COMPETITION COMMISSION

Merger Remedies:
Competition Commission Guidelines
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CC 8

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Merger Remedies: Competition Commission Guidelines

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Part 1: Introduction and context

Purpose of guidance

1.1. This guidance forms part of the advice and information published by the Competition Commission (CC) under section 106 of the Enterprise Act 2002 (the Act). The purpose of this guidance is to explain the CC's approach and requirements in the selection, design and implementation of remedies in merger inquiries referred to it by the Office of Fair Trading (OFT) under sections 22 or 33 of the Act.[1]

1.2. This document seeks to provide a single source of guidance on remedies for merger inquiries referred to the CC.[2] It therefore supersedes the CC's guidance on divestiture remedies,[3] existing guidance on interim measures[4] and guidelines on remedial action in the CC's general merger guidance.[5] The approach outlined in this document is consistent with these previous documents but has been updated and extended to take account of the CC's experience of inquiries in recent years, judgments of the Competition Appeal Tribunal and research into the outcomes of remedies.[6] In devising this guidance we have taken into account the principles outlined by the International Competition Network (ICN)[7] and the framework of merger control policy within the European Community.

1.3. This guidance reflects the views of the CC at the time of publication and may be revised from time to time to reflect changes in best practice, legislation and the results of experience, legal judgements and research. The CC website will always display the latest version of the guidance. Where there is any difference in emphasis or detail between this guidance and other guidance previously produced by the CC, this guidance takes precedence.

1.4. The CC will have regard to this guidance in considering remedial action in merger inquiries. However, in each inquiry the appropriate remedy will be determined having regard to the particular circumstances, available information and time constraints of the case. The CC will therefore apply this guidance flexibly and may depart from the approach described in the guidance where there are appropriate reasons for doing so.

1.5. References in this guidance to the CC refer to either an inquiry group or the Remedies Standing Group (RSG). During the course of an inquiry, the CC's functions are the responsibility of an inquiry group of members appointed by the Chairman of the CC. The RSG takes action in the absence of an inquiry group (see paragraph 1.29). Further information about the role of the RSG can be found on the CC website.

The objectives of remedial action

1.6. Where the CC concludes that a relevant merger situation has resulted, or may be expected to result, in a substantial lessening of competition (SLC), it is required to

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[1]Except where otherwise indicated, all references to sections and to Schedules are references to sections in and Schedules to the Act.
[2]General considerations regarding remedies in market inquiries are set out in *CC3 Market Investigation References: Competition Commission Guideline,* Part 4.
[3]*CC8 Application of divestiture remedies in merger inquiries.*
[4]*Guidance on the use of interim measures pending final determination of merger references.*
[5]*CC2 Merger References: Competition Commission Guidelines,* Part 4.
[6]See for example the CC's *Understanding past merger remedies: report on case study research* (2008) and DG COMP's *Merger remedies study* (2005).
[7]See the ICN's *Merger Remedies Review Project—Report for the fourth ICN annual conference* (2005).

decide whether action should be taken to remedy, mitigate or prevent the SLC or any adverse effect resulting from the SLC.[8] The CC is also required to decide whether such action should be taken by itself or recommended for others, such as Government, regulators or public authorities. In either case, the CC must state in its report the action to be taken and what it is designed to address.

1.7. The Act requires that the CC, when considering these remedial actions, 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'.[9] To fulfil this requirement, the CC will seek remedies that are effective in addressing the SLC and its resulting adverse effects and will then select the least costly and intrusive remedy that it considers to be effective. The CC will seek to ensure, as outlined in paragraph 1.12, that no remedy is disproportionate in relation to the SLC and its adverse effects. The CC may also have regard, in accordance with the Act,[10] to any relevant customer benefits arising from the merger. In the following paragraphs we consider these factors and their interaction in greater detail.

Effectiveness

1.8. The CC will assess the effectiveness of remedies in addressing the SLC and resulting adverse effects before going on to consider the costs likely to be incurred by the remedies. Assessing the effectiveness of a remedy will involve several distinct dimensions:

(a) *Impact on SLC and resulting adverse effects.* The CC views competition as a dynamic process of rivalry between firms seeking to win customers' business over time. Restoring this process of rivalry through remedies that re-establish the structure of the market expected in the absence of the merger (so-called structural remedies such as divestitures) should be expected to address the adverse effects at source. Such remedies are normally preferable to measures that seek to regulate the ongoing behaviour of the relevant parties (so-called behavioural remedies such as price caps, supply commitments or restrictions on use of long term contracts) as these are unlikely to deal with an SLC and its adverse effects as comprehensively as structural remedies and may result in distortions compared with a competitive market outcome.

(b) *Appropriate duration and timing.* Remedies need to address the SLC effectively throughout its expected duration. Remedies that act quickly in addressing competitive concerns are preferable to remedies that are expected to have an effect only in the long term or where the timing of the effect is uncertain. The effect of a remedy should also be sustained for the likely duration of the SLC.

(c) *Practicality.* A practical remedy should be capable of effective implementation, monitoring and enforcement. To enable this to occur, the operation and implications of the remedy need to be clear to the merger parties and other affected parties. The practicality of any remedy is likely to be reduced if elaborate and intrusive monitoring and compliance programmes are required. Remedies regulating ongoing behaviour are generally subject to the disadvantage of requiring ongoing monitoring and compliance activity.

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[8]Sections 35 and 36.
[9]Sections 35(4) and 36(3).
[10]Sections 35(5) and 36(4).

(d) *Acceptable risk profile.* The effect of any remedy is always likely to be uncertain to some degree. In evaluating the effectiveness of remedies, the CC will seek remedies that have a high degree of certainty of achieving their intended effect. Customers or suppliers of merger parties should not bear significant risks that remedies will not have the requisite impact on the SLC or its adverse effects.

The cost of remedies and proportionality

1.9. Having considered the effectiveness of remedy options, the CC will then consider the costs of those remedies that it expects would be effective in addressing the SLC and resulting adverse effects. In order to be reasonable and proportionate the CC will seek to select the least costly remedy, or package of remedies, that it considers will be effective. If the CC is choosing between two remedies which it considers will be equally effective, it will select the remedy that imposes the least cost or that is least restrictive. The CC will seek to ensure, as outlined in paragraph 1.12, that no remedy is disproportionate in relation to the SLC and its adverse effects.

1.10. The costs of a remedy may be incurred by a variety of parties including the merger parties, third parties, the OFT and other monitoring agencies. As the merger parties have the choice of whether or not to proceed with the merger, the CC will generally attribute less significance to the costs of a remedy that will be incurred by the merger parties than costs that will be imposed by a remedy on third parties, the OFT and other monitoring agencies. In particular, for completed mergers, the CC will not normally take account of costs or losses that will be incurred by the merger parties as a result of a divestiture remedy as it is open to the parties to make merger proposals conditional on competition authorities' approval. It is for the parties concerned to assess whether there is a risk that a completed merger would be subject to an SLC finding and the CC would expect this risk to be reflected in the agreed acquisition price. Since the cost of divestiture is, in essence, avoidable, the CC will not, in the absence of exceptional circumstances, accept that the cost of divestiture should be considered in selecting remedies.

1.11. The costs of a remedy may arise in various forms. Remedies may result in costs through distortions in market outcomes. This is more likely to be the case where behavioural remedies are used which intervene directly in market outcomes, especially over a long period. Remedies may also result in significant ongoing compliance costs. The CC will endeavour to minimize such costs, subject to the effectiveness of the remedy not being reduced, and will have regard to the costs of the OFT and other monitoring agencies in ensuring compliance. If remedies extinguish relevant customer benefits then, as we discuss in 1.15, the amount of benefits foregone may be considered to be a relevant cost of the remedy.

1.12. In exceptional circumstances, even the least costly but effective remedy might be expected to incur costs that are disproportionate to the scale of the SLC and its adverse effects (for instance if the costs incurred by the remedy on third parties were likely to be greater than the likely scale of adverse effects). In these exceptional circumstances, the CC would not pursue the remedy in question.

1.13. In unusual situations it is possible that all feasible remedies will only be partially effective in remedying an SLC. In such cases the CC will select the most effective remedy or package of remedies that is available provided that the costs of this remedy are not disproportionate (as described above) in relation to the SLC.

Relevant customer benefits

1.14. In deciding the question of remedies, the CC is permitted to have 'regard to the effects of any action on any relevant customer benefits in relation to the creation of the relevant merger situation concerned'.[11] Relevant customer benefits[12] are limited by the Act to benefits to relevant customers in the form of:

(a) 'lower prices, higher quality or greater choice of goods or services in any market in the United Kingdom…or

(b) greater innovation in relation to such goods or services'

1.15. The CC will normally take relevant customer benefits into account, as permitted by the Act, once it has decided on the existence of an SLC by considering the extent to which alternative remedies may preserve such benefits. In essence, relevant customer benefits that will be foregone due to the implementation of a particular remedy may be considered as costs of that remedy by the CC. The CC may modify a remedy to ensure retention of a relevant customer benefit or it may change its remedy selection, for instance it may decide to implement a remedy other than prohibition or, in rare cases, it may decide that no remedy is appropriate.

1.16. The Act provides that a benefit is only a relevant customer benefit if it accrues from or is expected to accrue to relevant customers within the UK within a reasonable period from the merger and would be unlikely to accrue 'without the creation of that situation or a similar lessening of competition'.[13] Relevant customers are customers at any point in the chain of production and distribution and are therefore not limited to final consumers.[14]

1.17. The merger parties will be expected to provide convincing evidence regarding the nature and scale of relevant customer benefits that they claim to result from the merger and to demonstrate that these fall within the Act's definition of such benefits. The following paragraphs provide examples of possible relevant customer benefits and how these will be considered by the CC.

1.18. A merger may lead to economies of scale, for example, in production or distribution. But this benefit to the merged firm may not constitute a relevant customer benefit even if the CC is satisfied that this is attributable to the merger. To qualify as a relevant customer benefit, the prospective cost reductions must be expected to result in lower prices (or better quality, service, choice or innovation) than if the merger did not take place. This may not be a reasonable expectation in many instances as the parties may have scope to charge higher prices, or not pass on cost reductions, due to the reduction in competitive pressures resulting from the merger.

1.19. Industries characterized by network effects may provide other examples of potential relevant customer benefits. Where services are provided over an infrastructure network, for example in public transport, an increase in the number of access points to the network may result in an increase in the value of the network to customers. A merger may result in enhanced network benefits through, for example, improving the reach or service provided by a network.

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[11]Sections 35(5) and 36(6).
[12]Section 30.
[13]Section 30(2)and 30(3).
[14]Section 30(4).

1.20. Vertical mergers involve the merging of firms at different levels of the supply chain of a particular good or service. Vertical mergers may generate efficiencies[15] that could potentially result in benefits to customers, such as lower prices, improved quality or greater innovation, even when the merger also substantially lessens competition, for instance through impeding entry. Examples include improved coordination, for instance in marketing and product design, between firms at different stages of the supply chain, lower transaction and inventory costs and removal of possible 'double marginalization' that may occur when two non-integrated firms both have significant market power.[16] However, as in the network effects example above, to view these as relevant customer benefits it would be necessary for the CC to be satisfied that these effects would not be expected to be achieved by plausible alternatives to a merger.

Summary of remedies process

1.21. When a merger is referred to the CC, it will consider whether interim Undertakings or an interim Order are necessary to prevent 'pre-emptive action' by the merger parties which might prejudice[17] possible remedial action if the CC were to conclude that there was an SLC. For example, integration of activities by the merger parties might reduce the possibility of successful divestiture. Such interim measures therefore seek to preserve the CC's scope for action if it were to reach an adverse finding. Considerations regarding the use, design and implementation of interim measures are set out in Appendix A of this guidance and are not considered in detail in the main body of this guidance.

1.22. The CC will start to gather information on possible remedies and consider relevant options after the basis of a possible SLC has been identified. However, this investigation of possible remedies will remain hypothetical until a decision regarding a provisional finding of an SLC has been made.

1.23. The CC will consult on possible remedies when it has reached a provisional finding of an SLC. In such cases the CC will publish a notice of possible remedies either with or following publication of provisional findings. The notice will contain details of remedies that may address the SLC effectively and is a starting point for discussion of remedies with the relevant parties to the inquiry, including merger parties, customers, competitors, any sectoral regulator and the OFT.

1.24. The CC will consider remedy options proposed by the merger parties and others in addition to its own proposals. The parties will be expected to demonstrate that their proposed remedy options will address effectively the expected SLC and the resulting adverse effects. Parties will also be expected to provide evidence to support any claims concerning relevant customer benefits. The CC will consult with relevant parties to explore remedy options prior to arriving at a provisional decision on remedies.[18] The CC will then consult on this provisional decision with relevant parties prior to making a final decision.

1.25. The CC will publish its final decision on the competition question and remedies together with supporting reasons and information in a final report.[19] The report will

[15]The extent to which efficiencies may also be taken into account by the CC in determining whether a merger gives rise to an SLC is considered in the CC's general merger guidance (CC2).
[16]Double marginalization may occur because, in the absence of price discrimination, each non-integrated firm has the incentive to raise prices above cost without taking account of the fact that this lowers the output of the other. The result is lower output and profits (and higher prices) than if the two firms pursued a policy of joint profit maximization.
[17]Sections 80 and 81.
[18]This may be set out in the form of a remedies working paper or provisional decision document published on the CC website or circulated to relevant parties.
[19]Section 38.

contain sufficient detail on the nature and scope of remedies to provide a firm basis for subsequent implementation of remedies by the CC.

1.26. Following publication of the final report, the CC has the choice of implementing remedies by obtaining Undertakings from the relevant merger parties or making an Order, subject to the limitations set out in Schedule 8 of the Act. The CC will consult the merger parties and other parties affected by the remedies in determining the required Undertakings or Order. This will include a period of formal public consultation as specified in Schedule 10 of the Act.

1.27. The CC will normally seek to obtain Undertakings in appropriate form from the merger parties as its first preference. However, if agreement on Undertakings is not forthcoming on a timely basis, the CC will have recourse to imposing an Order. The length of time required to obtain agreed Undertakings from parties following the final report will reflect, inter alia, the complexity of the remedies involved and the variety of parties involved in consultation. In the case of straightforward divestiture remedies, the CC will generally seek to obtain final Undertakings within 8 weeks of publication of the final report.

1.28. The CC will publish and update an administrative timetable regarding the implementation of remedies. The action the CC takes in implementing remedies must be consistent with the decisions in the final report unless there has been a material change of circumstances since the preparation of the report or the CC has a special reason for acting differently.

1.29. An inquiry group will disband following its acceptance of final Undertakings or the imposition of an Order to implement remedies. The RSG will then be responsible for overseeing the implementation of any divestiture Undertakings. The OFT is responsible for monitoring and enforcement of behavioural remedies[20] following acceptance of Undertakings or the imposition of an Order by the CC.

1.30. If a person fails to comply with any Undertakings that it has given or any Order imposed on it by the CC, compliance may be enforced by means of civil proceedings brought by the OFT or the CC for an injunction or for interdict or for any other appropriate relief or remedy in one of the UK courts.[21] In addition to enforcement by the OFT or the CC, any person affected by the contravention of Undertakings or an Order who has sustained loss or damage as a result of such contravention may also bring an action against the party bound by the Undertakings or Order.

Completed mergers

1.31. The CC's approach to remedies will follow similar principles for anticipated mergers and completed mergers. However, the remedies process in completed merger cases may often face circumstances in practice which increase the risks of not achieving an effective solution compared with equivalent anticipated mergers. For example, there may be greater difficulty in separating a divestiture package or the merger parties may have weaker incentives to pursue timely divestiture.

1.32. The CC will take action to limit these risks and ensure an effective outcome. Completed merger cases may therefore require greater use of protective measures,

[20]Section 92.
[21]Section 94.

such as hold separate Undertakings, monitoring trustees and divestiture trustees, than in anticipated mergers. The CC will normally seek interim Undertakings in inquiries into completed mergers whereas this is not normally the case in anticipated mergers. The CC, as outlined in paragraph 1.10, will also not normally consider the cost of divestiture in selecting remedies in completed merger cases.

Part 2: Choice of remedies

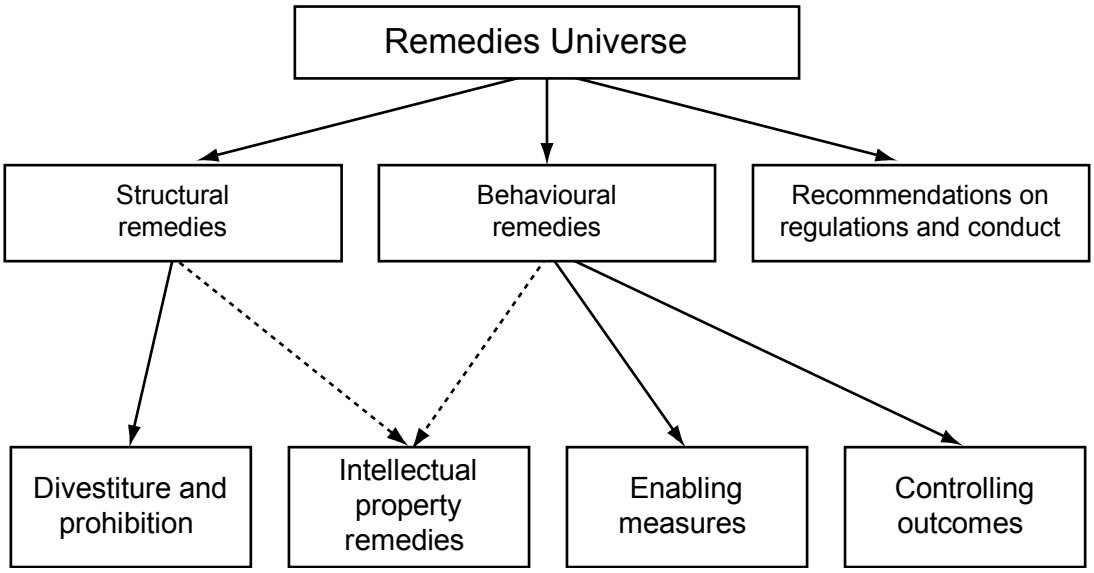
Types of remedies

2.1. This section provides an overview of the various types of remedy and their characteristics. In the next section we consider selection from these remedies through the application of the decision framework outlined in part 1.

2.2. A diagrammatic representation of the universe of merger remedies is shown below. Remedies are conventionally classified as either structural or behavioural. Structural remedies are generally one-off measures that seek to restore or maintain the competitive structure of the market. Behavioural remedies are normally ongoing measures that are designed to regulate or constrain the behaviour of merger parties. Some remedies, such as those relating to access to intellectual property rights, may have features of structural or behavioural remedies depending on their particular formulation.

FIGURE 1

Overview of the universe of merger remedies



Prohibition

2.3. Full prohibition of an anticipated merger will generally be an effective remedy as it necessarily maintains the competitive structure of a market that would have otherwise been changed by the merger.[22] Partial rather than full prohibition may be appropriate, if feasible, where the merger parties carry out activities in a market or markets other than those that are expected to give rise to an SLC.[23] Full or partial prohibition may be straightforward to implement but may result in the loss of any relevant customer benefits expected to arise from the markets subject to prohibition.

2.4. In some mergers a party to the merger may have built up a minority shareholding in the party to be acquired. In such instances, a decision to prohibit a merger may also

[22]The Serviced Dispense Equipment/Coors Brewers inquiry (2005) provides an example of full prohibition by the CC.
[23]The Stena/P&O inquiry (2004) is an example of the use of partial prohibition by the CC.

require a party to reduce its shareholding to below a specified maximum level at which the CC judges that the SLC will be remedied.

Divestiture

2.5. The aim of divestiture is to address an SLC by either creating a new source of competition through disposal of a business or assets from the merger parties to a new market participant or strengthening an existing source of competition through disposal of a business or assets to an existing participant independent of the merger parties.

2.6. A successful divestiture will effectively address at source the loss of rivalry resulting from the merger by changing or restoring the structure of the market. Divestitures will generally not require detailed monitoring following implementation although, in some cases, an effective divestiture may require supplementary behavioural measures for a specified period (eg to secure supplies of an essential input or service from the merger parties to the divested business). The requirements for design and implementation of divestiture remedies are considered in detail in part 3 of this guidance.

Intellectual property remedies

2.7. Remedies that provide access to intellectual property (IP) by licensing or assignment of patents, brands or other IP rights may be viewed in general as a specialized form of asset divestiture. The parties acquiring the IP rights should be able to compete effectively with the merger parties as a result of the acquisition. Where the terms of an IP remedy result in a material ongoing link between the merger parties and the parties gaining the IP (eg providing access to new releases or upgrades of technology) the measure may take on some of the characteristics of a behavioural commitment which requires ongoing monitoring and enforcement that may reduce its effectiveness compared to more conventional business divestitures. Considerations regarding the selection, design and implementation of IP remedies are outlined in Part 3 of this guidance.

Enabling measures

2.8. Certain forms of behavioural remedy operate principally to enable competition by removing obstacles to competition or stimulating potential competition. These include measures that seek to prevent merger parties from restricting access to their customers. Such measures may, for instance, limit the parties' ability to:

- Require their customers to enter into long term or exclusive contracts.
- Create switching costs for customers.
- Bundle or tie the sale of particular products.

2.9. In the context of vertical mergers, if the merged entity controls key facilities or inputs required by other firms to compete effectively then enabling measures may include:

- Provisions governing access to and pricing of facilities and products. These may include commitments that the merged entity will not discriminate in access to the facility or input as between itself and its competitors.

- Restriction of access to confidential information ('firewall provisions') generated by competitors' use of the merged companies' facilities or products.

2.10. A key question in evaluating the expected effectiveness of enabling measures is whether the response to these measures is likely to be of sufficient scale and timeliness to restore adequately the rivalry lost as a result of the merger. Enabling measures are likely to require ongoing intervention and monitoring and in some instances this may involve highly complex issues, for instance the pricing of access to facilities that are subject to rapid technological change. Considerations regarding the design and implementation of behavioural remedies are outlined in Part 4 of this guidance.

Controlling outcomes

2.11. Particular types of behavioural remedy such as price caps, supply commitments and service level undertakings control or restrict the outcomes of business processes. These aim to control the adverse effects expected from a merger rather than addressing the source of the SLC. This type of remedy may not only be complex to implement and monitor but may also create significant market distortions. Further considerations regarding these types of remedies are outlined in Part 4 of this guidance.

Recommendations on regulations or conduct

2.12. In some situations, the legal regulations or conduct applicable to a market may inhibit entry or restrict market outcomes, for example planning or certification requirements. In such situations it may be necessary for the CC to recommend modifications of these requirements to the Government or other controlling body to help address an SLC or control the adverse effects of a merger. For example, in a regulated sector, the CC may seek to take steps to address the effects of a merger by recommending a modification to a licence condition. It will, of course, be for the Government or other person to whom the recommendation is addressed to decide whether to act on the recommendation and the CC will consult with the relevant body before making the recommendation. In general, the CC will only use recommendations in merger inquiries where it lacks the jurisdiction to impose an effective remedy in its own right.[24]

Selection of remedies

2.13. As outlined in Part 1 of this guidance, the choice of remedies will reflect the circumstances of each inquiry and the CC will seek to select remedies that will effectively address the SLC and its resulting adverse effects and that are the least costly, effective remedies.

2.14. In merger inquiries, the CC will generally prefer structural remedies, such as divestiture or prohibition, rather than behavioural remedies because:

(a) structural remedies are likely to deal with an SLC and its resulting adverse effects directly and comprehensively at source by restoring rivalry;

[24]See the Drager Medical/Air-Shields inquiry (2004) as a rare example where the CC has used a recommendation as part of the remedies in a merger inquiry.

(b) behavioural remedies may not have an effective impact on the SLC and its resulting adverse effects, and may create significant costly distortions in market outcomes; and

(c) structural remedies do not normally require monitoring and enforcement once implemented.

2.15. In practice therefore, the CC has selected structural remedies in the great majority of merger inquiries that have required remedies under the Enterprise Act regime.[25] In some of these inquiries behavioural remedies have, however, been required in a supporting role, for example to protect the divested entity for a limited period or to ensure continuation of key contracts or inputs.

2.16. In general, one or more of the following conditions will normally apply in the unusual circumstances where the CC selects behavioural remedies as the primary source of remedial action in a merger inquiry:

(a) Divestiture and/or prohibition is not feasible or the relevant costs[26] of any feasible structural remedy far exceed the scale of the adverse effects of the SLC.

(b) The SLC is expected to have a relatively short duration (eg two to three years) due, for example, to the limited remaining term of a patent or exclusive contract.

(c) Relevant customer benefits are likely to be substantial compared with the adverse effects of the merger and these benefits would be largely preserved by behavioural remedies but not by structural remedies.[27]

2.17. In general, in the above circumstances, the CC will prefer to use enabling measures that 'work with the grain of competition' such as access remedies (see section 4) and measures that remove obstacles to competition rather than behavioural remedies that control market outcomes such as price caps. The latter measures tend to be onerous to operate and monitor, may create significant market distortions and do not address the causes of an SLC. These are therefore unlikely to be appropriate other than for a limited duration unless there is no practical alternative to a continuing regulatory solution.

2.18. In some instances where behavioural remedies are needed, enabling measures may be expected to work relatively slowly in addressing an SLC. In these circumstances, measures that control market outcomes may be needed to supplement enabling measures for a limited period to provide protection to customers from the adverse effects of an SLC.

2.19. In relation to condition *(a)* in paragraph 2.16, substantial uncertainty as to whether a suitable purchaser will emerge will generally not be sufficient for the CC to conclude that any form of divestiture remedy is not feasible. The CC has found that it is normally possible to implement divestitures, despite such uncertainties, given flexibility in the disposal price.

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[25]To the end of October 2008, structural remedies involving prohibition or divestiture have been required by the CC in 17 out of 21 merger cases requiring remedies since the Act has come into force.
[26]Relevant costs would normally exclude costs of divestiture to merger parties in completed mergers as noted in paragraph 1.10.
[27]The Macquarie UK Broadcast Ventures/National Grid Wireless Group inquiry (2008) is a rare example where significant relevant customer benefits have contributed to the selection of a behavioural remedy.

2.20. Vertical mergers that are expected to result in substantial relevant customer benefits may provide an example of condition *(c)* in paragraph 2.16. Where such a vertical SLC could be addressed effectively by enabling measures such as access remedies and firewall provisions then the CC may select these rather than structural remedies. However, even in such cases, if access measures are highly complex to set or monitor, or may be rendered ineffective by the merger parties, then the CC is likely to prefer structural measures.

2.21. It is possible that in unusual circumstances any fully effective remedy will result in a disproportionate loss of relevant customer benefits or incur costs that far exceed the scale of the SLC. In such circumstances the CC will select the most effective remedy that does not incur this disproportionate level of costs or disproportionate loss of relevant customer benefits. In cases where all feasible remedies are likely to incur disproportionate loss of relevant customer benefits or costs that far exceed the scale of the SLC, the CC may conclude that no remedial action should be taken. In practice, such instances are expected to be extremely rare.

Recommendations

2.22. Recommendations to Government or other persons to modify legal regulations or conduct, such as planning or licensing regulations, may, if adopted, act as enabling measures to encourage competition or deal with adverse effects in the specific circumstances of a merger inquiry. In deciding whether to make such recommendations for remedial action, the CC will consider the likelihood of whether such recommendations will be adopted. In view of this uncertainty, the CC will generally only make recommendations for action by others in merger inquiries where it lacks the jurisdiction to carry out relevant measures itself and only after consultation with the organizations possessing the relevant powers.

International constraints

2.23. In an international merger, the CC will consult competition authorities in other jurisdictions to seek consistency and effectiveness in the approach to remedies. It will normally be in the interests of the competition authorities and the merger parties for such consultation to take place at an early stage to prevent inconsistent approaches. The consultation will generally be more effective if the merger parties give their consent to remove significant restrictions on sharing relevant information between the CC and other authorities.

2.24. Where the CC has jurisdiction over only a small segment of an international merger, the choice of appropriate remedies may be limited significantly by the constraints of extra-territorial enforcement.[28] The desirability of consistency with the approaches adopted by other national competition authorities may add a further constraint to the selection of remedies.

[28]The Drager Medical/Air-Shields inquiry (2004) provides an example of constraints on the CC's remedy selection in an international merger as discussed in the CC's report *Understanding past merger remedies: report on case study research* (2008).

Part 3: Divestiture and intellectual property remedies

Divestiture principles

Introduction

3.1. In essence, a divestiture seeks to remedy an SLC by either creating a new source of competition through disposal of a business or set of assets to a new market participant or strengthening an existing source of competition through disposal to an existing market participant independent of the merger parties. To be effective in restoring or maintaining rivalry in a market where the CC has decided that there is an SLC, a divestiture remedy should involve the sale of an appropriate divestiture package to a suitable purchaser through an effective divestiture process. These critical elements of the design of a divestiture remedy are discussed in detail in subsequent sections.

3.2. The design of a divestiture remedy will seek to address the underlying cause of an SLC and will take account of any risks of not addressing the SLC and any relevant customer benefits that may be affected by the form of divestiture.

Divestiture risks

3.3. Divestitures may be subject to a variety of risks that may limit their effectiveness in addressing an SLC. It is helpful to distinguish between three broad categories of risks that may impair the effectiveness of divestiture remedies as follows:

(a) *Composition risks*—these are risks that the scope of the divestiture package may be too constrained or not appropriately configured to attract a suitable purchaser or may not allow a purchaser to operate as an effective competitor in the market.

(b) *Purchaser risks*—these are risks that a suitable purchaser is not available or that the merger parties will dispose to a weak or otherwise inappropriate purchaser.

(c) *Asset risks*—these are risks that the competitive capability of a divestiture package will deteriorate before completion of divestiture, for example through loss of customers or key members of staff.

3.4. The incentives of merger parties may serve to increase the risks of divestiture. Although merger parties will normally have an incentive to maximize the disposal proceeds of a divestiture they will also have incentives to limit the future competitive impact of a divestiture on themselves. Parties may therefore have, on balance, an incentive to make divestitures to weaker competitors of less competitive assets or businesses and may also allow the competitiveness of divestiture packages to decline during the divestiture process.[29]

3.5. Divestiture risks can be overcome, at least in part, through the design of the divestiture and by adopting protective measures such as appointment of monitoring and divestiture trustees and requiring 'up-front buyers' as shown later in this section.

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[29]See for example the SCR Sibelco/Fife Silica Sands inquiry (2001) as discussed in the CC's report *Understanding past merger remedies; report on case study research* (2008). See also the Federal Trade Commission's *A Study of the Commission's Divestiture Process* (1999) and DG COMP's *Merger remedies study* (2005) (for example paragraph 44 of Summary and Conclusions).

Scope of divestiture packages

Package definition

3.6. In identifying a divestiture package, the CC will take, as its starting point, divestiture of all or part of the acquired business. This is because restoration of the pre-merger situation in the markets subject to an SLC will generally represent a straightforward remedy.[30] The CC will consider a divestiture drawn from the acquiring business if this is not subject to greater risk in addressing the SLC.

3.7. In defining the scope of a divestiture package that will satisfactorily address the SLC, the CC will normally seek to identify the smallest viable, stand-alone business that can compete successfully on an ongoing basis and that includes all the relevant operations pertinent to the area of competitive overlap. This may comprise a subsidiary or a division or the whole of the business acquired. Following discussion with the merger parties, the CC may modify the scope of the proposed divestiture package provided that the parties can demonstrate, to the CC's satisfaction, that the modified package addresses the SLC and the modification does not create significant composition, purchaser or asset risks after taking account of protective measures.

3.8. The scope of a divestiture package will be outlined, with reasons, in the CC's report. The scope of the package will be specified in greater detail in the Undertakings accepted or Orders made by the CC when implementing the remedy. The parties to the merger may also add further assets to the specified package at their request with the approval of the CC, or may be required to do so by the CC, to secure divestment to a suitable purchaser. The merger parties will generally be prohibited from subsequently purchasing assets or shareholdings sold as part of a divestiture package or acquiring material influence over them. The CC will normally limit this prohibition to a sunset clause period of 10 years.

Divestiture of an existing business or package of assets

3.9. The CC will generally prefer divestiture of an existing business that can compete effectively on a stand-alone basis independently of the merger parties, to divestiture of part of a business or a collection of assets. This is because divestiture of a complete business is less likely to be subject to purchaser and composition risk and can generally be achieved with greater speed.

3.10. Where a proposed divestiture comprises part of a business or specified assets, such as intellectual property rights, the capabilities and resources of prospective buyers are likely to be more critical to a successful outcome than for a stand-alone business. A package of assets proposed for divestiture may, for example, lack an established infrastructure and its viability may therefore be more dependent on an appropriate match with the capabilities of the purchaser. A package of assets may also be far more difficult to define or 'carve out' from an underlying business[31] and the CC may have less assurance that the purchaser will be supplied with all it requires to operate competitively. In such circumstances, the CC is likely to require additional protective measures such as identification of an up-front buyer (see paragraph 3.19) to mitigate

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[30]This approach was upheld by the Competition Appeal Tribunal in the Somerfield PLC V Competition Commission case (2006). 'in our view 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'—paragraph 99.

[31]DG COMP's *Merger Remedies Study* (2005) found that carve-out problems were a common cause of serious design and implementation issues in a significant proportion of divestiture remedies within its purview—see section 6 of Summary and Conclusions (pp152–155, public version).

increased purchaser and composition risk.[32] Where a package of assets is proposed for divestiture, the CC will require the merger parties to specify the composition and operation of the package in detail.

3.11. In particular circumstances, merger parties may propose a 'virtual divestiture' consisting of divestiture of production capacity[33] for a specified period rather than conventional disposal of a business or package of assets. Such a proposal may have higher risks and costs than a conventional divestiture, and require continuing monitoring and compliance activity. The CC would need to satisfy itself that there was good reason to justify such a proposal in preference to a conventional divestiture and that the risks of the proposal could be appropriately contained.

Preference for avoiding 'mix-and-match' divestitures

3.12. Divestiture of a mixture of assets from both merger parties (a so-called 'mix-and-match' approach) may create additional composition risks such that the divestiture package will not function effectively. Therefore, if divestiture of a set of assets or parts of a business is proposed rather than a complete business, it will normally be preferable for all the assets to be provided by one of the merger parties unless it can be demonstrated to the CC's satisfaction that there is no significant increase in risk from a mix-and-match alternative.

Alternative divestiture packages

3.13. In some circumstances, it may be appropriate to define a more extensive and/or more marketable divestiture package ('alternative divestiture packages'[34]) which the CC would require the parties to sell if the initially proposed divestiture package were not sold within a specified period. Alternative divestiture packages may be appropriate if there is doubt as to the marketability of the initially proposed divestiture package or where a business is subject to major asset risks and speed of divestiture is likely to be a critical requirement. In such circumstances, prior identification of a more extensive, more marketable package may be the most effective means of facilitating rapid disposal if the initial package cannot be sold to a suitable purchaser within a specified period.[35]

3.14. The alternative divestiture package will include all the core assets necessary to remedy the SLC. The CC will wish to satisfy itself that the purchaser of such a package is committed to operate the core assets so as to compete effectively in the market(s) affected by the SLC and not primarily attracted by the additional assets. The CC will identify the alternative package in its report but the existence of an alternative package will generally be excised from the published version of the report to prevent the existence of the alternative package undermining divestiture of the initial package.

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[32]The Kemira GrowHow/Terra Industries inquiry (2007) is an example where the CC has insisted on an up-front buyer where a business to be divested has been 'carved out' of an existing business.
[33]So-called 'virtual power plant' remedies are examples of this type of remedy. See, for example, the Nuon/Reliant Energy case in the Netherlands, outlined in Appendix J of the ICN's Merger Remedies Review Project.
[34]Such packages are sometimes referred to as 'Crown Jewel' packages; however, in view of the wide variety of usage of this term, the CC uses the more closely defined terminology of 'alternative divestiture packages'.
[35]The EWS Railway Holdings/Marcroft Engineering inquiry (2007) provides an example of the use of alternative divestiture packages.

Suitable purchasers

Criteria

3.15. The identity and capability of a purchaser will be of major importance in ensuring the success of a divestiture remedy. The merger parties will therefore need to obtain the CC's approval of the prospective purchaser(s). The CC will wish to satisfy itself that a prospective purchaser is independent of the merger parties, has the necessary capability to compete, is committed to competing in the relevant market(s) and divestiture to the purchaser will not create further competition concerns. The relative importance that the CC attributes to each of these criteria will depend on the circumstances of the inquiry. These criteria are considered in more detail below:

(a) *Independence*—The purchaser should have no significant connection to the merger parties that may compromise the purchaser's incentives to compete with the merged entity, for example, an equity interest, shared directors, reciprocal trading relationships or continuing financial assistance.

(b) *Capability*—The purchaser must have access to appropriate financial resources, expertise and assets to enable the divested business to be an effective competitor in the market. This access should be sufficient to enable the divestiture package to continue to develop as an effective competitor. For example, a highly leveraged acquisition of the divestiture package that left little scope for competitive levels of capital expenditure or product development is unlikely to satisfy this criterion.

(c) *Commitment to relevant market*—The CC will wish to satisfy itself that the purchaser has an appropriate business plan and objectives for competing in the relevant market(s).[36]

(d) *Absence of competitive or regulatory concerns*—Divestiture to the purchaser should not create a realistic prospect of further competition or regulatory concerns. Moreover, the CC's approval of a purchaser may be subject to clearance by the OFT or other regulatory authority.

3.16. Except in circumstances, as specified below, where a divestiture trustee is in place, the merger parties are responsible for securing a prospective buyer and demonstrating that it satisfies the CC's criteria for a suitable purchaser. However, the CC will keep the progress of the divestiture under close scrutiny.

3.17. Where the merger parties receive interest from more than one prospective buyer, the CC will generally wish to evaluate whether purchasers fulfil the criteria before any purchaser is granted exclusivity to undertake detailed due diligence. This is to avoid situations where a prospective purchaser undertakes lengthy due diligence on an exclusive basis but is then found not to satisfy the CC's criteria.

Continuing links and purchaser protection

3.18. A purchaser should not have continuing links with the merger parties after divestiture that may compromise the purchaser's incentives to compete with these parties, eg

[36]This approach was upheld by the Competition Appeal Tribunal in the Somerfield V Competition Commission case (2006) where the CC excluded limited assortment discount retailers from acquiring Somerfield stores on the basis that these were insufficiently close competitors to conventional supermarkets, paragraph 183.

financial, ownership or management links. However, purchasers may require access to key inputs or services at appropriate terms from the merger parties, on an interim basis, in order to enable the divestiture to operate effectively. Such arrangements may be permitted by the CC for a limited period. The CC may also permit or require non-solicitation clauses or other measures to protect the purchaser from the merger parties for a limited period (eg one year) to enable the purchaser to become established as an effective competitor in the relevant market(s).

Up-front buyers

3.19. Where the CC is in doubt as to the viability or attractiveness to purchasers of a proposed divestiture package (ie composition risk) or believes there may be only a limited pool of suitable purchasers (ie purchaser risk), it may require the merger parties to obtain a suitable purchaser that is contractually committed[37] to the transaction before permitting a proposed merger to proceed[38] or a completed merger to progress with integration. Where the CC considers that the competitive capability of the divestiture package may deteriorate pending the divestiture (ie asset risk) or completion of the divestiture may be prolonged, it may also require that the up-front buyer completes the acquisition before the merger may proceed or, in the case of a completed merger, before the merger parties may progress with integration.

Effective divestiture process

Objective of process

3.20. An effective divestiture process will protect the competitive potential of the divestiture package before disposal and will enable a suitable purchaser to be secured in an acceptable timescale. The process should also allow prospective purchasers to make an appropriately informed acquisition decision.

Protecting the divestiture package

3.21. The parties to a merger may have significant incentives to run down or neglect the business or assets of a divestment package in order to reduce future competitive impact. The resulting asset risk may also be influenced by such factors as the length and complexity of the divestiture process and the pace at which customer goodwill and employee relations may erode.

3.22. To protect against asset risk, the CC will generally seek Undertakings from the relevant parties which impose a general duty to maintain the divestiture package in good order and not to undermine the competitive position of the package. The CC will also generally require 'hold-separate' Undertakings to mitigate asset risk. These will require the divestiture package to be held and managed separately from the retained business. These protection measures specified in final Undertakings will often continue measures specified in interim Undertakings (see Appendix A). The appointment of a 'hold-separate' manager or management team may also be required to manage the assets/business to be divested so as to maintain their competitiveness and separation from the retained assets.

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[37]Contractual commitment may occur, for instance, through exchange of contracts subject to limited conditions.
[38]The Kemira GrowHow/Terra Industries (2007) and Hamsard /Academy Music Holdings (2007) inquiries provide examples where the CC required an up-front buyer.

Use of monitoring trustees

3.23. Where divestiture Undertakings are in place, the CC will normally require the appointment of an independent monitoring trustee to oversee the parties' compliance with the Undertakings and, if applicable, the performance of the hold-separate manager. The trustee will have an overall duty to act in the best interests of securing an appropriate divestiture. The trustee will monitor the ongoing management of the divestiture package and the conduct of the divestiture process. The CC will have the right to propose and direct measures necessary to ensure compliance with the Undertakings. Considerations regarding the appointment of trustees are outlined in Part 5 of this guidance. The trustee will report to the CC at regular intervals.

The divestiture period

3.24. The CC will state in its report the period in which the parties should achieve effective disposal of a divestiture package to a suitable purchaser (ie the 'initial divestiture period'). However, this period may be excised from the report if it is considered that disclosure to third parties may undermine the divestiture process. The length of this period will depend on the circumstances of the merger but will normally have a maximum duration of six months. The CC, when determining the initial divestiture period, will seek to balance factors which favour a shorter duration, such as minimizing asset risk and giving rapid effect to the remedy, with factors that favour a longer duration such as canvassing a sufficient selection of potential suitable purchasers and facilitating adequate due diligence. The initial divestiture period may be extended by the CC where this is necessary to achieve an effective disposal.

3.25. While the merger parties are responsible for securing a suitable purchaser in the initial divestiture period, the CC will keep the progress of the divestiture process under close review through regular reporting and, where applicable, the scrutiny of a monitoring trustee.

Use of divestiture trustees

3.26. If the merger parties cannot procure divestiture to a suitable purchaser within the initial divestiture period, then, unless this period is extended by the CC, an independent divestiture trustee may be mandated to dispose of the package within a specified period (the trustee's divestiture period) at the best available price in the circumstances, subject to prior approval by the CC of the purchaser and the divestiture arrangements. If the CC has reason to expect that the merger parties will not procure divestiture to a suitable purchaser within the initial divestiture period, the CC may require that a divestiture trustee is appointed before the end of the initial divestiture period, or in unusual cases, at the outset of the divestiture process.[39] The role of a divestiture trustee is distinct from that of a monitoring trustee, but the two roles may be performed by the same person.

Review of divestiture documentation

3.27. The CC will wish to ensure, before providing its final approval of the divestiture at the end of the divestiture process, that the divestiture agreement and relevant supporting documentation convey all assets required to be divested, and contain no provisions

[39]The Tesco/Co-op store acquisition inquiry (2008) is an instance where the CC has required the appointment of a divestiture trustee from the outset of the divestiture period.

that are inconsistent with the remedial objectives of the divestiture. For example, continuing links between the purchaser and the parties, as outlined in paragraph 3.18, may undermine competitive incentives.

Intellectual property remedies

Introduction

3.28. The licensing or assignment of IP, including patents, licences and brands, may be viewed generally as a specialized form of asset divestiture. However, in certain cases, the terms of a licence may contain ongoing behavioural elements such that the remedy is a structural/behavioural hybrid. The key element is the extent to which any material link between licensor and licensee will exist following award of the licence. A remedy that requires an assignment or licence of an IP right that is exclusive, irrevocable and non-terminable with no performance-related royalties will effectively be treated by the CC as structural in form and subject to similar consideration and evaluation as an asset divestiture. A licence that requires a licensee to rely on the licensor for updates of the technology or continuing access to specialist inputs or know how will be regarded as a behavioural commitment which is subject to significant risks of not being an effective remedy.

3.29. For licensing of IP alone to be effective as a remedy, it must be sufficient to enhance significantly the acquirer's ability to compete with the merger parties and thus address the SLC.[40] Such a remedy may not be effective if the IP needs to be accompanied by other resources (for example, technical expertise and sales networks) to enable effective competition if these are unlikely to be available in potential purchasers of the IP.

3.30. In view of the possible risks to effectiveness, as outlined in 3.29, that may result from using IP remedies, the CC will generally prefer to divest a business including IP rights, where this is feasible, rather than rely on licensing IP alone. This is because divestiture of a business including IP rights is more likely to include all that the acquirer needs to compete effectively with the merger parties.

Design factors

3.31. The appropriate design of an IP remedy may be influenced by a number of case specific factors such as:

(a) *The form and jurisdiction of the relevant IP (eg patent, exclusive licence, trade mark etc).* The CC will wish to ensure that the IP to be divested is sufficient to enable a purchaser to compete effectively. This may sometimes include less easily transferable forms of IP (eg 'know how').[41] Where there is uncertainty regarding the scope of a licence or its terms and conditions, the parties may be required to divest the underlying right and accept a licence back.

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[40]See, for example, the Thermo Electron Manufacturing/GV Instruments inquiry (2007) in which the CC rejected a licensing remedy proposed by the merger parties on the basis that it would not adequately restore competition lost by the merger.
[41]See, for example, the Shell/BASF case in which the EC found that difficulties in transferring 'know how' and other types of IP could have significantly reduced the scope and effectiveness of a licensing commitment (as outlined in Appendix D of the ICN's Merger Remedies Review Project).

(b) *The relative specialization of the IP.* Highly specialized IP may impose particular constraints on selecting a suitable acquirer as there may be few parties competent to use the IP.

(c) *The rate of innovation expected in the relevant market.* A high rate of innovation may imply a shorter required duration for a licensing remedy than in a more stable market.

(d) *Forms of payment for IP.* As discussed previously, the form of payment (eg one-off payment, royalties or profit shares) may have an effect on competitive incentives.

3.32. IP rights generally enable the remuneration of investment in innovation by granting time-limited exclusivity. In considering the design and scope of IP remedies, the CC will recognize the need for preserving incentives for innovation while addressing competitive concerns.

3.33. Mergers critically dependent on IP rights may have international repercussions due, for instance, to international filing and licensing of patent rights. International cooperation with other competition authorities is therefore often particularly necessary in these cases.

Part 4: Behavioural remedies

Introduction and general principles

4.1. Behavioural remedies are designed to regulate the ongoing conduct of parties following a merger so as to address an SLC and/or its adverse effects. As noted in paragraph 2.16, the CC will generally only use behavioural remedies as the primary source of remedial action in a merger inquiry where structural remedies are not feasible, or where the SLC is expected to have a short duration, or behavioural measures will preserve substantial relevant customer benefits that would be largely removed by structural measures. However, the CC may also use behavioural measures as an adjunct to structural measures.

Design, monitoring and enforcement

4.2. Behavioural remedies seek to change aspects of business conduct from what may be expected based on businesses' incentives and resources. The design of behavioural remedies should seek to avoid four particular forms of risk to enable these measures to be as effective as possible:

(a) *Specification risks*—These risks arise if the form of conduct required to address the SLC or its adverse effects cannot be specified with sufficient clarity to provide an effective basis for monitoring and compliance. The intended operation of the measure needs to be clear to the persons to whom it is directed and other relevant parties so that it is apparent what conduct constitutes compliance and what does not. For example, a commitment to permit access 'on fair and reasonable' terms may create significant specification risk as the provision may be insufficiently specific to allow effective enforcement. Markets that are subject to frequent change in products or supply arrangements may be particularly prone to specification risk if the definition of required conduct is vulnerable to such changes.

(b) *Circumvention risks*—As behavioural remedies generally do not deal with the source of an SLC, it is possible that other adverse forms of behaviour may arise if particular forms of behaviour are restricted.[42] For example, if prices are controlled a firm may reduce product quality. To avoid or reduce these risks, behavioural measures need to deal with all the likely substantial forms in which enhanced market power may be applied. In practice this may not be feasible or may make the behavioural measures too complex to monitor.

(c) *Distortion risks*—These are risks that behavioural remedies may create market distortions that reduce the effectiveness of these measures and/or increase their effective costs. Distortion risks may result from remedies overriding market signals or encouraging circumvention behaviour. For example prohibiting the use of long-term contracts may result in a lack of incentives to compete for new business.

(d) *Monitoring and enforcement risks*—Even clearly specified remedies may be subject to significant risks of ineffective monitoring and enforcement. This may be due to a variety of causes such as the volume and complexity of information required to monitor compliance, limitations in monitoring resources, asymmetry

[42]This may be sometimes referred to as a 'waterbed effect'.

of information between the monitoring agency and the business concerned and the long timescale of enforcement relative to a rapidly moving market.

4.3. For behavioural remedies to have the desired impact it is essential that there are effective and adequately resourced arrangements in place for monitoring and enforcement so that there is a powerful threat that non-compliance will be detected and that action will be taken to enforce compliance where this is necessary.

4.4. The OFT is responsible for monitoring and enforcing compliance of remedies under the Act.[43] Customers and competitors of the merged entity may be in a strong position to report to the OFT on instances of non-compliance where they have appropriate resources and incentives. However, such persons may be inhibited from fulfilling this reporting role by lack of resources and verifiable information, lack of understanding of the measures, fear of reprisals and other disincentives. The likelihood of effective monitoring will be significantly increased if it is possible to involve a sectoral regulator in the monitoring regime.

4.5. In view of constraints on the OFT's resources and the possible limitations in the reliance that can be placed on the reporting role of customers and competitors, it may be necessary for the CC to seek Undertakings from the merger parties to appoint and remunerate a third-party monitor to enable the OFT to fulfil its monitoring responsibilities effectively.[44] Considerations regarding the appointment of third-party monitors are outlined in Part 5 of this guidance.

4.6. If the merged entity is considered to have a dominant market position then certain types of conduct that behavioural remedies may seek to prevent (eg predation, foreclosure of access) may be prohibited under section 18 of the Competition Act 1998 or under Article 82 of the EC Treaty. Similarly, a behavioural remedy may seek to prevent the making of agreements that may be prohibited under section 2 of the Competition Act 1998 or Article 81 of the EC Treaty. The CC recognizes the importance of ex-post competition enforcement. However, the CC has an obligation to achieve as comprehensive a solution to the SLC and its adverse effects as is reasonable and practicable. The CC will therefore normally prefer to specify its own remedial measures rather than rely on the general provisions of competition law as this has the advantages that the CC measures can be designed to take account of the circumstances of the case and the provisions for monitoring and enforcement can be fully defined.

Duration

4.7. As behavioural remedies are designed to have ongoing effects on business conduct throughout the period they are in force, the duration of these measures is a material consideration. The CC may specify a limited duration if measures are designed to have a transitional effect. Where measures need to apply as long as an SLC persists and as this period can rarely be predicted during the course of an inquiry, the CC will generally rely on the merged parties applying for variation or cancellation of the measures on the basis of a significant change of circumstances[45] or possibly recommend that the OFT reviews the need for the measures after a given period. However, the CC may, in addition, specify a long-stop date in a 'sunset clause' beyond which

[43]Section 92.
[44]The Macquarie UK Broadcast Ventures/National Grid Wireless Group inquiry (2008) provides an example where the merger parties undertook to remunerate an adjudicator responsible to the OFT to resolve contractual issues as part of a package of behavioural remedies.
[45]Section 92.

the measures will definitely not apply. The period used for the long-stop date will depend on the circumstances of the case.

Types of behavioural remedy

4.8. This guidance discusses behavioural remedies under the headings of enabling measures and measures that control outcomes. The former address an SLC by seeking to remove obstacles to competition or stimulating competition whereas the latter seek to restrict the adverse effects of an SLC rather than address the SLC itself. Effective remedy packages may require both categories of remedy. Enabling measures may be further subdivided between measures that restrain the impact of vertical mergers and measures that restrain market power in a horizontal[46] market context.

4.9. The variety of circumstances, conduct and possible behavioural measures that may be encountered on individual inquiries is extensive. This guidance therefore seeks to outline the CC's general approach rather than deal with all possibilities.

Enabling measures

Restraining the impact of vertical mergers

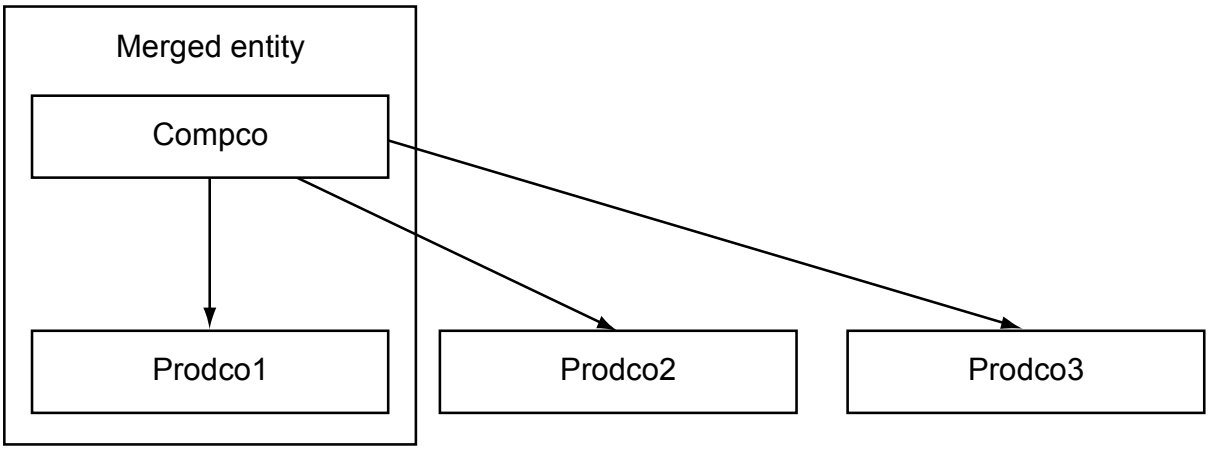
4.10. A vertical merger involves the merger of firms at different levels of the supply chain of particular goods or services. Where a party to such a merger has significant market power at one or more levels of the supply chain, the resulting merger may result in an SLC, typically through the incentive and ability of the merged entity to disadvantage competitors by foreclosing access to key inputs, facilities or customers and/or exploiting access to confidential information.

4.11. For example if, as illustrated below, the manufacturer (Compco) of most of a key industry component acquired a major user of this component (Prodco1) then the ability of other users (Prodco2 and Prodco3) to compete could be disadvantaged by the merged entity through restricting supply of this component to Prodco2 and Prodco3 or making use of information concerning component orders by Prodco2 and Prodco3.

[46]Horizontal mergers involve the merger of firms that operate at the same level of the supply chain of a particular product or class of products.

FIGURE 2

Illustration of vertical merger configuration



4.12. An SLC arising from a vertical merger may be remedied effectively by structural measures. Such measures might involve reversing the merger, but could also involve reducing the market power that the merged entity has at the critical stage of the supply chain (eg partial divestiture of Compco). If the vertical merger is expected to produce substantial relevant customer benefits that would be largely reduced by structural measures, or divestiture is otherwise not appropriate or feasible, then behavioural measures may be selected by the CC that enable continued access to necessary products or facilities on appropriate terms and/or measures that prevent the merged entity exploiting privileged access to information.

Access remedies

4.13. Access remedies seek to maintain or restore competition by enabling competitors to have access on appropriate terms to the products and facilities of a merged entity that they require to remain competitive.

4.14. An access remedy will normally need to specify an access commitment by the merged entity to customers in significant detail so that customers and monitoring agencies can enforce the commitment effectively. This will include details of the product or facility to be provided, including quality and technical parameters, and the terms of supply of the product or facility, including service levels and the basis of pricing. The latter may be particularly complex and will be subject to many of the same issues that are encountered with price caps as discussed in paragraphs 4.32 to 4.35. If the access commitment is not specified or monitored in sufficient detail then the measure will be vulnerable to specification risk and the merged entity may be able to avoid its obligations readily. In such circumstances the CC will need to consider alternative forms of remedy (eg divestiture) that are likely to be more effective.

4.15. To overcome specification risk, the CC will also generally require that an access remedy should make explicit provision for accommodating future changes, for example, in product specifications or supply arrangements. Where a market is likely to be subject to frequent technological change or other wide-ranging market developments, there is likely to be a significant risk that an access remedy will become ineffective if the terms of the access commitment do not accommodate these changes. However, significant technological change might also reduce the market

power that results in the SLC (eg effective substitutes are developed for the component supplied by Compco).

4.16. In some supply arrangements, certain factors may be particularly important for competitive access that are not easily specified, for example quality of product support, priority for system upgrades, quality of management assigned to a customer's account. Such factors may result in 'soft biases' in access to supply that may generate significant circumvention risk and may significantly undermine the purpose and suitability of an access remedy.[47]

4.17. In certain circumstances it may be possible to simplify the specification of an access remedy by obliging the merged entity to supply a particular product on fair, reasonable and non-discriminatory (FRND) terms where supplies to external customers are provided on the same or similar terms as apply to its own businesses. For this to be effective, the nature of FRND terms must deal adequately with the circumstances of external customers and must be transparent to customers and monitoring agencies in sufficient detail to enable effective enforcement.

4.18. The use of FRND terms may still leave competitors vulnerable to a margin-squeeze by the merged entity as it may have an incentive to charge all downstream businesses, including its own, a uniformly high price since reduced profitability in its downstream business can be offset by higher profitability in its upstream business. The CC may therefore require that use of FRND terms is accompanied by provisions to protect against a margin squeeze (eg submission of regular reports demonstrating full cost recovery in the downstream business).

4.19. Where it is necessary to preserve access to a key facility owned or controlled by a vertically merged company and the usage and capacity of the facility is readily assessed, the CC may determine that the most practical and effective means of providing access to competitors is to cap usage of the facility by the merged company and require it to auction remaining capacity to third parties.[48] This would be effectively a form of 'virtual divestiture' as considered in 3.11.

'Firewall' measures

4.20. 'Firewall' measures[49] seek to prevent a vertically integrated company from accessing and using privileged information generated by competitors' use of the merged company's facilities or products. For example, in Figure 2, in the absence of firewall provisions, Prodco1 may be able to exploit privileged information regarding the orders and deliveries of key components from Compco to Prodco2 and Prodco3.

4.21. Firewall measures prevent access to privileged information by effectively insulating the firm or division generating the information from other group companies. This is generally achieved by restricting information flows and use of shared services, physically separating premises and staff, and regulating transfers of management and any permitted interactions between relevant staff.[50]

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[47]In the London Stock Exchange plc inquiry (2005), the CC rejected a solely behavioural access commitment to clearing and settlement services due, in part, to the likely difficulty of 'soft biases'.
[48]In the Centrica/Dynegy Storage inquiry (2003), the CC required Centrica to restrict its usage of the Rough Gas Storage Facility to a percentage of total capacity to prevent foreclosure of access.
[49]These may be referred to alternatively as 'Chinese wall' measures.
[50]The Centrica/Dynegy Storage inquiry (2003) provides an example of the measures that may be required by the CC to make firewalls effective.

4.22. To ensure effective compliance with firewall provisions, the relevant firm will normally need to commit significant resources to educating staff about the requirements of the measures and supporting the measures with disciplinary procedures and independent monitoring.

Restraining horizontal market power

4.23. Where a firm gains market power as a result of a horizontal merger it may be able to use the strength of this position in a number of ways to limit or restrain competition. These may include:

(a) Requiring customers to enter into long-term and/or exclusive contracts.

(b) Creating switching costs for customers through, for example, volume discounts, contractual penalties or requiring complex switching procedures.

(c) Bundling or tying the sale of particular products.

(d) Selective discounting or predation.

4.24. This category of remedies comprises measures that prohibit, restrict or discourage types of behaviour, such as those listed above, that may limit or restrain competition. The selection and design of these measures will depend critically on the circumstances revealed by the inquiry and the need to avoid specification, circumvention, and monitoring and enforcement risks. Where circumstances point to the use of these measures, the CC will follow the general approach of considering the likely anti-competitive behaviours that the merger parties may have an incentive and ability to engage in. It will then consider the measures that may be taken to prevent or limit the behaviours and the effectiveness and costs of these measures.

4.25. As an example of this approach, the use of long-term and/or exclusive contracts may create a significant barrier to entry or expansion. However, if, in the market in question, firms need to invest heavily to acquire new customers (for example by investing in new facilities or systems) then requiring that all contracts are short term in nature may generate significant distortion risks as this would reduce incentives to compete for new contracts as firms may not have sufficient opportunity to recoup their investment. In implementing a constraint on the use of long-term contracts, the CC will therefore seek an appropriate balance between facilitating switching and permitting sufficient incentives to compete for new contracts.

4.26. Selective discounting or price discrimination can also have the effect of creating barriers to entry or expansion when used systematically to reduce prices to particular customers that are more likely to switch to other suppliers. Measures to restrict selective discounting or price discrimination may therefore be necessary where enabling entry and expansion is appropriate to address the SLC. However, such a restriction may only be necessary for a limited period until other sources of competition develop. Measures restricting selective discounting or price discrimination could generate significant distortion risk by adversely affecting the competitive dynamics of a market if maintained in the long term.

4.27. The CC will have particular regard to avoiding circumvention risk in implementing measures limiting behaviour that would restrict competition. This is because firms with enhanced market power may readily evolve new forms of behaviour to replace restricted conduct.

Controlling outcomes

4.28. Remedies that control or restrict the outcomes of business processes, such as price caps, supply commitments and service level Undertakings, seek to prevent merging firms from exercising the enhanced market power that they are likely to acquire from a merger. As such, these remedies seek to restrict the adverse effects expected from a merger rather than addressing the source of the SLC.

4.29. In order to overcome specification risk, remedies that control outcomes normally need to specify in significant detail the products or services that are subject to control and the basis of the control, for example, the application of price indices to a price cap. The remedy will generally also need to specify how the control will deal with changes, such as the introduction of new products.

4.30. This class of remedy is subject to several significant disadvantages regarding its effectiveness and cost:

(a) Defining appropriate parameters for the control measure, for example the level of a price cap, may be complex and impractical and the measure may therefore be vulnerable to specification risks. This is especially likely where any of the following conditions apply:

(i) Pricing in the relevant market is volatile.

(ii) Products or services are differentiated rather than homogeneous.

(iii) Prices are individually negotiated.

(iv) Supply arrangements and products are subject to significant ongoing change.

(b) This class of remedy directly overrides market signals with the result that it may generate substantial distortion risks over time that increase the effective cost of the remedy or reduce its effectiveness. For example, a price cap may deter entry or a supply commitment may discourage product innovation.

(c) The control may be vulnerable to circumvention risks despite the addition of complex preventative provisions. For example, a price cap may be circumvented by a firm reducing the quality of controlled products or restricting the supply of controlled products.

(d) Monitoring and enforcement may be costly and intrusive and may lack effectiveness, especially where the form of remedy is complex.

4.31. In view of these disadvantages the CC will only use remedies that control outcomes where other, more effective, remedies are not feasible or appropriate. In addition, where this class of remedy is employed, it is most likely to be used on a temporary basis unless there is no alternative to a continuing regulatory solution.

Price caps

4.32. Price caps are likely to be the most common form of measure for controlling outcomes and illustrate many of the issues outlined above.

4.33. Different approaches may be adopted to defining the products and prices to be controlled depending on the circumstances of the case:

(a) Prices of all affected products may be individually capped. This may be impractical where a large number of products are involved and may be inflexible in dealing with product changes.

(b) The average price of a basket of products may be capped. This allows greater flexibility in taking account of shifts in demand between products but the weighting of the constituents of the basket may be problematic and subject to distortion, for example, if revenue-weighting is used and the firm introduces a number of low cost product variants.

(c) The price cap may be restricted to key benchmark products. This approach could greatly simplify monitoring and compliance but is only likely to be effective if a few key products continue to account for a large proportion of sales and the pricing of other products is expected to remain closely related to the benchmark products.

4.34. The CC will seek a basis for the price cap which will prevent the enhanced market power acquired through the merger from being reflected in prices. The basis of a price cap may take a variety of forms:

(a) Prices may be benchmarked to the prices of products in analogous markets that are determined by competition. In practice, this may only be feasible in limited circumstances due to the lack of an analogous market.

(b) Prices may be determined on the basis of input cost data and an approved return on capital. This resembles the approach adopted by many sectoral regulators but generally requires a highly resource-intensive regulatory process backed by extensive information gathering and enforcement powers to be effective.

(c) The price cap may be indexed to pre-merger prices using an index that is representative of input cost changes after incorporating current productivity gains. The CC will wish to use an index which has robust data sources and is constructed independently of the merger parties. Use of such an index may provide a broad approximation to a competitive price outcome in the short term but is at risk of departing significantly from such an outcome in the medium to long term.

4.35. The CC will generally require that price caps are accompanied by measures to prevent circumvention risk that may arise, for example, through the merged entity restricting the supply or service levels of price-controlled products or reducing product quality.

Part 5: Use of trustees and third-party monitors

Appointment and responsibilities

5.1. As discussed elsewhere in this guidance,[51] trustees or third-party monitors (collectively 'trustees') may be used by the CC in a variety of circumstances to assist in monitoring and implementation of Undertakings or Orders. Divestiture trustees may be appointed to procure divestiture to a suitable purchaser if the merger parties are unable to secure divestiture within an initial divestiture period. Monitoring trustees may be required to monitor the compliance of merger parties with interim and/or final Undertakings. Third-party monitors may assist the OFT in fulfilling certain aspects of its role in monitoring the performance of Undertakings. In all cases, the trustees or monitors are under the direction of the CC (or OFT) but are remunerated by the merger parties.

5.2. Trustees should be independent of the parties, have appropriate qualifications and capacity for the task and should not be subject to conflicts of interest. Trustees may be part of an accounting firm, management consultancy or other professional organization. Trustee candidates may be proposed by the merger parties but can only be appointed by the parties following approval by the CC. The CC may set a timetable for the appointment of trustees and would normally expect a trustee to be nominated and approved before Undertakings are accepted. Typically only the CC (or OFT) can terminate the appointment of trustees before completion of their responsibilities. However, the parties can make representations to the CC (or OFT) to replace the trustees if they have good cause.

5.3. The trustee's responsibilities will be specified in the trustee mandate/letter of engagement which will be approved by the CC. The trustee will perform the directions of the CC (or OFT) in accordance with the mandate and will not be permitted to accept instructions from the parties. The mandate will also have appropriate clauses governing conflict of interest, trustee liability and confidentiality.

Remuneration

5.4. The merger parties are responsible for the remuneration of trustees. The structure of remuneration must not compromise a trustee's independence and must provide sufficient incentive to perform the required function to an appropriate standard. To ensure that this is so the CC (or OFT) must approve the remuneration agreement.

[51] See paragraphs 3.23, 3.26 and 4.5.

APPENDIX A

Interim measures

Introduction: interim powers and restrictions

1. When a merger has been referred to the CC by the OFT under the Act, the CC has the power to prevent 'pre-emptive action' during the course of an inquiry. This is action which might prejudice the outcome of the reference or impede the CC from later taking remedial action if it reaches an SLC decision.

2. The CC may accept interim Undertakings from the parties concerned to refrain from activity that would constitute pre-emptive action, or it may make an interim Order to achieve the result it seeks. The CC can also, for the same purpose, adopt any initial Undertakings or Order implemented by the OFT in relation to a completed merger within seven days of a reference being made.[52]

3. These interim/initial Undertakings and Orders (referred to collectively in this document as 'interim measures') continue in force—subject to subsequent variation, release or revocation by the CC[53]—until final determination of the inquiry.[54]

4. During the course of an inquiry into a *completed* merger, the Act prohibits the merged parties from taking further steps to integrate without the CC's consent if no interim measures are in force. During the course of an inquiry into an *anticipated* merger, the Act prevents the merger parties from acquiring any interest in shares in a company to which the reference relates without the CC's consent if no interim measures are in force.

5. When a merger reference is received by the CC, it will consider on a case-by-case basis whether the statutory restrictions described above are sufficient to prevent pre-emptive action, or whether it is necessary to accept interim Undertakings, make an interim Order or adopt any initial Undertakings or Order implemented by the OFT. In cases where a decision is made to adopt the OFT's initial measures, the CC will also consider whether, in the circumstances of the merger parties, the measures need to be strengthened by way of variation of the Undertakings or Order. In all cases where interim measures are implemented, the CC will keep them under review during the course of the reference. Wherever possible, the CC will seek to proceed by way of the acceptance of Undertakings rather than by imposing an Order.

Need for interim measures for completed mergers

6. While the statutory restrictions on dealing in relation to completed mergers prevent the parties from 'completing any outstanding matters' or 'making further arrangements' in connection with the merger and from transferring the ownership or control of any enterprise to which the reference relates, there may be scope for pre-emptive action which falls outside the remit of these statutory restrictions. For example, the acquirer may have significant incentives to run down or neglect the business or

[52]Sections 80 and 81 of the Act.
[53]Or unless the CC replaces the Undertakings or Order with a different type of measure (as envisaged in sections 80(7) and 81(7) of the Act).
[54]Final determination of an inquiry occurs on acceptance of final Undertakings or the making of a final Order or, in the absence of an SLC finding, on publication of the final report.

assets of the acquired business, or to extract know-how and other commercially sensitive information from the acquired business,[55] in order to reduce its competitive capability should divestiture be required.

7. In view of these possibilities, the CC will normally expect to receive interim Undertakings from the acquirer in a completed merger, to clarify or supplement the prohibitions set out in the statutory restriction. For example, the Undertakings may include a requirement that customer lists are operated separately and that any existing supplier or customer contracts continue to be serviced by the business which is party to them. The CC may also seek to restrict information flows between the parties and require the ring-fencing of information so that it can be destroyed or returned to the acquired business if this were required by any remedy that may be imposed by the CC. On occasion, the CC may require functions or decision-making processes to be separated where these have been integrated following completion of a merger and this integration might increase the difficulty of subsequent divestiture or other measures.

8. CC experience indicates that the acquiring party in completed mergers will often wish to negotiate Undertakings to clarify precisely what action it may carry out pending final determination of the reference. It will be in the best interests of both the CC and the parties to conclude discussions on interim Undertakings speedily. The speed at which these discussions can be concluded will be dependent on the speed and quality of information provided by the parties and the complexity of the subject matter. However, if appropriate Undertakings cannot be agreed on a timely basis, the CC may decide to impose an interim Order.

Purpose of standard interim Undertakings template

9. The consideration of interim measures—particularly in relation to completed mergers—will normally take place in the very early stages of an inquiry, possibly before the inquiry group has been appointed.[56] To deal expeditiously with interim Undertakings at the outset of an inquiry and provide a degree of certainty to parties regarding the CC's approach, the CC has prepared a template set of interim Undertakings and associated compliance statements for completed mergers. The template is displayed in the guidance section of the CC website and may be updated from time to time. It should be noted that the OFT also currently uses template Undertakings in similar form as a starting point for the implementation of its own interim measures.

10. The template represents a starting point for discussion between the CC and the relevant party or parties. The template will be applied flexibly and will be adapted to meet specific requirements on a case-by-case basis. The template is not intended to deal exhaustively with all matters that the CC may reasonably wish to see included in interim Undertakings. In some cases therefore, it will be necessary to put in place interim measures that go beyond the safeguards contained in the template.

11. In certain circumstances the CC may require interim Undertakings from both the acquirer and the acquired business, for example, where the senior management of the acquired business has transferred with the business.

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[55]The latter might fall outside the remit of the statutory restriction if the acquired business had been at least partially integrated with the business of the acquirer prior to the reference.
[56]In which case, any decision to accept interim Undertakings, make an interim Order or adopt initial measures will be taken by the RSG. See the CC's *Rules of Procedure* (CC1, rule 5.6).

Hold separate managers and monitoring trustees

12. Additional safeguards beyond those envisaged in the template Undertakings may involve the appointment of a hold separate manager (HSM) with executive powers to operate the acquired business separately from the acquirer and in line with the interim measures for the duration of the investigation. Alternatively or in addition, it may involve the appointment of a monitoring trustee to monitor and report on compliance with the interim measures.

13. The CC will normally consider the appointment of an HSM and/or a monitoring trustee at the outset of an inquiry and it will review the issue throughout the inquiry. The appointment of an HSM and/or a monitoring trustee will be at the expense of the acquiring party.

14. The appointment of an HSM and/or a monitoring trustee is likely where one or more of the following risk factors have been identified:

    (a) there have been breaches of the interim measures;

    (b) there has been substantial integration of the two businesses prior to implementation of the interim measures;

    (c) there is a need for further or continued integration of the business throughout the inquiry subject to the necessary consents from the CC, for example if the acquired business were not a stand-alone business;

    (d) there is a high risk of deterioration of the business, for example through loss of key customers or members of staff;

    (e) the pre-merger senior management of the acquired business is absent and/or strong incentives exist for the current senior management of the acquired business to operate the acquired business on behalf of the acquirer. This last risk factor, in particular, will suggest the need for the appointment of an HSM.

15. As noted above, the CC will examine the need for interim measures on a case-by-case basis, and it will be open to the parties to demonstrate that measures are neither necessary nor appropriate on the particular facts. However, as noted in the judgment by the Competition Appeal Tribunal in the Stericycle[57] case: 'Section 81 gives the CC wide powers for the purpose of preventing pre-emptive action, including "the appointment of a person to conduct or supervise the conduct of any activities"—ie including a HSM. Moreover, the word 'might' used in section 80(10) implies a low threshold of expectation that the outcome of the reference might be impeded.'

Need for interim measures for anticipated mergers

16. The statutory restriction on dealing for anticipated mergers prevents the transfer of shares, but not assets, pending final determination of the reference. Hence, there may be a need for interim measures in relation both to asset acquisitions and to certain share acquisitions (in the latter instance, where there is a concern that assets may be transferred from the seller to the acquirer prior to final determination of the reference). In such cases, the CC may put in place interim measures requiring the

[57] Judgment of the Competition Appeal Tribunal in Stericycle International LLC and Stericycle International Limited v Competition Commission (2007), paragraph 129.

parties not to proceed with the acquisition or with any related purchases or integration pending final determination of the reference. To date under the Act, the circumstances of anticipated mergers have not normally required interim Undertakings.

17. To the extent that interim measures may be required in relation to anticipated mergers, a set of Undertakings or an Order will be prepared preventing the parties from proceeding with the acquisition or with any related purchases or exercise of voting rights or any integration of the relevant businesses pending final determination of the reference. Such measures are likely to differ from those contained in the template interim Undertakings for completed mergers.

Compliance and enforcement

18. To help ensure compliance with interim measures, the CC will normally require the Chief Executive Officers of the companies providing interim Undertakings to provide a monthly compliance statement.[58] In addition, the CC may require further information or a further statement of compliance to be provided on an *ad hoc* or periodic basis. In certain circumstances, for example where there has been significant integration of the acquired business into the acquiring business or where there has been limited or no transfer of the senior management of the acquired business, the CC may also require a representative of the *acquired* business to prepare a monthly report to the CC in such form as may be directed by the CC for the purpose of monitoring compliance with any interim Undertakings given by the acquiring business. It is a criminal offence[59] for a person to provide, either knowingly or recklessly, false or misleading information to the CC.

[58]The matters set out in the template compliance statement are a starting point for discussion between the CC and the relevant party or parties. The template will be adapted to meet specific requirements on a case-by-case basis.
[59]Section 117.

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