EU MERGER CONTROL AND REMEDIES: THE PRICE OF GETTING THE DEAL CLEARED

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Introduction

While the transactions which are prohibited by the European Commission (Commission) on antitrust grounds such as *GE Honeywell*[1] grab the newspaper headlines, those transactions where the parties have to offer a remedy receive far less public attention. Yet of the transactions which the Commission considered problematic from an antitrust perspective, the vast majority resulted in clearances subject to remedies, as opposed to an outright prohibition. Since the adoption of the EC Merger Control Regulation in 1989,[2] 219 transactions which were considered to raise serious antitrust concerns were cleared further to remedies proposed by the parties. Only nineteen transactions have been prohibited by the Commission and in many of these prohibition cases, the parties proposed remedies. However, these remedies were allegedly insufficient to

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1. General Electric / Honeywell, Case COMP/M.2220.

2. Council Regulation (EEC) No 4064/89 of 21 December 1989 on the control of concentrations between undertakings, OJ (1989) L 395/1, as amended by Council Regulation (EC) No 1310/97 of 30 June 1997, OJ (1997) L 180/1, and replaced by Council Regulation (EC) No 139/2004 of 20 January 2004 of the control of concentrations between undertakings, OJ (2004) L 24/1.

remove the competition concerns identified by the Commission, or were offered too late in the proceedings.

Faced with significant European Commission antitrust objections to a deal, companies have few options to salvage the transaction. They may decide to maintain their position that the transaction does not significantly reduce competition in the market, adduce what further evidence they can collect and try to convince the Commission to change their initial opinion and not issue a prohibition decision. At a certain point in the review however, it may become evident that the likelihood of success is limited. The possibility of an appeal to the European Courts from a Commission prohibition decision is not usually considered a realistic option, not least because the timeframe for an appeal is such that the deal is unlikely to survive the lengthy process of obtaining a Court decision. If the parties and their advisors conclude that the proposed deal presents insurmountable antitrust issues, or for any other reasons that the Commission is unlikely to be persuaded otherwise, the parties will need to consider whether those concerns can be addressed by offering a remedy such as divestment of part of the merging businesses, licensing of intellectual property rights to third parties, exiting a joint venture, or granting competitors access to some of the merging parties' facilities in order to get a clearance decision from the Commission. The proposed remedy must be such as to eliminate the competitive problem identified by the Commission[3] and the parties, often with little practical guidance from the Commission, face the tricky task of devising a remedy that will be satisfactory to the Commission without going beyond what is necessary and further sacrificing the value of the deal.

In transactions which raise antitrust concerns, business people need to understand the general principles governing the Commission's policy on remedies under EC Merger Control since the remedy may often represent the 'price' at which the transaction will be approved. Control of timing is of the essence since remedies must be offered within strict time limits and companies should therefore identify sufficiently early in the notification process (where possible, even prior to formal notification) whether and which remedies will likely be considered necessary to obtain approval of their transaction.

Recent Developments in Remedies

The Commission's remedy practice has evolved in recent years as a result mainly of two factors. First, the Commission, after more than ten years of EC Merger Control, decided to carry out a survey on its remedy policy.[4] The survey identified some flaws in the effectiveness of the reme-

3. Recital 8 of Council Regulation (EC) No 1310/97, OJ (1997) L 180/1, and recitals 1 and 6 of Commission Notice on remedies acceptable under Council Regulation (EEC) No 4064/89 and under Commission Regulation (EC) No 447/98, OJ (2001) C 68/3.

4. Merger Remedies Study, DG Competition, European Commission, October 2005.

dies that have been proposed in a number of cases during a reference period of five years. Second, the Commission's policy on remedies has also been under recent scrutiny by the European Courts (the Court of First Instance and the Court of Justice), which have interpreted and clarified some important aspects of the Commission's practice, in particular in relation to behavioral remedies. In light of this, the Commission is in the process of drafting a new notice on remedies designed to give parties and their counsel more guidance on the current policy. The draft notice is expected to be published for comments in the first half of this year. In anticipating the likely changes which will be reflected in this notice and in order to understand the general approach to remedies in EC Merger Control, we first look at the main principles of the Commission's practice, as embodied in a notice adopted by the Commission in 2000, and then focus on the developments which are influencing the Commission's policy in this area.

Main Principles on Remedies (Commission Remedies Notice, 2001)

These principles are embodied in a notice that was adopted by the Commission in December 2000 and published in March 2001 (the Notice).[5] They can be summarized as follows:

Structural Remedies Preferred

The Notice clearly sets out the Commission's preference for structural as opposed to behavioral remedies. For the Commission, structural remedies, in particular divestitures, are far more efficient to restore conditions of effective competition in the case of mergers between companies competing in the same markets because they are expected to eliminate or limit the competitive overlap. Paragraph 9 of the Notice provides that:

> Commitments that would amount merely to a promise to behave in a certain way, for example a commitment not to abuse a dominant position. . .are as such not considered suitable to render the concentration compatible with the common market.

At the same paragraph, the Notice adds that:

> Commitments which are structural in nature, such as the commitment to sell a subsidiary, are, as a rule, preferable from the point of view of the Regulation's objective, inasmuch as such a commitment prevents the creation or strengthening of a dominant position previously identified by the Commission and does not, moreover, require medium or long-term monitoring measures.

Divestment remedies may also include the sale of shareholdings in joint ventures where this is necessary in order to sever a structural link with a

5. Commission Notice on remedies acceptable under Council Regulation (EEC) No 4064/89 and under Commission Regulation (EC) No 447/98, OJ (2001) C 68/3.

major competitor. The first ten years of application of EC Merger Control has confirmed the Commission's clear tendency to approve mergers on the basis of divestitures (for example, between 1996 and 2000, eighty-four out of ninety-six remedies involved divestiture commitments).

The Commission does not exclude that remedies other than divestitures may be acceptable. The Notice refers, for example, to the termination of exclusive agreements, or the granting of access to key infrastructure, content, or technology, in particular through licensing agreements. However, it is not clear from the Notice whether these remedies (referred to as access remedies) should qualify as structural or behavioral. In practice, they may be considered as a mid-way solution between the two types of remedies. On the one hand, their effect on the market structure may be considered as more significant than mere 'promises' to behave in a certain way. On the other hand, unlike divestitures, these types of remedies do not result in a transfer of ownership and, as such, their effectiveness may be subject to subsequent monitoring.

Sale of Viable Stand-Alone and Upfront Purchaser Requirement Business

In cases of divestitures, the divested activities must consist of a viable stand-alone business that is expected to act as a competitive constraint on the merging entity. In cases where the viability of the divestiture depends on the identity of the purchaser, the Commission may require that, before closing the transaction, the parties conclude a binding agreement with a purchaser, the identity of which must be approved by the Commission (the 'upfront purchaser' requirement).

Alternative Divestiture Remedies (Crown-Jewels)

The Notice allows for some flexibility by giving companies the possibility to use alternative remedy packages. The parties may devise a second remedy package to be applied in cases where the implementation of the 'first choice' remedy would prove difficult. The alternative proposal must be 'at least equal, if not better suited' to restoring effective competition in order to be attractive to potential purchasers. Alternative divestiture remedies (also called 'crown-jewels') have been used very infrequently.

Appointment of Trustees Pending Divestment

The Notice includes provisions that aim at monitoring and preserving the viability of the divested business until the parties find a purchaser. This is achieved by the parties' appointment of a trustee who must be approved by the Commission. Typically, the trustee is an investment bank, a management consulting company, an accounting company or similar institution. The parties may also appoint several trustees with different roles, usually a monitoring trustee in charge of preserving the divested business during the interim period, and a divestiture trustee in charge of implementing the transfer once a purchaser is found. Trustees must be independent of the merging parties and have appropriate qualifications to perform their function.

Strict Time Limits for Offer of Remedies

Last, the Notice contains a reminder that remedies should be offered within strict time limits. In Phase I cases, the parties must propose remedies within twenty working days from the date of receipt by the Commission of the notification. The original duration of Phase I (twenty-five working days) is then automatically extended by ten extra working days during which the Commission will 'market test' the proposed remedies. Such market testing usually involves consulting the parties' competitors, suppliers and customers on the appropriateness of the proposed remedies. Remedies offered in Phase I proceedings will be accepted if they readily rule out all potential concerns that the Commission might have about the merger.

In Phase II proceedings, the parties must offer remedies within the first sixty-five working days from the date of initiation of proceedings. In certain cases,[6] this period may be extended by twenty working days.

Since the adoption of this Notice, the Commission's experience with remedies in the meantime and the results of its 2005 remedies study is already influencing the Commission's policy on remedies. This evolution in policy and the implications of the recent judgments of the European Court of First Instance and the European Court of Justice in the *Tetra Laval* case will be reflected in the revised merger remedies notice expected this year.

The European Commission's Merger Remedies Study (2005)

In October 2005, the European Commission's DG Competition published a detailed *ex-post* assessment of merger remedies accepted in forty merger cases approved between 1996 and 2000 (the Study). The Study was carried out by interviewing a range of industry participants including companies that had offered remedies, purchasers, monitoring trustees, customers and competitors. The Study focuses on whether the remedies applied during the reference period were effective to solve the competition concerns identified by the Commission.

The Study identified the following flaws in the implementation of *divestitures*:

- Scope of divested business: the Study reveals that different types of issues in the divestiture process were not always given sufficient consideration, such as the purchaser's continuing dependence on the merging parties for critical inputs, after sales services, or other critical assets. In certain cases, problems occurred in relation to the geographic scope of the divested business, which was some-

6. For example Telia/Telenor, Case COMP/M.1439.

times found to be too small to be developed into an effective competitive asset.

- Influence of third parties: this mostly refers to cases where one of the merging parties had to sell its shareholding in a joint venture. The Study found that non-cooperation from, or additional conditions imposed on the new shareholder by the other partners to the joint venture had considerably delayed the implementation of the remedies in a number of cases.
- Carve-out of the divested business: the Study points out several problems in the divestiture of carved-out assets and notes that the separation of the carved-out assets from the assets remaining with the seller led to serious implementation issues. In some cases, the lack of cooperation from the seller was directly at the origin of the problems. The Study identifies a case where the seller refused to turn over vital proprietary assets and removed the related production equipment from the factory.
- Interim preservation: the Study also points to cases where inadequate preservation of the divested business during the transitional period weakened the competitive strength of the divested assets. The Survey gives examples of interruptions of investment programs or disruptions in customer/supplier relationships.
- Monitoring trustees: the Study notes that trustees were often appointed too late and rarely monitored the actual transfer of the business.
- Importance of selection of the purchaser: according to the Study, many purchasers underestimated the level of expertise required to operate the divested business. The Study also notes that some purchasers had little incentive to develop the acquired business into a competitive constraint on the merging parties, particularly when the business had been acquired for free or at a negative price.
- Transfer of the divested business: the Study identifies serious implementation issues in relation to the transfer of tangible and intangible assets, in particular the transfer of know-how and key personnel of the divested business. The Study found, for instance, that in sixteen divestiture remedies involving intangible assets, the transfer was either incomplete or significantly delayed.

For remedies other than divestitures, the Study suggests that 'access' remedies, such as termination of exclusive rights or granting access to key infrastructure or technology, have worked in a limited number of cases. For the Commission, this was mainly linked to difficulties in defining appropriate contractual terms for effective access (*e.g.,* in terms of scope and financial conditions).

Scrutiny of the European Courts

Back in 1999, in the case of *Gencor/Lonhro,*[7] the European Court of First Instance (CFI) seemed to partly endorse the Commission's practice to systematically favor structural over behavioral remedies. At paragraph 316 of the judgment, the Court mentions that, where the Commission concludes that a merger raises serious competition concerns: 'it is required to prohibit it, even if the undertakings concerned by the proposed concentration pledge themselves vis-à-vis the Commission not to abuse that position.' However, the Court added at paragraph 319 that:

> the possibility cannot be automatically ruled out that commitments which prima facie are behavioral, for instance not to use a trademark for a certain period, or to make part of the production capacity of [the merged entity] available to third-party competitors, or, more generally, to grant access to essential facilities on non-discriminatory terms, may themselves also be capable of preventing the emergence or strengthening of a dominant position.

Interestingly, the CFI seemed to categorize as 'behavioral' certain types of access remedies described in the Commission's Notice.

The Commission interpreted the *Gencor/Lonhro* judgment as a confirmation that promises to behave in a certain way, are generally unsuited to solve competition concerns in merger cases. However, this interpretation may be called into question by the recent judgments in the *Tetra Laval* case, where the European Courts have clarified previous statements made in *Gencor/Lonrho*. In 2000, the Commission prohibited Tetra Laval's acquisition of Sidel in spite of Tetra's behavioral commitments not to leverage its position from carton into plastic packaging, in particular by a commitment not to engage in 'bundling' practices.[8] The Commission considered that such remedies amounted to little more than a promise to refrain from engaging in illegal conduct and were insufficient pursuant to the principles established by the CFI in the *Gencor/Lonhro* case.

Tetra Laval appealed the Commission's decision to the CFI and the case was subsequently appealed to the European Court of Justice (ECJ). In its judgment of 15 February 2005,[9] the ECJ upheld the CFI's conclusion that the Commission's straight rejection, as a matter of principle, of behavioral remedies could not be sustained. The ECJ stated at paragraph 86 of the judgment that:

> Contrary to what the Commission claims, it is not apparent from that judgment [Gencor] that the Court of First Instance ruled out consideration of behavioral commitments.

In *Tetra Laval*, the ECJ considered that the CFI was right to point out that commitments relating to a merged entity's future conduct, in certain

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7. Case T-102/96 *Gencor v. Commission* [1999] ECR-II-759.
8. Teta Laval/Sidel, Case COMP/M.2416.
9. Case C-12/03P, Commission v. Tetra Laval, judgment of 15 February 2005, not yet reported.

instances, may be an adequate or even the *only* possible remedy. The ECJ concluded that the CFI had been correct to find that the Commission should have taken account of the implications of the proposed commitments 'in assessing the possibility that a dominant position might be created in future through leveraging.'

The dividing line between the *Gencor/Lonhro* and *Tetra Sidel* cases may be explained by the difference in competition concerns that the parties' undertakings had to address. In *Gencor/Lonhro*, the Commission was concerned that the merger would have created or strengthened a dominant position through the creation of a duopoly. As such, the transaction had *direct* effects on the market structure. In this context, a promise from the parties not to abuse their position was considered too general and insufficient.

On the other hand, in *Tetra Sidel,* the competition concerns resulted not so much from the creation or strengthening of a dominant position, but from the risk that the merged entity would *leverage* its alleged dominant position from one market to another market where it was not considered dominant. As such, the proposed merger only had *indirect* effect on the market structure. In this context, one could consider that Tetra's undertaking may well have been sufficient to avoid the specific concerns identified by the Commission.

Implications for Future Remedies

We are already seeing some evidence that the Commission's practice is evolving and is being influenced in particular by the results of its remedies study. For example, in its assessment of the proposed merger of *Inco/Falconbridge* last year, the parties offered to divest part of the business in order to address antitrust issues identified by the Commission. The Commission, in that case, required not only an upfront purchaser but also required that the divestment should be completed before implementation of the merger.[10]

In the *Siemens/VA Tech* decision,[11] the Commission accepted the divestiture of a VA Tech subsidiary which included not only the business in which there was a competitive overlap and where the Commission had identified concerns (namely hydro power equipment) but also included the combined cycle business which was a separate market where no antitrust concerns had been raised. In its 2006 Competition Policy Newsletter,[12] the Commission acknowledged in its report on this case that, in accepting this divestiture remedy, 'the Commission took the lessons drawn in its recent Remedies Study into account in order to ensure that the divestment business was a viable, stand-alone entity.' It pointed out that the hydro power equipment business and the combined cycle busi-

10. Inco/Falconbridge, Case COMP/M.4000.
11. Siemens/VA Tech, Case COMP/M.3653.
12. Competition Policy Newsletter Number 2-Summer 2006.

ness 'shared certain corporate functions that ensured the economic viability of the divested business.'

The combined cycle business was ultimately retained by Siemens with the Commission's agreement when it emerged later in the divestment process that the proposed purchaser, Andritz, did not need it in order to ensure the viability of the hydro business. There was yet another twist in that case when, following the Commission's clearance decision, it became apparent to the Commission that the divested business needed to have access in-house to certain technology which was retained by the merged entity. Following discussions with the Commission and the monitoring trustee, Siemens agreed to transfer further staff and assets to the divested business.

In light of all of these developments, we expect that some or all of the following will likely be reflected in the Commission's policy on remedies and in the new Commission notice:

- Divestitures will likely continue to be the preferred remedy although the scope of the divestment packages will be subject to greater scrutiny and the Commission may want to see more robust packages in terms of all of the elements necessary to ensure that the purchaser can emerge as a viable competitor. Prospective purchasers will also likely receive closer scrutiny from the Commission in terms of their ability and incentives to compete.
- The Commission will likely impose stricter requirements in order to protect the value of the assets pending divestment. In particular, the parties may need to appoint trustees at an earlier stage in the process and the Commission may be more demanding in terms of the role which these trustees will be expected to play.
- The Commission may also make increased use of requirements for 'upfront purchasers' or requiring complete implementation of the divestiture before closing of the merger.
- The *Tetra Laval* judgments do not necessarily mean that the Commission will more readily accept promises to behave as acceptable remedies. However, the Courts gave a clear signal that the Commission cannot dismiss such remedies out of hand. In practice, the Commission may find a 'mid-way' approach by requiring companies to combine behavioral remedies with 'access' remedies[13] and divestitures. Some examples of these mixed packages may be found in recent Commission decisions.
    - In Honeywell's acquisition of Novar[14] Honeywell undertook to divest the entire Italian fire alarm systems business of ESSER Italia and to grant an exclusive license to the use of the ESSER trademark for fire alarm products sold in Italy. In addition, Honeywell undertook to license to the purchaser of the

13. As mentioned above, access remedies may be considered as a form of behavioral remedies. See Gencor/Lonhro cf. above.
14. Honeywell/Novar, Case COMP/M.3686.

divested business all the technology necessary to manufacture the fire alarm products, enter into a transitional supply contract and commit to a non-compete obligation.

- In *Procter & Gamble/Gillette,*[15] Procter & Gamble undertook to divest its battery toothbrush business and grant a two year exclusive license for the co-brands used on the divested brand of battery toothbrushes in the EEA. It also committed not to reintroduce the licensed brands in the countries for which the license has been granted within a minimum period of four years after the termination of the license agreements.

For companies, increased scrutiny of remedies, likely increasing demands for a wider scope of divestment packages and wider use of upfront buyer requirements, will present further challenges to securing clearances of their transactions. On the other hand, a more flexible approach from the Commission in terms of accepting a combination of different types of remedies can present advantages in devising more effective remedies which may allow companies to secure clearance while preserving to a greater extent the value of their merged business.

15. Procter & Gamble/Gillette, Case COMP/M.3732.