JOINT COMMENTS OF THE AMERICAN BAR ASSOCIATION'S SECTION OF ANTITRUST LAW AND SECTION OF INTERNATIONAL LAW ON THE NEW ZEALAND COMMERCE COMMISSION'S DECEMBER 2009 DRAFT MERGERS AND ACQUISITIONS DIVESTMENT REMEDIES GUIDELINES

February 11, 2010

The views stated in this submission are presented jointly on behalf of these Sections only. They have not been approved by the House of Delegates or the Board of Governors of the American Bar Association and therefore may not be construed as representing the policy of the American Bar Association.

The Section of Antitrust Law and the Section of International Law of the American Bar Association ("the Sections") appreciate the opportunity to provide comments to the New Zealand Competition Commission (the "Commission") regarding its *Draft Mergers and Acquisitions Divestment Remedies Guidelines* ("Draft Guidelines"), issued in December 2009.

The Sections' comments reflect our experience before U.S. and non-U.S. antitrust authorities on a wide range of merger-related matters – including merger remedies guidelines issued by the Antitrust Division of the U.S. Department of Justice, by the Federal Trade Commission, and by the United Kingdom Competition Commission. The Sections have developed familiarity with the practical implications of divestiture remedies in mergers and acquisitions, and, accordingly, submit these comments based on our experience and learning to date.

Introduction

The Sections commend the Commission for enhancing transparency by developing the Draft Guidelines to describe the process and analytical framework used to assess divestment undertakings for mergers and acquisitions, and for inviting comment from interested parties. The Draft Guidelines incorporate international best practices and offer useful guidance for parties involved in transactions in New Zealand that may require such undertakings. The Commission's approach to merger remedies reflects substantial consistency with the approaches of U.S. and U.K. antitrust/competition authorities, which provides an additional level of certainty and efficiency to the merger clearance process.

The Commission's willingness to engage in discussions with merger parties about the form of a proposed divestment undertaking is a particularly welcome policy principle. The crafting of effective merger remedies is highly fact-specific, which the Draft Guidelines recognize. The collaborative approach described in the Draft Guidelines will assist the parties in structuring and setting the terms of a proposed divestment in a

manner that resolves the Commission's competitive concerns while preserving the merger's potential for creating efficiencies. Such a consultative procedure will likely expedite the process in individual cases and promote timely achievement both of the Commission's policy goals and the parties' commercial objectives.

The Preface to the Draft Guidelines sets a foundation for remedies policy that the Sections endorse. Paragraph 1.01 affirms that mergers "perform an important role in the market and can bring benefits to the economy, such as enabling businesses to achieve economies of scale and scope." Paragraph 1.02 explains that the "purpose of divestment undertakings is to remedy the competition concerns raised by the proposed acquisition while also allowing the merger to proceed with its potential benefits and efficiencies." Consistent with these principles, a pragmatic approach that tailors any divestment undertaking specifically to the competitive harm that must be remedied will best enable the merger to achieve its efficiency potential.

The Sections welcome the recognition expressed in paragraph 3.12 that the growing number of global mergers enhances the need for communication, coordination, and cooperation among competition authorities in different jurisdictions. Harmonization of merger reviews among all jurisdictions is important for creating consistency and efficiency in remedial obligations. In a particular case, for example, it may be that remedies imposed in a foreign jurisdiction are sufficient to resolve any competitive concerns in New Zealand, or that the reverse is true. Divestment undertakings may also have unforeseen or unpredictable cross-border competitive consequences. The Sections commend the Commission, therefore, for stating that it "may need to consult overseas competition authorities in order to ensure that divestments in New Zealand do not impact on markets overseas, or vice versa."

Below, the Sections briefly address certain provisions in Part 4 of the Draft Guidelines pertaining to how the Commission analyzes divestment undertakings, and the Commission's statutory restriction from accepting behavioral undertakings (of which the Draft Guidelines make note in paragraph 2.05).

How the Commission Analyzes Divestment Undertakings

The Draft Guidelines state in paragraph 4.02 that the Commission will apply "sound economic and legal analysis to the facts of each case to ensure that the divestment undertakings remedy the specific competitive harm." The Sections recommend that the Commission clarify here that divestment undertakings will be appropriately tailored, so that the remedy is not disproportionate to the potential lessening of competition arising from the transaction. An overly broad divestment relative to the harm to be remedied would likely impose excess costs and reduce efficiencies without creating an offsetting competitive benefit. Such a clarification would be consistent with paragraph 1.02, which, as noted, provides that the purpose of a divestment undertaking is to remedy competitive concerns "while also allowing the merger to proceed with its potential benefits and efficiencies."

Paragraph 4.09 states that composition risks, i.e., risks that a divestment undertaking is inadequately configured to attract a suitable purchaser, "will vary from case to case." It further states, in the second subparagraph, that composition risks may be mitigated by the divestment of "all assets that are necessary for the purchaser to be a viable competitive entity." The Commission, this paragraph continues, "prefers the divestment of an existing business entity or unit that has already demonstrated its ability to compete in the relevant market/s" and thus "will carefully examine divestment undertakings offered by an applicant if the applicant proposes to sell assets or shares that comprise something less than an existing business entity."

The Sections interpret the foregoing to mean that the Commission prefers the sale of an existing business entity but is mindful that such an undertaking is not necessary or appropriate in all cases – and more generally that the Commission will not rigidly impose remedial obligations that the competitive circumstances do not require. For example, a package of assets carved from an existing business entity and sold to a specific identified purchaser that does not desire or need additional assets to restore competition in the relevant market may well be an effective remedy.[1]

The divestment of less than a full business entity or unit may be appropriate where the merging party uses the relevant assets to manufacture multiple products, some of which are outside the relevant product market of competitive concern. (Pharmaceutical manufacturing is a typical example.) In some situations, moreover, the buyer need not own the assets because it can efficiently purchase from third parties the services those assets provide (e.g., contract manufacturing).

Read this way, paragraph 4.09 describes a flexible and pragmatic approach that the Sections endorse regarding the issue of whether an effective remedy involves the divestment of assets rather than of a stand-alone business. Such an approach is consistent with recent practice by the U.S. enforcement authorities and essential to ensure that remedies are not overly costly or disproportionate in scope relative to the specific competitive harm at issue. It may be particularly important when the remedy pertains to a transaction that is international in scope and addresses concerns in multiple jurisdictions.

In the third and fourth subparagraphs to paragraph 4.09, the Draft Guidelines identify two examples of undertakings that may mitigate composition risks: where "the most desirable products are not being withheld from the divestment undertaking" and where "the divestment undertaking does not include a declining product (i.e., an unfashionable or out-of-date product with declining market share)." Here, too, the Sections believe that a flexible and pragmatic approach should apply. As the Draft Guidelines note in paragraph 4.03, a divested business or set of assets must "remedy the loss of competition brought about by the initial proposed acquisition." In many instances,

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[1] *See* Staff of the Bureau of Competition of the Federal Trade Commission, "*Study of the Commission's Divestiture Process*" (1999) at 12, *available at* http://www.ftc.gov/reports/index.shtm#1999 ("divestitures of selected assets can succeed").

that loss can be overcome, and competition restored to the status quo ante, regardless of whether the divestment comprises the acquiring party's or the acquired party's overlapping business or assets.

The U.S. enforcement authorities frequently allow the merging parties to choose either side's assets for divestiture.[2] Acquiring parties are generally permitted to "trade up" by swapping their lower quality assets for the acquired party's business, when doing so has a neutral effect on competition.[3] The Sections respectfully suggest that the Draft Guidelines acknowledge that merging parties may retain "the most desirable products" or divest a "declining product" so long as the package of assets that is divested to the purchaser restores the competition that is lost as a result of the merger.

Paragraph 4.18 discusses certain attributes that a purchaser, to be acceptable to the Commission, may need to be an effective competitor in the relevant market. The Sections agree that the Draft Guidelines identify important attributes that may make a buyer acceptable in fashioning a remedy. Insofar as it points to buyers' possession of necessary "expertise" and "experience" to be an effective long term competitor in the market, however, this paragraph could be viewed as potentially too restrictive – such as regarding buyers that are principally financial entities.

A financial entity that lacks pre-existing market expertise and experience may nonetheless be an effective long term competitor in the market, if, for example, the divested business or assets will continue to be operated substantially by employees of the seller who accept employment with the buyer. The U.S. enforcement authorities have accepted financial entities as buyers when the entities have demonstrated they have the resources and incentives to ensure the success of the divested assets comparable to any other potential buyer. To the extent that Paragraph 4.18 is interpreted to mean that expertise and experience are attributes that may factor into the Commission's approval of a particular buyer, but are not conditions for acceptance of every buyer, the Sections agree with the Commission's guideline.

The Draft Guidelines also address "asset risks," which are defined as risks that the competitive capability of a divestment package will deteriorate prior to completion of the divestment. Paragraph 4.14 states that applicants "should provide sufficient evidence" to allay the asset risks, and that this evidence "might include an undertaking that the

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[2] *See, e.g.*, United States v. SBC Communications, 339 F. Supp. 2d 116 (D.D.C. 2004) (requiring divestiture of either party's overlapping business in the local wireless markets of concern); United States v. Manitowoc Co., 2003-1 Trade Cas. (CCH) ¶ 73,995 (D.D.C. 2002) (requiring divestiture of either side's boom truck business).

[3] *See, e.g.*, United States v. Monsanto Co. and Delta and Pine Land Co., Case 1:07-cv-00992 (D.D.C. filed May 31, 2007) (permitting Monsanto to acquire Delta and Pine Land but requiring Monsanto to divest its overlapping Stoneville cotton seed business).

applicant will appoint an independent manager to ensure that the assets to be divested are not eroded." The Sections read this paragraph to state that an independent manager may be necessary in some situations, but not in all cases. To this extent, the Sections endorse paragraph 4.14.

Special circumstances may require an independent manager – for example, in situations where there is a credible risk that the assets would be wasted. Otherwise, it should not be necessary to appoint an independent manager. In the Sections' experience, independent managers can add substantially to the compliance burden and remedy costs, often without making any significant difference to the outcome of the remedy. Conversely, the Sections agree that, if there is a credible risk of waste, that risk should be borne by the merging parties, not consumers.

Behavioral Undertakings

The Commission notes in paragraph 2.05 that it is restricted by statute from accepting behavioral undertakings, i.e., remedies other than a structural divestment of assets or shares. Consequently, extensive discussion of whether potential competitive benefits may in certain circumstances derive from non-structural remedies is beyond the scope of these comments. Respectfully, however, the Sections take this opportunity to suggest that a legislative change to permit the Commission to accept a broader range of undertakings would merit consideration. The Sections express this view with the expectation that, even if it had the authority to consider non-structural remedies, the Commission would typically prefer structural undertakings. This position would be consistent with that of the U.S. Department of Justice and the Federal Trade Commission.

Behavioral undertakings that modify or constrain the conduct of merged firms can be useful in addressing competitive concerns, and are sometimes used in conjunction with structural remedies. Vertical issues often present one such situation. For example, a merged firm that is vertically integrated may be required to erect an information firewall, if it is an input supplier to a competitor. There may also be situations in which a structural remedy would sacrifice efficiencies to such an extent that a behavioral solution would, on balance, provide a preferred result for competition.

If behavioral undertakings were available to the Commission, it would provide flexibility in developing tailored resolutions to address specific competitive concerns. Should the statutory prohibition on behavioral undertakings in the future become the subject of a proposed modification, the Sections would welcome the opportunity to provide more detailed comments on this issue.

Conclusion

The Sections commend the Commission for publishing the Draft Guidelines and soliciting comments from interested parties. The Draft Guidelines set forth a most welcome incorporation of international best practices within a framework designed to achieve remedies efficiently and consistent with competitive principles. The Sections

respectfully submit their comments in the spirit of further enhancing the efficacy of the Commission's remedies program, and hope that the Commission finds them helpful. The Sections look forward to reviewing the final version of the Guidelines.