MERGER REMEDIES: THIRD WAY, OR SOFT ENFORCEMENT?

John Kwoka
Northeastern University
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Effective Merger Control

• Merger control is not just analysis of competitive effects
  • Also requires taking appropriate policy actions against problematic mergers
• In past, policy often a choice of clearing vs. rejecting
  • Recently, much more often a Third Way, namely, remedies
• At DOJ, percent of investigated mergers resolved via remedy up from 35% to 60% over ten year period
• Remedies add to merger policy toolkit
  • But also may represent Soft Enforcement
  • Weak or ineffective remedy tantamount to approval
Economics of Merger Remedies

- Remedies have not always received same attention as analysis of competitive effects
  - Useful to do that, and bring same economics perspective to bear on remedies

- Perspective involves analysis of firm incentives
  - When firm is subject to the constraint of a remedy, how will it behave
    - Are its incentives altered, or if not, ill it strive and succeed in evading the constraint?

- Analogous to famous economics article on rate of return:
  - “Behavior of the Firm Under Regulatory Restraint”

- I will bring this incentives perspective to bear on remedies
  - First, analytically, then empirically
Analytical Perspective: Divestiture

• Asset divestiture--the easy case, but exactly why does it work?
• One reason concerns decision-making
  • Removes decision-making over the overlapping asset from merging firms
  • Puts decision-making in hands of independent entity
  • Preserves same number of decision-makers
• Related reason is separate-ness
  • Divested asset has no continuing relationship to earlier entities or to merged firm
  • Fully independent: maintains “sharp boundaries” between firms
• Further related reason is incentives
  • Each entity has its own profit-maximizing incentives
  • No mixed or compromised motives
• Outcome of asset divestiture rests on economic theory:
  • With the competitive structure and incentives, competitive outcome is predictable
  • Does not require ongoing oversight or intervention by agency
Analytical Perspective: Conduct

• Several different types of conduct remedies:
  • Firewalls, must-supply agreements, anti-retaliation provisions

• All these share key features
  • Merger is allowed to proceed
  • Merged firm subject to conduct restraints or requirements

• From incentives perspective, quite a different outcome
  • One decision-maker is lost to the market
  • Merged firm is required to act against own profit-maximizing incentives
  • Independent rivals are dependent on merged firm’s conduct
Incentives, Again

• Key is incentives
  • Asset divestiture harnesses incentives
  • Conduct remedy works only by defying them
• “Behavior of firm subject to conduct remedy”? 
  • It will predictably try to circumvent or minimize them
  • Can agency write a set of rules that make the firm act as a competitor for certain purposes (but not others) against own interests
• Much like traditional regulation, there are limits to agency’s ability to detect and prevent this
  • Information asymmetries, observability, enforcement costs
Why Use Conduct Remedies?

- Divestiture may not work in presence of decisive economies of scale, scope
  - Structural solution might be economically infeasible
- Example 1: Merger in a network industry
  - Two airlines with several overlap routes, but mostly non-overlapping
- Classic divestiture infeasible:
  - Service on single route (“standalone service”) prohibitively expensive due to economies of scope
  - Service on a route does not exist outside of network
- No obvious structural remedy
- This was policy problem facing DOJ in 4 airline mergers in past 7 years
Vertical Integration

• Example 2: Firms with vertical as well as horizontal properties
  • One is dominant at its stage, but faces independent rivals at other stages
  • Hence becomes both supplier and competitor
• Integrated firm has incentive to disadvantage or foreclose independent rival
  • Can this be prevented by conduct remedy?
• Merger between large cable TV distributor Comcast, and NBCU, large supplier of video content
  • Concerns over independent programming, access to downstream distribution, strategic use of broadband
  • Difficult to fashion effective remedy
Policy Preferences

• US has traditionally favored structural remedies
• In 2011 Justice Department issued new remedies guide endorsing wider use to conduct remedies
  • Validated uses such as in Comcast, Ticketmaster, Google-ITA
• Other jurisdictions generally state preference for structural remedies:
  • UK, EU, Canada, Australia
  • recent ICN Guide, OECD Report
New Frontier for Divestiture?

- Divested asset usually operates by self, or goes to third party that has little or no overlapping business.
- What if divested asset is by itself (or with a third party) seems insufficient to recreate effective competitor?
- Recent efforts in several merger cases to create a more effective competitor by combining divested asset with smaller third party.
  - Albertsons-Safeway, US Foods-Sysco, Staples-Office Depot
- Does this herald a new push to make divestiture policy into something like industrial policy?
Empirical Evidence: Agency Cases

- Two types of evidence with respect to remedies in practice
- One type is case studies compiled by competition agencies
- FTC Divestiture Study (1999) surveyed all divestitures in previous 6 years
  - Found that assets remained in market in 75% of cases
  - Major reasons for failures: capabilities of buyers, adequacy of divested unit
  - Did not evaluate competitive effects
- FTC is redoing this study now, including conduct remedies
  - Important that it attempt to evaluate effectiveness
- Other ex post studies done by EU (2005), CCB (2006), UK (2010)
  - EU study examined “effectiveness” based on post-divestiture market shares
- Most conclude that remedies work, structural remedies in particular
  - Most find similar practical issues to be very important
Empirical Evidence: Retrospectives

- Second type of evidence relates actual performance outcomes from carefully studied mergers, remedies.
- This is an extension of my research into outcomes of mergers.
  - Compiled all qualifying merger retrospectives.
  - Standard methodology is difference-in-difference.
- About 50 such studies.
  - About 120 observations on price outcomes for individual products.
- Used public documents and records to determine whether and which remedy used.
- Permits correlating remedy and outcome.
  - Effective remedy should result in no net price increase.
Price Effects: Kwoka Study

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<th>MERGER TYPE</th>
<th>PRICE EFFECT</th>
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<tbody>
<tr>
<td>All</td>
<td>7.2%</td>
</tr>
<tr>
<td>Divestiture applied</td>
<td>7.1%</td>
</tr>
<tr>
<td>Conduct remedy</td>
<td>16.0%</td>
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Price Effects: DGComp Study

- Centre for Competition Policy Center (East Anglia) used same methodology as mine
- Report to DC Comp compiled retrospectives on 27 EU mergers

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<th>MERGER TYPE</th>
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<tbody>
<tr>
<td>All</td>
<td>3.0 %</td>
</tr>
<tr>
<td>Cleared</td>
<td>5.1 %</td>
</tr>
<tr>
<td>Subject to remedy</td>
<td>0.6 %</td>
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Making Conduct Remedies Work

• For either type of remedy, better and worse outcomes
  • Much discussion in literature and policy guides regarding divestitures

• Conduct remedies likely more effective with
  • Simple standardized products
  • Administrative and physical separation of units
  • Outside monitors
  • Technology not changing too rapidly
Third Way? Or Soft Enforcement?

• Conclusions from the evidence
  • Divestitures can work, but they require caution
  • Conduct remedies are problematic and should rarely be relied on
  • It is time for Hard Enforcement:
    • More mergers simply need to be prohibited, rather than disposing of them through remedies of dubious effectiveness

• Recommendations
  • Need more and better evidence
  • Greater transparency from agencies regarding remedies under consideration
  • Agencies need to establish foundation for regular data production from merging parties