Merger Remedies Study

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DG Competition has recently published the Merger Remedies Study, a major ex post evaluation exercise. The Study reviewed the design and implementation of merger commitments accepted by the Commission in the five-year period 1996 to 2000.

The objectives of the Study were to identify with the benefit of hindsight i.e. three to five years after the Commission’s decision:

1. any serious issues arising in the design and implementation of remedies;
2. the effectiveness of the Commission’s merger remedies policy during the reference period; and
3. areas for further improvement of the Commission’s existing merger remedies policy and practice.

The evaluation of past merger remedies is important, as without effective remedies, the Commission’s merger intervention would be pointless. With this Study the Commission demonstrates its commitment to evaluate its policy and practice.

Methodology

The Study analysed 40 Commission decisions, which included 96 different remedies. These 96 remedies accounted for 42% of the 227 remedies adopted by the Commission during this five-year reference period and are a representative sample as regards (1) the types of remedies imposed, (2) the number of remedies accepted in Phase I or after an in-depth Phase II investigation, and (3) the different industrial sectors involved.

The Study conducted a thorough analysis of the processes involved in the design and the implementation of a relatively large number of remedies. Therefore, the Study opted for the method of interviewing the practitioners who were involved in the design and implementation of the remedies at the time.

A team of ten DG Competition case handlers carried out 145 interviews with a wide range of industry participants, including CEOs, heads and members of legal, M&A, finance, strategy, purchasing, marketing and sales departments, as well as product managers and outside legal advisors, who had the following functions at the time of the remedy process: committing parties (40 interviews); purchasers (61 interviews); trustees (37 interviews); and customers and competitors (7 interviews).

The one- to three-hour hour interviews were structured on the basis of a predefined questionnaire, yet were open-ended to allow the interviewees to comment freely on various aspects of the remedies process. The Study thus created an opportunity for the business and legal communities to provide feedback to the Commission on all merger remedy aspects, while being assured full anonymity. This opportunity for dialogue was well-received and used by the more than 300 participating persons and companies who shared their views on many aspects of the Commission’s remedy procedures. All interviews were recorded and transcribed. The quality of the replies was generally considered high. Of course, some interviewees did not comment on all aspects of the proceedings in their cases. Only 15 of the requested interviews could not be conducted, as the company declined to participate or all relevant respondents had left the business.

For a number of cases, interviews were followed-up with written questions; and for 20 remedies, detailed quantitative follow-up questionnaires were sent out to the parties and the purchasers of the divested business. After the interviews, the interview teams drafted detailed case reports for each remedy in accordance with a standard format. The case reports were subsequently discussed both within the interview team and in wider panels including other members of the Study team. The reports were also submitted for comments to the original case teams who had conducted the merger procedure at the time.

This vast amount of original information was compiled into a final report, a non-confidential version of which has recently been published on DG Competition’s website.

Divestiture remedies

The vast majority of remedies — 84 out of 96 — involved divestiture commitments. The Study’s findings have confirmed the relevance of various aspects of the Commission’s merger remedies practice introduced since 2000, i.e. after the reference period of the selected sample, such as the Remedies Notice and the Model Commitments Texts. Nevertheless, they have also identified a number of serious issues regarding the design and implementation of the analysed remedies which require further attention.

The following Chart shows the type of serious unresolved design and implementation issues that
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were found to be arising in the different stages of the remedies’ implementations.

Of these issues, the failure to adequately define the scope of the divested business was the most frequent problem, followed by the approval of an unsuitable purchaser, the incorrect carve-out of assets and the incomplete transfer of the divested business to the new owner.

The following indications are some of the main findings of the Study which may lead the Commission to consider introducing certain refinements to the current merger remedies policy and practice.

Definition of the scope of a divested business: Removing only the market share overlap often resulted in insufficient consideration of important aspects in the analysis of the commercial viability of a divested business. Such aspects included the upstream and downstream dependence of the divested business on the merging parties, geographic limitations, critical size of the divested business, and also product cycle effects and difficult IPR issues. The Remedies Notice already generally mentions the viability requirement. The Study also confirmed that a more detailed description of the scope of the divested business in the commitment texts would have made a number of remedies more effective. The Study highlighted that the assessment of a divested business typically required important insights into the relevant business, going much beyond the initial competition assessment.

Third party dependence: Where third parties were able to legally block the implementation of remedies (for example rights of partners in a JV the parties committed to exit), this did not ultimately lead to any reported failed remedies. However, the Study found that non-co-operation by third parties regularly delayed implementation up to several months and thus affected the full restoration of effective competition. Such situations will have to be better dealt with at the design stage by identifying all third-party issues upfront and, wherever possible, by consulting such third parties during the Commission’s investigation.

Carve-out issues: The carving out of assets from a wider company structure led to many serious implementation issues, such as delay, reduced effectiveness, or longer term dependence of the divested business on the sellers. Carve-out issues involved both tangible and intangible assets (in particular know-how), as well as (key) personnel. To date, the Commission has issued very little guidance on the principles according to which business carve-outs should be carried out.

Interim preservation: The preservation of the viability, marketability and competitiveness of the divested business in the interim period pending divestiture raised a significant number of serious issues, thus confirming the crucial role of monitoring during this stage. The Study found that particular damage can be done when investment programmes are stopped, or customer and supplier relationships neglected. The cases examined showed that the longer the divestiture period and thus the period of uncertainty, the greater the need for effective interim preservation and hold-separate measures.

Monitoring trustees: All but two studied divestiture remedies required the monitoring of the commitments by a trustee. In more than half of these remedies, the role of the trustee raised issues regarding the selection and appointment, its qualifications, its mandate, its relationship with the Commission and the parties, or its particular functions. Trustees were more often than not appointed too late to monitor or influence crucial early decisions in the divestiture process. Also, trustees rarely monitored the actual transfer of the business following the conclusion of the sales and purchase agreement. Few trustees had close enough contact with the divested business.

The Study generally concluded that the role assigned to the monitoring trustee had great potential for improvement in many analysed cases. Trustee mandates were often not sufficiently precise to guide their intervention.

Hold-separate managers: The carving-out of the divested business and its preservation and holding-separate was sometimes carried out by a hold-separate manager appointed for that task, who was expected to stay with the divested business. The Study’s assessment underlined the crucial importance of hold-separate managers, their independence from the retained business, their co-operation with the trustee, their loyalty to the divested business, and their adequacy of experience and preparedness. So far, the Remedies Notice contains little guidance on hold-separate managers.
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Purchasers: The selection and approval of a suitable purchaser proved critical to the effectiveness of many analysed remedies. In interviews, many purchasers, as well as a number of sellers and trustees, highlighted the unforeseen difficulties they experienced because they had underestimated the level of expertise required to operate the divested business.

The purchaser's incentives to maintain and develop the business proved questionable in hindsight for a number of remedies where the purchaser either ceased operation of the divested business shortly after its acquisition, quickly sold on the divested business, or seemed unwilling to compete with the parties and other competitors. Purchaser incentives often seemed questionable where the divested business had been acquired for free, or at a negative price. Financial investors proved unproblematic in the two analysed cases where they were the purchaser.

Transfer of the divested business: Serious issues also arose in connection with the final step of a divestiture remedy, i.e. the transfer of the business to the new owner. Such issues concerned all tangible and intangible assets, including IP, know-how, authorisation and contract matters, as well as personnel. Purchasers — particularly smaller firms and new entrants — were sometimes not able to safeguard their interests and enforce implementation of vital provisions of their sales and purchase agreements.

Access remedies

The Study analysed ten commitments to grant access. They were designed to maintain actual or potential competition in the relevant market by preventing foreclosure to critical infrastructure or technology or by surrendering exclusive rights. They raised a number of serious design and implementation issues, mainly involving the terms of access to be granted. These problems led to considering one access remedy as 'ineffective' and two as only 'partially effective'. In four access remedies (three of which involved access to infrastructure), the actual market developments turned out substantially differently from what had been anticipated by the parties and the Commission at the time the commitments were offered, in that the dynamic market growth that had been predicted had failed to materialise in those specific sectors.

The insights offered by the Study tend to suggest that such access remedies have only worked in a very limited number of instances. The primary causes for the failure of access commitments were found to lie in the inherent difficulties in setting the terms for effective access and in monitoring them. The Study confirmed how challenging it is to effectively minimise these difficulties.

Effectiveness in competition terms

The Study also attempted an overall evaluation of the effectiveness of each remedy. This was based on an assessment of the collected quantitative market data (operational status of the divested business, evolution of relative market shares, etc.), as well as the findings from the Study case reports, and taking account of relevant facts from the case file, the statements of purchasers, the parties, trustees (and sometimes other third parties involved in the interviews), and the replies to the detailed follow-up questionnaires. This effectiveness indicator attempts to classify the assessed remedies on the basis of the extent to which they have fulfilled their competition objective (i.e. maintaining effective competition by preventing the creation or strengthening of a dominant market position). However, in the absence of a full new market investigation for each remedy, the Study's evaluation can only provide first indications.

The overall effectiveness evaluation was possible in 85 of the 96 analysed remedies and is presented in the chart on the right.

The Study found that 57% of the analysed remedies were fully effective, while 24% were considered only partially effective. Few remedies (7%) had clearly not reached their intended objective and were thus considered ineffective.

As regards different types of remedies, the Study found that, overall, remedies for the dissolution of JVs were the most effective type of remedy (no failure), while the effectiveness of access remedies was the weakest.

What next?

The Study has been published on DG Competition’s website (1) in a non-confidential format. All interested persons are invited to make their comments directly to the project leader Alexander KOPKE.

The results of the Study and comments will be contributing to an upcoming review of the Merger Remedies Notice and of the Model Divestiture Commitments and Trustee Mandate.

(1) See: http://europa.eu.int/comm/competition/mergers/legislation/remedies.htm