John Kwoka
Northeastern University
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Effective Merger Control

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

Economics of Merger Remedies

- Remedies have not always received same attention as analysis of competitive effects
  - Useful to do that, and bring same economics perspective to bear on remedies
- Perspective involves analysis of firm incentives
  - When firm is subject to the constraint of a remedy, how will it behave
  - Are its incentives altered, or if not, ill it strive and succeed in evading the constraint?
- Analogous to famous economics article on rate of return:
  - “Behavior of the Firm Under Regulatory Restraint”
- I will bring this incentives perspective to bear on remedies
  - First, analytically, then empirically

Analytical Perspective: Divestiture

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

Analytical Perspective: Conduct

- Several different types of conduct remedies:
  - Firewalls, must-supply agreements, anti-retaliation provisions
- All these share key features
  - Merger is allowed to proceed
  - Merged firm subject to conduct restraints or requirements
- From incentives perspective, quite a different outcome
  - One decision-maker is lost to the market
  - Merged firm is required to act against own profit-maximizing incentives
  - Independent rivals are dependent on merged firm's conduct

Incentives, Again

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

Why Use Conduct Remedies?

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

Vertical Integration

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

Policy Preferences

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

New Frontier for Divestiture?

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

Empirical Evidence: Agency Cases

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

Empirical Evidence: Retrospectives

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

Price Effects: Kwoka Study

MERGER TYPE	PRICE EFFECT
All	7.2%
Divestiture applied	7.1%
Conduct remedy	16.0%

Price Effects: DGComp Study

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

MERGER TYPE	PRICE EFFECT
All	3.0 %
Cleared	5.1 %
Subject to remedy	0.6 %

Making Conduct Remedies Work

- For either type of remedy, better and worse outcomes
  - Much discussion in literature and policy guides regarding divestitures
- Conduct remedies likely more effective with
  - Simple standardized products
  - Administrative and physical separation of units
  - Outside monitors
  - Technology not changing too rapidly

Third Way? Or Soft Enforcement?

- Conclusions from the evidence
  - Divestitures can work, but they require caution
  - Conduct remedies are problematic and should rarely be relied on
  - It is time for Hard Enforcement:
    - More mergers simply need to be prohibited, rather than disposing of them through remedies of dubious effectiveness
- Recommendations
  - Need more and better evidence
  - Greater transparency from agencies regarding remedies under consideration
  - Agencies need to establish foundation for regular data production from merging parties