Early Settlement and Errors in Merger Control

An ESRC Research Centre
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CCP Executive Summary

BACKGROUND

- A merger may be welfare-enhancing if it creates efficiencies, but it can reduce welfare if it increases market power and reduces competition. This delicate balance justifies merger control by a competition agency which can prohibit mergers that are expected to lessen competition.
- In practice, few mergers are entirely prohibited. Instead, the agency accepts a remedy offer that the evidence suggests will eliminate the parts of a merger that are likely to lessen competition while allowing the remainder to merge.
- Merger appraisal is usually determined by a two-phase process, Phase I and Phase II, the details of which are jurisdiction specific.
- Merger control is subject to Type 1 or Type 2 error, depending on whether the remedy is too restrictive or too lenient.

METHODOLOGY

- The authors develop a model of remedy offers made to an expert agency whose delegated task is to allow any merger unless it finds evidence of likely competitive harm having taken account of offered remedies.
- In Phase I of the merger appraisal process, the merging parties make a remedy offer. The agency investigates the appropriateness of the offer and gathers evidence. If settlement is not reached, the merging parties can choose to withdraw the merger application or proceed to Phase II which involves a cost of delay. In Phase II, the merging parties make a revised offer which is again investigated by the agency.
- The model describes the relationship between factors determining the probability of delay and the type of error in early settlements, that is, an insufficient remedy versus an excessive remedy.
- The model is evaluated using data from European Commission merger settlements.

KEY FINDINGS

- Of the 150 cases in the sample, just over 60% settled in Phase I. Of the 58 referred to Phase II, there were 37 conditional clearances (that is, with remedies), 13 unconditional clearances and eight prohibitions.
- The analysis shows that parties condition their offers on the degree of uncertainty (measured by the complexity of merger appraisal and the pressure on agency resources) and the cost of referral:
    - merging firms make more generous offers in Phase I if the cost of referral would be high
    - a high case load, up to a point, makes it more difficult for the agency to discover the true competitive effects and so makes it more difficult to reach early agreement.
- There are also significant learning effects as the agency's findings become more predictable when it has more industry-specific experience.
- Major administrative reforms in 2004 appear to have improved predictability.
- The difficulty of appraising coordinated effects, potential entry or the failing firm or efficiency defenses mean these are likely to cause delay in settlement.
- It cannot be proved empirically that the potential anti-competitiveness of the merger has no effect on referral. However, consistent with the model, there is no evidence to

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E·S·R·C ECONOMIC & SOCIAL RESEARCH COUNCIL support a superficially plausible claim that more harmful mergers are harder to agree in Phase I.

- A wider implication of findings is that Type 2 errors (eg too little required divestiture of assets) can be associated with early agreement of remedies in complex mergers with a low cost of delay. These are the mergers where firms find it worthwhile to bluff and the agency does not find sufficient evidence of anti-competitive harm in its initial investigations. Although some of these mergers may have caused substantial welfare loss, they are relatively few in number. More often, early agreement is associated with Type 1 errors (firms offering excess remedy).

THE CCP

The ESRC Centre for Competition Policy (CCP), at the University of East Anglia, undertakes competition policy research, incorporating economic, legal, management and political science perspectives, that has real-world policy relevance without compromising academic rigour.

FOR MORE INFORMATION

The full working paper (Number) and more information about CCP and its research is available from our website: www.ccp.uea.ac.uk

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