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# CLIENT ALERT

## FTC Issues Report Evaluating Merger Remedies

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On February 3, 2017, the staff of the Federal Trade Commission released a report entitled "The FTC's Merger Remedies 2006-2012." The study is a review of the Commission's merger orders (89 in total) from 2006-2012. Commission staff concluded that the great majority of its remedy orders "maintained or restored competition," and that "the Commission's practices relating to designing, drafting, and implementing its merger remedies are generally effective." Overall, 80 percent of the Commission's remedies succeeded.

Building on its previous Remedy Study (1999), Commission staff reaffirmed its commitment to the principles and practices in place since then, and identified some best practices and guidance for merging parties considering a settlement with the agency. While the Department of Justice's Antitrust Division is not an author of the study, the agencies have traditionally attempted to align their remedial policies whenever possible.

Key findings from the 2017 report include the following:

- All buyers of an ongoing business succeeded in restoring or preserving competition, while buyers of limited packages of assets sometimes were not successful, even with an upfront buyer.
- The study included four vertical mergers where behavioral remedies were designed to address potential input foreclosure and access to confidential information, and concluded that all vertical merger remedies were successful.
- Some buyers experienced difficulties in transitioning critical back-office functions, such as IT systems, and sometimes needed more time than expected to transition such services.
- Buyers expressed concern about the time available for due diligence and access to the seller's facilities and employees.
- Commission staff will scrutinize a proposed buyer to ensure that it has the requisite assets to compete effectively, and will look more closely at a buyer's source of funds and any funding limitations.

Significant reforms from the 1999 study included requiring upfront buyers instead of holding assets separate while the parties searched for a buyer; shortening the time for divestiture to six months; appointing an independent monitor under certain circumstances; and following up with the buyer on a more routine and systematic basis. Those policies remain in place.

The Commission staff's 2017 study added to the findings by identifying the following best practices.

> *Divesting Ongoing Businesses*: Commission staff prefers divestitures of ongoing businesses, as opposed to a selected group of assets. Divestiture of an ongoing business — which includes all assets necessary for the buyer to begin operations immediately — maximizes the likelihood that competition will be preserved and minimizes the likelihood that the divestiture buyer will exit the market.

*Divesting Selected Assets*: Although the merging parties may propose a divestiture of selected assets rather than a divestiture of an ongoing business, Commission staff will accept such a proposal only if it is demonstrated that divesting the more limited asset package is likely to maintain or restore competition.

*Vetting a Proposed Buyer*: Vetting an interested buyer is a critical component of the remedy process and Commission staff will engage in an extensive review to ensure that the proposed buyer will be able to compete successfully.

*Conducting Due Diligence*: The respondent should provide adequate opportunity for the buyer to conduct due diligence and the buyer should take advantage of the due diligence process by conducting a deliberate review to ensure it is sufficiently prepared to compete successfully in the marketplace.

The context and timing of this study and guidance are important. Over the past few years, both the FTC and the Antitrust Division have been seen as insisting on more robust remedies, even when the parties are unwilling or unable to provide them and the result is abandonment of the deal or litigation to block it. Whether that litigation-oriented trend holds in the new administration will be up to President Trump's appointees at the agencies, but this study and resulting policies make it somewhat harder for the government to accept conduct remedies like commitments not to raise prices or to preserve jobs. Current Acting FTC Chair, Maureen Ohlhausen, praised the Commission staff report, calling the information "valuable" and noting that it and similar evidence-based assessments are "tremendously important." The Commission's staff report will be a relevant factor in judicial review of DOJ settlements under the Tunney Act and, similarly, the FTC will need a reasoned explanation for any sudden shift in practices if it reverses course from the findings and policies identified over such a long period.

With that overview in mind, below is additional detail on the Commission staff's current best practices.

**Remedy Best Practices**

As noted, Commission staff identified certain concerns when evaluating proposed remedies. Based on these findings, the FTC developed best practices for both improving the merger remedy process generally, and the success rates of remedies going forward.

The top concerns that Commission staff identified were (I) defining the proper asset package to be divested—a full ongoing business versus selected assets; (II) properly vetting the buyer to ensure it is equipped to compete successfully; and (III) successfully implementing the remedy to ensure that the buyer is an effective competitor in the marketplace.

Both merging parties and proposed buyers should be prepared to explain and address questions from Commission staff on various aspects of a proposed remedy.

I. Defining the Asset Package to be Divested

*Divesting Ongoing Businesses*: Commission staff prefers divestitures of ongoing businesses, as opposed to a selected group of assets. Divestiture of an ongoing business — which includes all assets necessary for the buyer to begin operations immediately

— maximizes the likelihood that competition will be preserved and minimizes the likelihood that the divestiture buyer will exit the market.

Merging parties should:

- Explain how the proposed divestiture contains all aspects needed for the divestiture buyer to operate successfully on its own.
- Explain how likely it is that the buyer will acquire the ongoing business and begin competing right away.
- Consider identifying at least three potential buyers that the merging parties believe are interested and approvable if they propose to divest an ongoing business.
- Be aware that the FTC will talk with potential buyers and other market participants to vet the proposed divestiture.

*Divesting Selected Assets*: Although the merging parties may propose a divestiture of selected assets rather than a divestiture of an ongoing business, Commission staff will accept such a proposal only if it is demonstrated that divesting the more limited asset package is likely to maintain or restore competition.

Merging parties should:

- Explain why an alternative ongoing business divestiture is inappropriate or infeasible.
- Demonstrate how the selected assets can operate as a viable and competitive business in the relevant market.
- Explain what aspects of an ongoing business are excluded from the package and how a proposed buyer would be able to address these gaps, at what cost, and how quickly.
- Provide the buyer with adequate time and access to employees, facilities, and information to conduct due diligence.

Buyers should:

- Explain how it plans to maintain or restore competition with the selected asset package.
- Assess what additional assets and services it will need to operate the selected assets as a viable and competitive business in the relevant market.
- Document cost and time estimates to obtain these additional assets and services and explain how quickly they will be obtained.

II. Vetting the Proposed Buyer

Vetting an interested buyer is a critical component of the remedy process and Commission staff will engage in an extensive review process to ensure that the proposed buyer will be able to compete successfully.

Merging parties should:

- Explain to the FTC how it selected the proposed buyer.
- Share with the FTC the offering memorandum and other documents it intends to provide to potential buyers prior to distribution.
- Know that the FTC will talk to potential buyers as well as other market participants.

Buyers should:

- Identify all sources of financing for the acquisition, including private equity or other investors, and explain the criteria it used for evaluating such sources.
- Explain how it, and all entities providing financing for the transaction, reviewed and evaluated the transaction and formed the basis for authorizing it. These entities should be available for discussions with the FTC.
- Provide detailed financial and business plans, with supporting documentation, to demonstrate its competitive and financial viability.
- Explain the underlying assumptions of its financial and business plans, including contingency plans if sales and other financials do not meet projections.
- Make management, sales, marketing, accounting, and other representatives available for discussions with the FTC.

III. Successfully Implementing the Remedy

*Due Diligence*: The merging parties should provide adequate opportunity for the buyer to conduct due diligence and the buyer should ensure that it takes advantage of the due diligence process by conducting an adequate review.

Merging parties should:

- Provide access to information, facilities, and employees to interested buyers.
- Explain to the FTC the extent to which the buyer has taken advantage of due diligence opportunities.

Buyers should:

- Explain to the FTC the specific due diligence efforts it undertook.

*Customer and Other Third-Party Relationships*: Commission staff found that some buyers in the study had difficulty attracting and retaining customers, while others stepped into complicated third-party relationships. Respondents and buyers should be prepared to take certain steps to facilitate the transition in these relationships.

Merging parties should:

- Provide the buyer access to customers and relevant third parties early in the process to facilitate the transition.

- Inform customers of the divestiture, of the buyer's identity, and (when required) generally assist the buyer in building a customer base, such as assigning customer contracts to the buyer or waiving contract restrictions that would prevent customers from switching to the buyer.
- Assist the buyer in obtaining any necessary governmental or regulatory approvals necessary to operate.

Buyers should:

- Take advantage of the access to all third parties involved, including customers, suppliers, landlords, and others to facilitate the successful transition into a marketplace competitor.
- Review and understand customer and other third-party relationships, including customers' buying patterns, customer brand and product loyalty, and customer switching costs.

*Transfer of Back-Office Functions and Transition Support*: Commission staff found that back-office operations were important for a buyer to operate as a viable competitor and that the successful transfer of these back-office functions is often essential for a buyer to compete in the affected market. The respondent should be prepared to provide back-office and other functions for a limited period until the buyer can provide them itself.

Merging parties should:

- Identify for the FTC and the buyer all back-office functions related to all relevant products, as well as all necessary personnel and documentation.
- Ensure that the proposed buyer can conduct adequate due diligence to understand what back office functions will be needed and the complexities involved in the transfer of such functions.
- Make information technology employees available to discuss and plan the transfer of the back-office functions with the buyer.
- Provide back-office functions to the buyer as needed on a transitional basis for a period sufficient to allow the buyer to transition all services, at no more than respondent's cost.
- Provide the supply of products or inputs that a buyer may require to successfully compete for a sufficient period, such as the length of a product qualification process or the time needed to enable the buyer to manufacture the product on its own or obtain the inputs.

Buyers should:

- Explain to the FTC the scope and cost of back-office functions it will need to support the asset package and how it will provide for them.
- Explain the length of time it will need transition services and its options if the transition takes longer than expected.

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