, Balto D (2000) "The Evolving Approach to Merger Remedies", available at www.ftc.gov). This reveals that the likelihood of successful entry is much higher when an entire ongoing business is divested, whereas entry is significantly more problematic in the case of divestiture of selected assets from both merger parties.

The FTC ex-post study of merger remedies, then, reveals that the mix-and-match approach is not very successful in fostering entry. The seller is incentivised to design a package that does not include, from the point of the view of the potential competitor, the right assets to be successful. A competition authority may have limited experience in any given sector and therefore may often not know whether a mix and match package prepared by the seller will lead to a buyer becoming a viable competitor.

The same difficulties arise where technology transfers are an integral part of the mix and match package. The combination of the potential lack of information available to the buyer, who may not know the technology and the seller's lack of incentives to provide the buyer with assistance and know-how means that technology transfers often do not have the desired results.

3. USE OF CROWN JEWELS PACKAGES

At paragraph 3.6 of the Consultation Paper the Competition Commission proposes that in order to incentivise parties to complete an agreed divestiture, a broader, more valuable group of assets may be defined (i.e. "crown jewels") which the Competition Commission would require the parties to sell if a proposed divestiture is not completed within a specified period. The Competition Commission will generally only consider use of such crown jewel packages in circumstances where other effective options are not available. The Competition Commission would wish to be satisfied that the purchaser of a crown jewels package was committed to operate the core assets necessary to remedy the lessening of competition caused by the merger and not primarily attached to the ancillary assets.

We can see that the Competition Commission's proposed tough new approach requiring a merged company to sell off a broader more valuable group of assets if an agreed divestiture is not completed promptly should encourage merged companies to ensure that agreed divestitures run smoothly and make divestiture packages more attractive to buyers, due to certainty of timing.

The European Commission in its Notice on remedies acceptable under the European Merger Regulation (paragraphs 22 and 23) also sets out a "crown jewels" packages regime. The Notice states that "in certain cases, the implementation of the parties' preferred divestiture option (of a viable business solving the competition concerns) might be uncertain or difficult in view of, for instance, third parties' pre-emption rights or uncertainty as to the transferability of key contracts, intellectual property rights or employees, as the case may be. Nevertheless, the parties may consider that they would be able to divest this business within the appropriate short time period. In such circumstances, the Commission cannot take the risk that, in the end, effective competition will not be restored. Accordingly, it is up to the parties to set out in the commitment an alternative proposal, which has to be at least equal if not better suited to restore effective competition, as well as a clear timetable as to how and when the other alternative will be implemented."

However, we consider that the established European regime in relation to crown jewels packages is better than that proposed by the Competition Commission in the Consultation Paper. Crucially, under the European Commission Notice, the alternative remedies originate with the merging parties - the companies themselves tend to propose the alternative packages. We think that it should normally be for the merging parties themselves to propose the alternative packages, except in very unusual cases. Here, the Competition Commission's Consultation Paper's wording on this subject suggests that the Competition Commission intends to specify which assets are sold if the agreed divestiture is not completed within the agreed period, and

that this may be imposed without the parties consent. There is certainly no suggestion that crown jewels packages will emanate from the merging parties.

Whilst the Competition Commission's crown jewels proposals will give teeth to compliance remedies, we also question whether they are proportionate. We consider that the Competition Commission should consider imposing less burdensome options than requiring the parties to sell crown jewels packages if a proposed divestiture is not completed within a specified period. These could include the appointment of a monitoring trustee or a divestiture trustee or the requirement of an "up front buyer".

4. SELECTION OF SUITABLE PURCHASERS

At paragraphs 4.1 - 4.4 of the Consultation Paper the Competition Commission discusses how the identity and capability of purchasers will normally be of major importance in ensuring the success of a divestiture remedy. When assessing the suitability of prospective purchasers, the criteria used by the Competition Commission will include the independence of the prospective purchaser and its capability of becoming an effective competitor in the market.

Where the Competition Commission is in doubt as to the viability or attractiveness to purchasers of a proposed divestiture package or believes that there may only be a limited pool of suitable purchasers, it may require the merger parties to identify a suitable purchaser (an upfront buyer) that is contractually committed to the transaction before permitting a proposed merger to proceed or a completed merger to progress with integration.

We agree that the identity and capability of a purchaser will normally be of major importance in ensuring the success of a divestiture remedy. The viability of the divested business is likely to depend upon the identity of the purchaser and its ability to become an effective competitor in the market. If the purchaser does not have any experience in the market, or does not have the appropriate know-how or financial standing, the divestment is unlikely to be a success. The viability of the purchaser is crucial, when it comes to merger remedies, because the degree of competition on the market depends on the competitiveness of the acquirer. We agree that the purchaser should normally be a viable existing or potential competitor, independent of, and unconnected to the parties, possessing the financial resources, proven expertise and having the incentive to maintain and develop the divested business as an active competitive force in competition with the merger parties.

We also agree that there will be circumstances where the merger parties should be required to identify an upfront buyer before being allowed to proceed with a proposed merger. This is because it is clear that there will be circumstances where the merging parties will have an incentive to make sure that the purchaser of the divested assets will not be a competitive firm. (Also, in the period the assets are for sale and it still controls them, the seller could have an incentive to decrease their value, by transferring valuable personnel, disposing of certain brands, patents and activities, or not maintaining properly the production plants or shop premises.) The identity of the upfront buyer can be crucial, not only for the continuing viability of the business, but also to make sure that the purchaser will be an effective competitor. In order to evaluate these aspects, we consider that identifying an upfront buyer should be systematic: the competition authority should conduct a full assessment of whether the upfront buyer is likely to be able to engage in effective competition with the merging parties.

The Competition Law Association appreciates the opportunity to comment on the Competition Commission consultation document on the Application of Divestiture Remedies in Merger

Inquiries If the Commission would find it helpful to discuss any of the above comments, we should be happy to do so and request that you contact Geraldine Tickle of Martineau Johnson, No 1 Colmore Square, Birmingham B4 6AA telephone 44(0)870 763 1529; email: geraldine.tickle@martjohn.com in the first instance.

**Competition Law Association
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