THE ROLE OF REMEDIES IN MERGER CONTROL

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The Growing Role of Remedies

- Merger control is not simply the evaluation of effects
- Ultimately requires policy action:
  - Could be approval or prohibition
  - More often recently, modification or remedy
- Objective is to allow merger to proceed
  - Target competitive concern and resolve in some other manner
- Increasingly common:
  - At US DOJ, ten years ago 1/3 of anticompetitive mergers resolved with remedies, now about 60 percent
  - In EU, ten times as many mergers resolved by remedies as subject to prohibition
  - In China, dozens of recent merger cases addressed using remedies
Merger Remedies in Principle

- What are merger remedies?

- Classic example:
  - Two multiproduct companies with one overlapping product
  - Standard remedy is divestiture of one overlap product
  - Preserves same number of independently supplied products
  - Recreates premerger market structure and competitive outcome

- Real world case of UTC and Goodrich
  - Both made certain aircraft electronics and control products in worldwide market
  - UTC had 70%, Goodrich 12%
  - MOFCOM reviewed and required divestiture of Goodrich’s operations in this product
Purpose(s) of Merger Remedy

• Remedy has major purpose: Preserve competition that would otherwise be lost
• But also in a manner that
  • Allows efficiencies and other benefits of consolidation
  • Minimizes administrative costs and distortion
Economic Approach to Remedies

- Economic literature on remedies rather sparse
- Addresses three major issues:
  - (1) Most analyzes types of remedies
  - (2) Interaction between merging firms, buyers, and competition agency
  - (3) Increasing attention to effectiveness of remedies
Types of Remedies

• Above example of divestiture is "structural"
• Alternative is conduct or "behavioral"
  • Conduct remedies more common in cases where structural approach infeasible
  • Typically when economies of scope decisive, so that structural separation economically infeasible
Network Merger: What Is Remedy???

- Example of merger of two network airlines
  - 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 US in 4 airline mergers in past 7 years
  - All were approved, subject to certain conditions that did not address core problem of overlap routes
Vertical Integration: What is Remedy?

• Second case: two vertically related businesses
  • One is dominant at its stage, faces independent rivals at other stages
  • Hence becomes both supplier and competitor
• Integrated firm has incentive to disadvantage or foreclose independent rival
• Recent US example of merger between large cable TV distributor Comcast and NBCU, large supplier of video content.
Economic Problem=Policy Dilemma

• Challenge was how to prevent merged Comcast-NBCU from refusing access to content to its competitors in distribution
• No obvious structural solution
• Alternative remedy is conduct approach
• As applied in Comcast-NBCU, merged firm required to:
  • Make content available to rival distributors on “reasonable terms”, with option of arbitration
  • Make “economically equivalent” content available to new streaming technologies on “nondiscriminatory” basis
  • Make broadband available to network streaming services
  • Offer competing content providers easier access to cable systems
Structure vs. Conduct

• Key issue is economics of production
  • In some cases, structural separation likely to destroy product itself
• But network example and vertical integration different
  • With vertical integration, conduct remedies possible
  • In network industries, few solutions of either kind
• Most agencies have clear preference for structural remedies
  • Use conduct only where necessary
  • Sometimes adopt elements of both: “hybrid” remedies
Economic Basis for Preference

- Divestiture seems preferable since it preserves same number of supplier firms
- More fundamentally, works because it harnesses the incentives of maximizing agents
  - Each supplier fully independent of each other
  - Each supplier has same incentives as previously
    - Should produce same results as premerger
- Minimizes distortions and administrative costs
- Structural remedy “modifies the allocation of property rights and creates new firms” (Motta et al)
Practical Side of Divestiture Remedies

- Example of Safeway, Albertson’s supermarkets
  - Overlap in northwest US
  - FTC required divestiture of 145 stores to much smaller Haggens chain
  - Haggens collapsed, filed for bankruptcy, alleged fraud
- Successful divestiture requires
  - Prospective buyer must have skills and resources
  - Divested operation must full capabilities
- Supermarket divestiture was ambitious use of divestiture
  - Sought to make small supplier into much larger and more effective competitor
Economics of Conduct Remedies

• Rey notes that conduct remedies “expand the toolkit of policy” so such mergers need not simply be prohibited

• But conduct remedies face several difficulties

• Rather than harnessing firms’ incentives, seek to make firms act against own interests
  • Intent is to have them ignore merged status and behave like independent firm in some particular transactions
  • Requires sharing assets, supplying rivals, providing technical support

• Question is whether a written set of prohibitions or requirements can prevent firm from doing what is in its interest but would be anticompetitive?
Remedies and Regulation

• Difficulties similar to traditional rate of return regulation (Kwoka and Moss)
  • Asymmetry of information between agency and firms
  • Non-specifiable aspects of product and transaction
  • Incompatible incentives
  • Administrative costs and distortions

• Results may well be similar to regulation as well
  • Averch-Johnson model of “Behavior of the Firm Under Regulatory Constraint” demonstrated perverse effects
Causation as Evasion

• Evidence from Comcast-NBCU case:
  • Independent Spanish language programming offered to 68 percent of viewers on rival cable TV
  • On Comcast, which owned NBCU and its own Spanish channels, viewership was only 32 percent
  • Enforcement difficult since the integrated firm controls the transaction
  • Many ways of achieving its objective that evades remedy, or violates it with an explanation that outside party cannot disprove
Delay as Evasion

• Example of remedy for Microsoft in US monopoly case
  • Compulsory licensing of communications protocols for connecting servers, desktop PCs
  • After 9-and-a-half years, Microsoft had still not complied

• Case illustrates fundamental asymmetry between competition agency and firms
  • Asymmetry of information
  • Unobservable causality

• Also, cost of poorly devised or enforced remedy
  • Difficulty of writing complete contract
  • Requirement for ongoing supervision
Types of Conduct Remedies

• Several quite different types of conduct remedies
  • Where information exchange is problematic, Information firewalls
  • Where rivals are reliant on the now integrated firm, must-supply agreements
  • When rivals might not wish to report concerns, anti-retaliation provisions
  • Where the divested asset includes technology, transfer requirements
When Conduct Remedies Might Work

- Information and incentive issues suggest conditions in which conduct remedies may more likely be effective:
  - Simple standardized products
  - Administrative and physical separation of units
  - Outside monitors
  - Technology not evolving too quickly
- List is similar to when conventional regulation more likely to work
Policy Preferences…

• US has traditionally favored structural remedies

• In 2011 Justice Department issued new remedies guide endorsing wider use to conduct remedies
  • Increased use of conduct approaches in major cases
    • Comcast-NBCU
    • Google-ITA
    • Ticketmaster-Live Nation

• Other jurisdictions generally state preference for structural remedies: UK, EU, Canada, Australia, ICN Guide
Remedy Policy in China

• Evolving policy toward remedies
• Interim Regulations on remedies issued in 2010
  • Viewed as endorsing use of conduct remedies
  • Of first 24 mergers cleared with conditions, 20 subject to conduct remedies
• Final Remedies Regulation issued in 2015
  • Much of it devoted to procedures for structural remedies
• Reasons that MOFCOM might choose conduct approach
  • Many subject mergers involve foreign producers, so divestitures may be difficult to require, enforce
  • AML provides for objectives in addition to competition
Second Issue: Players and Games

- Competition authority faces challenges
  - informational disadvantage relative to companies
  - Incompatible incentives with merging parties
- Farrell has model where buyer is teammate or partner of merging firms
  - Uses standard bargaining approach to show incentive to maximize joint profit, then share
  - Also, introduces cost to agency of protracted process, and incentive for agency to bring issues to early resolution
More on Players and Games

- Medvedev uses Cournot model to analyze how characteristics of alternative buyers affect outcomes
  - Incumbents vs. entrants, each with different cost structures
  - Finds that conditions when merging parties prefer incumbent often the same as when the agency prefers entrant
- Vasconselos broadens model to examine how firm interested in merging may choose among alternative merger partners in anticipation of merger review and remedy
- These and other models remain specific and rudimentary, but eventually important in advancing understanding
Third Issue: Evaluating Effectiveness

- Two types of evidence on remedies: Case studies
- FTC study of divestitures (1999) surveyed all divestitures by agency in previous 6 years
  - Found that 25% did not even survive
  - Major reasons included capabilities of buyers, adequacy of divested unit
  - Did not evaluate competitive effects
- Other ex post studies done by EU (2005), UK (2010), and CCB (2011)
  - Most support remedies, structural remedies in particular
  - Most find similar practical issues to be very important
Empirical Investigations

• Second type of work examines performance outcomes from various types of remedies
• My work is extension of research into outcomes of mergers themselves
  • Compiled all qualifying merger retrospectives
  • Standard methodology is difference-in-difference
• About 50 such studies
  • About 120 observations on price outcomes for individual products
  • Found that more than 80 percent of mergers resulted in price increases, and increases averaged about 7%
Extension to Remedies

• Used public documents and records to determine whether and which remedy used
  • Structural vs. conduct vs. combination
• Permits correlating remedy and outcome
  • Effective remedy should result in no net price increase
## Price Effects

<table>
<thead>
<tr>
<th>CASE 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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Implications and Recommendations

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

• More research needed
  • Many more studies needed
  • Examine cases where remedies worked better, worse