Merger Remedies: Principles, Incentives, and Effectiveness

John Kwoka
Economics Department
Northeastern University, Boston
September 2014
Merger Control and Remedies

- Remedies an integral part of merger control
- Objective is to preserve or restore the degree of competition otherwise lost due to merger
  - Market outcome should have same degree of competition as in premerger market
  - For example, postmerger price of merging firms should be not rise beyond relevant benchmark
- Securing this objective requires effective remedy
Effective Remedies: ICN Criteria

• ICN Merger Remedies Report lists four characteristics of an effective remedy
  1. Comprehensive
  2. Appropriate duration
  3. Minimal risk of failure
  4. Practicality
Effective Remedies: Incentives Perspective

• Effectiveness of a remedy depends on the incentives it gives to merging firms
  ▫ How does remedy change incentives, if at all?
  ▫ Does it take advantage of economic incentives, or try to prevent firm from acting on them?
  ▫ What determines likelihood that a postmerger firm can effectively constrained?
Outline of Presentation

- Examples illustrating incentives perspective
  - Simple case
  - More complicated case

- Evidence on incentives and effectiveness
  - Available evidence
  - Importance of assessments
Simple Example

- Proposed merger of firms with only one overlapping product
- Remedy would likely require divestiture of overlap product by either firm
  - Rest of firms’ operations can be allowed to merge
  - Maintains same number of independent entities
- Key is that divestiture harnesses incentives
  - New entity has same competitive incentives
  - Economics predicts same competitive outcome without need for on-going oversight, intervention
Practical Issues and Limitations

1. Divested unit must have full capabilities

2. Overlap product may be embedded in network or vertical structure

3. Jurisdictional issues
Effectiveness: Evidence from Studies

- U.S. FTC Divestiture Study examined effects of all divestiture orders over several year period
  - Found most resulted in financial viability
  - Divestiture should be entire line of business
  - Divesting company might choose weak competitor

- Other studies
  - DG Comp (2005)
  - UK Competition Commission (2010)
  - Competition Bureau of Canada (2012)
Not-So-Simple Example

• Suppose divestiture not feasible (network, etc.)
• Now conduct remedy can be used
  ▫ Allows entire merger to proceed
  ▫ Sets rules seeking to make postmerger firm behave as would an independent competitive firm
• Examples:
  ▫ “Firewalls” to limit information exchanges
  ▫ “Must-supply agreements” for necessary inputs
  ▫ Anti-retaliation rules
Constraining Incentives

• Crucial difference is that conduct remedies do not alter postmerger firm’s incentives
  ▫ Those remain to engage in self-interested behavior that may be competitively harmful

• Are conduct remedies likely effective? Can firm be constrained from acting in own interests?
  ▫ Requires written “contract” with firm that fully specifies, anticipates issues
  ▫ Can be tested using “war games”
Effective Conduct Remedies

- More likely effective for
  - Simple standardized products (must-supply)
  - Separation of units (firewalls)
  - Outside monitors (retaliation)
  - Technology not changing rapidly (access)

- Also require resources and capabilities for ongoing monitoring and enforcement
Evidence, Concerns over Effectiveness

- Research connecting types of remedies to actual merger outcomes (Kwoka, 2012)

<table>
<thead>
<tr>
<th>Resolution</th>
<th>Price Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cleared</td>
<td>5.8%</td>
</tr>
<tr>
<td>Divestiture</td>
<td>6.7</td>
</tr>
<tr>
<td>Conduct</td>
<td>12.8</td>
</tr>
</tbody>
</table>
Assessing Effectiveness of Remedies

• Always important to do retrospective analyses
  ▫ Divestiture vs. conduct remedies
  ▫ Types of conduct remedies

• Case studies are OK, but systematic evidence from all experiences is better
  ▫ Conclusions have generality, legitimacy
  ▫ Can be used to modify future remedy choices and strategies
Conclusion: Incentives and Effectiveness

• There may be other considerations and perspectives on remedy effectiveness
  ▫ Useful to view through lens of incentives

• Evidence suggests that remedies that preserve and rely on incentives are effective and efficient
  ▫ Important to continually study remedy outcomes in order to improve their effectiveness
Sources

• Kwoka and White, *The Antitrust Revolution*, 2014
• Leveque and Shelanski, *Merger Remedies in American and European Union Competition Law*, 2004

j.kwoka@neu.edu