Negotiating an Antitrust Remedy with Regulators: Factors to Consider in a Merger

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Almost all mergers raising significant competitive issues are reviewed by the Antitrust Division of the Department of Justice ("DOJ") and the Federal Trade Commission ("FTC"). In cases where the agencies identify a competitive concern, they have the power to enjoin or challenge the merger, but in the vast majority of cases the concerns are resolved through some sort of consent decree requiring the merging parties to divest some assets and/or agree to some conduct remedies. Indeed, the agencies have broad powers to fashion remedies to resolve the competitive concerns in a merger.

To provide greater guidance on the remedy process, the DOJ and FTC recently issued guidelines that give businesses a valuable glimpse into the methods by which they arrive at—and enforce—merger remedies. The Department of Justice's Antitrust Division published its "Policy Guide to Merger Remedies" ("DOJ Guide")[1] in late 2004, and the Federal Trade Commission issued a "Statement of the Federal Trade Commission's Bureau of Competition on Negotiating Merger Remedies" ("FTC Statement")[2] in 2003. The statements reveal that both agencies impose similar requirements for merger remedies.

There are four general principles that govern the agencies' analysis:

- Both agencies prefer divestiture—the sale of business assets—as a method of curing their concerns for competition in a given market.
- The divestiture must fully restore competition in the market after the merger goes through.
- The agencies are not obligated to attempt to improve competition in the market; rather the goal is simply to restore competition to the state prior to the merger.
- The agencies will be flexible as to the range of assets that need to be divested or licensed.

The agencies are generally consistent about their approach to merger remedies. Yet there are a few significant differences.

- The FTC, but not the DOJ, may require the selection and approval of a buyer of the assets to be divested before the merger is approved (known as an "up-front buyer").
- The FTC, but not the DOJ, will frequently require the use of a monitor trustee to assure that the remedy will be successful, although both agencies have the ability to do so.
- The DOJ may permit the parties to resolve the merger through a private agreement, without a consent order, known as a "fix-it-first" remedy.
- The FTC typically will not permit the merging parties to retain rights to intellectual property that must be divested.
- In many cases, the FTC will require a broader range of behavioral and conduct relief than the DOJ.
- The FTC will require a back-up form of relief in some cases, known as a "crown jewel;" the DOJ does not require—and even disfavors—this back-up relief.

There are myriad potential terms and conditions that could apply to any antitrust remedy, and the agencies are open to negotiation in crafting the terms of a consent decree or order. Therefore, a firm facing a potential challenge from one of these two agencies should consider the following principles of antitrust remedies, which are described in greater detail in the DOJ Guide and FTC Statement.

The Purposes and Goals of Divestiture

Divestiture is superior to conduct remedies. Divestiture simply means that the DOJ or FTC will require one of the merging parties to sell a component of its business. Divestiture, which the DOJ calls a "structural remedy", has benefits in its speed, certainty, cost, and efficacy (as compared to a "conduct" remedy).[3] Although both agencies may also impose conduct remedies, such requirements are hard to craft, cumbersome to monitor, and difficult to enforce.[4]

The goal of divestiture is to fully restore competition in the relevant market. When either the FTC or DOJ investigate a proposed merger, they may propose a divestiture if they have concerns about competition in a given market. The agencies will of course consider the market, barriers to entry, competitive effects, and likely efficiencies of the proposed merger, but they will also identify any potential anticompetitive effects. The simplest way to cure their anticompetitive concern is to sell the entity in question—otherwise known as a divestiture. To undertake an appropriate divestiture remedy, the merging firms sell business assets—either tangible or intangible—that are sufficient for the purchaser to continue conducting business in the relevant market, and thus, maintain or restore competition.[5]

Identifying the Divested Assets: What to Sell

The DOJ and FTC prefer that the merging firms divest an existing business entity. The divested assets must allow the buyer to compete in the relevant market. If a buyer acquires an ongoing business entity, it is fairly easy to show that it will be able to maintain competition. It also ensures that the buyer has an incentive to employ the assets in the market affected by the proposed merger. Moreover, the entity has demonstrated that it can survive in the market because it has been operating for some amount of time.[6]

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The DOJ and FTC will be flexible regarding which assets should be sold. For example, when two firms are merging and either could sell its assets in a given market, the DOJ is indifferent as to which entity makes the divestiture, so long as competition remains at premerger levels.[7]

The antitrust agencies acknowledge that they may approve divestitures that form a combined business entity, consist of less than a single business entity, or consist of more than a single business entity. The DOJ and FTC both understand that the merging firms may not own a separate business entity appropriate for divestiture. Both agencies agree that it is appropriate for the merging firms to propose to combine some of their assets in order to create a whole business likely to maintain competition in the relevant market.[8] It is the merging firms' burden to establish that the combined divestiture amounts to an entity that will cure the anticompetitive concerns and be able to survive as a competitor in the market.[9]

The agencies will consider divestiture of assets comprising *less* than a whole entity if the potential purchaser already owns—or will be able to acquire—the assets necessary to create a viable business. The merging firms are likely to obtain offers from more than one potential buyer, and the agencies recognize that different buyers will have varying needs. For example, the potential purchaser may already own some of the assets necessary to create a viable business and will not need to purchase all of the assets of an entire business. But it is the merging parties' burden to convince the agencies that the assets will be able to function as a competitive entity and fully restore competition.[10]

Both agencies recognize that the merging firms may have to divest *more* than an existing business entity in order to fully maintain premerger competition. They cite situations where the divested business must be able to provide a full product line or be able to take advantage of vertical integration in order to be competitive. In such instances, the agencies may require that the divested assets include a full product line even though not all of the products constitute the relevant market. Or they may require that the divestiture include applicable upstream and/or downstream counterparts in order to provide appropriate vertical integration.[11] The DOJ warns, however, that in this situation it may be easier to simply block the merger.[12]

Special Considerations for Intellectual Property

The merged firm may have overlapping patents or other intellectual property rights such as licenses, in which case it may be required to divest them.[13] Since patents grant the patentee the right to attempt to exclude others from practicing within the patent, a merger of two firms might have the potential to lock up all of the intellectual property for a given market in one merged firm, preventing competition in the relevant market. Therefore, the merging firms may have to divest some of their intellectual property. The parties must demonstrate that any buyer would be able to use the intellectual property to enter and compete in the market.

The FTC's Statement and the DOJ's Guide split with respect to a seller's ability to retain some rights to the intellectual property.[14] The FTC requires that the buyer receive all of the rights to the property, including the right to alienation.[15] It does not discuss any potential for the seller to retain any rights to the intellectual property. On the other hand, the DOJ Guide indicates that it may or may not allow the merging firms to retain rights of the divested intellectual asset. The DOJ will require the merged firm to relinquish all rights to the intellectual property if it would harm the purchaser's ability to use the property in furtherance of competition.[16]

Both agencies may require that the seller grant a license to use intellectual property, but differ in their views about whether a nonexclusive license is appropriate. A license for intellectual property is likely to:

(1) give the purchaser an incentive to develop the relevant product;

(2) ensure that the purchaser has the right to develop other products; or

(3) provide the purchaser the ability to sell outside the relevant market.

The FTC differs from the DOJ in that the FTC envisions an exclusive license will be divested, whereas the DOJ Guide states that either an exclusive or nonexclusive license may be appropriate.[17] The DOJ Guide notes that some intellectual property is likely to promote competition, such as a production process patent, in which case it would require that the merging firm merely grant the purchaser a nonexclusive license.[18] In some limited circumstances the DOJ may require the merging entity to license to all comers in order to promote competition from smaller firms and new entrants.[19]

Conduct Remedies Related to a Divestiture

The DOJ disfavors conduct-based remedies. DOJ is very clear that conduct remedies are less efficient than divestitures because they require the antitrust agencies or the courts to monitor (perhaps unsuccessfully) a market.[20] Yet such remedies are appropriate when: (1) they are necessary to facilitate an otherwise structural remedy, or (2) when the merger is likely to achieve significant efficiencies but a divestiture—or full-blown block on the merger—would sacrifice those efficiencies.[21] The FTC does not state its preference, but the DOJ's position makes more sense.

Short-term conduct remedies may apply in order to ensure that the structural remedy maintains or restores the pre-merger competition in a market. Examples of common short-term measures that facilitate divestitures are:

- Short-term supply arrangements;
- A bar on reacquiring employees that left with the divestiture; and
- Conduct remedies designed to ensure the competitiveness of the divested assets.

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Short-term supply arrangements are one example where the conduct will support an otherwise structural remedy. The purchaser, for example, may need short-term supply during a temporary post-purchase reconfiguration. The FTC and DOJ are likely to require a short-term supply arrangement when the buyer requires an immediate supply to effectively compete in the market—as is likely when the purchaser bought a less-than-whole entity.[22]

As another short-term measure, the DOJ may prohibit the divesting firm from reacquiring employees that went along with the divested business entity, due to the obvious harms that such a "brain-drain" would impose on the purchaser.[23] The FTC does not discuss such a measure, but may require that the seller provide short-term "assistance" to the buyer of a highly complex product line or business. Where mere assistance is not sufficient, the FTC states that it may require the seller to take steps to transfer appropriately knowledgeable employees to the purchaser.[24]

The FTC discusses another short-term measure based on the competitive advantage of the parties' reputations. If the merging firms' reputations are significant to conducting business, the FTC may require the merging firms to affirmatively encourage their customers to transfer to the buyer, and stay there for some transitional period.[25]

The DOJ is unlikely to approve of a non-compete restriction, even a short-term one, as it is strongly disfavored in lieu of a full-blown denial of the merger.[26]

Longer-term remedies are also possible, but only in rare instances. The DOJ may require that the divested assets not be sold to a particular future purchaser. This may be because, sometimes, certain assets would qualify for an antitrust exemption in the hands of a purchaser with certain characteristics. In that case, the DOJ would require that neither the merged firm nor the purchaser transfer the divested assets to such a party.[27]

Stand-Alone Conduct Remedies

Conduct remedies are possible without an accompanying structural component, but they are rare. They tend to occur in industries that are already heavily regulated, or where there are established relationships between competitors, and only when preventing the merger would sacrifice significant cognizable (not merely alleged) efficiencies. The DOJ will compare the costs of monitoring the conduct remedy, taking into account existing regulation and market transparency, and weigh them against the attainable or existing efficiencies that a full block or divesture would prevent.[28]

A non-structural conduct remedy most likely to be one of the following:[29]

- A firewall provision;
- A fair dealing provision; or
- A transparency provision.

Firewalls, generally used in vertical mergers, prevent an upstream monopolist from sharing information with its merged downstream firm. If a divestiture arrangement calls for some form of transitional services (*e.g.*, assistance with know-how or a short-term supply arrangement), the agreement should provide for a communication firewall to prevent the disclosure of competitively sensitive information.[30]

Fair dealing provisions, again generally used in the context of vertical mergers, may require that an upstream monopolist not discriminate against other downstream firms in the same market as its merged downstream firm. [31]

Transparency provisions require heightened reporting to a regulatory authority, which will monitor the merged firm to protect the agencies' anticompetitive concerns. [32]

In the event that an order requires an ongoing relationship between the seller and buyer, the FTC may appoint a third party to monitor that provision.[33] The monitor is a de facto agent of the FTC, ensuring that the parties fully comply with the terms of the order and the divestiture agreement, but is compensated by the parties. A monitor is typically an expert in the field, and is often recommended by the parties to the merger. The FTC has the right to reject any nominee for conflict of interest, lack of experience, or other factors.[34]

Identifying and Approving an Acceptable Buyer

The buyer must be able to fully restore or maintain competition in the relevant market.[35] The central issue in whether a buyer is appropriate is whether it has the incentives and ability to fully restore competition. Therefore, the potential acquirer must have the financial capability and incentives to acquire and operate the asset, and it must be able to fully restore competition in the market. Moreover, the sale cannot cause competitive harm (*e.g.*, the purchaser should not be an already-dominant firm in the market). The agencies will also ensure that the proposed buyer is likely to use the assets for competitive purposes, as opposed to redeploying them.

The DOJ defines a "fit" purchaser as one that has sufficient "managerial, technical, and financial capability" to compete effectively over the long run. The FTC will analyze the buyer's commitment to competing in the relevant market, judging by the buyer's experience in related product markets or nearby geographic markets.[36]

The merging firms may select an appropriate buyer and price themselves. The merging parties control the divestiture process. This is often accomplished via an offering memorandum, competitive bidding process, auction, or simply approaching suitable individual firms.[37] The agencies may provide some guidance in general terms on the qualifications of an appropriate buyer, but the agencies do not intervene in the selection process. There is no obligation on the merging parties to select the "most competitive" or "most capable" buyer, nor is there any obligation to accept the buyer offering the highest price.[38]

The FTC Statement focuses on whether the buyer is capable of competing in the market, which requires the

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seller to engage in a higher level of scrutiny than it ordinarily would in a typical sale: instead of ensuring that the buyer is financially capable of closing the deal, the seller also must ensure that it is going to be viable as ongoing concern.[39] The DOJ Guide notes that sale to the highest bidder—after the asset has been widely promoted—leaves a presumption of purchaser fitness.[40] Conversely, the FTC notes that just because the buyer and sellers came to an agreement does not necessarily mean that the agreement will cure the FTC's concerns for competition.[41]

The value and structure of the deal are generally irrelevant. While the purchaser or seller may be getting the better of the bargain, such concerns are generally irrelevant to the preservation of competition. But both agencies note that certain provisions, such as long-term supply arrangements or an extremely low purchase price, will raise a red flag.[42] An extremely low price may give rise to a concern that the purchaser does not intend to engage in competition in the market.[43] On the other hand, a high price may also raise a red flag as it may indicate that the proposed purchaser is attempting to acquire market power, or that it is not going to be financially solvent enough to maintain the business after its acquisition.[44]

The buyer may finance the acquisition however it likes, except for a seller-financed acquisition. The FTC may wish to review the method of financing and the proposed lender to be confident in the purchaser's ability to compete. But both agencies are skeptical of seller-financed transactions.[45] They conflict with the requirement of "absolute" divestitures. A seller-financed sale can lead to a host of problems related to the seller's involvement with the assets it was supposedly divesting.[46]

In Some Cases, the Divestiture May Take Place Before the Merger

On occasion the FTC will require an "up-front buyer," especially when the divestiture is a package of assets that comprise less than a whole business. When the divestiture consists of assets comprising less than an ongoing business, the merging firms must have finalized and executed a purchase agreement and all ancillary agreements with the buyer at the time they present their proposal to the FTC. This requirement is not absolute, and other protections may suffice, *i.e.*, hold-separate arrangements.[47]

The merging firms may be able to cure the DOJ's concerns before the merger takes place, which is known as a "fix-it-first" remedy. The merging firm(s) may simply state a plan to divest before the merger ever takes place. It is a quick-and-easy method for the DOJ as it restores (or promotes) competition while obviating the DOJ's need to engage in further negotiations or even file a lawsuit. The DOJ gives a proposed fix-it-first remedy the same scrutiny it would give any other remedy, however, the remedy must equal the competition that the DOJ could achieve by filing a lawsuit.[48] The DOJ does not obtain an order when it negotiates a successful fix-it-first remedy, and therefore it differs from an FTC-ordered up-front buyer requirement.

The FTC may require a back-up divestiture if the initial divestiture is not successful, known as a "crown jewel." In many cases, the FTC requires the seller to add specified valuable assets to the initial divestiture package in the event that the merging firms are unable sell the assets in a given timeframe.[49] The DOJ refrains from including these provisions because they may undermine the DOJ's determination of the appropriate divestiture remedy and may lead to potential gamesmanship among the seller and potential purchasers.[50]

Implementing the Divestiture

Both agencies give a reasonable period of time for the divestiture. There is no preset period of time for a divestiture. But the agencies typically give the parties 3-6 months (after the merger is approved) to find an appropriate buyer.[51]

Both agencies may utilize "hold-separate" provisions.[52] Merging firms that agree to a post-merger divestment will be required to ensure that the assets to be divested are maintained as separate, distinct, and saleable. The parties must maintain the assets as an independent entity that must include all of the assets to be divested. The provision ensures that firms can rapidly comply with the terms of the divestiture. It also prevents diminution of the assets' competitive strength and may also address employee stability concerns.

The FTC staff will monitor the hold-separate arrangement. It will utilize a third-party monitor to ensure that the held-separate assets are appropriately maintained. The monitor functions as an agent of the FTC, monitoring compliance, but also (unlike an ongoing-relationship monitor) oversees the operations of the held-separate entity much like the chairman of the board. The FTC encourages parties to propose appropriate candidates—it wants someone with appropriate experience and no financial ties to the merging parties or potential purchasers.

The parties must complete the divestiture pending the review of the presiding agency. Both the DOJ and FTC reserve the right to approve of the divestiture and the buyer, taking all of the foregoing into account. [53]

The FTC requires that the parties enter a divestiture agreement that reflects all of the terms of the FTC's order, including all of the assets identified by the FTC for divestiture. It can include terms beyond the FTC's order, but they must comply with the spirit of the order and allow the order's remedial objectives to be obtained. Once a purchaser is found, the parties must submit an application explaining why the proposed transaction meets the requirements of the FTC's order. The application must include the information and documents necessary to satisfy the parties' burden of demonstrating that all of the assets identified in the FTC's order will be divested to an appropriate buyer. The application is then subject to a 30-day public comment period.[54]

Once the sale is completed, the DOJ is unlikely to place ongoing constraints on the divested assets. The DOJ's approval of the divestiture and purchaser is merely a forecast. If it is satisfied that the purchaser has the intent and ability

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to use the assets competitively in the market, the DOJ will approve the sale, allowing the purchaser to do what it will with the assets in the future.[55] There are situations, however, when the DOJ will limit a purchaser's rights, as discussed above (regarding ongoing conduct remedies that prohibit the sale of the assets to certain categories of purchasers).

Compliance and Enforcement

A DOJ consent decree is binding on the parties and enforceable.[56] If a party fails to comply with the terms of its fix-it-first remedy or consent decree, the DOJ can pursue an enforcement action. If the DOJ concludes that the defendants violated the provisions of the consent decree, it will institute an enforcement action via contempt proceedings, either civil (mandating compliance and/or imposing a fine) or criminal (imposing a fine, imprisonment, or both).[57] The DOJ will also include a trustee provision in the consent decree, which will provide the DOJ the ability to appoint a trustee if the defendant cannot sell the divestiture assets within the specified period. This guarantees that the decree will be implemented, regardless of the reason that the assets could not be sold. It also provides an incentive for a seller that wishes to maintain some degree of control over the sale to complete it on time. It also prevents a seller from attempting to avoid a new competitive entrant into the market. While the provision generally allows for the DOJ to request the appointment of a nominated trustee after a certain amount of time, it may also provide the DOJ the right to request an immediate appointment. Such action is generally reserved for unwilling defendants or situations where a trustee's management is necessary. [58]

An FTC order is legally binding. If the parties fail to consummate the divesture by the deadline in the order, the parties are in violation of the order.[59] The deadline applies to the date of the transaction, not the date of the application for approval. The only way to cure the violation is to complete the divestiture. Parties may be subject to an $11,000 per day fine and other penalties until the divestiture is complete. The FTC will also include a provision in the order that allows it to appoint a third-party trustee to divest the assets.[60]

Conclusion

Antitrust issues need to be addresses in many mergers, and merger remedies are an important tool to keep such issues from causing problems in a deal. With the DOJ and the FTC offering guidance on how best to structure merger remedies, dealmakers and their advisors would be wise to heed such advice.

Notes

1. *Available at* http://www.usdoj.gov/atr/public/guidelines/205108.htm.
2. *Available at* http://www.ftc.gov/bc/bestpractices/bestpractices030401.htm.
3. DOJ Guide at III.A.
4. *Id.*
5. *Id.* at III.C.; FTC Statement.
6. DOJ Guide at III.C.; FTC Statement.
7. DOJ Guide at III.C.
8. DOJ Guide at III.C.; FTC Statement.
9. FTC Statement.
10. DOJ Guide at III.C.
11. DOJ Guide at III.C.; FTC Statement.
12. DOJ Guide at III.C.
13. FTC Guide.
14. DOJ Guide at III.D.; FTC Guide.
15. FTC Guide.
16. DOJ Guide at III.D.
17. *Id.* at III.D.; FTC Guide.
18. DOJ Guide at III.D.
19. *Id.*
20. DOJ Guide at III.E.
21. *Id.*
22. DOJ Guide at III.C., III.E.1.; FTC Statement.
23. DOJ Guide at III.E.1.
24. FTC Statement.
25. FTC Statement.
26. DOJ Guide at III.E.1.
27. *Id.*
28. DOJ Guide at III.E.2.
29. *Id.*
30. *Id.*
31. *Id.*
32. *Id.*
33. FTC Guide.
34. *Id.*
35. DOJ Guide at IV.D.; FTC Statement.
36. *Id.*
37. FTC Statement.
38. DOJ Guide at IV.E.
39. FTC Statement.
40. DOJ Guide at IV.E.
41. FTC Statement.
42. FTC Statement; DOJ Guide at IV.E.
43. *Id.*
44. *Id.*
45. FTC Statement; DOJ Guide at IV.G.
46. *Id.*
47. FTC Statement.
48. DOJ Guide at IV.A.
49. FTC Statement.
50. DOJ Guide at IV.H.
51. DOJ Guide at IV.C., V.; FTC Statement.
52. DOJ Guide at IV.B.; FTC Statement.
53. DOJ Guide at IV.D., V.C.; FTC Statement.
54. FTC Statement.
55. DOJ Guide at IV.D.,V.
56. DOJ Guide at V.
57. DOJ Guide at V.C.-V.D.
58. DOJ Guide at IV.I.
59. FTC Statement.
60. *Id.*

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