Joint Comments of the American Bar Association's
Section of Antitrust Law and
Section of International Law on the United Kingdom Competition Commission
Draft Guidelines on Application of Divestiture Remedies
in Merger Inquiries

The Section of Antitrust Law and the Section of International Law (together, the "Sections") of the American Bar Association welcome the opportunity to respond to the request of the United Kingdom Competition Commission (CC) for comments on the draft guidelines on Application of Divestiture Remedies in Merger Inquiries (Divestiture Guidelines or Guidelines) under the Enterprise Act 2002. The views expressed herein are being presented jointly on behalf of the Sections.* They have not been approved by the House of Delegates or the Board of Governors of the American Bar Association and, accordingly, should not be construed as representing the policy of the American Bar Association.

The membership of the Sections includes over 22,000 lawyers, most of whom are based in the United States. Given the long history of competition law in the United States, the Sections have substantial familiarity with the practical implications of divestiture remedies to address concerns of antitrust enforcers. The Sections hope and intend that these comments, from the perspective of the Sections and grounded in the historical development of U.S. antitrust law and practice regarding similar issues, will assist the CC in its development of guidelines for use in divestitures in merger inquiries referred to it by the Office of Fair Trading (OFT).

The Sections have had prior opportunity to give substantial consideration to policy questions and operational issues arising in the context of divestiture remedies in merger inquiries. The Sections submitted joint comments to the European Commission in response to its request for public comment on model texts for divestiture commitments and trustee mandates. *See* Joint Comments of the American Bar Association's Section of Antitrust Law, and Section of International Law on the draft Model Texts for Divestiture Commitments and the Trustee Mandate under the EC Merger Regulation (September 27, 2002), *available at* http://www.abanet.org/antitrust/comments/2002/reports.html ("EC Divestiture") (EC Joint Comments). The Antitrust Section also expressed detailed views on remedies in a letter sent two years ago to the U.S. Federal Trade Commission. *See* Letter from Roxane C. Busey, Chair of ABA Antitrust Section, to Joseph Simons, Director of FTC Bureau of Competition, parts VI-XII (Aug. 6, 2002), *available at* http://www.abanet.org/antitrust/comments/2002/reports.html ("Merger Review Process") (Busey Letter)**.** The positions expressed in the EC Joint Comments and Busey Letter substantially inform the comments expressed here. Although the Sections draw on the considerable U.S. law and practice on merger remedies, as the CC will see from the

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comments below, the Sections' position differs in some respects from U.S. enforcement practice. The Sections are of course also mindful that the underlying U.K. statute and other aspects of the U.K. merger control process differ from those in the U.S. and that some differences in treatment of divestiture remedies may be appropriate for that reason even if the CC were otherwise minded to proceed in a manner consistent with U.S. practice.

The Sections support the CC's efforts in preparing and circulating for comment the Divestiture Guidelines as a means of increasing efficiency, consistency and transparency in the merger review process. We also fully support the CC's approach "to apply this guidance flexibly", recognizing that a specific merger may present "appropriate reasons" for departing from the Divestiture Guidelines. (Paragraph 1.4). It is impossible to anticipate all circumstances and issues that can be presented by every merger, and a reasonable amount of flexibility is necessary to serve the ultimate goal of remedying a perceived substantial lessening of competition (SLC).

The CC also notes that the guidance "may be revised from time to time to reflect changes in best practice and experience gained from inquiries." (Paragraph 1.3). Again, the Sections support this approach, and encourage the CC to consider docketing a specific period for review, e.g., after working with the Guidelines for two years, and in any event once again seeking some level of public participation in such revision and review process.

Most of the concepts and principles articulated in the Divestiture Guidelines are familiar to U.S. practitioners, broadly consistent with our experience in merger review undertaken by the Federal Trade Commission and the Antitrust Division of the Department of Justice, and have generally fostered rational and effective merger enforcement in the U.S. As a broad template for approaching divestitures, therefore, we are in general accord with the draft. We thought it would be most helpful to the CC if we keyed our comments to specific paragraphs of the consultation document, and, accordingly, our comments below follow the organization of the draft Divestiture Guidelines.

Part 1. Introduction

<u>The context of remedial action</u>

In paragraph 1.8, the Divestiture Guidelines note that "in deciding whether a remedy is appropriate the CC will consider the effectiveness of different remedies and their associated costs." By cross-reference to the Merger References: Competition Commission Guidelines (CC Merger Guidelines), we understand the "costs" to include: (a) costs of implementing the remedy (but generally not the cost to the parties of the divestiture); (b) "costs to the companies of foregone economies" but only "in the context of relevant customer benefits"; and (c) compliance costs-- both to the parties and the OFT in monitoring compliance. CC Merger Guidelines paras. 4.6-4.13. We also understand that the "costs" do not include environmental costs or social costs of unemployment. It would be helpful if the Guidelines clarified the manner in which such costs will be balanced against a remedy’s effectiveness. For instance, would the CC be open to calculating the cost of the unremedied, predicted price increase resulting from the merger and comparing it to the "associated costs"? Is this cost balancing more likely to result in favoring one possible remedy over another rather than no remedy at all? We note in that regard that the CC Merger Guidelines provide that there may arise an exceptional circumstance where having found SLC, the CC decides to impose no remedy 'because the costs of any practicable remedy seem disproportionate in the light of the size of the relevant market." CC Merger Guidelines para. 4.6. Is there any guidance to be delivered on "de minimis" markets where a remedy is unlikely to be sought? *Cf*. German markets with turnover below €15 million considered de minimis, falling outside the jurisdiction of the Bundeskartellamt pursuant to Section 35(2)(1)(2) GWB.

Paragraph 1.8 also refers to the “principle of proportionality”, by which we understand that the CC would be required to justify any remedy on the basis that it go no further than required to achieve its aim. This principle strikes us as a helpful limitation on certain protective mechanisms discussed in the Divestiture Guidelines, such as up-front buyers and crown jewel provisions. These may test the outer boundaries of this principle; but there also may be sound justifications for the use of such mechanisms in some situations. In this context, the discussion of risks in paragraphs 2.4 and 2.5 is particularly useful.

Paragraph 1.9 of the Divestiture Guidelines notes that structural remedies are “likely to be preferable to behavioural remedies,” but goes on to suggest that behavioral remedies may be more suitable in certain circumstances.[1] The U.S. experience is mixed. The federal antitrust agencies will generally use behavioral remedies only to address a vertical issue, e.g., information firewalls within a vertically integrated firm that is also supplying a competitor with an important input, or as an adjunct to a structural remedy. As we understand it, the U.S. agencies’ general concern is that behavioral remedies may not create the full competitive incentives that structural remedies create, and that they may require costly review and monitoring by the agencies. The state attorneys general have been more willing to consider and implement behavioral remedies to address horizontal issues, e.g., a commitment on price levels. Canada has also been willing to use behavioral remedies, evidently with success. Paragraph 1.9 suggests that the CC will have more tolerance for such solutions than the U.S. federal agencies.

The guidance offered by paragraph 1.9 would be enhanced if the CC could more clearly set forth the types of transactions in which behavioral remedies would be considered by the CC, as well as the limitations of such remedies. The example currently provided in the paragraph - the absence of suitable buyers for a divestiture package - is potentially controversial, and the CC may wish to consider whether it creates more potential confusion than guidance. A divestiture package may fail to attract buyers for any of a number of reasons; and depending on the cause of the failure, a behavioral remedy may be more or less appropriate. For example, sometimes buyers are not interested because

[1] The use of behavioral remedies in conjunction with and in aid of structural remedies, for example in ensuring continuity of supply of essential inputs, is uncontroversial.

the divestiture package is too broad to be efficient or too narrow to be viable, in which case the appropriate response may be (depending on proportionality considerations) to reconsider the scope of the package. In our experience the reluctance of U.S. enforcers to accept behavioral remedies for horizontal effects carries over even when suitable buyers are absent; some would contend that in those circumstances the adverse effects cannot be remedied and the transaction should be blocked entirely. In our view, the CC's greater openness to various possibilities is commendable, and we hope it will prove to be administrable.

Part 2. Effective divestiture remedies

Objectives

Paragraph 2.1, describing the objectives of a divestiture remedy, suggests that the remedy may involve "either creating a new source of competition . . . or strengthening an existing source of competition through disposal of assets to an existing market participant." The Sections agree with what is implicit in Paragraph 2.1: there should be no requirement that a divestiture result in no increase in concentration, or "zero delta." First, there is no empirical evidence that a minor increase in concentration has any competitive effects. Second, it is unclear why the CC should prevent a party from divesting an asset to another party when it is unlikely that the agency would challenge, *ab initio*, such a transaction. (Similarly, the CC should not be concerned about the acquiring party in the principal transaction retaining certain assets of the acquired party after other assets have been divested when it would not have challenged a transaction that consisted simply of the acquiring firm purchasing the assets to be kept, without more.) Third, there is a very real tension between wanting a buyer that is likely to succeed with the divested assets and a zero delta. A zero delta requires the buyer to be outside of the relevant market. The Sections are pleased to note the clear implication that the CC does not insist that merging parties divest sufficient assets to result in a zero concentration change. Rather, the Sections agree that the appropriate focus of the inquiry should be whether the proposed divestiture is sufficient to maintain or restore competition in the relevant market.

Constraints on effective outcomes

Paragraph 2.4 identifies three categories of risk:

- "Composition risks—these are risks that the scope of the divestiture package may be too constrained or not appropriately configured to attract a suitable purchaser or may not allow a purchaser to operate effectively and viably in the market."
- "Purchaser risks—these are risks that a suitable purchaser is not available or that the merger parties will dispose to a weak or otherwise inappropriate purchaser."
- "Asset risks—these are risks that the competitive capability of a divestiture package will deteriorate prior to completion of divestment, for example, through loss of customers or key members of staff."

These risks are also recognized in the U.S.[2], and in our experience, are the appropriate ones upon which to focus. In addition to the use of discretionary "protective measures" identified in paragraph 2.3 of the Guidelines, these risks are managed to a large extent in the U.S. by standard features of the divestiture process. These features counter composition risks with extensive market testing of proposed divestiture packages, purchaser risks with comprehensive assessment and pre-approval of purchasers and the purchase contract, and asset risks with hold-separate orders. The Guidelines broadly embrace these measures, consistent with U.S. practice.

Part 3. Scope of divestiture packages

The Sections have in the past suggested a four-step approach to address the adequacy and scope of divestiture packages and to determine whether an up-front buyer may be needed in a specific case. Busey Letter p. 34. The Sections thus outline the same four-step approach here so that the CC might consider it in relation to the relevant provisions in its Guidelines:

(1) Establish baseline presumptions for the process. The Sections suggest that the CC begin with the presumption that divestiture of an entire business will usually resolve competition concerns in the merger context. The "entire business" should be the smallest operating unit of a business (whether a subsidiary or a division) that contains the manufacturing, sales and marketing, research and development, and general management functions pertinent to the area of competitive overlap, without need for support (e.g., in the form of supply of raw materials) from other units of the same parent. This is the Divested Business.

(2) Determine whether the Divested Business meets the baseline presumptions. If the Divested Business meets the presumptions, then the up-front buyer requirement should not be applied. In these situations, the stand-alone nature of the Divested Business indicates that it would be no less viable in the possession of the purchaser than in the control of the prior owner. On the other hand, if the baseline presumptions are not satisfied, then the merger parties should be required to demonstrate the adequacy of the Divested Business in terms of scope (Step 3) and independence (Step 4).

(3) Determine the adequacy of the divestiture to sustain a viable competitor. Sales of parts of a business are commonplace in private commercial transactions. Nonetheless, the CC should be assured that the particular divestiture is adequate to assure continued competition. The merger parties might demonstrate this adequacy in any number of ways, including, but not limited to, by (i) identifying an acceptable up-front buyer, (ii) establishing that the business is in a sector in which there is substantial investment interest, or (iii) identifying a number of acceptable parties potentially interested in buying the Divested Business and capable of operating the Divested Business in a manner comparable to its present operations.

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[2] In the U.S. we tend to refer to the sufficiency or adequacy of the divestiture package, the need for a qualified purchaser and concern about interim anticompetitive effects.

(4) Determine the likelihood of independence of the Divested Business. Ongoing relationships between a seller's group and a business being sold are also common in private commercial transactions. Such relationships between the merged entity and the purchaser may be common in routine commercial divestitures, but should be reviewed to determine whether, in the particular circumstances, these relationships will not undermine the objectives of the divestiture. Commonplace ongoing relationships should not, however, be automatically disqualifying.

Package definition

Paragraph 3.2 states that in general "the merger parties will be restricted from subsequently purchasing assets or shareholdings sold as part of a divestiture package or acquiring material influence over them." The CC may wish to consider whether any outright prohibition is necessary. The Sections believe that such a prohibition is not necessary, because the relevant facts and markets can change over time, and the OFT and CC should review any proposed acquisition at the time under the SLC standard unencumbered by presumptions. If there is a realistic concern that the subsequent acquisition will not be reviewed, a prior notice requirement to the OFT could be imposed. Such a notice requirement should carry with it a reasonable "sunset" period, e.g., five years. If the CC nonetheless outlines a prohibition, it should be made clear that such prohibition is more in the nature of a rebuttable presumption for the parties to overcome due to a change in market conditions. *Cf*. Section 82(2) EA 2002 provides that an undertaking may be varied or superseded by a subsequent undertaking or may be released by the CC and subsection (5) requires the CC to as soon as practicable consider any representations received by it in relation to varying or releasing an undertaking made under Section 82. The Sections believe, *a fortiori*, that if the CC imposes a prohibition it too should be "sunsetted."

Presumption for divestiture of an existing business

Paragraph 3.3 establishes a presumption in favor of the divestiture of an existing business, which is defined as a viable, stand-alone entity and against "divestiture of part of a business or a collection of assets". The Sections are on record as favoring an analysis that begins with a presumption that the divestiture of an entire business will solve the competitive problem. The Sections believe it is important for the CC to make clear that such a "presumption" is only the starting point for the analysis, and can often be rebutted. The U.S. agencies have approved numerous divestitures that involved the sale of only a specific product line or package of assets rather than a stand-alone business. In some cases, moreover, partial divestitures will serve the principle of proportionality. A partial divestiture that remedies the SLC should be sufficient.

Presumption against 'mix and match' divestitures

Paragraph 3.5 establishes a presumption against 'mix and match' divestitures – "[a] divestiture of a mixture of assets from both merging parties such that the divestiture package will not function effectively." This presumption seems unnecessary. The success of the proposed asset package in achieving the objective of remedying the SLC should be evaluated on a case-by-case basis rather than with any blanket presumptions against ‘mix and match’ divestiture packages. The Sections believe it is more appropriate to consider a "mix and match" of assets as a factor that may raise more questions, require further inquiry or require more protections, but not erect a presumption. The "presumption" becomes particularly unhelpful to the process if in practice it becomes irrebuttable or leads to a highly elevated standard of proof. At a minimum, the CC should make clear that the presumption against so-called "mix and match" divestitures is per product market; that is, if the merger will cause SLC in two separate product markets, the remedy could include the assets of one party in the first market and the assets of the other merging party in the second market.

Use of ‘crown jewels’ divestiture packages

Paragraph 3.6 provides 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 CC would require the parties to sell if a proposed divestiture is not completed within a specified period. The CC will generally only consider use of such crown jewels packages in circumstances where other effective options are not available. The CC would wish to be satisfied that the purchaser of a crown jewels package was committed to operate the core assets necessary to remedy the SLC and not primarily attracted by the ancillary assets.”

The Sections believe that where there is an up-front buyer, or the divestiture of an entire business, a crown jewel provision is disproportional and unnecessary. Moreover, to the extent that the parties identify an up-front buyer, it is important that the CC take steps to resist the natural tendency of potential divestiture buyers to use the antitrust authorities effectively as an agent of the divestiture buyer in "gaming" the process to extract additional assets from the merging parties that are not necessary to compete.

Where there's not an up-front buyer, the question is whether the agency can find some other means for reducing the risk of a failed divestiture effort or whether the "crown jewel" provision is the only means. The Sections believe that the agency should limit the divestiture package to only those assets that are needed by the divestiture buyer to compete as effectively as the merging party in the affected relevant market. The draft Divestiture Guidelines appear consistent with this principle, as they signal that a "crown jewel" should only be used sparingly. The Sections recognize that in some instances the asset packages will need to include more than just the assets used solely in connection with the relevant product or service market, It is important, however, that asset packages not be enriched on the grounds that such assets would be "useful" to the divestiture buyer, but rather focus on what is "necessary" for the divestiture buyer to compete as effectively in the provision of the affected relevant product or service. It should be undesirable from a public policy standpoint to take unrelated assets from the seller, which may have the unintended effect of weakening the seller in other areas or eliminating certain synergies that would ultimately inure to the benefit of consumers. Indeed, requiring the divestiture of additional assets of one of the merging parties' presence in the affected market can eliminate some synergies from the transaction without necessarily making the divestiture buyer a more competitive entity. Accordingly, the CC should be careful not to over-enrich divestiture packages in an attempt to guarantee the success of the divestiture at the risk of losing synergies or harming the merging parties' ability to compete post-merger. *See* Busey Letter pp. 43-44.

Part 4. Suitable purchasers

Up-front buyers

In Paragraph 4.4 of the draft Divestiture Guidelines, the CC says that where it believes there may be "doubt as to the viability or attractiveness to purchasers of a proposed divestiture package (i.e. composition risk) or . . . a limited pool of suitable purchasers (i.e. purchaser risk), it may require the merger parties to identify a suitable purchaser that is contractually committed to the transaction before permitting a proposed merger to proceed or a completed merger to progress with integration. Where the CC considers that the competitive capability of the divestiture package may deteriorate pending the divestiture (i.e. asset risk) or completion of the divestiture may be prolonged, the Group may also require that the up-front buyer completes the acquisition before the merger may proceed or, in the case of a completed merger, before the merger parties may progress with integration."

The Sections have previously observed that an up-front buyer requirement potentially imposes significant costs and unfairness on the merging parties, at least where a stand-alone business unit is being divested. *See* EC Joint Comments p. 2. The Sections have also acknowledged that the requirement may need to be used sparingly to address certain circumstances where there are serious questions about the divestiture. *Id*. The Sections read the Guidelines as broadly consistent with the Sections' recommended approach to up-front buyers as captured by the four-step analytical framework described above. *See also* Busey Letter pp. 33-36; 41-42; EC Joint Comments pp. 2-3.

Part 5. Effective divestiture process

Use of monitoring trustees

Paragraph 5.4 provides that where "hold-separate undertakings are in place, the CC will usually require the appointment of an independent monitoring trustee to oversee the performance of the hold separate manager and the parties' compliance with the undertakings."

The Sections do not believe it is "usually" necessary to appoint a monitoring trustee in the initial divestiture period to oversee either the hold separate or the parties' compliance with the undertakings generally. This can add significantly to the cost and complexity of the process. The same end can and should be achieved by hold-separate obligations and a regular reporting requirement. Absent a specific reason to be concerned about assets being run down in the initial divestiture period, there should not be a presumptive requirement of a monitoring trustee. *See* EC Joint Comments pp. 3-4.

<u>Timescale for divestiture</u>

The draft Divestiture Guidelines provide that the "CC will disclose in its report the period in which the parties should complete disposal of a divestiture package to a suitable purchaser (i.e. the 'initial divestiture period'). However, this period may be excised from the report if it is considered that disclosure to third parties may undermine the divestiture process. The length of this period will depend on the circumstances of the inquiry. The CC, when determining the initial divestiture period, will seek to balance factors which favour a shorter duration, such as minimizing asset risk and giving rapid effect to the remedy, with factors that favour a longer duration such as canvassing a sufficient selection of suitable purchasers and facilitating adequate due diligence." (Paragraph 5.5)

The U.S. experience has been that disclosure of the divestiture period does not itself permit third parties to undermine the process. In most cases, third parties do not wait to express an interest in purchasing the assets until the end of the divestiture process. In addition, achieving fair value for the assets to be divested is typically related to the number of potential buyers and has not been affected by disclosure of the time period for divestiture.

It would be helpful if the CC could give some indication of suitable divestiture periods (e.g., 6 months) and how it might address requests for extensions.

Paragraph 5.8 states that "continuing financial links between the purchaser and the parties may undermine competitive incentives." The Sections submit that any bright-line rule against such financing arrangements is too rigid. Not all financing arrangements are structured such as to change the incentives of the parties in competing against one another post-divestiture. As with supply, technical support, and licensing arrangements, the Sections suggest that the CC focus on the substance to determine whether the arrangement alters the companies' financial incentives in a way that will likely reduce the vigor with which they compete. Absent such potential adverse effects (which can be determined by looking at the financing terms), buyer financing should not be objectionable so long as the divestiture buyer and the package are otherwise acceptable.

Conclusion

The Sections appreciate the opportunity to submit these comments and hope that they are helpful to the CC as it finalizes its Guidelines.

September 10, 2004