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Merger Remedies

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Over the last few years, the U.S. antitrust agencies have clarified their merger remedies to enable counsel to anticipate and respond to the agencies' concerns. The latest example is "Policy Guide to Merger Remedies," issued on Oct. 21, 2004, by the Antitrust Division of the U.S. Department of Justice (DOJ) following a review of its remedy practices. See www.usdoj.gov/atr/public/guidelines/205108.htm. A DOJ review led to a decision not to change its approach and not to conform to certain different Federal Trade Commission (FTC) practices. Differences between the DOJ and FTC approaches to merger remedies remain, most notably their treatment of "fix-it-first" and "crown jewel" provisions.

DOJ has strong preference for structural remedies

DOJ's policy guide, which largely reaffirms DOJ's prior practices, explains how DOJ uses merger remedies and gives advice on how practitioners can expect DOJ to handle negotiations of merger remedies. DOJ has a strong preference for structural remedies, i.e., divestiture, rather than conduct-based remedies because they are "relatively clean and certain, and generally avoid costly government entanglement in the market."

DOJ's policy guide establishes three broad principles for divestitures.

The divestiture must include all assets necessary for the purchaser to become an "effective long-term competitor" to maintain premerger competition.

DOJ prefers divestiture of an existing business because it is more likely that the divested business will be an effective competitor. The policy guide notes that DOJ will carefully scrutinize proposals to divest less than an existing business entity because the merging parties have an "obvious incentive to sell fewer assets than are required for the purchaser to compete effectively going forward."

The merged firm must divest rights to any intangible assets that are necessary for the purchaser of those assets to compete effectively.

The FTC's primary comment on merger remedies are the "Statement of the Federal Trade Commission's Bureau of Competition on Negotiating Merger Remedies," www.ftc.gov/bc/bestpractices/ bestpractices030401.htm, and the 1999 "Divestiture Study" at www.ftc.gov/os/ 1999/08/divestiture.pdf.

The FTC also prefers divestitures of discrete business units because they require the commission to "make the fewest assumptions" about the market, its participants and the proposed package of assets. When the parties propose to divest something less than a separate business unit, the parties must show either that the proposed package includes all assets necessary for operation of a competitive business, or that the necessary assets are easily accessible elsewhere. When the parties propose a "mix and match" package of assets from both firms, the assets must be sufficient to maintain premerger competition.

DOJ's policy guide indicates that conduct remedies are disfavored and will be permitted only in limited circumstances, primarily to complement or "perfect" structural relief, such as a temporary limit on the merged firm's ability to rehire the employees of a divested business when personnel are important to the purchaser's ability to compete successfully, or a short-term supply agreement. When structural remedies are impractical, DOJ is more likely to prohibit the merger than allow it to proceed with conduct relief.

DOJ has always encouraged merging parties to complete divestitures as quickly as possible to maintain premerger competition and prevent dissipation of the assets' value. The policy guide reaffirms this principle, stating that DOJ will usually give the parties 60 to 90 days to locate an acceptable purchaser and will require regular reports on the divestiture process to ensure the parties make good-faith efforts.

Both FTC and DOJ must approve the proposed purchaser and apply similar standards. DOJ's policy guide permits DOJ to seek information to evaluate the purchaser and lays out a three-part test to evaluate the suitability of the purchasers: Divestiture to the purchaser should not itself cause competitive harm; the purchaser must have sufficient incentive to use the assets to compete effectively in the relevant market; and the purchaser must have sufficient business experience and financial resources to be an effective long-term competitor.

One of the key differences between FTC and DOJ remedies has been DOJ's willingness to accept "fix-it-first" remedies, which are structural remedies that the parties implement without a consent decree if the remedies restore premerger competition and contain as much substantive relief as DOJ could achieve in litigation. Between June 2001 and July 2003, about one-third of DOJ remedies involved fix-it-first divestitures. The policy guide reaffirms DOJ's acceptance of fix-it-first remedies, but DOJ will require a consent decree if the competitive harm requires conduct relief, such as a supply agreement with the purchaser, that includes some continuing obligations for the merging parties.

The policy guide notes that allowing parties to enter into fix-it-first divestitures may restore competition without burdening the parties and consumers with costs and delays associated with consent decrees. On a practical level, as Assistant Attorney General R. Hewitt Pate has noted, "If parties alter their deal in a way that resolves our competitive concerns, we cannot then file a complaint challenging a transaction that no longer violates the antitrust laws." "Antitrust Enforcement at the DOJ-Issues in Merger Investigations and Litigation," (Dec 10, 2002), at www.usdoj.gov/atr/public/speeches/200868.htm.

The FTC generally does not allow fix-it-first remedies-it usually requires a consent decree and that the parties propose an up-front buyer, which reduces the risk that the parties will be unable to find a buyer capable of restoring competition and mitigates the possibility of asset deterioration pending divestiture. FTC Chairman Deborah Majoras recently stated that the FTC strongly prefers consent orders that bind the parties regarding the assets to be divested and includes an up-front buyer where appropriate. "Looking Forward: Merger and Other Policy Initiatives at the FTC" (Nov. 18, 2004), at www.ftc.gov/speeches/majoras/041118abafallforum.pdf .

Another significant difference between the agencies is DOJ's opposition to "crown jewel" provisions, which require the merging parties to include certain additional or different specified (and usually more valuable) assets if a suitable purchaser is not found within a certain period.

DOJ's policy guide cites two primary reasons for not using crown-jewel provisions. First, they can be either underinclusive or overinclusive. Crown-jewel provisions usually amount to an admission that DOJ accepted "less than effective relief at the outset" because the divestiture assets were insufficient to give a purchaser the incentive to acquire the assets. When DOJ must choose between demanding a smaller, less valuable package that entails more risk of competitive harm or a more substantial divestiture that would be highly likely to fully preserve postmerger competition, DOJ's policy guide instructs staff to seek the more substantial divestiture from the outset. Crown-jewel provisions also provide an opportunity for purchaser manipulation; if there are only a few potential purchasers and they know about the crown-jewel provision, they have an incentive to delay negotiations so they can purchase the crown jewels at a reduced price.

In contrast, the FTC regularly requires crown-jewel provisions in its decrees, especially when the availability of suitable purchasers is uncertain, because it creates an incentive to divest quickly. The FTC's 1999 divestiture study noted that a crown-jewel provision also provides an incentive to maintain the originally proposed assets.

FTC, unlike DOJ, regularly appoints monitor trustees

One potential difference between the agencies is the use of "monitor trustees" to ensure that the parties fulfill their consent decree obligations. DOJ's policy guide requires third-party oversight only in rare cases when DOJ may benefit from the trustee's experience. The FTC, on the other hand, regularly appoints monitor trustees to oversee the terms of the consent order, especially when the order requires the merging parties and the prospective purchaser to maintain a temporary relationship such as a supply arrangement. Under DOJ's policy guide, a monitor trustee is required only when "the trustee's experience is critical to an effective divestiture" because in most cases the monitoring trustee would "simply duplicate" DOJ's enforcement efforts.

The recent DOJ and FTC remedies statements shed light on the small but significant differences between the agencies in their approach to merger remedies and highlight the substantial similarities in their goals and processes. Indeed, despite the apparent differences between the U.S. agencies, Majoras believes that "the supposed difference is overblown." Nevertheless, Majoras has asked FTC staff to review DOJ's policy guide to determine whether DOJ and FTC policies and practices differ significantly. She also pledged to work closely with DOJ to determine whether there is a need for greater conformity between the agencies and, if so, to determine how it can be accomplished. This spirit of cooperation and the seeming convergence between the U.S. agencies should continue to improve the certainty and efficiency of the merger review process.