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Merger remedies in the UK

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UK Competition Regime: Overview

- Two domestic competition bodies:
 - Office of Fair Trading (OFT) – Phase I
 - Phase I mergers, market studies, Competition Act cases (anti-competitive agreements, abuse of dominance), Cartels
 - Interface with European Commission (EC Merger Regulation)
 - Competition Commission (CC) – Phase II
 - Phase II mergers, in-depth market investigations, regulatory appeals, reviews of remedies
- The future: UK Government has announced plans to create one competition body – Competition and Markets Authority (CMA)
 - Merger of OFT and CC during 2014
 - Aims to retain strengths of both authorities

UK Competition Regime: Mergers

- One significant unusual characteristic of UK regime: Voluntary notification of mergers; no mandatory notification
 - Parties can complete mergers and begin to integrate if they wish but they do so at their own risk and may need to unwind
 - OFT 'calls in' potentially problematic completed mergers
 - Turnover test (£70m acquired firm) and share of supply test (combined 25% share)
 - c.40% mergers referred to Phase II are completed (60% anticipated)
 - On completed mergers, UK authorities often need to consider interim remedial measures to ensure parties do not take action that would otherwise prevent the competition bodies from implementing an effective remedy
 - 'Hold separate' undertakings
 - Use of Monitoring Trustees and/or Hold Separate Managers
 - Unravelling pre-reference integration (plant closures, combined senior management team, redundancy programmes underway, information exchange, integration of operational systems)

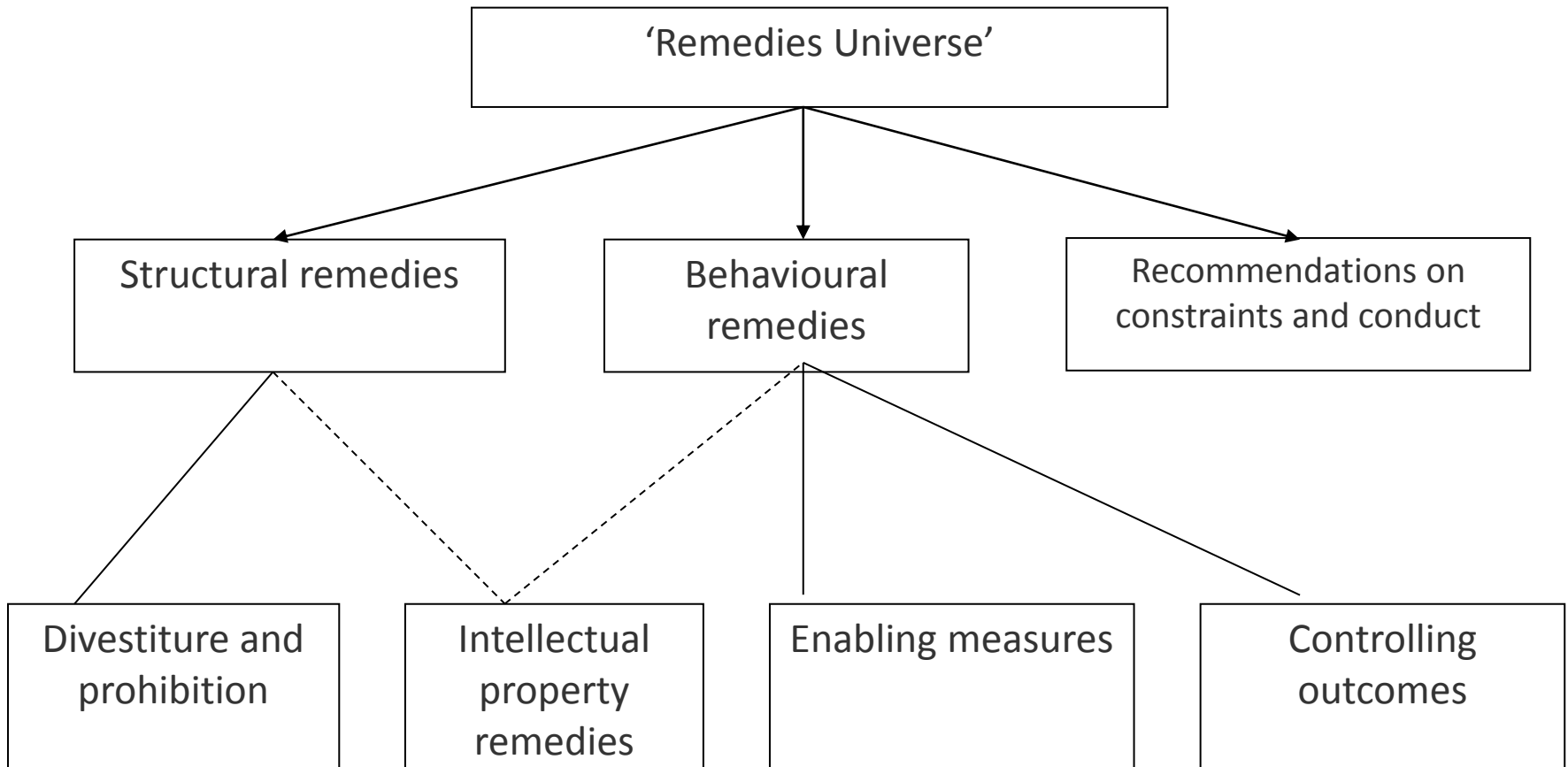
Merger remedies in UK: Principles of approach

- Substantive test = Substantial Lessening of Competition (SLC)
- At phase I, if the OFT believes there is or it may be the case that there is an SLC (realistic prospect), it has a duty to refer to the CC
- But it may consider whether to accept remedies offered by parties by accepting **undertakings in lieu of a reference (UILs)**
 - Suspends duty to refer
 - OFT must be confident that the competition concerns identified will be resolved without the need for further investigation
 - Remedies must be **clear cut** and capable of ready implementation
- At phase II, if the CC finds an SLC (balance of probabilities), it has a duty to consider what, if any, remedial action to take
 - Can be achieved through **undertakings** from parties or making an **enforcement order**

Merger remedies in UK: Principles of approach

- Enterprise Act requirement - *“to achieve as comprehensive a solution as is reasonable and practicable”*
- Consider **effectiveness** of possible remedy options
 - Must address the SLC and be timely, practicable and enforceable
- Then consider **proportionality of effective options**
 - Seek least costly option that is effective and not disproportionate to scale of problem
- Each case assessed on merits against background of **published guidance**
- Objective of **fair and transparent process**
- Competition Appeal Tribunal upheld the CC approach to merger remedies in Somerfield, Stericycle (2 separate appeals) and BSkyB/ITV
- Timing for phase II remedies:
 - On average, remedies assessment takes 10 weeks out of statutory 24 weeks
 - Undertakings negotiation (c. 8 weeks)

Choice of remedies in merger inquiries (1)



Choice of remedies in merger inquiries (2)

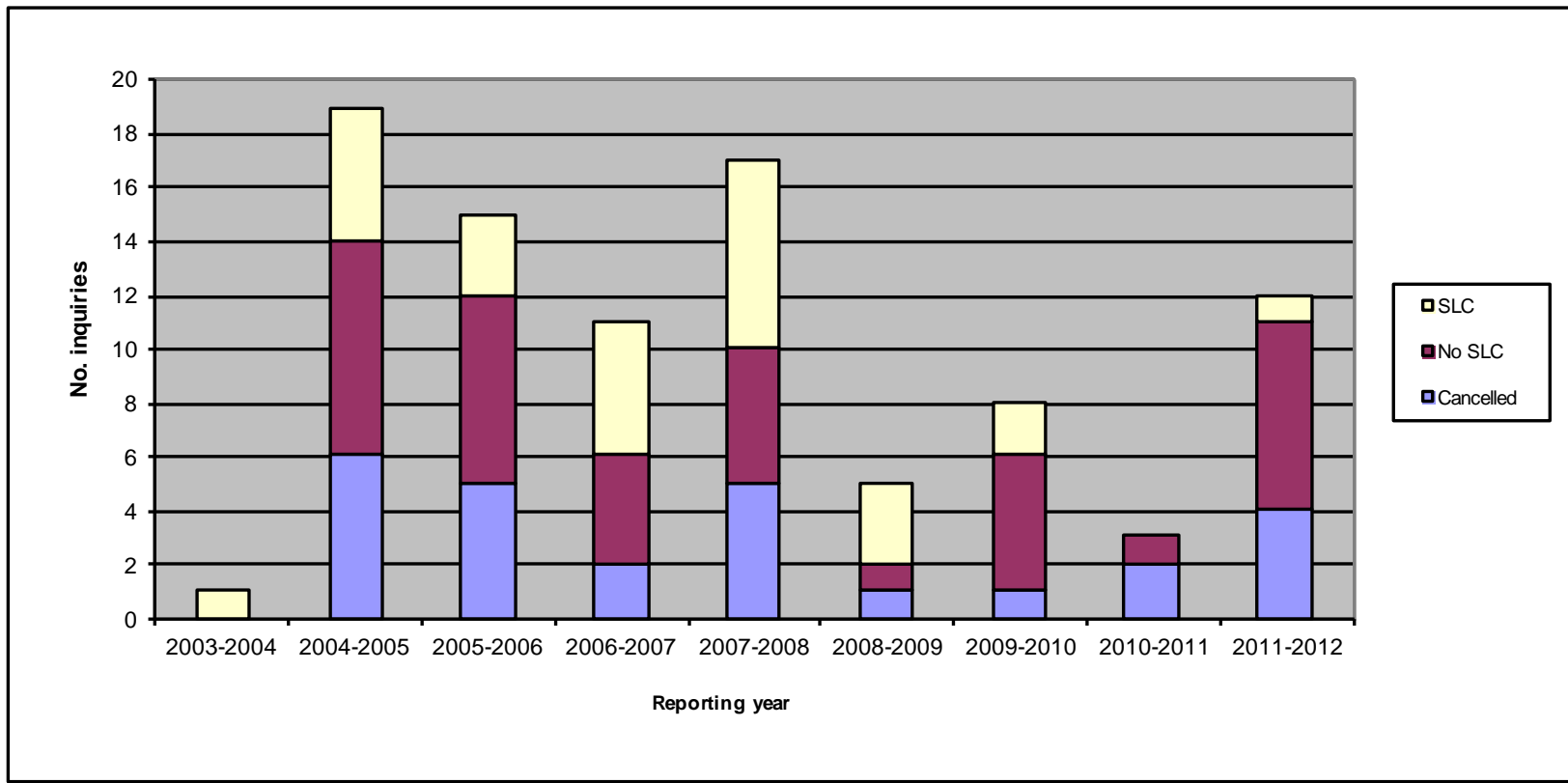
- General preference for structural remedies (i.e. divestiture and prohibition)
 - Clear cut solution
 - Directly restore competition
 - Do not require ongoing monitoring and enforcement
 - Proportionality – UK authorities will **not** normally take into account costs or losses of divestiture for completed mergers
- Behavioural measures may be used:
 - If structural remedies are unavailable (eg Draeger/Airshields (2003))
 - If competitive harm is expected to be short-lived (eg First Group/Scotrail (2004))
 - If merger generates large customer benefits that would be lost through divestiture or prohibition (eg Macquarie/National Grid Wireless (2008))

Merger remedy outcomes in UK: Phase I

- Need for a clear-cut solution at phase I means behavioural measures are particularly unlikely
- 95 per cent of cases in which UILs have been accepted at phase I are structural UILs
- Only 2 cases where behavioural UILs have been accepted (since 2003/2004)

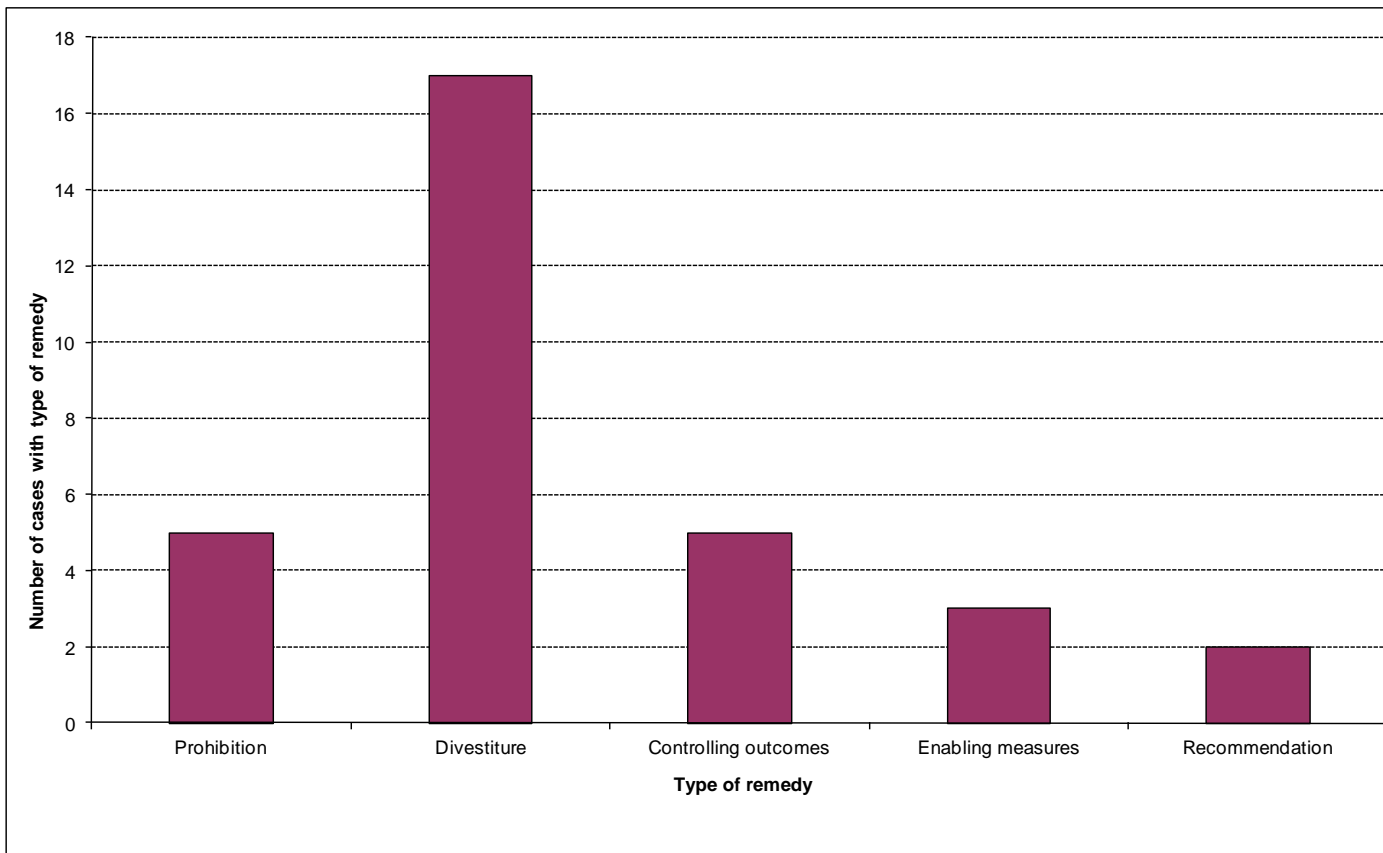
Merger remedy outcomes in UK: Phase II

- c.25% cases cancelled on reference to Phase II
- Remedies needed in c.40% cases that are not cancelled



Merger remedy outcomes in UK: Phase II

- > 80% of remedies involve divestiture or prohibition



- Note: Figure includes cases that cover more than one type of remedy (e.g. partial divestiture and enabling measures)

Focus on structural remedies

- Aim: Restore the loss of competition through disposal of a business or assets leading either to creation of a new source of competition or to strengthening of an existing source of competition
- Critical success factors:
 - Appropriate divestiture package for the SLC (**Composition** risks)
 - Scope: “smallest viable, stand-alone business”
 - Alternative divestiture package?
 - Suitable purchaser (**Purchaser** risks)
 - Effective divestiture process (**Asset** risks)
 - Will the competitive capacity of the divestiture package deteriorate before it is sold?
 - These risks can normally be overcome by careful remedy design and protective measures (eg up-front buyer, use of Monitoring Trustee)

Effective divestiture process

Divestiture undertakings agreed

- Consider best use of Monitoring Trustee during divestiture period

Divesting party seeks bids

If no bids received or slow progress in divestiture

Appoint Divestiture Trustee to seek bids or offer extension

- Mandate = dispose of the divestiture package within a specified period at no minimum price

Bids received

Purchaser assessment

- Independence; Capability; Commitment to the market; Absence of competition concerns

Final negotiations and agree draft SPA

Review draft SPA

- Check for: anti-compete clauses, ongoing links, transitional arrangements

COMPLETION

Timescales

- Usually maximum duration of 6 months (but may be shorter or longer)
- Shorter timescales used to minimize asset risk
- Longer timescales used to ensure sufficient selection of prospective purchasers and allowing adequate due diligence

Case study: Stonegate/Deans (2007) (1)

- June 2006: Completed merger of two egg suppliers: Stonegate and Deans
 - Two largest suppliers of shell and processed eggs in UK
 - Combined market share – 60-70 per cent of supply to grocery retailers
 - September 2006: Referred to CC by OFT
- Interim measures:
 - Significant integration upon completion: Stonegate CEO had departed, operational functions had been integrated
 - Interim measures put in place:
 - Unwinding integration (e.g. Separating IT, accounting, production)
 - Hold Separate Manager at Stonegate
- CC found an SLC in supply of shell eggs to retailers (no buyer power of grocery retailers)

Case study: Stonegate/Deans (2007) (2)

- Chosen remedy was divestiture of Stonegate business
 - Fallback behavioural remedy also identified in event divestiture was not possible
- October 2007: Final undertakings accepted
 - Initial divestiture period = 3 months, with possible extension to 6 months
 - Option of appointing a divestiture trustee after this period
- Marketing process for sale of Stonegate had begun in advance of acceptance of final undertakings

Case study: Stonegate/Deans (2007) (3)

- October 2007-April 2008: Protracted divestiture process
 - November 2007: CC approved several bidders as suitable purchasers
 - Some delay in approving the vendor's preferred bidder due to concerns about independence and financial capability; led to extension of divestiture period
 - February 2008: CC eventually approved vendor's preferred bidder
 - But global financial crisis led to further funding concerns and new doubts as to suitability of vendor's preferred bidder
 - April 2008: Sale had not yet been completed (6 months after start of process)
- April 2008: CC appointed Divestiture Trustee
 - Divestiture Trustee conducted in depth review of financial capability of vendor's preferred bidder
 - June 2008: CC re-approved vendor's preferred bidder
- July 2008: Divestiture completed
 - 9.5 months after final undertakings

Case study: Stonegate/Deans (2007) (4)

- CC conducted ex-post evaluation of the remedy in 2012
 - Part of a rolling programme of evaluating past merger remedies so CC can learn from its experience
 - Evaluation is published on the CC's website
- Although a protracted and difficult divestiture process, evidence that remedy has been successful
 - Stonegate has come through an uncertain period and continues to compete effectively
 - Number of learning points:
 - Purchaser selection assessment must be sufficiently detailed
 - Need a clearly defined disposal plan to monitor during divestiture process
 - Need clear milestones for appointment of Divestiture Trustee and appointment should not be protracted