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Merger remedies in the UK

Roundtable 1

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Outline of presentation

- UK Merger Regime Present and future
- Outline of UK Merger process
- CC approach to Remedy selection and design
- Case Study 1 – Stericycle and Ecowaste (2012)
- Case Study 2 – Imerys Minerals Limited and Goonvean Limited (2013)

UK Merger Regime (1)

Present:

- Substantial lessening of competition (SLC) test
- Phase 1 – Office of Fair Trading
 - Phase 1 – if believe will result in an SLC (reasonable prospect) OFT must refer to Phase 2
 - Although may accept remedies – Undertakings in lieu of a reference
- Phase 2 – Competition Commission
 - Phase 2 – expectation of an SLC
 - Remedies implemented – Either by Undertakings or by Order

UK Merger Regime (2)

- Voluntary regime – many mergers are discussed with the Office of Fair Trading in advance of completion. Some complete
- Timescales (present):
 - Phase 1 – 40 day administrative timetable (may be suspended)
 - Phase 2 – 24 weeks investigation (extension of up to 8 weeks) (from reference to publication of Final Report)

UK Merger Regime (3)

1 April 2014: Competition and Markets Authority

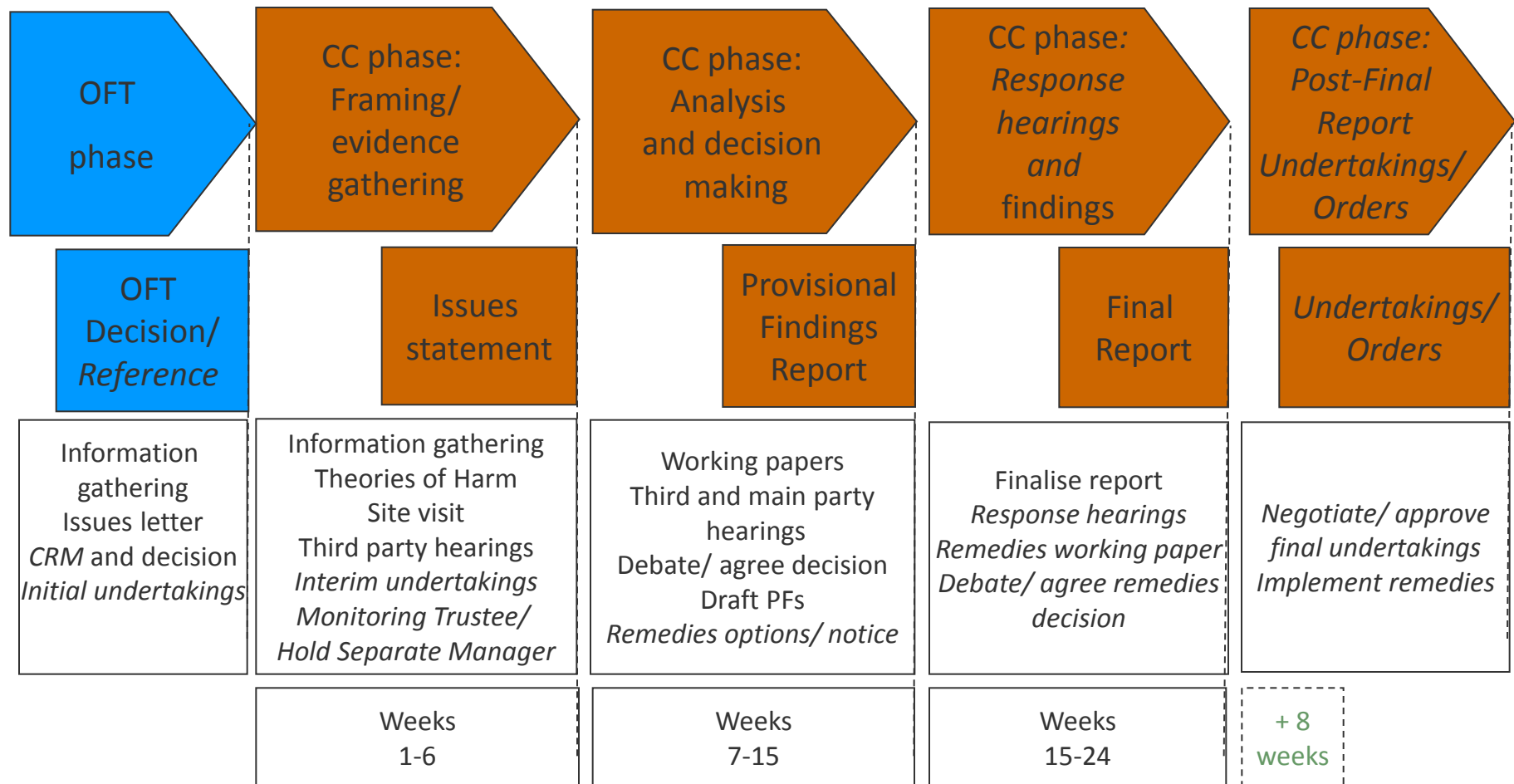
- Retention of 2 phases and separate decision making
- Some changes with effect 1 April 2014
 - Phase 1
 - 40 days statutory time period
 - New compulsory information powers (main and third parties)
 - Phase 2
 - 12 weeks (extension of up to 6 weeks) in which to implement remedies

UK Merger Regime (4)

Process at Phase 2

- Phase 2 decision making by Group of Commissioners appointed by CC chairman
- Decision makers meet parties (main and some third parties) – site visits, hearings
- Transparency:
 - Use of website for publication of key views of parties, surveys, interim measures, CC preliminary analysis (working papers), consultation documents
 - Duty to consult on proposed decision on SLC and remedies
- CC Published Guidance (includes CC8: Merger Remedies)
- Decisions challengeable to the Courts – Competition Appeal Tribunal

Merger Investigations follow a consistent, transparent process



Remedy Design – Legal Requirements

CC shall **‘decide whether action should be taken by it .../whether to recommend the taking of action by others... for the purpose of remedying, mitigating or presenting the SLC ... or any adverse effect which has resulted or may be expected to result from the SLC’.**

CC 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’.***

The CC may have regard **‘in particular to the effect of any action on any relevant customer benefits arising from the merger’.**

(Sections 35 and 36 Enterprise Act 2002)

Implications of legal requirements for remedy design

There are two key issues:

- Is the remedy effective? [slide 10]
- The costs of the remedy and the proportionality of the remedy [slide 11]

Additionally, the Enterprise Act 2002 enables the CC to consider whether the remedy be modified to take relevant customer benefits. Relevant customer benefits are defined – benefits resulting from the merger (quality price, innovation) and unlikely to arise without the merger

Effectiveness

- Impact of remedy – addressing the SLC or the resulting adverse effects?
- Distortive effect of remedy
- Compliance and Monitoring issues
- These factors apply differently to different types of remedies

Costs of Remedy and Proportionality

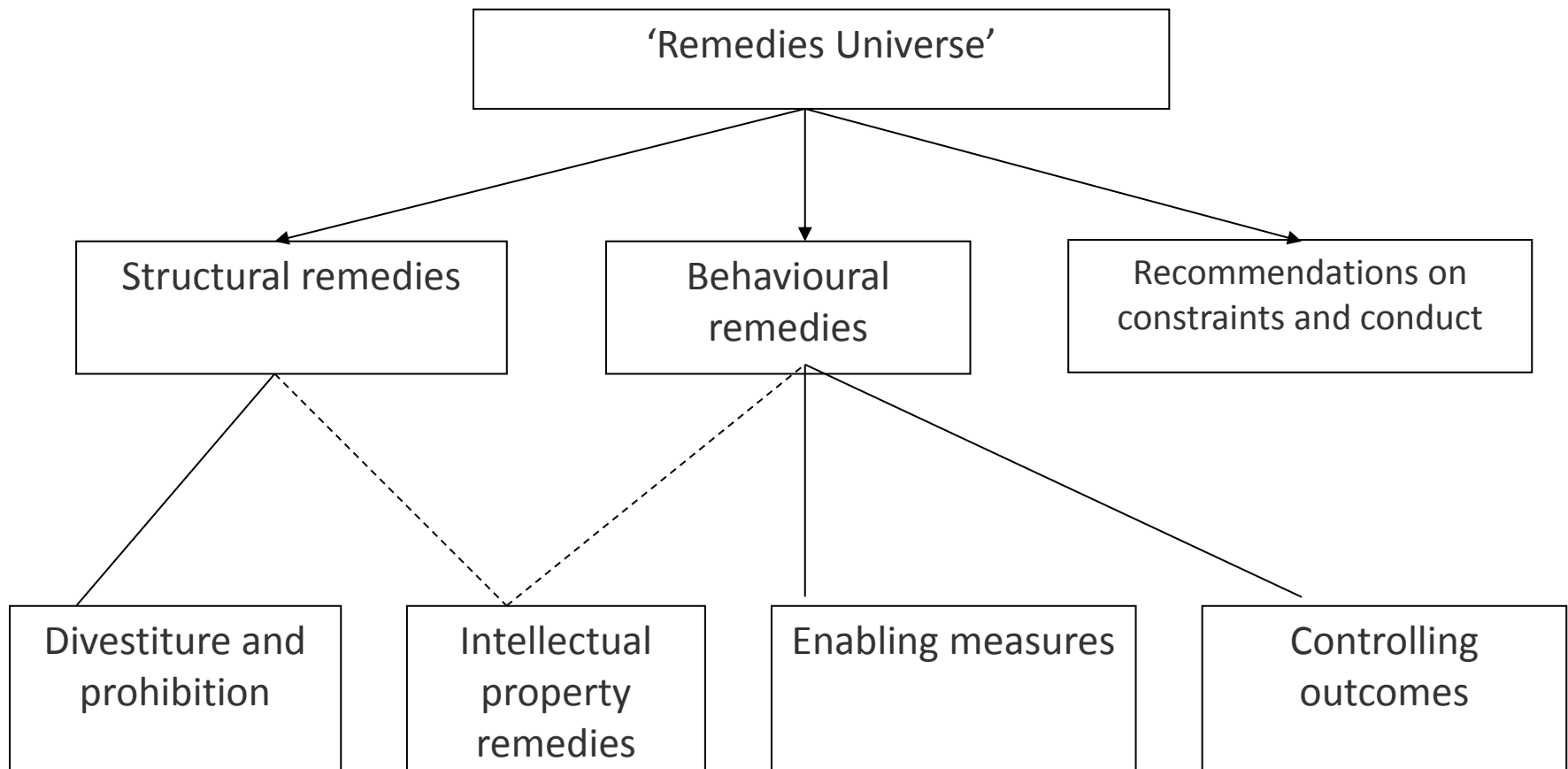
Proportionality assessment

- CC will seek to impose the least costly remedy that it considers to be effective
- If two remedies are equally effective, it will select the remedy that imposes the least cost or that is least restrictive [CC8: para 1.9]

Costs taken into account

- Costs of remedy include costs through distortions to market outcomes, ongoing compliance costs, benefits foregone

Choice of remedies in merger inquiries (1)



Choice of remedies in merger inquiries (2)

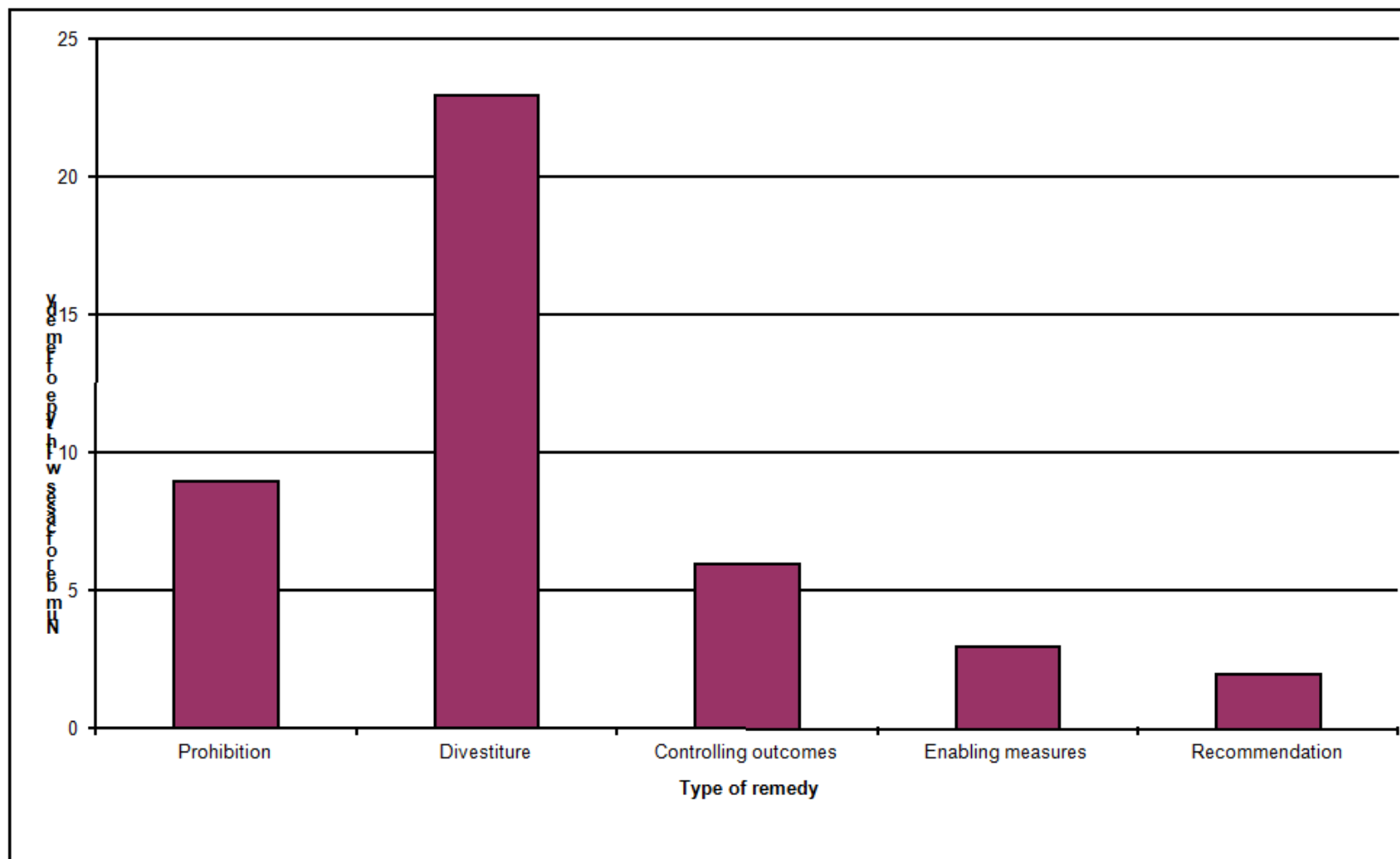
- CC has stated preference for Structural remedies
 - Likely to address the SLC AND resulting adverse effect directly and comprehensively
 - Behavioural remedies may not have effective impact on the SLC and resulting adverse effects and may create significant costly distortions in the market outcomes
 - Structural remedies do not usually require long term monitoring and enforcement
- Behavioural remedies can play supporting role with structural remedies

Choice of remedies in merger inquiries (3)

Behavioural remedies may be appropriate if:

- Divestment is not feasible or relevant costs far exceed scale of adverse effects of the SLC
- The SLC is expected to have a relatively short duration (2 to 3 years)
- Relevant Customer Benefits are likely to be substantial compared to the adverse effects of the merger and these would be largely preserved by behavioural remedies but not structural remedies

Choice of remedies 2003 - 2014



Remedy selection in practice – case studies

Two completed mergers:

- Stericycle and Ecowaste (2012) – structural remedy
- Imerys Minerals Ltd and Goonvean Ltd (2013)- behavioural remedy

Stericycle and Ecowaste 2012 (1)

The Merger

- Industry: Treatment of health care risk waste (HRW). Stericycle owned treatment plant at Frome. Ecowaste at Avonmouth
- Acquisition by Stericycle of Ecowaste Southwest Ltd from Ecowaste Group
- Acquisition included Avonmouth treatment plant, customer contracts and other assets, staff, collection vehicles. CC found that there were 4 Key Contracts (relevant to consideration of remedies proposed by Stericycle)
- Customers: large majority of healthcare waste is produced by majority NHS organisations (e.g. Hospitals) – Large-quantity generators (LQGs). Smaller volume produced by private and other public health sector (eg. Doctors, dentists) – small quantity generators (SQGs)
- LQGs collection by large vehicles on daily basis – LQG less regular/small van

Stericycle and Ecowaste 2012 (2)

- Other providers of health risk waste services included other integrated collection and treatment companies and collection only companies
- Relevant markets: (a) supply of the collection, treatment and disposal of HRW for SQG customers in the City of Bristol, Bath and North East Somerset and North Somerset and South Gloucestershire (Avonmouth plant area); and (b) supply of the collection, treatment and disposal of HRW for LQG customers in the Avonmouth Plant area
- SRCL and Ecowaste (and other integrated collection and treatment companies) competed for SQG and LQG and collection only companies. Collection only companies competed for SQG customers (including some Primary Care Trust contracts). Closest competitors were other integrated collection and treatment companies
- Geographic market – 50 miles from the plant

Stericycle and Ecowaste 2012 (3)

Competitive effects analysis:

- LQG: reduction in number of bidders in the Avonmouth Plant Area. Examined bids by competitors including one that had bid at a price close to the winning SRCL bid. But close to full capacity and decided not sufficient to mitigate loss of competitor
- SQG: competitors not competitive in supplying SQG customers in the Avonmouth Plant Area
- Avonmouth plant had substantial spare capacity and established presence in the area
- Collection only companies only a potential constraint for SQG and not LQG customers but are dependant upon the treatment plant operator

Stericycle and Ecowaste 2012 (4)

- Barriers to entry
 - Entry extremely risky unless significant NHS contracts could be secured
 - Both SRCL and Ecowaste operating with spare capacity
 - Some history of sponsored entry in response to high prices
 - Concluded a large difference in price/quality required before sponsorship
- Entry not timely, likely and sufficient to constrain the merged entity
- With loss of credible bidder, did not believe that LQG or SQG customers had sufficient buyer power to constrain SRCL post-merger

Stericycle and Ecowaste 2012 (5)

The CC Remedy

- Remedy selected by the CC: Full divestment of all assets acquired including Avonmouth plant, an additional asset brought onto site by Stericycle, contracts, licences and staff (n.b. remedy did not include back office functions – these had not been acquired by Stericycle)

Stericycle and Ecowaste 2012 (6)

The Merger

- Alternative remedies proposed by Stericycle but rejected:
 - **Option 1:** Access remedy to Avonmouth plant for treatment at agreed price, plus an existing contract, and renting of space plus [transfer/hire of] as vans bins and staff members
 - **Option 2:** Divestment of Avonmouth plant, intellectual property rights associated with the name “Ecowaste”, transfer of staff, all business records, all licences for operation at the Avonmouth site PLUS:
 - **Option 2 (A)** 2 Key contracts, Guaranteed volume of waste for treatment at the Avonmouth plant, waste collection service

Stericycle and Ecowaste 2012 (7)

Review by the Competition Appeal Tribunal (CAT) of CC decision included consideration of:

- Preference for full divestment in favour of Option 2
 - Evidence showing that existing relationships for NHS customers was important as well as price
- Relevance of costs of option 2 for Stericycle as compared to full divestment
- Impact of announcing existence of backstop of appointment of Divestment Trustee and sale without minimum price

Judicial Comment on Divestment Package (1)

Issue: Starting point when considering divestment package

Somerfield plc v CC [2006]

- it is not unreasonable for the CC to consider, as a starting point, that “restoring the status quo ante” would normally involve reversing the completed acquisition unless the contrary were shown. After all, it is the acquisition that has given rise to the SLC, so to reverse the acquisition would seem to us to be a simple, direct and easily understandable approach to remedying the SLC in question. ...
- We do not therefore consider that the CC’s approach in deciding that its normal starting point is to consider divestment of the acquired business can be criticised as outwith its margin of appreciation.”

Similarly Stericycle/Ecowaste 2012 Judgment of 25 May 2012

Judicial Comment on Divestment Package (2)

Issue: Duty to consider alternative packages to full divestment

“We agree with the CC that it is not required to investigate of its own volition every possible configuration of divestment package before concluding that divestment of the business acquired is the only effective option. It is sufficient if it assesses those which present themselves as likely candidates to the members of the panel considering the issue or which are proposed by consultees, including, of course, the parties to the merger.”

Stericycle/Ecowaste 2012 Judgment of 25 May 2012 (para 21)

Judicial Comment on Divestment Package (3)

Issue: Relationship between composition of package and approved purchaser

“It was the loss of Ecowaste as a credible bidder in the Avonmouth Plant Area that gave rise to the SLC and it was the ability to compete effectively as a provider of both collection and treatment services that was being sought as a remedy. The question of what was needed in order to restore a credible bidder to the market was the question that was rightly addressed by the CC in section 8 of the Report.”

“The CC noted that the purchaser of the divestment package was likely to be a company which already had industry expertise and a track record of successful operation: see paragraph 8.45. That affected the content of the divestment package in that there was no need to include what the CC referred to as back office functions in the package. But the CC was not bound, in our judgment, to conclude that because the purchaser was likely to be an existing operator rather than a new entrant, this meant that the purchaser would become a credible bidder simply by acquiring the Avonmouth plant and equipment. “

Stericycle/Ecowaste 2012 Judgment of 25 May 2012 (paras 23 and 24)

Imerys Minerals Limited and Goonvean Limited (1)

The Merger

- Industry: Extraction and supply of Kaolin from sites near St Austell, Cornwall
- Imerys purchased the Kaoliin Business of Goonvean
- Merger involved several markets (paper filler, sanitaryware, tableware, performance mineral applications)
- SLC found in supply of Kaolin performance-mineral applications market

The CC Remedy

Remedy selected by the CC: price control in relation to supply of Kaolin for performance-mineral applications, for 5 years

Imerys Minerals Limited and Goonvean Limited (2)

- Remedies considered by the CC
 - Full divestment
 - Partial divestment
 - Price Control
- Remedies proposed by Imerys :
 - Option 1: Partial Divestiture remedy involving divestment of Goonvean's UK performance-mineral customer details and associated assets, transitional supply contract
 - Option 2: price control for Goonvean's and Imerys's existing performance-mineral customers

Imerys Minerals Limited and Goonvean Limited (3)

CC Full divestment – issues:

- Effective however,
- Scope was substantially wider than the product market in which the SLC had been identified
- Loss of efficiencies

CC Partial divestment – issues:

- Involved entire carve out from extraction through to process
- No track record of ability to be a standalone business – so riskier as compared to full divestment
- Would need continuing relationships with Imerys, so adding to costs
- Not effective

Imerys Minerals Limited and Goonvean Limited (4)

Imerys partial divestment – issues:

- difficulty of identifying and separating assets for producing kaolin for performance-mineral customers as compared to other kaolin grades
- significant uncertainty that a purchaser could bring own production on stream within a reasonable time
- transitional arrangements created close commercial relationship between Imerys and purchaser
- customers disadvantaged through sales chain (created uncertainty)
- not effective

Imerys Minerals Limited and Goonvean Limited (5)

Price Control Remedy:

- **5 year duration only**
- Applied to all existing customers
- Ability to transition to alternative products with customer agreement (dispute mechanism included in remedies)
- Transparent pricing (ex works) – at prevailing prices
- Price cap imposed – no increase for 2 years, thereafter at RPI
- Monitoring – customer complaint (ie. Low costs)
- **CC concerned not to distort market by discouraging new entrants – evidence suggested that would enter in right market conditions**