Claim efficiencies or offer remedies? An analysis of litigation strategies in EC mergers

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Abstract

Efficiency defence and merger remedies are key components in most merger control regimes. Although in many jurisdictions both the provision of efficiency-related evidence and remedy offers are at the merging firms’ discretion, most previous works have only analysed them separately. This paper is an attempt to empirically model the system of decisions that firms face in merger litigation where they are allowed to choose what combination of efficiency claims and settlement offers to make. The main novelty of this work is the use of data from company reports on the merger-generated synergy expectations signalled to shareholders, which allows the direct empirical testing of some of the assumptions and findings from previous works. Evidence is presented that the current EC merger control regime is incapable of extracting information from firms on their efficiency expectations and the identity and experience of the legal advisor plays a key role in this: that pre-merger synergy expectations enhance the willingness to offer remedies; and finally, that the cost of delay plays a central role in designing firms’ litigation strategy, especially when these costs exceed the cost of the remedy.

1. Introduction

Merger control is focused on governing mergers that hinder competition and are large enough for this effect to be harmful for the society. When determining the competitive impact of a merger, the competition authority (CA) takes into account expected efficiencies put forward by the merging firms (efficiency defence). The efficiencies brought about by the merger can counteract the negative effects on competition and the potential harm to consumers. If these efficiencies are sufficient to outweigh the anticompetitive effects, the CA will approve the merger. In the absence of efficiency gains, anticompetitive mergers may also receive regulatory approval if parties to the merger offer a settlement package (merger remedy) to the CA, which modifies the notified merger transaction, as a result of which the anticompetitive effects are eliminated.

The common factor in the two legal instruments – merger remedies and efficiency defence – in many jurisdictions is that they both have to be initiated by the merging parties. The CA is not in a position to impose remedies on the merging parties, but it can assess whether the remedies are capable of eliminating the competition problem. Similar rules apply to efficiency claims. Given the information asymmetry between the CA and the merging firms, the CA only takes those substantiated and likely efficiencies into account that were brought forward by the merging parties. In this regulatory framework, firms have to balance between the cost of divesting valuable assets, and the cost of a delay caused by the regulatory assessment of efficiencies. If the cost of delay is higher than the cost of divestiture, evidence on efficiencies may be withheld during the investigation. If delay is less costly than divestiture, firms will probably reveal efficiency evidence and offer smaller remedies.

For these reasons, the unbiased analysis of merger litigation should account for the fact that firms simultaneously assess what combination of efficiency claims and remedy offers to opt for. Nevertheless, only a few papers allow for the possible interaction between the above two merger control instruments. Papers by Lagerlöf and Heidhues (2005), Motta and Vasconcelos (2005), and Neven and Röller (2005) model merger litigation with a special emphasis on efficiency claims, whereas Garrod and Lyons (2011) focus more on the analysis of remedy offers in litigation. Cosnita and Tropeano (2009) is an example where both efficiency claims and remedy offers exist simultaneously, and interaction between the two leads to the finding that efficient mergers value their assets more highly and are therefore less willing to divest them.1 Bougette (2010), who analyses the effectiveness of remedies, also found that cost savings reduce the scope of remedy offers.

This paper is an attempt to model merger litigation empirically by looking at how firms design their litigation strategy, of which efficiency claims and remedy offers both form part. Its novelty lies not only in empirically modelling the system of decisions that firms face in

1 For repeated referencing to the Lagerlöf and Heidhues (2005), the Cosnita and Tropeano (2009), and the Garrod and Lyons (2011) papers, they are hereinafter denoted as LH, CT, and GL respectively.
merger litigation but in using data from company reports on the
merger-generated synergy expectations signalled to shareholders.
This allows the direct empirical testing of some of the assumptions
and findings from previous works. Synergies communicated to share-
holders are also used as a proxy for cost of delay in order to distin-
guish cases where cost of delay dominates divestiture costs, and to
test how it impacts merging parties’ willingness to find an early set-
tlement. The focus of analysis is on European Community mergers
but the findings of this paper should bear relevance to all jurisdictions
that place both remedy offers and efficiency defence at the merging
parties’ discretion.²

Although CAs should take both the benefits and the harms of
mergers into account, this paper finds that the EC fails to extract
information on potential benefits from the merging firms. Firms report
some evidence on the synergies that their merger is expected to generate
through integration but this evidence is not necessarily revealed to
the Commission. This calls into question the assumptions used in Motta
and Vasconcelos (2005), Neven and Röller (2005), and CT, i.e. that
mergers with efficiency evidence in hand always have the incentive
to reveal this evidence. Rather, this is more likely to depend on the experi-
ence of the legal advisors in the case. Evidence is presented that EU law
firms with more experience in merger litigation are less likely to advise
on making efficiency claims. This creates a situation where some mergers
with relevant evidence may decide to keep quiet about it, potentially for
reasons discussed in LH.³ At the same time, other mergers that have no
efficiency-related evidence may try to bluff and make efficiency claims.

Both CT and Bougette (2010) claim that high cost savings reduce the
size of remedy offers, because the cost of divestiture increases for more efficient mergers. Although this paper only makes inferences
on the size of divestitures relative to the level required by the CA,
evidence is presented that firms that reported high efficiencies to
shareholders only exhibit reluctance to offer relatively large upfront
remedies when they made efficiency claims to the CA. Firms become
more eager to find an early settlement when they choose not to apply
for efficiency defence, and this effect becomes stronger the more ef-
ciencies they signalled to shareholders. One possible explanation for
this could be that this paper allows cost of delay to dominate the
cost of divestiture in some cases. Given the higher saving expecta-
tions, parties to these mergers are expected to be more delay-averse
(higher cost of delay) and are therefore likely to be offering overly
large remedies to gain early approval, as proposed by GL.

Finally, evidence is provided that mergers with higher efficiency expectations are willing to reach early settlement by making larger and quicker remedy offers, except when they had made efficiency claims to the Commission. This implies that firms may have an expecta-
tion that the CA tailors remedies to take the total effect of mergers
(including the claimed efficiency gains) into account, the importance
of which has been highlighted by Röller and de la Mano (2006).

The paper is structured as follows. Section 2 presents the motiva-
tion and the economic framework of the paper, based on preliminarily observed data, the characteristics of the EC merger control regime, and
the priors brought from theoretical papers. Section 3 introduces the
data and the key variables. Section 4 discusses the econometrics used
in the paper, including a discussion of the exogeneity of these variables
and potential treatment effect issues. Finally, Section 5 presents a set of
estimates and their economic interpretation is discussed. The paper
concludes with a discussion of the validity of the assumptions made.

2 Although with minor differences, this is the case in a number of jurisdictions. For example in the US the DOJ and the FTC negotiate a settlement (a consent decree) or accept a “fix-it-first” remedy proposed by the merging parties, and efficiencies are only considered if parties establish them by clear and convincing evidence. The UK is an exception, where the CA can impose remedies.

3 LH argue that by choosing the enforcement regime (laissez-faire, hard-evidence, or strict regime) CAs can influence the amount of evidence merging firms provide on efficiencies.

2. Motivation of the paper

An unbiased CA should take both the resulting harms as well as the
potential benefits of a merger into account. Given the information
asymmetry between the CA and the merging firms, the assessment of
the latter is a potentially challenging task, which requires that merging
terms to have a sufficient incentive to bring forward all available
efficiency-related evidence. To examine whether this is the case, this
paper looks at the synergy expectations that merging firms signalled
to shareholders pre-merger. These quantified merger-generated saving
expectations are based on firms’ pre-merger assessment of the effect of
the merger.² Firms start assessing the impact of their merger much be-
fore it is notified to the CA. This often entails months of rather costly
work of clean teams, and in-house experts, that build detailed financial
models for assessing cost synergies arising from the merger.³ Few extra
direct costs would be incurred by bringing this evidence forward to the
Commission, and one would thus expect that many mergers will do so.
Fig. 1 shows that this is not the case by plotting the number of cases
where the merging firms report efficiency gains to shareholders against
the number of cases where efficiency claims are made to the EC. This
suggests that even with efficiency evidence in hand, firms may choose
to not reveal it, much in the same way as in the case of LH’s hard-evidence competition regime.

Table A.6 in the Appendix A also shows that there is no correlation
between efficiencies signalled to shareholders and efficiencies signalled
to the EC. This implies that assumptions in Motta and Vasconcelos (2005), Neven and Röller (2005), or CT, that (when available) efficiency
related evidence is always shared with the CA, may not hold. One po-
tential reason could be that efficiency claims take a long time to inves-
tigate and can typically only be undertaken within a lengthy second
phase investigation.⁴ This potential delay represents extra costs for
the merging parties. These two effects (having the evidence in hand, and
facing the prospect of a delay as a result of providing this evidence)
should, in theory, simultaneously determine how much efficiency-
related evidence firms reveal to the CA.

The main objective of this paper was to confirm that these findings
hold when firms are allowed to make settlement offers to the CA, and
when other effects are also controlled for. In passing, the possibility of
the contrary situation (i.e. making efficiency claims even when firms
do not in fact expect them) is also examined.

2.1. The regulatory framework

In order to understand how the withholding of efficiency-related ev-
idence may be in the interest of merging of firms, some understanding
of the underlying legal system is needed. According to the European
Merger Regulation (ECMR),⁵ an otherwise anticompetitive merger can
be approved only if the benefits arising from the merger outweigh the
negative effects, but the burden of proof is on the merging parties.⁶ This
would suggest that withholding information on the benefits makes very
little sense. However, the assessment of efficiencies is very likely
to trigger a lengthy investigation, which has been clearly pro-
nounced out by the Commission in previous cases.⁷ These

⁴ This data is discussed in more detail in Section 3.3.
⁵ As the pre-merger cooperation or coordination of firms would trigger the intervention of anti-cartel agencies, merging parties often hire clean teams to design an effective inte-
gration strategy. Clean teams carry the mandate of the merging parties and have legal clearance to analyse any relevant company data and work under strict confidentiality. They provide monitoring instruments for tracking synergies, advise lawyers on regulatory
issues, and set up the post-merger governance model. See more on clean teams in Chamunugam et al. (2005).
⁶ Ormosi (2011) provides an analysis of this delay.
⁷ Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concen-
⁸ Paragraph 87 of the Horizontal Merger Guidelines.
⁹ See for example the Commission’s statement in Paragraph 62, Case No IV/M.4057-
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