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What's the FTC up to?

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Recently, the business community has been confused about the merger review process being applied by the Federal Trade Commission. On the one hand, mega-mergers such as Exxon's with Mobil have been approved by the FTC, leading some people to believe that any merger is possible.

But at the same time, recent FTC pronouncements on merger policy have aroused concerns in the business community that the FTC has "raised the bar," and many observers fear that businesses will no longer be able to make educated guesses as to how it will treat mergers. However, a closer examination of recent enforcement decisions and speeches by FTC Chairman Robert Pitofsky and Bureau of Competition Director Richard Parker reveal that the FTC's *new* position on mergers can be predicted by experienced antitrust counsel.

This article first will provide a brief history of the FTC1s position on divestitures and then will discuss the changes that the merger review process is undergoing. Finally, the authors will provide suggestions that businesses can use in structuring deals and will propose remedies to maximize the probability that the FTC will approve them.

The merger review process

As a result of federal pre-merger notification requirements, the FTC and the Justice Department's Antitrust Division have an opportunity to review transactions in advance. Most deals are non-controversial, but a small number – 125 out of roughly 4,700 filings in fiscal year 1998 – receive detailed scrutiny. The merger review process for transactions that raise serious antitrust concerns, such as mergers between direct competitors, involves the production of millions of documents, plus interviews and depositions of key business people from the merging parties, competitors and customers.

During that process, the reviewing agency and counsel for the parties focus on issues of concern and either eliminate or substantiate those concerns. Some deals are abandoned in the face of government opposition. But in other cases, lingering agency concerns lead to talks about how the companies can alleviate those concerns, such as by divesting certain assets or business units to viable competitors.

The divestiture process

Although divestitures are a relatively common fix for problem mergers, some divestitures have failed to counteract fully the anti-competitive effects of a merger. As a result, the FTC released a paper in August 1999, titled “A Study of the Commission’s Divestiture Process,” which systematically reviewed the success (or failure) of all the FTC-ordered divestitures between 1990 and 1994. The study also evaluated which factors made certain divestitures more successful than others and proposed process improvements. The study included the following findings:

- Divestitures are generally more successful when they involve an “up-front buyer” – i.e., a buyer identified and proposed by the merging parties and vetted by the FTC before the acceptance of a consent decree.

- Some options create incentives for the merging parties to divest quickly and effectively – such as trustees who monitor the divested assets or business and “crown jewel” provisions, which require the merging parties to find a buyer and divest the agreed-upon assets before a certain date or risk losing bigger, more attractive assets.

- Divestiture to an experienced firm in a related business is more likely to be successful than divestiture to a new entrant.

- Divestiture of an ongoing business is generally more effective than divestiture of only a product line or selected assets.

- Buyers of divested businesses are more likely to succeed if they have adequate access to accurate information during the divestiture process and if the sellers are precluded from engaging in strategic conduct to impede the buyer1s success. In searching for potential buyers, merging companies often do not look for buyers that offer the strongest competition. Since the divestiture study, the FTC has announced that it will learn from its past successes. It has also made clear that some transactions will not be approved at all, and that other deals will not proceed unless successful divestitures can be implemented. For instance, Mr. Parker has stated, “[S]ome transactions may not be capable of being remedied because the overlaps are so pervasive or numerous....Our obligation is to assure that competition not be reduced one iota – that may mean that some transactions cannot be remedied short of an injunction.” (This and other FTC speeches can be found at **www.ftc.gov**.)

Likewise, in a December speech that caused a huge stir, Mr. Pitofsky indicated that the FTC should not negotiate to fix anti-competitive problems with a proposed merger unless it is prepared to challenge the merger in court, and it should not try to “change the law” through negotiated settlements.

More controversially, Mr. Pitofsky stated that the FTC should not try to remedy anti-competitive problems if the remedy would involve a divestiture of 40% to 60% of the total deal.

Chairman Pitofsky denies raising the bar

After his December speech, there was widespread speculation about whether Mr. Pitofsky had announced "new" policies. Mr. Pitofsky responded on Feb. 17 by describing the agency's evolving approach to merger remedies. In his February speech, Mr. Pitofsky denied that the FTC had raised the bar and said that he m e rely wanted to make the process of restructuring mergers "transparent." He elaborated on what factors the FTC will consider in evaluating merger remedies , including: (a) how much restructuring will be required, (b) whether the company acquiring the divested business/asset will be *equal to* the divesting company or merely an adequate option, (c) how complicated the restructuring will be, (d) the precedential value for future deals in the same industry, (e) whether there are efficiencies, (f) whether similar divestitures have worked and (g) what is being divested – an ongoing business or a single asset.

Some of his remarks signaled changes in the FTC's attitude toward remedies. For instance, he suggested that because the divestiture study demonstrated that potential buyers are often under-informed or misinformed, the FTC had to be skeptical of buyers' predictions of success and would undertake its own feasibility analyses.

He also said the study showed that ongoing relationships between the buyer and the merging companies can chill the buyer's future success. Consequently, such relationships should be approached with caution, with the FTC serving "as a continuing monitor."

He also indicated that, as in the past, the FTC's role is to examine each deal based on current market conditions, including a review of the increased concentration as a result of previous mergers and a review of "where the industry... might be going."

Transparency of the FTC divestiture policies

So how transparent do those comments make the divestiture process, and what remedies will the FTC require to approve deals? While there are no definite answers to these questions, Mr. Pitofsky's speech and a later speech by Mr. Parker provide some practical guidance, as do recent FTC enforcement actions:

- The nature and extent of the competitive overlaps will be critical to whether the deal can be done. For example, as Mr. Parker noted, although Exxon/Mobil was a huge deal, the industry was relatively unconcentrated and the competitive overlaps were discrete and fairly modest. Although the value of the divested assets was several billion dollars, that was less than 3%

of the value of the assets of the merged firm. In contrast, the competitive issues in other mergers that failed based on competitive concerns – such as Royal Ahold/Pathmark – were greater and covered a significant share of the combined business.

- Mr. Parker has cautioned that eliminating the anti-competitive overlap is not always enough. For example, in the Rite Aid/Revco merger, divesting overlapping stores was insufficient because effective competition required that a company have a regional network.

- As Mr. Pitofsky and Mr. Parker have both suggested, the FTC prefers divestitures of ongoing businesses because a divestiture of limited assets may reduce the potential viability of the buyer.

- The FTC also prefers divestitures to up-front buyers because it wants to avoid lengthy (and possibly unsuccessful) searches for buyers.

- Nevertheless, Mr. Parker has also said the FTC can be persuaded that up-front buyers are not necessary in some cases. For instance, in Exxon/Mobil, there was no up-front buyer, but based on extensive vetting of potential buyers, the FTC was comfortable that there were viable potential purchasers.

- Both Mr. Pitofsky and Mr. Parker explained that the identity of the buyer is key, and that the FTC will reject buyers that may not be viable competitors. They also suggested that buyers who present detailed business plans will be given more credence by the FTC.

- The parties should provide potential buyers with up-front due diligence data and should attempt to structure the divestiture so that there are no continuing ties with the buyer.

- Finally, they noted that the FTC's role is not to find buyers or to choose one viable buyer over another‹the merging companies must do that.

Conclusions

In addition to the FTC1s public statements, the government's action or inaction on certain matters offers other practical lessons about merger enforcement:

- The FTC revisions in divestiture policy are not being followed at DOJ's Antitrust Division. So the ultimate outcome of a proposed transaction may depend on which agency reviews it.

- The FTC increasingly requires that a remedy totally eliminate any increased concentration from the merger. For example, Exxon/Mobil, BP/Amoco/Arco

and Albertsons/American Stores involved divestitures of all of one firm's operations in are a s that presented competitive concerns.

- Antitrust counsel should evaluate a proposed transaction before it is announced, to identify potential competitive risks based on the best available market data and on recent enforcement decisions by both agencies. This will help the parties anticipate the obstacles they may face and evaluate whether the transaction can be completed and, if so, at what price. Before signing the merger agreement, the parties should consider whether that is a price they are prepared to pay.

- The parties must be realistic about the nature of the remedy that the FTC is likely to require and must move quickly from an opening settlement offer to a position the FTC may find acceptable. Failure to do so may result in a hardening of positions and make settlement more difficult, or perhaps even impossible.

- The parties must not underestimate the difficulty and time involved in negotiating a settlement with the FTC. They should expect this process to take several weeks. In negotiating the terms of the consent order, FTC lawyers may attempt to direct the entire divestiture process, including dictating the commercial terms of the asset sale agreement, even when large, sophisticated up-front buyers are involved. If it is clear from the outset that some remedy will be required, the parties should at least consider divesting the assets before announcing the deal and filing their Hart-Scott-Rodino notification and report forms, to avoid this process altogether. Although the FTC's recent speeches, enforcement decisions and the divestiture study do not involve radical policy changes, the commission has tried to be more "transparent" about the policies it is implementing, and companies and their counsel must be aware of those policies. In addition, counsel should be aware that Commissioner Mario Monti has announced that the European Commission is also re-examining its remedy processes to ensure that the remedy restores the status quo.

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