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Are merger remedies effective in the EU?

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Abstract

The European Commission released in 2005 an in-depth study of merger remedies. The study is an ex post evaluation of the design and implementation of 96 remedies accepted in merger cases notified between 1996 and 2000. At first glance, remedies seem highly effective, since 94% of divested businesses were still on the market three to five years after divestiture, and 81% of the total analyzed remedies are considered partially or fully effective. In fact, these initial figures are misleading. The study highlights numerous obstacles to the success of remedies, especially the strategic behavior of merging firms and the failure of trustees to perform their mandate properly.

The European Commission published the results of its merger remedies study in October 2005. The study is an ex post evaluation of roughly half of the merger decisions involving remedies issued over the 1996-2000 period. The study has attracted little attention, despite being the first attempt in Europe to analyze this issue of major importance. Decisions to clear with commitments are ten times more common than decisions to ban mergers. An assessment of these clearances with remedies is therefore extremely useful. In the United States, the Federal Trade Commission conducted a similar - albeit far less detailed - study in 1999[1]. The European Commission's study is first-rate. It contains a large number of figures and factual observations. This article focuses on the data from the survey of remedy effectiveness, i.e., do the remedies achieve their goal of eliminating the anticompetitive effects of mergers?

Two figures from the study seem to suggest there is no need to examine this question in detail. Firstly, 94% of assets divested to competitors or new entrants are still in business three to five years after the divestiture. In other words, a majority of buyers of the merging companies' divested businesses have a lasting presence on the market. In principle, therefore, they represent a competitive force. This viability rate is higher than in the US study, which reports that one-fourth of divestitures were eventually abandoned by their buyers. Secondly, 81% of remedies are considered effective. Measured by these two indicators, the success rate of the remedies accepted by the CommisFision is impressive. Why take the matter any further? Because, on further reading, the study reveals a far less rosy picture. The study shows, for example, that each remedy poses an average of two serious design or implementation problems; that remedies involving intellectual property rights are almost always ineffective; that the buyer's market share decreases while that of the merging firms increases; and that slightly more than one remedy in ten is pointless.

Before analyzing the mixed results of the study on the effectiveness of remedies, the characteristics of the dataset and method used by the European Commission should be explained. The representative sample studied consists of 40 clearance decisions with remedies. There are 96 remedies in total and they are grouped into different categories, described in Box 1. Note that, in the study, "a remedy" refers to a measure – or, more usually, a set of measures - intended to eliminate an anticompetitive effect. For example, divesting a plant and granting the license for the manufacturing process only count as one remedy. The number of remedies in the study is therefore the same as the number of anticompetitive effects identified during the examination of the merger. Moreover, structural remedies (i.e., that alter ownership rights) strongly predominate. However, their proportion is overestimated because the study counts an

[1] A Study of the Commission's Divestiture Process prepared by the Staff of the Bureau of Competition of the Federal Trade Commission. The report can be downloaded from:

asset divestiture combined with a behavioral remedy (e.g., guaranteed supply of a key input for the divested plant) as a structural remedy. The authors of the study assessed the effectiveness of the remedies by observing changes in competition in the market. The assessment divides the remedies into four main categories: effective, partially effective, ineffective and undetermined[2]. The study was conducted internally by the Competition Directorate-General (DG COMP). The information gathered therefore has the advantage of being complete and first-hand. The method used is also thorough. It would nevertheless have been preferable for the evaluation to have been conducted by an organization other than the one that performed the action under review.

Box 1: Categories of remedies analyzed in the study

The study divides remedies into three major categories: commitments to transfer a market position, commitments to exit from a joint venture, and commitments to grant access. Remedies in the first category are designed to create or strengthen a competitive position on the market. They include divestiture of a controlling stake that was already a viable stand-alone business; divestiture of a business unit that needed to be carved out extensively from a greater company structure; divestiture of a package of assets that combined the assets of more than one of the parties (so-called “mix and match”); and lastly, divestiture or grant of an intellectual property right. Commitments to exit from a joint-venture require the merging companies to give up their joint control over a business. The remedies in the third group facilitate access to the market for other companies and new entrants. This may involve granting access to infrastructure, access to technology through patents or the termination of exclusive vertical agreements. The number of remedies for each category and sub-category is indicated in the table below.

Type of remedy	Number	
Transfer of a market position	68	
stand-alone business	15	
extensive carve-out	37	
packages of “mix and match” assets	9	
d) exclusive license		8
Exit from a JV		15
Grant access		10
a) to infrastructure		4
b) to technology		5
termination of a vertical agreement		1
Other		3

A first set of results makes it possible to identify the extremes. The most effective type of remedy is exit from joint ventures. This remedy is specific in two ways. It is often related to the problem of collective dominance: half of cases involving a problem of this type receive this remedy, and one-third of exits from joint ventures are in response to a problem of collective

http://www.ftc.gov/os/1999/08/divestiture.pdf.

2 Note that the study gives no indication of data dispersion. This is a problem because we may be unaware that some results may be distorted. For example, a merger case with ten remedies will count for more than one-tenth in the dataset.

dominance. Moreover, divestiture is simple and has the right ingredients for success: the joint venture's business is highly independent, so can continue easily after the divestiture; and the buyer is usually the other joint venture partner, which already has experience managing the business. Unsurprisingly, the study shows that all the exits from JVs were effective except one, which was partially effective. Conversely, the least effective remedies are those aimed at providing access to infrastructure or an intellectual property right. Note that this is when these behavioral remedies are the main commitment, not supplementary measures to the divestiture. In general, they are intended to remedy vertical effects. The study stresses that they "have only worked in a limited number of instances"[3] and that, in the particular case of commitments to grant intellectual property rights alone, "in each case the respective licensee was never able to compete, and in one case, the licensee was not even able to sell a single product"[4].

A second set of results concerns problems encountered that reduce the effectiveness of structural remedies. This category covers all divestitures, including exits from joint ventures, sales of exclusive licenses, or transfers of stand-alone businesses, extensive carve-outs or mix and match packages (see Box 1). Depending on the type, unresolved issues caused the remedy to be totally or partially ineffective. As Figure 1 indicates, a solution was found in 70% of cases. Seven divestiture remedies out of ten are therefore effective. The resolution rate obviously depends on the type of problem encountered. It is difficult to remedy an unsuitable buyer whereas it is easy to find a solution to the disagreement of third parties with an interest in the divested asset (usually the joint-venture partners). The problem of inadequate scope of the divested assets falls in the middle ground, since a solution is found in only one-third of cases. This is the most common problem encountered, accounting for 34% of problems reported, raised by 79% of remedies, and present in all the remedies found to be partially or totally ineffective. Furthermore, it is the source of some of the other issues raised during implementation of the commitment.

A third set of results shows the situation to be worse than this. Firstly, remedies have a high likelihood of failure. For each remedy, the study finds an average of two serious problems likely to reduce its effectiveness. Secondly, divestiture remedies are less effective in Phase II than in Phase I, despite the greater anticompetitive risk of a merger that requires an in-depth investigation[5]. Thirdly, changes in market share are to the disadvantage of the companies that bought the divested assets. The buyer's market share falls in almost half of cases, and increases

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[3] Op cit. note i p. 120.
[4] Op cit. note i p. 119.
[5] It is not counterintuitive for Phase II remedies to be less effective, because Phase I remedies are more likely to be disproportionate to the anticompetitive effects. In Phase I, the Commission can reject remedies that would not directly eliminate the problems raised by the merger. Companies may also be

in only one case in five. The buyer's market share also decreases in relation to that of the merging companies (see Figure 2). These results certainly qualify the apparent success of remedies as measured by the extremely high viability rate. Even the 70% effectiveness rate suggested above needs to be revised down, because the sample excludes remedies whose effect is undetermined and those that are rendered pointless. However, those remedies can clearly not be counted with the successes. For the sake of accuracy, they must therefore be reincorporated into the total. This brings the effectiveness rate down to 50% (see Figure 3).

A fourth set of results offers some explanations for the actually low effectiveness of remedies. There is some basic economic reasoning at work[6]. Firstly, the merging company has more information on the quality of the divested assets than the Commission and the buyers. In particular, it has thorough knowledge of the complementary assets required (e.g., information system, specialized personnel, know-how) to keep the divested business operational. Secondly, the merging company's interest is at odds with the Commission's. The former wants future competition to be as low as possible. Consequently, the merging company may prefer to sell at a lower price to a weaker competitor than at a higher price to a stronger competitor. There is an incentive to sell assets of inadequate scope or unviable assets, to sabotage asset transfers, and to collude with the buyer. The study abounds in concrete examples of these types of behavior (see Box 2). Indeed, half of the remedies with unresolved design or implementation issues appear to suffer from strategic behavior by sellers[7].

Box 2: Sellers behaving badly: unviable assets, sabotage, and probable collusion

The study provides numerous examples of strategic behavior by companies with regard to remedies. Selected examples:

1. The buyer of a technology business found it was unable to attract new customers because it did not have a state-of-the-art demonstration plant. The plant it purchased was old and unsuitable for demonstration purposes. Another plant, which would have been better adapted to that purpose, was retained by the seller. The buyer lost the opportunity of developing the technology it bought and competing with the seller (p. 25).
2. A buyer was given only two days to examine the accounts and technical processes, only to discover later that it was missing key employees, customer documentation and other essential assets (p. 69).
3. A buyer lost half the customers of the business because it remained dependent on the seller's network, which the seller operated negligently, offering substandard service (p. 44).
4. In another case, the seller failed to transfer infrastructure supporting production and international organization to the seller (p. 83).
5. During the divestiture period, the seller stopped promoted the brands included in the divestiture package. Production fell below 70% of the target set at the time of the transaction (p. 58).
6. In several cases, sellers took advantage of divestitures to transfer unproductive staff (p. 43).
7. One buyer, a small and inexperienced new entrant, reported that vital assets had not been transferred, including key personnel and support functions, such as marketing. Sales operations continued to be carried out by the seller's sales force and the production assets remained on the seller's premises (p. 100).

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willing to accept more extensive remedies to obtain faster clearance.

[6] See *Merger Remedies in American and European Union Competition Law*, edited by F. Lévêque and H. Shelanski, Edward Elgar, Cheltenham, 2003, in particular M. Motta, M. Polo and H. Vasconcelos, "Merger Remedies in the European Union: An Overview," pp. 129-136.

[7] See reference cited in note i p. 71.

The study does not report specific examples of collusion. However, it can be inferred from cases like the previous one, where ties between sellers and buyers endure after the divestiture. Collusion is also the likely explanation for the 88% of buyers who indicate that they would "do it again", despite all the obstructions they have faced. This rate should be considered in the light of the many serious problems encountered and the drop in market share of the divested businesses (see Figure 2).

Paradoxically, the Commission does not seek to counteract this behavior systematically and effectively. The study only mentions one case of an upfront buyer (i.e., when the buyer is known at the time of the decision). This process would nevertheless limit the merging company's opportunism when choosing a buyer. The study also reports only one "crown jewel" remedy (i.e., a more attractive commitment than the original one) when the sellers are unable to divest to a buyer within the foreseen deadline. It is not sufficient for the Commission to ask companies to divest more than the "overlap" between the merging companies in the market after the merger. In cases of horizontal overlap with anticompetitive effects, the divested assets represent more than the market share overlap resulting from the merger in 28% of cases, the same as the overlap in 58% and less than the overlap in 14% of cases. The Commission also accepts numerous remedies that are complex in design and implementation. Simple remedies, namely exits from joint-ventures and divestiture of a stand-alone business, account for only 36% of divestiture remedies. Lastly, trusteeships have many shortcomings. In many cases, the trustees lack the requisite industrial expertise. The study reveals that investment banks are particularly lacking in this regard[8]. It also notes that trustees are often appointed too late – when the divested business is already in trouble – or terminate their mandates too early – before the transfers have been completed. Furthermore, their role is often poorly defined and poorly understood by the parties. To make matters worse, in many cases, the trustees have a conflict of interest. The study cites the example of an investment bank where one department was the seller's M&A advisor and another acted as the trustee, with the latter relying on information provided from the former to assess the performance of the divested business[9]. Lastly, the compensation of trustees is a disincentive. Although they are appointed by the Commission to monitor the commitments, they are paid by the merging company. They are often paid a flat fee set in advance. Some trustees receive a commission proportional to the value of the divestiture. They thus have an incentive to sell to the highest bidder, which is not always the buyer likely to be the strongest competitor ex post[10].

[8] See in particular the reference cited on pp. 91 and 92, e.g., "Investment banks are generally not very well suited to carry out monitoring trustee duties".
[9] See reference cited in note i p. 92.
[10] See M. Motta: *Competition Policy Theory and Practice*, Cambridge University Press, Cambridge, 2004, pp. 265-270.

In conclusion, on the one hand the Commission takes risks with commitments by accepting remedies that are complex in design and implementation, and divestitures that represent only the horizontal overlap, while on the other it fails to take sufficient steps to counteract the merging companies' opportunism. There is substantial room for improving the effectiveness of remedies, and the study shows where efforts should be concentrated. It would be useful for a comparable study to be conducted in a few years' time in order to measure the progress made.

For each remedy examined, the study sought to identify problems encountered in the design and implementation of remedies via questionnaires and interviews. A total of 194 serious problems were reported. "Serious" means that unless the problem is resolved, the remedy will be partially or totally ineffective.

Fig.1 Number of serious design and/or implementation issues

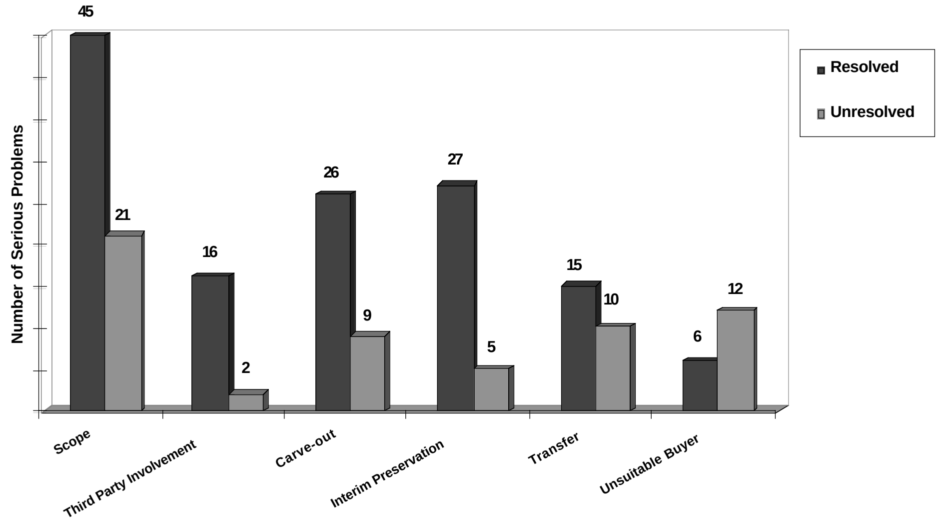
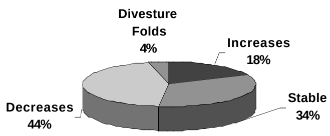
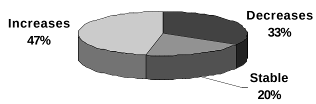


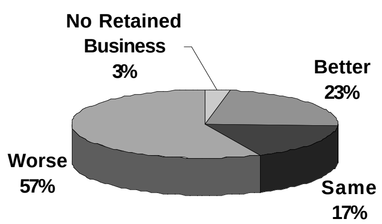
Figure 2. Changes in market share





a) Market Share of Divested Business

b) Market Share for Retained Business



c) Market Share of the Divested Business Compared to Market Share of Merged Business

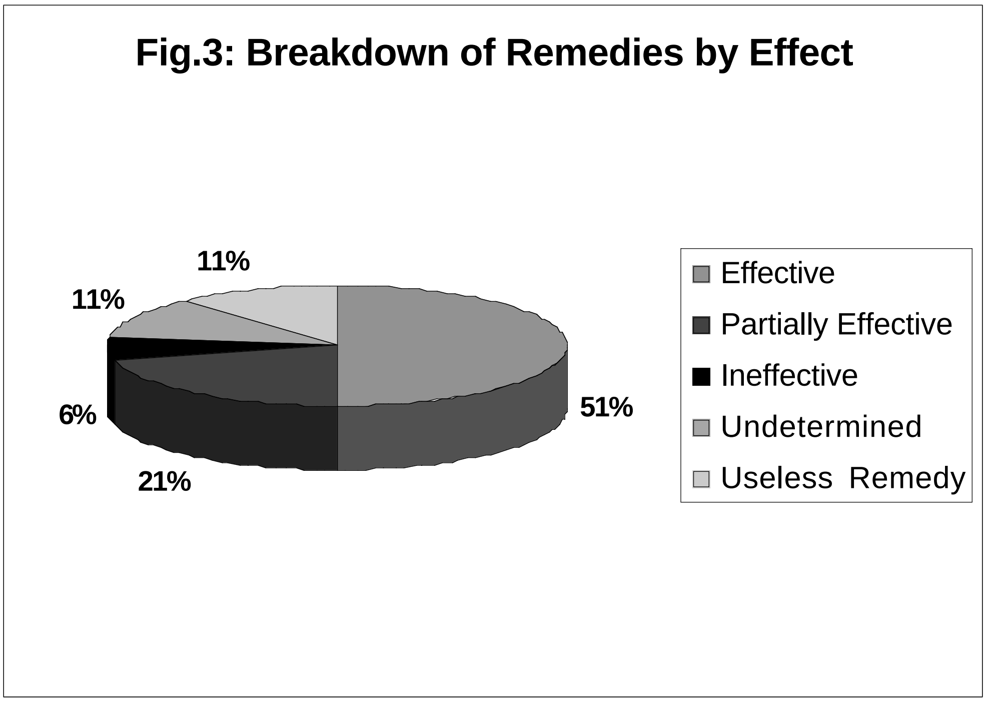


Fig.3: Breakdown of Remedies by Effect
11%
11%
6%
21%
51%
Effective
Partially Effective
Ineffective
Undetermined
Useless Remedy