

**Application of Divestiture Remedies in Merger Inquiries:
Competition Commission Guidelines**

Consultation document

Overview of consultation

Introduction

This consultation document seeks views on the guidance the Competition Commission (CC) proposes to issue in outlining its proposed approach to applying divestiture remedies, where appropriate, in merger inquiries referred to it by the Office of Fair Trading (OFT). The guidance will form part of the advice and information published by the CC under the Enterprise Act 2002.

The guidance has been drawn up following discussions with members of the CC and the OFT, although this does not mean that they will have no further comments on the draft guidance.

The proposed guidance is self explanatory and there are no particular sections of the document that the CC wishes to draw to consultees' attention. We would, however, welcome comments on the guidance either of a general nature or on any specific points.

This consultation document is exhibited on www.competition-commission.gsi.gov.uk

Responses

You can respond to this consultation:

by email to: david.roberts@competition-commission.gsi.gov.uk

by post to: David Roberts
Director of Remedies
Competition Commission
Victoria House
Southampton Row
London
WC1B 4AD

If you have any questions relating to this consultation either email as above or telephone 020 7271 0215.

Closing date

Responses should be received by 17 September 2004.

A summary of the consultation and outcome will be provided during October 2004 on www.competition-commission.org.uk.

Confidentiality

Your response to this consultation may be made publicly available in whole or in part at the CC's discretion. If you do not wish all or part of your response or your name to be made public, you must indicate in your response what you wish us to keep confidential. Any email response sent from a corporate system may carry an automatically generated notice stating that the content of the message should be treated as confidential. Where you do not wish your views to be treated as confidential, please make it clear that such an automatically generated message does not apply.

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Contents

	<i>Page</i>
Part 1. Introduction.....	4
Purpose of guidance	4
The context of remedial action	4
Part 2. Effective divestiture remedies	6
Objectives.....	6
Constraints on effective outcomes	6
Part 3. Scope of divestiture packages	8
Package definition	8
Presumption for divestiture of an existing business	8
Presumption against ‘mix and match’ divestitures	8
Use of ‘crown jewels’ divestiture packages	8
Part 4. Suitable purchasers.....	9
Criteria.....	9
Up-front buyers.....	9
Part 5. Effective divestiture process.....	10
Objective of process.....	10
Protecting the divestiture package	10
Use of monitoring trustees	10
Timescale for divestiture	10
Use of divestiture trustees.....	10
Review of divestiture agreement.....	11
Part 6. Employment of trustees.....	12
Appointment and responsibilities.....	12
Remuneration.....	12
Part 7. Role of the inquiry group and remedies standing group.....	13
Annex.....	14

Part 1. Introduction

Purpose of guidance

- 1.1 This guidance forms part of the advice and information published by the Competition Commission (CC) under section 106 of the Enterprise Act 2002 (the Act). The purpose of this guidance is to explain the CC's proposed approach to applying divestiture remedies, where appropriate, in merger inquiries referred to it by the Office of Fair Trading (OFT) under sections 22 or 33 of the Act.
- 1.2 A separate document, *Merger References: Competition Commission Guidelines* (the Merger Guidelines) should be read in conjunction with this guidance. Information on procedural aspects of CC inquiries can be found in the CC's *Rules of Procedure* and *General Advice and Information*. Details of these and other publications of the CC and the OFT that are relevant to merger inquiries are provided in the Annex to this document.
- 1.3 This guidance reflects the views of the CC at the time of publication and may be revised from time to time to reflect changes in best practice and experience gained from inquiries. The CC's web site will always display the latest version of the guidance.
- 1.4 The CC will have regard to this guidance in considering remedial action, where relevant, in merger inquiries. However, each reference will be considered with regard to its particular circumstances, available information and time constraints. The CC will therefore apply this guidance flexibly and may depart from the approach described in the guidance where there are appropriate reasons for such departures. References in this guidance to the CC refer to either an inquiry group or the Remedies Standing Group appointed to carry out the CC's functions (see Part 7).

The context of remedial action

- 1.5 Where the CC concludes that a relevant merger situation has resulted, or may be expected to result, in a substantial lessening of competition (SLC), it will decide whether action should be taken by the CC, and whether to recommend action be taken by others, to remedy, mitigate or prevent the SLC or any adverse effect resulting from the SLC.¹ In either case, the CC will need to state in its report the action to be taken and what it is designed to address.
- 1.6 The Act requires that the CC, when considering these remedial actions, shall 'in particular, have regard to the need to achieve as comprehensive a solution as is reasonable and practicable to the substantial lessening of competition and any adverse effects resulting from it'.² The Act also permits the CC to have regard to the effects of any action on any relevant customer benefits that are expected to result from the merger in deciding the remedies questions.³ For more information about relevant customer benefits, please see the Merger Guidelines (paragraphs 4.34 to 4.45).
- 1.7 The CC will publish its decisions on the competition question and remedies together with supporting reasons and information in a final report.⁴ The report will contain sufficient detail on remedies to provide a firm basis for implementation by the CC

¹Sections 35 and 36.

²Sections 35(4) and 36(3).

³Sections 35(5) and 36(4).

⁴Section 38.

through the acceptance of undertakings or the imposition of orders. The action the CC takes in respect of remedies must be consistent with the decisions in the final report unless there has been a material change of circumstances since the preparation of the report or the CC has a special reason for acting differently.

- 1.8 When deciding whether a remedy is appropriate the CC will consider the effectiveness of different remedies and their associated costs and will have regard to the principle of proportionality. For more information about these factors, please see the Merger Guidelines (paragraphs 4.6 to 4.16).
- 1.9 Structural remedies, such as divestiture or prohibition, are likely to be preferable to behavioural remedies, which seek to regulate the behaviour of firms, as structural remedies address the effects of a merger more directly and will usually require less monitoring or enforcement of compliance.⁵ However, behavioural remedies may be considered more suitable in some circumstances, for example, where the effectiveness of structural remedies is constrained (for example, through the absence of suitable buyers for a proposed divestiture). It may also be necessary to add behavioural remedies to a structural remedy in order to provide an effective and comprehensive solution. For example, a divestiture may need to be supported by a commitment from the merged firm to supply inputs for a limited period at agreed prices.

⁵Merger Guidelines 4.15.

Part 2. Effective divestiture remedies

Objectives

- 2.1 In essence, a divestiture seeks to remedy an SLC by either creating a new source of competition through disposal of a business or set of assets to a new market participant or strengthening an existing source of competition through disposal to an existing market participant independent of the merging parties.
- 2.2 To be effective, a divestiture should involve the sale of an appropriate divestiture package to a suitable purchaser through an effective divestiture process. These critical elements are discussed in detail in subsequent sections.

Constraints on effective outcomes

- 2.3 All remedies are, to some extent, uncertain as to their eventual impact. Divestitures are no exception to this general rule and may be subject to a variety of risks that may limit their effectiveness in addressing an SLC. In particular, risks may be increased where the parties to a merger have the incentive and means to impair the success of a divestiture and the future competitive impact that it could create. These divestiture risks can be overcome, at least in part, by adopting protective measures such as appointment of monitoring and divestiture trustees and requiring 'up-front buyers'. Further details of these measures are discussed in subsequent sections.
- 2.4 It is helpful to distinguish between three broad categories of risks that may possibly impair the effectiveness of divestiture remedies as follows:
 - 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.
- 2.5 The nature and magnitude of perceived risks will guide the type and extent of protective measures to be adopted by the CC in formulating and implementing an effective divestiture remedy. The CC may, of course, conclude that the perceived risks are such that even with the adoption of protective measures, a divestiture would not be effective so that prohibition of the merger or other remedies may be appropriate.
- 2.6 As noted in paragraph 1.7, the CC will outline the nature and scope of a divestiture remedy with supporting reasoning in its final report. The final report may also outline any protective measures thought necessary by the Group to ensure effective divestiture. However, absence of mention in the final report would not prevent subsequent implementation of such measures should they prove necessary.
- 2.7 The CC's approach to divestiture remedies will, in principle, be similar for anticipated mergers and completed mergers. However, divestiture remedies in completed merger cases may face circumstances which increase risks compared with equiv-

alent anticipated mergers. For example, there may be greater difficulty in separating a divestiture package or the merger may have triggered migration of customers. Thus, depending on the circumstances, divestiture remedies may require greater use of protective measures in completed merger cases.

Part 3. Scope of divestiture packages

Package definition

- 3.1 The starting point for defining the scope of a divestiture package is identifying that minimum package of assets or substantive business which if successfully divested would prima facie remedy the SLC. To this package other assets or business segments may need to be added to ensure an ongoing ability to compete.
- 3.2 The scope of a divestiture package will be determined by the CC and outlined, with reasons, in its report. The scope of the package will be specified in greater detail in the undertakings accepted or orders made by the CC when implementing the remedy. The parties to the merger may also add further assets to the specified package at their request with the approval of the CC, or may be required to do so by the CC, to secure investment to a suitable purchaser. 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.

Presumption for divestiture of an existing business

- 3.3 The CC will generally prefer divestiture of an existing business, which can operate on a stand-alone basis independently of the merger parties, to divestiture of part of a business or a collection of assets because divestiture of such a business is less likely to be subject to purchaser and composition risk.
- 3.4 Where a proposed divestiture comprises part of a business or certain specified assets, such as intellectual property rights, the capabilities and resources of prospective buyers are likely to be more critical to a successful outcome than for a stand-alone business. A package of assets proposed for divestiture may, for example, lack an established infrastructure and its viability may therefore be more dependent on an appropriate match with the facilities of the purchaser. In such circumstances the CC may require additional protective measures such as identification of an up-front buyer (see paragraph 4.4) to mitigate increased purchaser and composition risk.

Presumption against 'mix and match' divestitures

- 3.5 In general, if divestiture of a set of assets or parts of a business is proposed rather than a complete business, it will normally be preferable for all the assets to be provided by one of the merging parties. Divestiture of a mixture of assets from both merging parties (a so-called 'mix and match' approach) may create additional composition risks such that the divestiture package will not function effectively.

Use of 'crown jewels' divestiture packages

- 3.6 In order to incentivise parties to complete an agreed divestiture, a broader, more valuable group of assets may be defined (ie '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.

Part 4. Suitable purchasers

Criteria

- 4.1 The identity and capability of a purchaser will normally be of major importance in ensuring the success of a divestiture remedy. When assessing the suitability of prospective purchasers, the criteria used by the CC will include:
- Independence—the purchaser should have no significant connection to the merger parties.
 - Capability—the purchaser must have the necessary financial resources, incentives, and access to appropriate expertise and assets to enable the divested business to become or develop as an effective competitor in the market.
- 4.2 When considering the suitability of a particular purchaser, the CC will take into account potential SLC and other regulatory concerns that might arise as a result of divestment to the purchaser. The CC will also wish to satisfy itself that the purchaser has an appropriate business plan for competing in the relevant markets.
- 4.3 The merger parties will need to obtain the CC's approval of the prospective purchaser. The CC's approval of a purchaser may be subject to clearance by a relevant competition or regulatory authority. The CC will also wish to review the divestiture agreement (see paragraph 5.7). Except in circumstances, as specified below, where a divestiture trustee is in place, the merging parties are responsible for securing a prospective buyer that satisfies the CC's criteria for a suitable purchaser.

Up-front buyers

- 4.4 Where the CC is in doubt as to the viability or attractiveness to purchasers of a proposed divestiture package (ie composition risk) or believes there may only be a limited pool of suitable purchasers (ie 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 (ie 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.

Part 5. Effective divestiture process

Objective of process

- 5.1 An effective divestiture process will protect the competitive potential of the divestiture package prior to disposal and will enable a suitable purchaser to be secured in an acceptable timescale.

Protecting the divestiture package

- 5.2 The parties to a merger may have significant incentives to run down or neglect the business or assets of a divestment package in order to reduce future competitive impact. The resulting asset risk may also be influenced by such factors as the length and complexity of the divestiture process and the pace at which customer goodwill and employee relations may erode.
- 5.3 In order to protect against asset risk, the CC will generally seek undertakings from the relevant parties which impose a general duty of care to maintain the divestiture package in good order and not to undermine the competitive position of the package. Where asset risk is perceived to be significant, the CC may also require 'hold separate' undertakings. These will require the divestiture package to be held and managed separately from the retained business. The appointment of a 'hold-separate' manager or management team may also be required to manage the assets/business to be divested so as to maintain their competitiveness and separation from the retained assets.

Use of monitoring trustees

- 5.4 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 trustee will have an overall duty to act in the best interests of the divestiture package. The trustee will oversee the ongoing management of the divestiture package and will have the right to propose and direct measures necessary to ensure compliance with the hold-separate undertakings. The trustee will report to the CC at regular intervals.

Timescale for divestiture

- 5.5 The CC will disclose in its report the period in which the parties should complete disposal of a divestiture package to a suitable purchaser (ie 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.

Use of divestiture trustees

- 5.6 If the merging parties cannot procure divestiture to a suitable purchaser within the initial divestiture period then, unless this period is extended by the CC, an independent divestiture trustee may be mandated to dispose of the package within a specified period (the extended divestiture period) at the best available price in the circumstances, subject to prior approval of the agreement and purchaser by the CC.

The role of a divestiture trustee is distinct from that of a monitoring trustee, but the two roles may be performed by the same person.

Review of divestiture agreement

- 5.7 The CC will wish to ensure before providing its approval at the end of the divestiture process, that the divestiture agreement conveys all assets required to be divested and contains no provisions that are inconsistent with the remedial objectives of the divestiture. For example, continuing financial links between the purchaser and the parties may undermine competitive incentives.

Part 6. Employment of trustees

Appointment and responsibilities

- 6.1 Monitoring or divestiture trustees should be independent of the parties, have appropriate qualifications for the task and should not be subject to conflicts of interest. Trustee candidates may be proposed by the merger parties but can only be appointed by the parties following approval by the CC. The trustee's responsibilities will be specified in the trustee mandate which will be approved by the CC. The trustee will perform the directions of the CC in accordance with the mandate and will not be permitted to accept instructions from the parties. A trustee may be part of an accounting firm, management consultancy or other professional organisation. The CC may set a timetable for the appointment of a trustee and would normally expect a trustee to be nominated and approved before undertakings are accepted. Only the CC can terminate the appointment of a trustee before completion of its responsibilities. However, the parties can make representations to the CC to replace the trustee if they have good cause.

Remuneration

- 6.2 The merger parties are responsible for the remuneration of trustees. The structure of remuneration must not compromise a trustee's independence and the CC must approve the remuneration agreement.

Part 7. Role of the inquiry group and remedies standing group

- 7.1 During a reference, the CC's functions are carried out by an inquiry group of members appointed by the Chairman. Following publication of the final report the group will oversee the negotiation of undertakings with the parties or, in certain cases, the imposition of orders to secure the implementation of the divestiture. Undertakings and orders will be published on the CC's web site and will also be exhibited on a register maintained by the OFT.
- 7.2 The role of the inquiry group will normally expire on its acceptance of final undertakings from the parties. The CC's Remedies Standing Group will then be responsible for monitoring implementation of the divestiture undertakings until the divestiture is complete and will deal with such matters as receiving reports from monitoring trustees, approving the appointment of divestiture trustees and approving the purchaser of the divestiture package and reviewing the divestiture agreement. Further information about the role of the Remedies Standing Group can be found on the CC's web site. Compliance with ongoing aspects of divestiture or behavioural remedies will be monitored by the OFT.

Information relevant to the Enterprise Act

Competition Commission publications

www.competition-commission.org.uk

- CC1 *Competition Commission: Rules of Procedure*
- CC2 *Merger References: Competition Commission Guidelines*
- CC3 *Market Investigation References: Competition Commission Guidelines*
- CC4 *General Advice and Information*
- CC5 *Statement of Policy Penalties*
- CC6 *Chairman's Guidance to Groups*
- CC7 *Chairman's Guidance on Disclosure of Information in Merger and Market Inquiries*
- CC8 *Application of Divestiture Remedies in Merger Inquiries: Competition Commission*

Competition Commission Annual review and accounts

OFT publications

www.oft.gov.uk

- OFT 508 Overview of the Enterprise Act*
- OFT 506 Mergers: Substantive Assessment*
- OFT 526 Mergers; procedural guidance*
- OFT 501 Market Investigation References*

Competition Appeal Tribunal publications

Competition Appeal Tribunal Rules www.catribunal.org.uk

Department of Trade and Industry information

See DTI web site www.dti.gov.uk/ccp