Europe Economics

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Mr David Roberts
Director of Remedies
Competition Commission
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Dear Mr Roberts

Competition Commission Consultation on Divestiture Remedies in Merger Enquiries

Europe Economics is a firm of economist consultants specialising in the economics of competition and regulation. We are pleased to have the opportunity of commenting on this Consultation Paper on the important subject of divestiture remedies in merger cases that are referred to the Commission. While relatively few Commission enquiries in recent years have led to such remedies (Morrison's proposed acquisition of Safeway being one of the few examples), the Commission is well-advised to set out the principles it will apply in considering divestiture remedies in future cases. This should help to improve the effectiveness of this important part of the merger control process.

The main part of the Paper describes in general terms the three categories of risk that the Commission says it will need to assess in deciding whether a divestiture remedy would be an effective remedy to the adverse effects of a substantial lessening of competition, namely composition risks, purchaser risks and asset risks, and the various available techniques for reducing those risks. The Commission has clearly been able to draw on the experience of the European Commission and the US anti-trust agencies. Indeed, we think some of the leading cases from those jurisdictions might, in the absence of many UK cases (indeed of any UK cases since the Enterprise Act merger control regime came into force), have been referred to in order to illustrate some of the Paper's key points, and to give some feeling for the factors that are most likely to point to a successful outcome for a divestiture (this was the great value of the Federal Trade Commission's 1999 study).

We offer the following specific comments on the Consultation Paper.

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1 We think that within the composition, purchaser and assets risks, it would be useful also to identify **implementation risk**. The impact of any remedy will depend on the likelihood of its successful, full and timely implementation. An effective divestment remedy is likely to require the rapid transfer of assets in order to minimise assets risk, but this may handicap the efforts to find a suitable buyer and hence reduce the effectiveness of the competition provided by the new business. Time has to be given for a divestiture to be effected but a lengthy implementation means that the adverse effects of the merger continue and the chance of finding a suitable buyer may diminish rather than increase. Implementation may be delayed if the purchaser has to be approved by the competition authority or if the divestiture needs to be supported by other remedies, for example, a licensing of know-how which can take time to negotiate. Delays increase the opportunities of strategic behaviour by the merged entity directed against its putative competitor.

2 It is clear that one of the problems of any competition authority is to anticipate the **strategic responses** of firms to its interventions (consider the example of the brewers' response to the Beer Orders). But this can be an important aspect of any analysis of possible remedies, and certainly of divestiture remedies. When parties know that the competition authority will be willing to accept a divestiture package as an alternative to out-right prohibition of the merger, their attention switches to devising a package that the authorities will "buy" and which does least damage to the value of the merged entity. They obviously have an interest in limiting the required divestment and reducing as far as possible the prospect of a new and efficient competitor emerging from the divestiture package. This will encourage them to offer assets rather than a going-concern business and to do what they can to run down the value of the assets/business to be divested, for example, by transferring intellectual property rights or running down order books. These are the composition and assets risks identified in the Consultation Paper. The merged entity also has an incentive to find (or suggest) a buyer who it thinks is least likely to provide effective competition, the purchaser risk identified in the Consultation Paper. Our point is that the Consultation Paper should more explicitly acknowledge the need to take account, as far as is possible, of the strategic interests of the parties in the Commission's evaluation of any divestiture remedy (indeed, of any remedy).

3 The assessment of possible remedies is an exercise in assessing the uncertain future. The implementation and strategic behaviour risks are compounded by **information asymmetries**, especially where the markets/technologies involved are complex (even, indeed, where they are not: consider the Morrison/Safeway merger experience). The Commission has the necessary powers for obtaining the information it needs; the issues here are whether it is in a position to **know** what information it needs and/or is likely to be available for the analysis of possible divestitures, and whether it has the **expertise** to assess the information. The Consultation Paper is surprisingly silent on the information aspects of divestiture remedies.

4 We note that the Consultation Paper makes no reference to any analysis of **the impact of the remedy on the competitive process** in the relevant market(s). The Commission will no doubt say that the starting point of the document is a view by the Commission that the adverse effects of the merger, whatever they may be, will be remedied by the divestiture,

and that that can be taken as read. But this would seem to leave out a major step in the decision on what would be an appropriate remedy. We appreciate that there is some discussion of this in the Commission's Merger Guidelines. But that should not rule out any discussion in this document. Consider, for example, the distinction that is (rightly) made in the Merger Guidelines between unilateral and coordinated effects. There is a long discussion of the factors that are conducive to coordinated effects and of how the Commission will handle mergers that appear likely to give rise to coordinated effects. Since the Guidelines were published, the EU Merger Regulation has been revised, further highlighting the importance of the distinction between the two types of effect. It is rather surprising, therefore, that there is no mention of the two types of adverse effect in the Consultation Paper's discussion of divestment remedies. Where the adverse effects are coordinated behaviour post-merger rather than unilateral effects, some of the remedy risks identified in the Consultation Paper will be particularly significant. For example:

a) Finding a suitable buyer will be particularly difficult. One of the remaining oligopolists cannot be a suitable buyer since coordination would then be likely to continue, but it might be difficult to find another purchaser who would be prepared to enter the market and take on the oligopolistic group. Even if an "outside" purchaser can be found, he may find it more profitable to "join the club" and coordinate with the existing firms, particularly if the entrant feels exposed to predatory behaviour by the incumbent oligopolists should he choose to go his own way. The more dissimilar, the more maverick-like, the outsider, the less likely that may be, but then the greater the risk that the purchaser would not have the expertise to be able to mount a credible competitive threat to the group.

b) Where the divestiture is of assets rather than a going-concern business, there may need to be continuing contacts with one or other of the merger parties, for example, over know-how or the supply of inputs, and this may lead to continuing coordination. The FTC study found evidence that continuing relationships between buyers and sellers of divested assets reduced the probability of success of the remedy. This could be the consequence of strategic actions of the seller hindering the efforts of the buyer to establish himself in the market, or of the on-going business relationships discouraging genuinely competitive behaviour by the parties, particularly the buyer.

c) The divestiture process itself may encourage coordination. If the divestment means that the oligopolists post-merger are more symmetrical (in market share or in cost structure) than before the merger, coordinated behaviour might be facilitated. Or, if the competition authority is prepared to discuss possible divestments with a number of possible purchases a good deal of information and market intelligence will inevitably shared with those parties. The effect may that aggressive, competitive behaviour is discouraged from the outset.

5 At the end of the day, it is the Commission that must be satisfied as to the adequacy of the remedy, but presumably **the onus** is upon the parties (as with any claims of benefits arising from a merger) to satisfy the Commission. In this context, we would have expected the Consultation Paper to say something about the stage in the enquiry process

that the CC will entertain suggestions of a remedy short of prohibition, the obligations of the parties to satisfy the CC on the various risks it identifies in the paper, and the powers (if any) of the competition authorities to intervene further if the divestiture package for any reason fails to have the desired effects. We think it would be useful for the Commission to include a warning that, where it is not satisfied that a divestiture would remedy the adverse effects of a merger, it will not hesitate to revert to the total prohibition of the merger.

We trust that these observations are of interest to the Commission and we look forward to seeing the document in its final form.

Yours sincerely

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