

Competition Memo: March 1997

Remedies: so much to do, so little time



INTERNATIONAL

The process of devising remedies in competition law cases often seems similar to calculating damages in a litigation case: months spent arguing over liability and then a back-of-the-envelope damages calculation on the last morning of the case. There is no doubt in our minds that insufficient time is devoted to the framing of remedies. The results are often highly disruptive to the industry involved and have no countervailing benefits for consumers. The 1989 MMC report into the supply of beer, for example, led to a radical restructuring of the industry but it is not easy to see how consumers have benefited from the ownership restrictions imposed on large brewers (indeed, despite wholesale prices falling, retail prices have risen in real terms).

It is particularly important to devote adequate time to devising remedies in “failing firm” cases (i.e. in merger cases in which the acquired company is likely to exit the market if the merger does not take place). This is because in such cases it is not possible to return to the original market structure. If the merger is prohibited, the market structure will still change because the “failing firm” will exit the market.¹

In failing firm cases the competition authority frequently wishes to devise a remedy that allows the assets of the failing firm to be put to productive use without leaving the merged company in too powerful a position. A recent UK case provides an example of the unnecessary disruption and damage that can be caused in a failing firm case when regulatory authorities pay inadequate attention to remedies.

Scottish Milk

Robert Wiseman Dairies, a large milk processor accounting for 52% of sales of fresh processed milk in Scotland, was seeking clearance to bid for its principal rival, Scottish Pride, which had a 26% share. Wiseman had expanded rapidly both by acquisition and organic growth, also entering the English market via a depot in Manchester. In contrast, Scottish Pride was in financial difficulty. Wiseman argued that entry barriers were low, geographic markets wide and buyer power

formidable so the high post merger market share in Scotland would not lead to higher prices.

The MMC accepted some, but not all, of these arguments. Most significantly, it asserted that an enlarged Wiseman might be able to exert market power by raising prices in the ‘secondary’ sector (i.e. to customers other than supermarkets). That is, the MMC accepted the buyer power argument in respect of the multiple grocers but did not accept that this extended to smaller buyers. It did not block the merger, however, because Scottish Pride was unlikely to remain viable as an independent company, and the prospects of finding an alternative buyer were thought to be remote. Moreover, it realised that if Scottish Pride left the market, most of its customers would go to Wiseman. So the MMC’s task was to balance two countervailing pressures. On the one hand it had to construct a remedy that would protect consumers from the possibility that Wiseman might be able to raise some prices after the merger. On the other hand it had to ensure that the remedy was not so onerous that Wiseman would be better off abandoning the merger, with the result that Scottish Pride’s assets left the market.

On Making Markets Transparent

The MMC recommended that Wiseman should be required to submit regular audited reports to the Director General of Fair Trading (DGFT) on its prices to the various categories of customer in Scotland. This would give the DGFT early warning of any attempt by Wiseman to abuse its market position by raising prices to customers other than the national supermarket groups, and it would involve minimal regulatory costs. The MMC argued that the threat of a monopoly reference, with the associated risk of divestment of one or more of Wiseman’s Scottish plants, should deter Wiseman from attempting to raise prices.

On the face of it, this was a reasonable remedy. Indeed, Wiseman at first thought the remedy acceptable. The devil was in the detail. Hidden away at the end of a chapter in the MMC report was the requirement that the price data “should be made available to the public on demand so that consumers could, if they wished, see how the prices they paid compared to the average and the range for their sector”. The MMC’s aim was to make prices in the industry extremely transparent in order to strengthen the bargaining position of Wiseman’s smaller customers. But the MMC had not fully thought through the implications of this remedy.

¹ There is an exception to this. It could be that market structure is unchanged because the assets of the exiting firm are bought by another firm that enters the market in the same or a better competitive position as the firm that left the market.

Merger Inquiry or Monopoly Inquiry?

The MMC had failed to realise that the degree of price transparency that it was proposing far exceeded the level that had existed pre-merger or that was likely to exist if the merger did not proceed. Understandably, Wiseman did not relish the prospect of explaining to customers paying above average prices why they were more costly to supply. There would have been a potential loss of goodwill from customers who were paying above the average price and the resulting pressure for price equalisation would have resulted in an inefficient outcome in which prices did not reflect marginal costs.²

There is a further, important point here. The MMC appeared to forget that this was a merger inquiry, not a monopoly inquiry. The aim of a merger inquiry is to ensure that the post-merger position is not less competitive than the position which would apply in the absence of the merger. The situation absent the merger would not have had completely transparent prices³ leading to price equalisation, so it was not, in our view, appropriate for the MMC to insist on it post-merger. This is particularly true given that there was a simple remedy that was available which would have ensured that the post-merger position was no less competitive than the pre-merger position and that Wiseman was happy to accept. Simply submitting confidential, regularly audited, price reports to the OFT would have allowed the OFT to ensure that Wiseman was unable to raise prices in the secondary market without risking a MMC monopoly reference and possible divestment of assets.

Failing Firms Fail

A protracted debate ensued between Wiseman, the OFT and the DTI. Various compromises were proposed by Wiseman which would have allowed the OFT to detect anti-competitive behaviour in the secondary sector without requiring Wiseman to divulge commercially sensitive information. After much deliberation, the OFT announced in the middle of February that the Secretary of State had rejected Wiseman's compromise proposals.

In a matter of days, Scottish Pride went into receivership. Whilst Wiseman and the regulatory

authorities had been negotiating, Scottish Pride's financial position had worsened, losing further large supermarket customers. The OFT and DTI, realising that their bargaining position had been undermined by events, apparently relaxed their insistence that prices had to be published. Wiseman was happy to meet the other undertakings and completed the purchase.

Lessons

What lessons should we learn from this sorry tale? The most important is that competition authorities need to give more consideration to remedies than they currently do. The Wiseman "super-transparent" price remedy was not discussed during any MMC hearing that Wiseman attended and in the final report it was tucked away at the end of a chapter: it did not even make it into the Summary of the report. This suggests that the MMC had not fully appreciated the impact of the remedy it was recommending. The lack of analysis by the MMC, detailed above, was particularly unfortunate in a failing firm case in which regulatory delay can have long-lasting effects.

The big losers are the 2,000 farmer-shareholders of Scottish Pride. The original Wiseman bid (at 50p a share) would have yielded them £15m. Most of the valuable business having melted away, the shares are now effectively worthless and the farmers are likely to get nothing. To make matters even worse, many of these farmers are owed money by Scottish Pride in their role as suppliers of milk to the failed firm.

It appears, however, that competition authorities in both Europe and the UK will take the issue of remedies more seriously in future.⁴ The European Commission has recently commissioned a research study to look at remedy policy in the EU and at the effectiveness of the Commission's past remedies in major cases.⁵ We hope that this initiative marks the beginning of a more systematic approach to remedies by the Commission. We note with approval that the Office of Fair Trading in the UK is also currently sponsoring research into remedies.

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² There is a serious economic efficiency point here. Unless all consumers in a given category paid the same price (which would be clearly economically inefficient as the marginal cost of supplying customers varies considerably), there would always be some who were paying above the average and who would be unhappy, thus leading to a loss of goodwill.

³ Note that it is extremely rare for prices to be completely transparent in wholesale markets with heterogeneous buyers.

⁴ This is well timed given that recent developments in the quantitative analysis of markets makes it easier to fully analyse the implications of a remedy for the competitive structure of a market.

⁵ This work is being carried out by Lexecon and associates. We expect to deliver our final report in November.