



Bulletin

Water

Energy

Retailing

Transport

Financial services

Healthcare

Telecoms

Media

Post

→ **Competition policy**

Policy analysis and design

Regulation

Strategy

Contract design and evaluation

Dispute support services

Market design and auctions

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MAKING SENSE OF EUROPEAN MERGER REMEDIES

The Competition Directorate of the European Commission has recently published a study of the effectiveness of the merger remedies that it accepted over a five-year period, with the aim of seeing whether its practices could be improved. This bulletin examines the findings of the study, in order to offer companies contemplating a merger some pointers as to what the Commission might be looking for in the future.

The Directorate-General for Competition of the European Commission has recently released a study of merger remedies which reviews the design and implementation of merger commitments accepted by the EC between 1996 and 2000.¹ The aim was to assess the effectiveness of the Competition Directorate's policies towards remedies and to work out how to improve these.

The analysis covered 44% of all merger decisions involving remedies in the five-year period: 40 mergers in total, involving 96 remedies. While the methodological approach has some limitations, the study highlights a range of

¹ The study was written by DG Comp staff and is therefore a DG Comp staff paper and does not represent the views of the European Commission.



issues that have reduced the effectiveness of remedies in practice. It provides valuable insights into concerns that merging parties may need to address in future, if they are to succeed in offering remedies the Commission will accept.

NEW MERGERS START HERE

As the Commission's notice on remedies makes clear, if it reaches the view that a transaction would lead to a significant loss of competition, it is the responsibility of the merging parties to propose remedies that would be effective in reversing this loss.² The various types of remedies that are accepted by the Commission and other competition authorities are commonly divided into two types.

- **Structural remedies**, involving the sale of business assets by the merging parties, either to reinstate an independent competitor, or to improve the ability of existing rivals to compete with the merged entity.
- **Behavioural remedies**, involving commitments to conduct business in ways designed to protect competition: e.g., to guarantee rivals access to essential inputs, or give undertakings not to make exclusive dealing agreements.

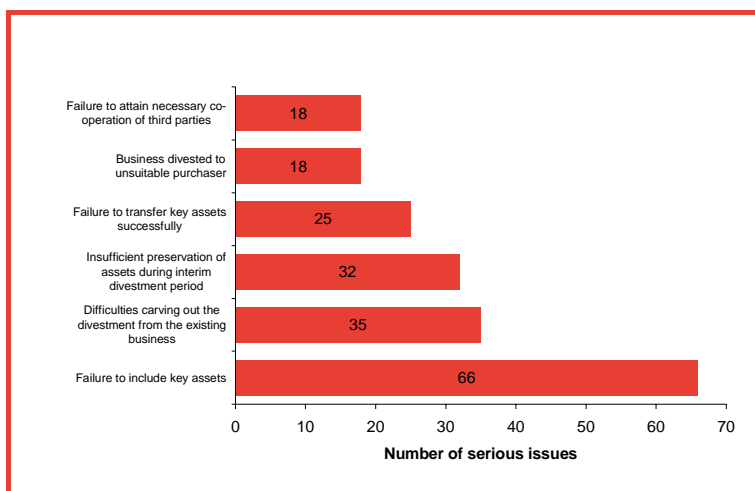
In its study, the Competition Directorate looked at both types, grouping them under the following headings.

- **Commitments to transfer a market position** – structural remedies including the sale of an existing stand-alone business, the spin-off of business units from within companies, the divestment of packages of “mix-and-match” assets, and the sale or long-term grant of exclusive licenses.
- **Commitments to exit from a joint venture (JV)** – structural remedies involving the transfer to a suitable purchaser, normally the JV partner.
- **Commitments to grant access** – behavioural remedies involving measures to ensure that other market participants have access to key assets or inputs.
- **Other remedies** – for example, a commitment by a merged firm to withdraw a brand from a market.

Of the 85 remedies the Competition Directorate felt able to assess, only 49 (or 58%) were definitely found to be effective in reversing, on a permanent basis, the negative effects on competition resulting from the transaction. Although the number of cases analysed was too small to draw conclusions about all types of remedy, exit from a JV stood out as the most likely to be effective. Compared with structural remedies, the behavioural remedies appeared to have slightly lower success rates; but since they involved access agreements rather than restrictions on commercial behaviour they were not very representative of behavioural remedies as a whole. This bulletin therefore focuses on structural ones³. The chart opposite summarises the design and implementation issues identified.

² Commission notice on remedies acceptable under Council Regulation (EEC) No 4064/89 and under Commission Regulation (EC) No 447/98.

³ Our previous bulletin *Surgery or Medicine* examines the use of behavioural remedies in merger control.



Number of serious issues arising at the time of the design and/or implementation of the remedies

Source: Based on Competition Directorate Merger Remedies Study

As the chart shows, a failure to include key assets in the divested business was the most common reason for remedy ineffectiveness. The typical problems identified in the study are listed below.

- **Upstream or downstream links** between the divested business and the retained business - for example, the divested business still depended on the merging parties for inputs or after-sales service.
- **Geographical restrictions** – e.g., the firm purchasing the divested licence was only able to sell the product in one country.
- **Insufficient size** – the divested business lacked, for example, economies of scale.
- **Product cycle effects** – e.g., the divested firm was left with a product range which would soon become obsolete.
- **Lack of intellectual property rights** – the divested firm was not given all the rights necessary to compete effectively.
- **Problems with carve-outs** – e.g., the need to replicate parts of the existing IT infrastructure in order to make a carve-out viable.
- **Commitments dependent on third parties** – e.g., agreements to transfer the necessary know-how to make a divestment viable which may be blocked by firms over which the merging parties have no control.
- **Asset deterioration during the divestment process** – e.g., the loss of personnel, or damage caused by “front-loading”, whereby prices are cut to bring forward sales and harm future profitability.

In some cases, however, it was difficult for the Competition Directorate to tell whether viability problems were the result of missing assets in the divested business or an unsuitable purchaser. For example, was the lack of a sales force in the package an issue? That would depend on whether the purchaser had an existing sales force capable of selling the product itself.

Given the failure rate shown up by the study, the Commission is likely to set the remedy bar higher in future, requiring merging parties to demonstrate even more clearly that they are divesting the right assets and have found the right buyer. The following points, in particular, are worth noting.

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- The Commission will have taken note of the fact that exit from a JV, which would normally involve the divestment of viable business to a highly suitable purchaser (the JV partner) was the remedy with the highest success rate.
- The study suggested the Commission should more clearly identify any links between the divested and retained businesses, in order to assess viability. It is obviously easier to make this assessment when considering an already separate business, rather than a hypothetical carve-out.
- Merging parties should try to minimise the role of third parties, especially because neither the Commission nor the merging parties have any right to force third parties to implement remedies.
- Merging parties need to make sure that the purchaser has all the necessary regulatory approvals, proven expertise, financial resources and incentives to develop the business and that the purchase will not create any new competition concerns. One approach, discussed in the Commission notice on remedies, is to give potential purchasers some degree of flexibility regarding the assets transferred. This flexibility is also likely to increase the number of suitable purchasers.
- The Commission is more likely to look favourably on divestments which propose the prompt appointment of a trustee to protect the viability of the firm during the divestment period, a fixed divestment period of six months (in line with the Commission's Best Practice Guidelines); and the inclusion of effective non-solicitation clauses.

CONCLUSION

While the Competition Directorate's study does not represent the official views of the European Commission, and the methodology adopted has a number of potential drawbacks, it provides a valuable insight into the issues that are likely to influence Commission officials' decisions on whether to accept proposed remedies. For structural remedies, this implies merging parties should focus much harder on divesting the right assets and finding the right buyer. Exit from a JV is likely to be viewed most favourably in this light, but there are other pointers too. Merging parties should be prepared to identify any remaining links with divested assets, avoid dependence on third parties, offer some flexibility in the divestment package and protect assets against deterioration during divestment.

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