ECONOMICS OF MERGER
REMEDIES: ISSUES AND EVIDENCE

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Overview of Remedies

- Merger control involves more than analysis of effects
  - Increasingly requires attention to remedies
- At US DOJ, ten years ago 1/3 of mergers deemed anticompetitive were resolved with remedies
  - Now up to nearly 60 percent
- Same is true elsewhere
  - In EU, nearly ten times as many mergers resolved by remedy as by challenge
  - In China, remedies appear to be default policy for mergers
Reliance on Remedies

- Guides to merger remedies do exist in many jurisdictions
  - Australia, Canada, Japan, Brazil, US, others
- Some ex post analyses, but limited in scope
  - US FTC (1999)
  - EU (2005)
- Major new initiatives underway
  - US FTC conducting ex post review of its use of remedies
  - ICN about to issue new Merger Remedies Guide
Economics of Remedies

- Economics literature on remedies sparse
- Addresses primarily three major issues
  - Types of remedies:
    - Under what circumstances are structural, conduct, hybrid best suited?
  - Interaction between players:
    - How do merging firms, competition authority, and buyers interact and possibly game the remedy process?
  - Effectiveness of remedies:
    - Are these various remedies in fact effective in achieving their objectives?
(1) Choice of Remedy

- Two basic alternative remedies:
  - Structural/divestiture
  - Conduct/behavioral

- Economics examines these from vantage point of market structure, incentives, administration
  - Motta: structural remedy “modifies allocation of property rights and creates new firms”

- Usual preference is for structural solutions
  - Preserves same number of independent suppliers
  - Preserves market incentives
  - Minimizes post-remedy administration and costs
Conduct Remedies: Theory

- Conduct remedies where structural infeasible
  - Typically where economies of scope decisive
  - Also, in cross-border cases
  - Rey notes conduct remedies “expand toolkit of competition policy”
- Examples where economies make divestiture impractical
  - Network industries
  - Vertical integration
- Types of conduct provisions
  - Information firewalls
  - Anti-retaliation provision
  - Must-supply agreements
  - Technology transfer support
Conduct Remedies: Practice

• But inherent problem is that most try to make merged firms act against own interests
  • Question is whether written restrictions can prevent a merged firm from pursuing profit maximization?
• Concerns similar to traditional regulation (Kwoka-Moss)
  • Incompatible incentives
  • Nonspecifiable aspects of product and transaction
  • Asymmetry of information
  • Oversight and enforcement burdens
• Adverse outcomes of conduct remedies
  • Failure due to capabilities of buyers
  • Failure resulting from divested assets
  • Evasion through delay
  • Evasion due to compound causation

• Better prospects when
  • Products simple and standardized
  • Administrative and physical separation of units
  • Outside monitors
  • Slow change in technology
(2) Players and Games

- Competition authority faces challenges
  - Informational disadvantage relative to firms
  - Incompatible incentives with merging parties
- Farrell has model where buyer “teams with” merging firms
  - Uses standard bargaining approach to show incentives to maximize joint profit
  - Also, introduces cost of protracted process, incentive for agency to resolve issues quickly
• Medvedev uses Cournot model to analyze how characteristics of possible buyers affect outcomes
  • Incumbents vs. new entrants, each with different costs
  • Finds that the conditions when merging parties prefer incumbents are often the same as when agency prefers entrant
• Vasconcellos examines how a firm interested in merging chooses among alternative partners in anticipation of remedy game
• Modeling to date of limited help to policy
(3) Evaluating Effectiveness

- Two types of evidence on remedies:
  (1) Case studies and compilations: FTC, EU, UK, CCB
  - FTC study surveyed all divestitures in previous 6 years
    - Found that 25% did not even survive
    - Major reasons: capabilities of buyers, divested unit
  - EU study found higher survivorship (90%)
    - Also investigated effectiveness--concluded that 57% fully effective, another 23% partially effective
  - Most such reviews support remedies
    - Structural remedies generally favored
    - Most find similar process issues to be very important
    - Measuring effectiveness is difficult task
Second type of work examines performance outcomes from specific types of remedies

- My work is extension of research into outcomes of mergers themselves (Kwoka, 2013, 2015)
  - Compiled all qualifying merger retrospectives
  - Standard methodology is difference-in-difference
  - Then determined whether and which remedy was used

- About 50 such studies
  - Can correlate remedy and outcome
  - Effective remedy should result in no net price increase
### Price Outcomes

<table>
<thead>
<tr>
<th>CASE TYPE</th>
<th>PRICE EFFECT</th>
</tr>
</thead>
<tbody>
<tr>
<td>All Mergers</td>
<td>7.2%</td>
</tr>
<tr>
<td>Cleared</td>
<td>6.0%</td>
</tr>
<tr>
<td>Divestiture applied</td>
<td>7.0%</td>
</tr>
<tr>
<td>Conduct remedy</td>
<td>16.0%</td>
</tr>
</tbody>
</table>
Conclusions

• Implications
  • Most mergers result in competitive harm
  • Remedies not especially effective
  • Conduct remedies especially ineffective

• Recommendations
  • More attention to remedy phase
  • Examine cases where remedies work better, worse
  • More studies needed, including routine follow-up by competition agencies