MERGERS AND ACQUISITIONS: DIVESTMENT REMEDIES GUIDELINES

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COMMERCE COMMISSION

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1 PREFACE

1.01 Mergers perform an important role in the market and can bring benefits to the economy, such as enabling businesses to achieve economies of scale and scope. However, some mergers may alter the structure of markets in such a way as to substantially lessen competition. The Commerce Commission is responsible for assessing applications for clearance from businesses seeking to acquire or merge with competitors.

1.02 Under section 69A of the Commerce Act 1986 (Commerce Act), the Commission is able to accept structural divestment undertakings from an applicant in respect of the clearance of a business acquisition. The purpose of divestment undertakings is to remedy the competition concerns raised by the proposed acquisition while also allowing the merger to proceed with its potential benefits and efficiencies.

1.03 These guidelines relate to applications for clearance and aim to:

- ensure that applicants are fully informed of the Commission's approach for assessing divestment undertakings;
- ensure that applicants provide the Commission with sufficient and relevant information to enable the Commission to expeditiously consider a divestment undertaking; and
- provide a single source of guidance on the Commission's approach to assessing divestment undertakings.

1.04 These guidelines reflect the Commission's current approach for assessing divestment undertakings. The Commission's practice will continue to develop in light of judicial precedent, general practice and experience. These guidelines may, in due course, be supplemented, revised or replaced.

1.05 Although they cover the main process issues for businesses and their advisers, these guidelines are not intended to cover every issue that may arise. They are not intended to be:

- a binding statement of how discretion will be exercised in a particular case;
- a substitute for legal advice; or
- a restatement or definitive interpretation of law.

1.06 Anyone in doubt about whether to offer a divestment undertaking when submitting an application for clearance should consider seeking legal advice.

1.07 These guidelines should be read alongside the Commission's *Mergers and Acquisitions Guidelines* and the *Merger and Acquisition Clearance Process Guidelines*.

2 THE LEGAL FRAMEWORK

2.01 Section 47 of the Commerce Act prohibits acquisitions of the assets or shares of a business when this would have, or would be likely to have, the effect of substantially lessening competition in a market.

2.02 Under section 66(3)(a) of the Commerce Act, the Commission may give clearance for a merger if it is satisfied that the acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in a market.

2.03 A merger clearance provides applicants with protection from proceedings initiated under sections 27[1] and 47 of the Act by the Commission and/or from any other party. If a merger has not been completed, a clearance expires:

- 12 months after the date on which it was given; or
- in the event of an appeal being made against the Commission's determination, 12 months after the date on which the determination is confirmed by the court.

1. Section 27 provides a broad rule that states that no person shall enter into an agreement that contains a provision that substantially lessens competition in a market.

2.04 Under section 69A of the Commerce Act, the Commission may accept undertakings in giving a clearance. Undertakings must be provided in written form by the applicant or on behalf of the applicant.

2.05 The Commission can only accept undertakings to divest assets[2] or shares.[3] Under the Commerce Act the Commission is only able to consider structural undertakings. The Commission is unable to accept behavioural undertakings.

2.06 If divestment undertakings are accepted by the Commission, they are deemed to form part of the clearance given.

2.07 Section 69AB of the Commerce Act states that if a divestment undertaking is contravened (eg, the divestment does not occur), the clearance to which the undertaking relates is void from the date it was granted. This means that the applicant is no longer protected from proceedings initiated under sections 27 and 47 of the Act by the Commission or another party.

2.08 If the Commission is satisfied that there is a contravention of an undertaking, it can apply to the Court under section 85B of the Commerce Act for a divestment order. Under section 85B, the Commission is not required to establish a substantial lessening of competition in a market. Rather, the Commission must show that the terms of the divestment undertaking have not been met by the applicant.

2.09 The Commission may also employ the following enforcement options:

- seek an injunction from the Court under section 84 of the Commerce Act to halt the merger; or
- use a cease and desist order under section 74A of the Commerce Act to halt the merger; or
- apply to the Court under section 85A of the Commerce Act for pecuniary penalties for a contravention of an undertaking.

2.10 The Commission will monitor an applicant's compliance with a divestment undertaking.

2.11 If for any reason an applicant considers it is unable to meet a term of a divestment undertaking, it should contact the Commission as soon as possible. Under section 69AC of the Commerce Act, the Commission may, on application, accept a variation of an undertaking if it considers that the variation would not have materially affected its decision to give the clearance.

2.12 Any application for variation of an undertaking must be made no later than 20 working days before the date on which the relevant obligation under the undertaking must be met.

3 THE COMMERCE COMMISSION'S PROCESS

3.01 This section outlines the process by which the Commission will consider divestment undertakings including:

- the need for applicants to inform the Commission early and to engage in pre-notification discussions;
- the letter of issues and letter of unresolved issues sent by the Commission;
- how the Commission communicates with the applicant; and
- liaison with overseas jurisdictions.

2. Section 2(1) of the Commerce Act 1986 states that assets include intangible assets.
3. Under section 2(1) of the Commerce Act 1986, share means "a share in the share capital of a company or other body corporate, whether or not it carries the right to vote at general meetings; and includes—
   (a) A beneficial interest in any such share;
   (b) A power to exercise, or control the exercise of, a right to vote attaching to any such share that carries the right to vote at meetings of the company;
   (c) A power to acquire or dispose of, or control the acquisition or disposition of, any such share;
   (d) A perpetual debenture and perpetual debenture stock."

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INFORMING THE COMMISSION EARLY

3.02 The Commission encourages applicants to offer divestment undertakings as early as possible if they consider that they may remedy a substantial lessening of competition in the relevant market(s) that would be caused by the proposed acquisition.

3.03 When divestments are offered as part of an application for clearance, the Commission is able to assess the effects of the merger taking into account divestments from the beginning of the process. If divestments are offered near the end of the Commission's assessment of an application for clearance, the Commission may need to request an extension to the timeframe in order to consider the application in light of the proposed divestment.

3.04 Merger parties are encouraged to contact the Commission via the Determinations Manager as early as possible to inform the Commission about potential applications for clearance, including those that may include divestments.

3.05 In addition to early contact with the Determinations Manager, applicants can choose to engage in pre-notification discussions with Commission staff. Based on the information provided by applicants, Commission staff may discuss the possibility of divestment undertakings at the pre-notification discussion meeting. However, any feedback given to applicants at this stage would be the Commission's 'preliminary' view only. Ultimately, it is applicants and their advisers who must determine whether a divestment undertaking is offered.

LETTER OF ISSUES AND LETTER OF UNRESOLVED ISSUES

3.06 Competition concerns may be highlighted in the Letter of Issues or Letter of Unresolved Issues sent by the Commission to the applicant.[4] These may include any issues raised by the divestment undertakings, and provide an opportunity for applicants to respond to issues raised by the Commission.

3.07 If divestment undertakings are not offered as part of the original application for clearance, the Commission will identify the likely competition concerns, and may invite divestment undertakings as a possible option in the Letters of Issues or Letters of Unresolved Issues. Feedback given to the applicant by the Commission at this stage is based on the information available and is not a final view. As stated above, it is the applicant and its advisers who must ultimately determine whether a divestment undertaking is offered.

3.08 While the Commission will clearly identify the likely competitive harm, it will not seek to design the divestment undertaking. The Commission will tend not to identify particular assets[5] to be divested because the applicant and its advisers are usually in the best position to do so. However, the Commission is available to discuss the terms of a proposed divestment undertaking insofar as it enables the applicant to structure or vary the terms of the divestment undertaking to remedy the competition concerns.

COMMUNICATION BETWEEN THE COMMISSION AND THE APPLICANT

3.09 The Commission aims to give the applicant relevant and pragmatic feedback with regard to the divestment undertakings offered, to ensure transparency and certainty.

3.10 The Commission may provide feedback to the applicant that divestment undertakings are not necessary because it considers there are unlikely to be competition concerns absent the divestment. In this situation, the applicant will be given the opportunity to withdraw its divestment undertakings. However, this will be solely the decision of the applicant.

4. Further information on the Letter of Issues or Letter of Unresolved Issues can be found in the *Mergers and Acquisitions Clearance Process Guidelines*.
5. All references to assets from now on in these guidelines refer to both assets and shares as defined in footnotes 2 and 3.

3.11 Where the Commission is assessing an application that contains divestment undertakings either for a single market or for a number of different markets, the Commission may conclude that, absent the divestment, there are unlikely to be competition concerns in some of these markets. The Commission will then clearly communicate to the applicant that there are unlikely to be competition concerns in specific markets. Similarly, the Commission might also highlight where there are competition concerns in specific markets that will require the offered divestment remedy. Based on the Commission's feedback, the applicant will then be given the opportunity to vary its undertakings before the Commission makes its final decision. Whether the applicant chooses to vary its undertaking or not is solely the decision of the applicant.

ACCEPTING DIVESTMENTS – HYPOTHETICAL EXAMPLE 1

The applicant (Supplier A) submits an application to the Commission to acquire the assets of Supplier B. Supplier A and Supplier B are both large competitors for the supply of widgets.

In its application for clearance, Supplier A offers to divest one of its brands in order to remedy any substantial lessening of competition in the market. As part of its investigation and analysis, the Commission considers whether there is a substantial lessening of competition without the brand being divested. The Commission finds that there are unlikely to be any competition concerns even if the divestment does not occur. This is due to a number of factors such as strong existing competition, imports and the countervailing power of large retail stores.

The Commission provides this feedback to the applicant. Supplier A may then decide to vary its application in order to withdraw the divestment undertakings. Supplier A would remain free to keep the brand or sell it.

ACCEPTING DIVESTMENTS – HYPOTHETICAL EXAMPLE 2

The applicant (Retailer A) submits an application for clearance to purchase the assets and shares of a large retail outlet (Retailer B). Retailer A and Retailer B have a number of retail outlets around New Zealand and, in some locations, are direct competitors.

In its application for clearance, Retailer A offers to divest four of its retail outlets in locations where Retailer B also has retail outlets. These locations are Whangarei, New Plymouth, Westport and Dunedin. This is to remedy any substantial lessening of competition in these specific locations.

Following the Commission's full investigation and analysis, the Commission considers that, even without the divestment, there are no competition concerns in Westport and Dunedin.

The Commission finds competition concerns in Whangarei and New Plymouth which may require a divestment undertaking to remedy a substantial lessening of competition.

The Commission contacts Retailer A to provide the following feedback:

→ subject to any new significant information or material changes in the markets (which Retailer A will be immediately advised of), the Commission has found that, absent the divestment, there are no competition concerns in Westport and Dunedin; and

→ competition concerns remain in Whangarei and New Plymouth which the current divestment undertakings are likely to remedy.

Retailer A may then vary its application and divestment undertakings based on the Commission's feedback. It is Retailer A's choice as to content of the divestment undertakings. Retailer A may still opt to divest in all four locations. The Commission is available to discuss the specifics of the divestment undertakings insofar as it enables the applicant to structure the terms of the divestment undertaking to remedy the competition concerns.

LIAISON WITH OVERSEAS JURISDICTIONS

3.12 The increasing number of global mergers has enhanced the need for communication, coordination, and cooperation among competition authorities in different jurisdictions. The Commission may need to consult overseas competition authorities to ascertain whether divestments overseas are likely to have an effect (either positive or negative) on competition in markets in New Zealand. A voluntary waiver from the applicant that allows the Commission to exchange confidential information with overseas competition regulators will be sought before any confidential information is exchanged.

4 HOW THE COMMISSION ANALYSES DIVESTMENT UNDERTAKINGS

4.01 Where the Commission considers that the proposed acquisition is likely to result in a substantial lessening of competition in the relevant market(s), it will consider whether the proposed divestment undertakings will remedy that likely substantial lessening of competition.

4.02 If a divestment undertaking is offered at the very beginning of the application process, in practice, the Commission concurrently considers the acquisition with and without the divestment undertaking. However, if a divestment undertaking is offered later in the Commission's consideration of a clearance application, in practice, this will mean that the Commission may have to consult industry participants again, adding to the time taken to consider the matter.

4.03 The Commission's assessment of the market and divestment undertakings will be specific and fact-based to ensure that the divestment undertakings are sufficient to remedy the specific competitive harm.

4.04 Divestment undertakings are to some extent uncertain as to their eventual impact on the relevant market. In order for a divestment undertaking to remedy competition concerns in the relevant market, the Commission must be satisfied that the divestment of the business and assets will be capable of providing sufficient constraint on the combined entity. If the divested business cannot remedy the loss of competition brought about by the initial proposed acquisition, then a substantial lessening of competition may occur, and consumers may be harmed. Thus, it is important for the Commission to consider all the relevant risks associated with divestment proposals.

4.05 In order to assess these divestment risks, the Commission compares the relevant market both with and without the divestment undertaking. The Commission considers whether the divestment would, of itself, or in combination with other market conditions, address the competition concerns that the Commission has identified.

4.06 The Commission assesses the risks associated with divestment undertakings within the analytical framework that comprises the following three kinds of risks:

- composition risks;
- asset risks; and
- purchaser risks.

4.07 To ensure that the divestment undertaking will, indeed, remedy any competition concerns identified, the applicant must provide evidence that addresses these risks. This will enable the Commission to be satisfied that the proposed acquisition, complete with the divestment, will not have, or would not be likely to have, the effect of a substantial lessening of competition.

4.08 Each of these kinds of risks is explained in more detail below.

COMPOSITION RISKS

4.09 Composition risks are risks that the scope of a divestment undertaking may be too constrained, or not appropriately configured, to attract a suitable purchaser.

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4.10 Composition risks will vary from case to case. Examples of terms of an undertaking that may mitigate composition risks include:

- Ensuring that the separation of the assets to be divested is practically achievable within the undertaking timeframe. It should also occur with the minimum disruption to and deterioration of the assets.
- Ensuring that all assets that are necessary for the purchaser to be a viable and competitive entity are included in the divestment undertaking. The Commission prefers the divestment of an existing business entity or unit that has already demonstrated its ability to compete in the relevant market/s. The existing business entity should ideally contain all the physical assets, relevant personnel, customer lists, information systems, intangible assets and management infrastructure required. The Commission will carefully examine divestment undertakings offered by an applicant if the applicant proposes to sell assets that comprise something less than an existing business entity.
- Ensuring that, where products within a market may have increasing or declining market shares, ensuring that the package of assets comprising the divestment undertaking is sufficient to remedy the competition concerns.
- Ensuring that, if the acquirer is offering to divest assets that belong to the target, it has sufficient and relevant information about the target's assets.

4.11 A full description of the assets to be divested must be detailed in the terms of the divestment undertaking.

4.12 An example of how an applicant can address composition risks is contained in the appendix.

ASSET RISKS

4.13 Asset risks are risks that the competitive capability of a divestment package will deteriorate prior to completion of the divestment. The Commission generally looks at three phases of a proposed acquisition that may affect the divested assets:

- after the clearance and prior to the acquisition, when uncertainty may remain over the future of the divested assets;
- after the acquisition and prior to the divestment, when the acquirer has control over the assets; and
- following the divestment, when the divested assets are owned by another party.

4.14 In any of the three stages above, the competitive value of the divested assets could weaken, and their market share could be eroded. Possible causes of erosion of market share that the Commission might consider include:

- reduced marketing and sales effort arising from employee-related factors, including possible distraction from normal duties as a result of the sale process; and
- the applicant having an incentive to erode the divested assets, thereby reducing market share and the ability of a new owner to provide a competitive constraint post-divestment.

4.15 Applicants should provide sufficient evidence to the Commission to allay the above asset risks. This might include an undertaking that the applicant will appoint an independent manager to ensure that the assets to be divested are not eroded.

4.16 An example of how an applicant can address asset risks is contained in the appendix.

PURCHASER RISKS

4.17 The Commission analyses two main purchaser risks, namely that:

- a purchaser acceptable to the Commission may not be available; and/or
- the applicant has an incentive to sell to a weak competitor, albeit for a low price, rather than to a strong competitor for a high price.

4.18 In some cases there may be little or no interest from potential purchasers. This might indicate that the assets are unattractive to potential purchasers which may cast doubt on the effectiveness of the undertaking.

4.19 A buyer acceptable to the Commission may need to have certain attributes that enable it to be an effective competitor in the relevant market. If a buyer is not acceptable, the Commission may find that the proposed divestment does not remedy the substantial lessening of competition in the market. Examples of attributes that may make a buyer acceptable are:

- it is independent of the merged entity;
- it possesses or has access to the necessary expertise, experience and resources to be an effective long term competitor in the market; and
- the acquisition of the divested shares or assets by the proposed buyer does not raise competition concerns.

4.20 Possible ways in which applicants could allay the Commission's purchaser risk concerns include, but are not limited to, the following:

- Ideally, offering to divest to a named buyer before the Commission makes its decision. In this instance, the Commission will assess whether the proposed buyer is likely to provide sufficient competition post-acquisition. If the Commission is so satisfied, the divestment undertaking that forms part of the clearance will include the buyer as the named purchaser.
- If no buyer is apparent prior to clearance being granted, including in its divestment undertaking to the Commission that it:
  - will divest the assets to a buyer that is acceptable to the Commission within a specified timeframe; and
  - will inform the Commission of the identity of the proposed buyer prior to entering into a binding contract for sale and purchase of the shares/assets, providing reasons and evidence that establish that the buyer is likely to provide sufficient competition post-acquisition.

  In this scenario, the Commission will assess whether sale of the assets to the proposed purchaser is likely to allay the competition concerns identified and will communicate its conclusions to the applicant.
- Including in its divestment undertaking to the Commission a clause stipulating that if the divestment does not take place within the specified timeframe, that it:
  - will appoint an independent sales agent to divest the assets at no minimum price to a buyer acceptable to the Commission. In that event, the agent's mandate will be discussed and agreed with the applicant on a case-by-case basis; and
  - will inform the Commission of the identity of the proposed buyer prior to entering into a binding contract for sale and purchase of the assets, providing reasons and evidence that establish that the buyer is likely to provide sufficient competition post-acquisition.

  In this scenario, the Commission will also conduct an analysis of the buyer as described above.

4.21 Under the second and third options above, if the Commission does not consider the nominated buyer is acceptable because it does not meet the criteria specified in the divestment undertaking, the applicant may choose to seek a variation pursuant to section 69AC of the Commerce Act.

4.22 When assessing purchaser risks, the Commission will consider each case on its particular facts.

4.23 An example of how an applicant can address purchaser risks is contained in the appendix.

4.24 The composition, asset and purchaser risks are inter-related and the Commission will carefully assess them on a case-by-case basis.

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5 THE DIVESTMENT UNDERTAKING

5.01 A divestment undertaking should set out the obligations of the applicant to divest the assets, including the timeframe in which the assets must be divested. It should also specify all of the assets to be divested.

5.02 Generally, the assets must be divested as quickly as possible in order to remedy any potential competition concerns over asset and composition risks. The shorter the divestment period, the less likely it is that factors such as the deterioration of assets, the loss of customers and/or key personnel, or similar, will cause the divestment to be ineffective.

5.03 Applying tight timeframes to the divestment process aims to improve the effectiveness of a remedy. The timeframe in which the assets must be divested will vary depending on the facts of each application for clearance. In general, the Commission will allow six months for an applicant to fulfil the terms of the divestment undertaking.

5.04 This timeframe may be shorter if the Commission considers there are high risks related to the divestment. However, the Commission recognises that New Zealand is a small economy and that there may be a small number of potential purchasers. If this is the case, the Commission may allow a longer divestment timeframe. A longer timeframe for divestment may also be appropriate in times of economic recession as there may be fewer potential purchasers.

5.05 In most cases, the timeframe for divestment will be kept confidential to prevent gaming by potential purchasers or an undesirable 'fire-sale'. If the purchaser has been identified, this should be included in the undertaking.

5.06 The applicant should keep the Commission fully informed throughout the divestment timeframe as to the status of the asset(s) to be divested and the progress of the divestment generally. The Commission will also monitor whether the applicant is on track to complete the divestment.

APPENDIX

COMPOSITION RISK EXAMPLE

GALLAGHER HOLDINGS LTD AND TRU-TEST CORPORATION LIMITED
COMMERCE COMMISSION DECISION 545, 23 FEBRUARY 2005

Gallagher Group Holdings Limited (Gallagher) sought clearance from the Commission to acquire up to 100 per cent of the ordinary shares of Tru-Test Corporation Limited (Tru-Test). The application stated that Gallagher would undertake to divest the 'Stafix' brand of electric fencing, post-acquisition; Stafix was one of Tru-Test's major electric fence brands.

In examining the composition risks of the proposed divestment undertaking of the Stafix brand, the key issue was whether the composition of the divestment undertaking would allow the new owner of Stafix to be an effective competitor in the electric fencing market.

The Commission first noted that an important complication with this divestment was that Gallagher was proposing to divest an asset it did not own. Therefore, the Commission needed to be satisfied that the composition of the divestment would not impact on the future competitive constraint of the Stafix brand.

The applicant addressed the Commission's concerns by providing evidence that:

- the manufacture of Stafix could be outsourced;
- the new owner of Stafix would have all of Stafix's key products; and
- the new owner of Stafix would have royalty-free access to all intellectual property necessary to manufacture the Stafix Products.

Overall, the Commission was satisfied that the composition of the divestment undertaking was sufficient to ensure that the new owner of Stafix would be an effective competitor in the electric fencing market.

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ASSET RISK EXAMPLE

SCHERING PLOUGH CORPORATION AND ORGANON BIOSCIENCES NV
COMMERCE COMMISSION DECISION 621, 4 OCTOBER 2007

On 5 July 2007 Schering-Plough Corporation (Schering-Plough) applied for clearance to acquire 100 per cent of the shares in, or assets of, Organon BioSciences N.V. (Organon BS).

Subsequent to that notice, a divestment undertaking was provided by Schering-Plough to the Commission pursuant to section 69A of the Commerce Act. The undertaking stated that Schering-Plough would undertake to divest the Campylovexin campylobacter vaccine business after the acquisition.

The Commission spoke with a number of industry participants including veterinarians, existing competitors, and potential buyers in respect of the Campylovexin vaccine. Despite the view by some that it was a declining product, and was inferior to its competitor, Organon BS product Campyvax4, Campylovexin was viewed by veterinarians as reliable and effective, and a strong competitor in the campylobacter vaccine market. Notwithstanding Campylovexin's solid reputation, the Commission identified a number of asset risks.

A major asset risk was the potential for sales (and therefore market share) of Campylovexin to decline during the divestment period (between the acquisition and the completion of the divestment).

A decline in Campylovexin's market share and competitiveness during the divestment period might result from the following factors:

- uncertainty in the market about the continued supply of Campylovexin;
- a disincentive to promote or maintain the Campylovexin brand after acquiring control of Campyvax4; and
- incentives for the combined entity to switch customers to Campyvax4.

The Commission considered that the timing of the divestment allayed concerns regarding the asset risks. The six month period (with a further stipulation that the divestment occur prior to 31 May 2008) meant that Schering-Plough would be in the position of having to market both vaccines for only a short period, as the acquisition was expected to occur prior to the end of the calendar year. Also, this time period fell after the season in which campylobacter vaccines were most heavily promoted, and prior to the promotion and sales of vaccine for the 2008/09 season.

PURCHASER RISK EXAMPLE

TRANSPACIFIC INDUSTRIES GROUP (NZ) LIMITED (TPI) AND IRONBRIDGE CAPITAL PTY LIMITED (IRONBRIDGE)
COMMERCE COMMISSION DECISIONS 622, 623, 624 AND 625, 31 OCTOBER 2007

In August 2007, Transpacific Industries Group (NZ) Limited (TPI) filed four separate applications with the Commission seeking clearance for TPI to acquire the following businesses and assets of EnviroWaste Services Ltd (EnviroWaste) from Ironbridge Capital Pty Limited (Ironbridge) (a private equity company): EnviroWaste's solid waste collection businesses in (1) Blenheim and Nelson, (2) Timaru and Oamaru, (3) Christchurch, and (4) Dunedin.

Having analysed the relevant markets, the Commission identified a number of competition concerns which it communicated to TPI. Subsequently, TPI began discussions with the Commission in respect of the possible divestment of certain assets. During those discussions, TPI provided the Commission with expressions of interest from five parties that were interested in acquiring the assets.

The Commission was of the view that its competition concerns were unlikely to be allayed if any one of three of the parties identified by TPI were to acquire the assets. Eventually, TPI provided the Commission with an undertaking that it would divest the relevant businesses and assets it would acquire to a named party who, in the opinion of the Commission, would provide TPI with considerable degree of competitive constraint post-divestment.

As the Commission had an acceptable up-front buyer it was satisfied that there was no purchaser risk in this case.