CorporateLiveWire

COMPETITION & ANTI-TRUST LAW 2016

EXPERT GUIDE

www.corporatelivewire.com

MÖHRLE HAPP LUTHER

SERGII KOZIAKOV & PARTNERS
ATTORNEYS & COUNSELLORS AT LAW

manatt

BAKER & MCKENZIE

Lisl Dunlop
ldunlop@manatt.com
+1 212 790 4507
www.manatt.com

manatt

Trends in U.S. Merger Remedies

By Lisl Dunlop

When mergers pose serious competitive concerns in the United States, offering remedies has traditionally been a means for parties to get their deals through the antitrust agencies. The U.S. Federal Trade Commission (FTC) and Department of Justice Antitrust Division (DOJ) have always had high standards for remedies proposals. Recently, however, there have been calls for parties to take a more stringent approach to remedy proposals, and the agencies have made several high-profile challenges to transactions without accepting remedies.

This article outlines key principles to guide the offering of merger remedies and negotiation with the FTC and DOJ, and discusses factors contributing to the trend towards a more stringent approach to merger remedies.

1. Agency requirements for remedies proposals

Effective remedy packages will vary from deal to deal. As a general principle, the objective of any remedy is to restore or replace competition that is likely to be lost from the transaction. This means more than merely identifying and divesting competing assets or services: the agencies' focus is on preserving the competitive process, factoring in the nature of the market and participants, as well as the characteristics of the divestiture buyer.

The agencies have emphasized several key elements for effective remedy proposals:

a. ***Structural remedies.*** Where antitrust concerns are horizontal in nature, the agencies require structural remedies in the form of divestiture of assets to a third party. Behavioral remedies, such as undertakings to deal with third parties on certain terms, or institute firewalls, are occasionally used where the competitive concerns are vertical, but are highly disfavored in deals where the parties are horizontal competitors.

b. ***Complete package.*** A structural remedy package must include all assets—tangible and intangible—that the divestiture buyer needs to compete. Tangible assets often include manufacturing facilities and machinery, sources for raw materials and key inputs, personnel, marketing and distribution organizations, customer relationship information and capital resources. Intangible assets include intellectual property rights and know-how. The package may go beyond those assets required to sell the product or service in issue if the buyer needs more to compete effectively in the market.

c. ***Limited entanglements.*** The agencies seek to avoid long-term ongoing financial, supply and technical relationships and other entanglements between the merged firm and the divestiture buyer relating to the divestiture business. Short-term transitional arrangements are permitted, but are very limited and typically at the option of the divestiture buyer. If the buyer needs significant ongoing support, this may be an indication that the buyer is unsuitable or the package inadequate.

d. ***Identified buyer.*** Past retrospectives of merger remedies have indicated that the identity of the divestiture buyer is central to the success of the remedy. There has been a clear trend—particularly in FTC remedies—for parties to identify a buyer and negotiate the divestiture agreement before formal approval of the remedy, so that the consent order expressly identifies the buyer and agreement. This will particularly be the case if something less than an existing stand-alone business is being divested.

2. Effectiveness of past remedies and recent remedy failures

There have been several retrospective studies of the effectiveness of merger remedies and economic analyses of markets in which mergers have taken place. A recent study of data from 53 transactions concluded that remedies imposed on problematic mergers did not appear generally effective in preventing post-merger price increases, and that on average there was a 9% post-merger price increase.[1] Still other studies concluded that past divestitures ordered in health insurance company mergers had been ineffective in preserving competition and resulted in the liquidation of plans.[2]

> *In a transaction likely to raise serious antitrust issues, early and transparent engagement with the agencies on the competitive concerns and potential remedies may prove to be an effective strategy in achieving clearance smoothly.*

Coupled with growing skepticism as to the effectiveness of merger remedies have been the failure of remedies in two recent high-profile transactions. In 2012, the FTC cleared the acquisition of Dollar Thrifty car rental company by Hertz on the condition that the parties divest the Advantage Rent a Car brand making it an independent competitor. Advantage filed for bankruptcy several months after the FTC's approval. And, in 2015, when the FTC approved the merger of grocery chains Safeway and Albertsons subject to the sale of 168 stores, Albertsons was able to buy back 33 of those stores when one of the divestiture buyers went bankrupt. These cases have thrown a spotlight on the adequacy of divestiture packages and vetting of divestiture buyers.

The agencies' increased wariness has been evident in several recent merger challenges. In *Sysco/US Foods*, a merger between two national broadline foodservice distributors, the parties offered to sell a package of 11 distribution centers, generating $4.6 billion in revenue, to Performance Food Group, a smaller industry player. The restructured transaction would have left US Foods with 159 facilities and PFG with only 35. The FTC rejected the plan and sought an injunction against the transaction, eventually winning at trial.

In *Baker Hughes/Halliburton*, the parties offered a divestiture package made up of a mix of assets extracted from the parties' overlapping business lines. Because the package offered did not comprise full business units and excluded important facilities, employees, contracts, intellectual property, and research and development resources, the DOJ was concerned that the divestiture would put the buyer of those assets at a competitive disadvantage and would not be effective in restoring competition. The DOJ rejected the plan and challenged the transaction, following which the parties called off their deal.

In yet another transaction, *AB Inbev/Modelo*, the parties initially offered a distribution and licensing agreement to resolve competitive concerns about the sale of Modelo beer in the U.S. The DOJ rejected this proposal and filed suit to enjoin the deal. After several months, the parties capitulated, and agreed to an extensive divestiture package, including a brewing plant, perpetual and exclusive license of Modelo brands for sale in the US, and Modelo's interest in the U.S. importer of Modelo beers in the U.S.

3. Takeaways

The agencies' greater focus on ensuring the long-term effectiveness of merger remedies, coupled with a clear willingness to litigate to block transactions in the face of inadequate remedy proposals, puts an emphasis on early analysis and assessment of potential antitrust issues and what might be required to address them in deal planning. Parties to complex deals need to be realistic about competitive concerns and the potential for significant restructuring.

In a transaction likely to raise serious antitrust issues, early and transparent engagement with the agencies on the competitive concerns and potential remedies may prove to be an effective strategy in achieving clearance smoothly. Leaving remedies discussions until late in the process—after extensive discovery and possibly work with complaining customers—may lead to a hardening of litigation positions and less willingness to negotiate. The agencies' success in several high-profile merger challenges has given them the confidence to reject potentially inadequate proposals and hold out for a solution that completely preserves competition, even if this means stopping a deal in its tracks.

Lisl Dunlop is a partner in the Litigation Division of Manatt, Phelps & Phillips and co-chair of Manatt's antitrust practice. She advises leading U.S. and multinational companies in an array of industries, in particular in the media, technology and health care sectors, on a broad range of antitrust investigations, litigation and transactional matters. Ms. Dunlop advises on antitrust-related aspects of mergers and acquisitions, joint ventures and other combinations, represents clients in merger, antitrust and cartel investigations, and has represented major corporations in complex antitrust litigations, including multi-district treble damages class actions.

Ms. Dunlop is an active speaker and writer on antitrust issues and has been recognised as a leading antitrust lawyer in Chambers USA, The Legal 500 and Global Competition Review. She currently serves as Chair of the Antitrust Section of the New York State Bar Association and Co-Chair of the International Antitrust Committee of the American Bar Association.

1. "Does Merger Control Work? A Retrospective on U.S. Enforcement Actions and Merger Outcomes," John E. Kwoka, 78 Antitrust L.J. 619 (2013).
2. "Divestitures Will Not Maintain Competition in Medicare Advantage," Topher Spiro, Maura Calsyn, and Meghan O'Toole, March 8, 2016, available at https://cdn.americanprogress.org/wp-content/uploads/2016/03/04044219/MergersFollowUp.pdf