Remedy Study
FTC File No. P143100

Comment on the Merger Remedies Study Proposed by the Federal Trade Commission

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March 2015

INTRODUCTION AND SUMMARY

This Commission is proposing a systematic study of remedies that it has ordered in merger cases between 2006 and 2012. It invites comment on several issues, two of which are the subjects of my comment. The first issue is the need for such a study, and the second concerns methods to improve the "quality, utility, and clarity" of the information collected.

In this comment, I express my strong support for the need and value of such a study. In addition, I offer recommendations for ways in which the proposed study can be strengthened. I elaborate on these two points in that order.

THE NEED FOR A MERGER REMEDIES STUDY

In 1999 the FTC issued a report evaluating divestitures that it had ordered in the years 1990-94.[1] This report–commonly called the "Divestiture Study"–broke important new ground both in substance and methodology. From a methodological perspective, it illustrated how policy evaluation–common in many other areas of public policy–could be brought to bear on merger remedy policy. The method was in principle straightforward: to examine the parameters and outcomes of a substantial set of comparable past policy experiences with a view to extracting inferences. And indeed, substantively the Divestiture Study led to a number of changes in how the FTC conducted divestiture policy in the past fifteen years. As further confirmation of the importance of that study, it has subsequently been emulated in other jurisdictions, notably, the European Union, the United Kingdom, and Canada.[2]

But much has happened during the past fifteen or twenty years to underscore the need to replicate, expand, and improve on the scope and focus of the original study of divestiture remedies. I list four reasons for the need for a new study.

For one, there now are many more experiences on which to draw and whose inclusion would strengthen the empirical foundation of any conclusions. Indeed, the FTC's own notice in this matter references 92 orders in the seven year period 2006-12, compared to just 35 during the five years of the prior study. Nearly tripling the number of observations would significantly strengthen its empirical foundation and might well permit formal statistical analysis. For example, the correlates of successful vs. unsuccessful remedies might now be subject to explicit empirical testing, a step that would represent a substantial advance in precision and insight.

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[1] Federal Trade Commission, "A Study of the Commission's Divestiture Process," 1999.

[2] European Union Directorate General for Competition, "Merger Remedies Study," 2005. UK Competition Commission, "Understanding Past Merger Remedies," 2010. Canada Competition Bureau, "Merger Remedies Study," 2011.

Secondly, the nature of mergers has arguably changed in recent years, so that a study reliant on twenty-year-old experiences may not capture the policy choices that are most relevant in the matters before the FTC today. For example, many high-profile mergers now arise in information and technology industries, where firms are involved in multiple successive stages of production. This creates vertical as well as horizontal relationships, which in turn confronts remedy policy with greater challenges than for purely horizontal mergers. The relative dearth of such complicated merging structures and associated remedies in the past leaves a gap precisely where current policy faces some of its major challenges.

Third, over the past decade remedies themselves have shifted in their emphasis. The 1999 FTC study focused on divestitures, since at the time divestitures represented the dominant approach to resolving competitive harms from merger short of outright opposition. That emphasis was echoed in the 2003 FTC Bureau of Competition statement on “Negotiating Merger Remedies”[3] and in the 2004 Department of Justice “Antitrust Division Policy Guide to Merger Remedies.”[4] But shortly thereafter, the Justice Department in particular shifted policy toward resolving competitive problems through the use of conduct (“non-structural” or “behavioral”) remedies. Cases such as Ticketmaster/Live Nation, Google/ITA, and Comcast/NBCU all illustrated this shift.[5] And indeed, the 2011 revised policy guide toward remedies issued by the Justice Department articulated exactly this change in approach.[6]

For several reasons, the use of conduct remedies has proven controversial. They do not preserve the same number of competitors, nor do they alter the postmerger incentive for the merging firms to act as a single profit-maximizing entity. Rather, they seek to prevent the merged entity from acting on those incentives, requiring monitoring and other administrative costs. For all these reasons, conduct remedies have attracted considerable attention and criticism.

Only recently has there been any systematic evidence of the efficacy of conduct and other types of remedy. My just published book[7] has compiled all available reliable statistical evidence on the effects of mergers and the effectiveness of policy, including remedies, applied to those mergers. It shows that these carefully studied merger cases, when subject to divestiture remedies, on average resulted in price increases on the order of seven percent, while those

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[3] Bureau of Competition, Federal Trade Commission, “Negotiating Merger Remedies,” 2003.

[4] Department of Justice, “Antitrust Division Policy Guide to Merger Remedies,” 2004.

[5] These are discussed in detail in J. Kwoka and D. Moss, “Behavioral Merger Remedies: Evaluation and Implications for Antitrust Enforcement,” Antitrust Bulletin, 2012.

[6] Department of Justice, “Antitrust Division Policy Guide to Merger Remedies,” 2011.

[7] J. Kwoka, *Mergers, Merger Control, and Remedies*, MIT Press, 2015.

subject to conduct remedies permitted price increases that averaged sixteen percent. These data suggest a serious cause for concern about the use of conduct remedies in particular, but they also raise concern about the efficacy of divestitures that have been more widely used. Hence, for this reason, too, the proposed remedy study–not limited to divestitures--will address what have become very important questions about the efficacy of remedies.

Fourth and finally, despite its breakthrough nature and its significant findings, the original FTC Divestiture Study suffered from some methodological weaknesses. Rectifying those limitations would create a sounder foundation for conclusions that might emerge, whether those conclusions are identical to those in the 1999 Divestiture Study or different from them. In particular, the following limitations of that study need attention:

• It relied almost exclusively on interviews with buyers of divested assets. Interviews are compromised by imperfect recollection by the parties, by a tendency to reconcile views to present reality, and by an asymmetry in that only surviving competitors and customers can participate. While some of these potential distortions may be addressed, these concerns really imply value to corroboration from additional techniques.

• It sought to determine only whether the divested assets survived. Survivorship is a necessary but not a sufficient condition for a successful remedy. Success requires replacing the competition otherwise lost due to merger, and in practice requires that the divested assets not only be financially viable but also that they result in either a new competitor or the strengthening of an existing competitor, in either case to a degree sufficient to restore competition.

For all of these reasons, I have previously advocated that the antitrust agencies undertake a new study of merger remedies (as well, I might add, a study of merger control).[8] I believe that the core of this proposal--to replicate and enhance the prior FTC Divestiture Study--is essentially the necessary study. It will provide important new insight into remedy policy and lead to improvements in that policy at least as substantial as from the earlier study.

IMPROVING THE MERGER REMEDIES STUDY

The proposal for a merger remedies study describes a process involving enumeration of all FTC merger orders in the relevant time period, and then a breakdown of those orders into categories depending on the extent of information about the sector that already resides within the FTC. For the majority of orders, a case study approach analogous to that in the original FTC Divestiture Report would be adopted. For fifteen orders where the FTC has what is said to have "extensive expertise in crafting remedies," interviews would be largely replaced by questionnaires, and for the remaining twenty-four orders in the pharmaceutical industry, again FTC expertise and on-going monitoring are said to suffice. The notice then lists about a dozen specific topics, with perhaps others to be added, that will be investigated.

[8] Kwoka, p. 160.

There are a number of aspects of this proposed study that could, and I believe should, be strengthened. I list five such matters.

First and perhaps most importantly, the proposal does not state clearly the criteria for a successful remedy, and thus leaves ambiguity in how these orders will ultimately be judged. The proposal states that the study will seek to determine the "factors that contributed to the Commission successfully or unsuccessfully achieving the remedial goals of the orders," but the crucial part of that statement–what those remedial goals are–is not clarified. As I noted above, the 1999 Divestiture Study adopted the criterion of financial viability of the divested assets, and thus was able to conclude that in about 75 percent of cases the remedies achieved their objective. But that favorable conclusion was made possible only by setting an incorrect standard. The criterion for a successful remedy is that it preserve or restore the competition that would otherwise be lost as a result of the merger being approved. Language to that effect can be found in the FTC Bureau of Competition Statement on Negotiating Merger Remedies (2003) and in both the 2004 and 2011 versions of the Justice Department Antitrust Division's Policy Guide to Merger Remedies.

To be sure, this proposal does not explicitly adopt the same low bar for "success" of an order as did the 1999 Divestiture Study, but evaluating success against the "remedial goals of an order" does not preclude the possibility that some orders may have had only modest goals, so that they could be construed as successful even if competition ultimately suffered. I would therefore urge that the guiding principle for evaluating the studied remedies be made explicit, and that principle should be whether or not the remedy resulted in preservation or restoration of the same degree of competition in the market as would otherwise have occurred.

Secondly, while every data collection exercise must have bounds, this study proposes a limit of the period 2006-12. The stated reasons have merit, but there are other factors that, I believe, should also be considered in the ultimate determination. It would be important to know, for example, whether going back before 2006 for even a small number of years would capture a set of different experiences with respect to mergers and their remedies than what characterized the 2006-12 period. If the nature of mergers or the types of remedies changed, there might be merit in going farther back, even though the more recent years would seem relevant now.

Related to that is the fact, stated in this proposal, that the chosen period contains only ten orders that relied exclusively on conduct remedies. The particular importance of that type of remedy again raises the question of whether a somewhat earlier starting point would pick up enough additional observations to make that worthwhile. That need is underscored by the fact that the term "conduct remedies" in fact encompasses several different types of behavioral constraints, including firewalls, supply agreements, anti-retaliation provisions, and mandatory access requirements. Each of these raises somewhat different incentive and administrative issues, so that merely ten observations for conduct remedies overall will predictably result in too few examples of specific types and the inability to draw necessary inferences for policy. I would therefore urge consideration of an extension of the time period to ensure development of adequate information about conduct remedies in general, and about their specific types.

Third, the proposed methodology relies heavily on interviews–interviews with buyers, but also interviews with competitors and customers. The latter represent a commendable effort to develop a more comprehensive picture of the effects of each remedy than was achieved in the 1999 Study, but interviews have certain limitations that should be recognized as well. Not only do people forget, but their views may be distorted by the events themselves. Parties that may have been adversely affected may reconcile themselves to the new reality or simply choose not to revisit their more skeptical understanding of the merger. Worse yet, competitors or buyers whose business operations may have thoroughly undermined by the merger and forced to exit are not candidates for being interviewed under this protocol–and indeed, may have simply disappeared. Interviews only with "survivors" raises a clear concern with selection bias.

I also would question the decision not to conduct interviews for more than 40 percent of the orders. Again, I understand the stated rationale, but the study may ultimately be less convincing to some readers due to the failure to adhere to the same methodology throughout, and instead for the Commission in cases like pharmaceuticals simply to declare that it already knows enough. As the saying goes, it does not know what it does not know. Moreover, pharmaceutical cases often involve intellectual property issues, which raise some distinctive concerns that arguably require more attention, not less, than ordinary remedies.

Additionally with respect to the interviews, the strategy of interviewing exactly two respondents raises concern over disclosure. The final report, for example, cannot say that "buyer opinions were divided" on some question, without each of the buyers thereby knowing what the other buyer reported. While this can be avoided by saying less in the report, that would seem clearly an inferior strategy to conducting an additional interview or two so as to be able to report what respondents generally had to say.

Fourth, the proposed study would collect quantity and revenue data for three years before and after the remedy. The proposal is silent as to exactly what is to be done with these data, but they seem obviously designed to permit a retrospective analysis of the remedy. The Commission has considerable expertise in this area, and again, I have advocated precisely this.[9] If that is the intent, this is a very important and very welcome supplement to reliance strictly on interview-based information about the outcomes of remedies, but to do this properly requires attention to issues not specified in this study proposal. Let me list three such issues.

One concerns the specific data to be collected. The proposal states that the data will be for sales revenue and quantity. This will, of course, permit calculation of something like "price." While price is the best single metric for many, perhaps even most, mergers, it is not the only outcome variable of interest, and indeed in some industries not the most important outcome. In hospital mergers, much debate surrounds quality outcomes as well as price. In pharmaceutical mergers,

[9] Kwoka, p. 160. A useful summary of this methodology appears as chapter 4in that book: "A Guide to Merger Analysis Using Difference in Differences," by D. Greenfield.

an important concern often involves commitment to R&D or its productivity. In these and other cases, good measures of price outcomes are manifestly not sufficient to address the key questions. Since this study will be gathering data from the parties subject to many recent remedy actions, it is important to collect all the necessary data, which in some cases involve nonprice outcomes.

A further concern involves the chosen time period of three years before and after the remedy. There is simply no standard time period for all mergers or remedies. For example, three years after divestiture may be not sufficient for the firm to approach post-remedy equilibrium in cases where technology, fixed and sunk costs, learning curves and the like slow the adjustment process. Moreover, adhering to three years before a remedy runs considerable risks of not capturing the relevant equilibrium, which is the premerger state of the market, and not simply pre-remedy. There are many well-known cases where expectations of a merger contaminate premerger data, and certainly instances where a merger investigation and remedy process consumes a good fraction of three years. I would strongly urge a more flexible standard for both the length of time and for the benchmark year, both tailored to the historical experience of any particular case.

Furthermore, if these data are ultimately to be employed in conducting merger remedy retrospectives, in many cases data beyond quantity and revenues will be required. It would be prudent for the Commission to consider what additional data are required in each case in advance, and for the study to obtain such data from the parties in the same request as for quantity and revenues.

Also, the prospect of retrospectives on many remedies and the underlying mergers opens up the following possibility: the Commission could compare the results of its interview-based evaluation of these remedies with the results of the outcomes as measured by actual data. Not only would this offer great insight into the capabilities of retrospectives, but it would also represent a test of whether the standard interview-based approach–use by the FTC, DGComp, UK Competition Commission, and CCB–is sufficiently accurate to arrive at the correct results. If so, this would corroborate the consistency of these techniques and permit agencies to employ whichever represented the better alternative in specific circumstances. If not, that would be important to know in order to avoid reliance on an inaccurate technique. More constructively, discrepancies in the conclusions of the two approaches could be analyzed for the factors responsible for causing the interview process to fail. This would, in turn, help improve the interview process in its future applications.

Fifth and lastly, I would urge further attention to the role and performance of monitors and trustees. Parties to remedies not infrequently complain that monitors issue burdensome requests, conduct fishing expeditions, and run up expenses, and indeed there are anecdotal experiences that appear to corroborate these concerns. I think a fair and thorough evaluation of the remedy process should also seek information and insights into the procedures employed by monitors, the contractual arrangements that set out their duties, the costs associated with their activities, and the effectiveness of any oversight to which they may be subjected. Much as with the 1999 Divestiture Study and this proposed new study of merger remedies, a close examination of monitors might shed light on the factors that make for more efficient and effective enforcement of remedy policy. I would urge attention to these issues as this proposed study takes final form.

CONCLUSIONS

Let me reiterate my belief that the proposed study of merger remedies is an important undertaking, and one that I fully support. I have offered several suggestions for ways in which I believe its methodology and ultimately its conclusions could be made stronger yet. I urge attention to these as the study takes final form.

Respectfully submitted,

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