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DOJ, FTC Get Tougher On Remedies: Can Your Deal Be Fixed?

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These days there seems to be as many high-profile M&A transactions abandoned because of an inability to obtain antitrust clearance as ones that successfully pass muster. The list of abandoned transactions is long and includes some the largest cross-border transactions of the decade: Comcast Corp./Time Warner Cable Cable Inc., Applied Materials Inc./Tokyo Electron Ltd., Sysco Corp./US Foods Inc., Baker Hughes Inc./Halliburton Co., General Electric Co./AB Electrolux, Staples Inc./Office Depot Inc. and others. In several of these ultimately abandoned transactions, the merging parties offered remedies inadequate to obtain clearance. In some cases, the merging parties decided to litigate against an antitrust agency — and eventually lost. This has generated many headlines characterizing an increasingly aggressive environment at the U.S. Department of Justice and the Federal Trade Commission against big deals and "antitrust cops … break[ing] out the batons."[1]

One fundamental question — if often overlooked — in all these transactions is whether they actually could have been fixed. Was there a remedy that would satisfy the "antitrust cops"? Or were remedies too dilutive of the value of the transaction that the parties were better off litigating or walking away? In some cases, the agencies rejected remedy proposals that were too small or otherwise inadequate. In other cases, the agencies rejected proposed divestiture buyers because they would not become viable competitors.

While merging parties are increasingly sophisticated and creative in allocating antitrust risk via a variety of clauses (including remedy caps, hell-or-high-water, and reverse breakup fees), this ever-expanding menu of contractual risk allocation clauses may not entirely answer this fundamental question: Can your deal be fixed? How likely is it the agency will determine that a very large set of assets must be divested? That there is no buyer (or only one or two) who could become a viable competitor? How do you contractually provide for this type of antitrust concern?

These should have been central questions in Applied Material's $9.3 billion proposed acquisition of Tokyo Electron. After an 18-month regulatory review, the parties abandoned the transaction when the DOJ informed them that "their remedy proposal failed to resolve the Department's competitive concerns."[2] The DOJ was concerned that Applied Materials and Tokyo Electron were the two largest competitors, and the only competitors with the expertise to develop a specific type of next-generation semiconductor (high-volume non-litography semiconductor). Even if the parties agreed to divest assets that included individuals with the relevant expertise and know-how to a third party, the question remained whether that third party could step in and compete as effectively as one of the merging parties. If not that proposed buyer, who else would be better situated to become a more viable competitor? Could anyone purchase the divested assets and restore competition for next-generation technology? Despite an 18-month review period, the parties hit a roadblock they could not fix. They were unable to convince the DOJ that the proposed divestiture buyer would be adequate to operate the divested assets in a way that would restore competition for next-generation technology. It was reported that that issue killed the transaction.

In Staples/Office Depot, the FTC was concerned that Staples and Office Depot, the two largest vendors of office supplies, would hold close to 80 percent of the market for supplies to large businesses. While the parties disputed the FTC's market definition and competitive effects analysis, they also announced a remedy to try to address the FTC's concerns. The parties proposed to divest more than $500 million in large corporate contract business and related business to Essendant Inc., a wholesale distributor of workplace essentials.

The FTC rejected the proposal and articulated several reasons why the fix was "woefully inadequate" to address the harm.[3] One key concern was that Essendant was not a competitor in the market at issue: "[I]t is not an office supplies vendor competing with Staples and Office Depot for sales of large B-to-B customers. Thus, by definition, the divestiture cannot replace the competition from Office Depot that would be eliminated by the Merger."[4] Another concern was that Essendant would be entangled with Staples — it would need Staples to compete against Staples: "Essendant would continue to need Staples to help transition customers, work with vendors, transition the e-commerce platform, and provide customer deliveries. In other words, Tier 1 vendors partnering with Essendant would have to rely on their primary competitor — and by far the biggest vendor in the market — to succeed."[5] Here, the FTC's concerns were both a question of the scope of the remedy as well as the divestiture buyer itself.

In Baker Hughes/Halliburton, the DOJ alleged that the combination of two of the "big three" providers of oilfield services would diminish competition and likely lead to higher prices and less innovation in a range of oilfield services markets. In its complaint enjoining the transaction, the DOJ articulated that Baker Hughes, Halliburton and Schlumberger Ltd. were the largest globally integrated suppliers of the myriad products and services necessary to compete and win the business of exploration and production companies. The DOJ was also (again) concerned about the development of next-generation technologies for oilfield services. To address such concerns, "Halliburton had proposed divesting a collection of assets selected from various Halliburton and Baker Hugues business lines in an attempt to remedy the many antitrust concerns that have been raised by [DOJ] and by antitrust authorities in other countries."[6] The DOJ rejected this "mix and match" remedy, calling it "among the most complex and riskiest remedies ever contemplated. It would separate business lines and divide facilities, intellectual property, research and development, workforces, contracts, software, data, and other assets across the world between the merged company and the buyer of divested assets. Many customer contracts would not be transferred. For some of the services for which the transaction is likely to lessen competition substantially, the proposed remedy fails to divest many of the assets used to provide such services."[7] The DOJ concluded that "the proposed remedy would thus leave the buyer dependent on Halliburton for services that are crucial to the business being divested."[8]

In GE/Electrolux, the DOJ also rejected the remedy proposal after concluding that it fell short of replacing the competition that would be lost as the result of the transaction.

In Sysco/US Foods, the FTC challenged the merger of the two largest "broadline" foodservice distributors in the United States. The FTC alleged, and the court accepted, that the parties had a 71 percent combined share nationally, and shares exceeding 63 percent in more than 10 local markets (post-divestitures). To address the FTC's concerns, the parties offered to divest 11 "strategically located" US Foods distribution centers to the third largest competitor, PFG. The FTC rejected the remedy proposal, and the court agreed with the FTC, finding that the divestiture buyer would not be "able to step into USF's shoes to maintain — certainly not in the near term — the pre-merger level of competition that characterizes the present marketplace."[9] The key criticism here was that this remedy proposal was not enough to create a major player; post transaction, the divestiture buyer "will have only 35 distribution centers — far fewer than the at least 100 distribution centers owned by the combined Sysco/USF."[10]

These stories beg the question of whether these deals could actually be fixed. The concerns raised by the DOJ and the FTC on the ineffectiveness of these remedies are nothing new. It is not new that a proposed remedy needs to address the entire loss of competition — not just a part of it. It is also not new that the agencies disfavor a remedy that creates a long-term entanglement between the divestiture buyer and the merged company. And it is certainly not new that a company needs to ensure that it presents a viable divestiture buyer to the agencies. These principles are clearly articulated in myriad speeches by DOJ and FTC officials, and by DOJ and FTC remedy manuals and guidelines, such as the DOJ's 2011 "Policy Guide to Merger Remedies,"[11] or the FTC's 1999 "Study of the Commission's Divestiture Process" (headed by then Bureau Director of Competition Bill Baer). In that study, the FTC noted that "the Commission is not required to accept whatever buyer respondent proposes. In fact, the Commission may disapprove a marginally acceptable buyer if a better buyer might be available."[12]

What may be new, however, is that the agencies have been under heightened scrutiny for recent failed merger remedies. The two most often cited examples are Hertz Global Holdings/Dollar Thrifty Automotive Group Inc. and Albertsons LLC/Safeway Inc. In both instances, the divestiture buyer approved by the FTC sought bankruptcy protection shortly after the FTC cleared the transaction. In Hertz/Dollar Thrifty, the divested Advantage Rent a Car business filed for Chapter 11 bankruptcy protection four months after the FTC signed off on its business plan and the bankruptcy trustee ended up selling several divested locations back to Hertz. In Albertsons/Safeway, the divestiture buyer filed for Chapter 11 bankruptcy protection less than nine months after FTC approval, and Albertsons ended up reacquiring a number of stores in the bankruptcy auction.

To their credit, both the DOJ and FTC are working very hard not to add to the "failed remedy" transactions list. This means, however, that the merging parties need to understand that the agencies will scrutinize the proposed remedy in all its elements, and perhaps like never before. It is now standard operating practice for the agencies to thoroughly scrutinize the scope of the remedy and the long-term viability of the proposed divestiture buyer.

Merging parties should take notice of this heightened scrutiny, as it is here to stay. The FTC is currently conducting a retrospective review to update and expand on the 1990 divestiture study.[13] The new FTC study is focusing on the effectiveness of remedies in 90 orders between 2006 and 2012. The DOJ too has proven that it is continuously taking a "harder look at remedies."[14] And international competition authorities are also following this trend. For instance, on April 5, 2016, the International Competition Network Merging Working Group issued a "Merger Remedies Guide" in which it describes the necessary conditions for an acceptable remedy and divestiture buyer.[15]

The parties, and the M&A community as a whole, can take several steps and change their best practices to address this trend.

First — know thy antitrust problem: thoroughly investigate any actual and potential antitrust issues before signing. This may seem obvious, but there can be strategic and practical impediments to thorough antitrust diligence pre-signing. The buyer may not want to engage in detailed discussions with the seller regarding antitrust issues before signing in an effort to avoid bearing significant antitrust risk. If this is a concern, the buyer should ensure that its unilateral analysis leaves no stone unturned, and anticipate all possible agency concerns. There are also practical impediments. In many instances, the parties' subject matter experts on the competitive landscape may not be "in the tent" and aware of the parties' negotiations. Consider broadening the tent to ensure that antitrust counsel and economists evaluating the antitrust risk have all available facts early in the process. And build your deal timeline to ensure that such an analysis can be conducted pre-signing.

Second — know thy remedy: thoroughly investigate any possible weakness of the antitrust remedy. Assess internally whether the assets to be divested and potential divestiture buyers would pass muster at the agencies. Focus on the weaknesses and create an internal red team if need be to vet and question the effectiveness of the proposed remedy. Do unto your remedy proposal what the agencies will do to it.

Third — know thy customers: develop a strategic plan to understand whether your customers, and the other side's customers, would have negative reactions to the remedy as well as the transaction itself. The agencies will market test the proposed remedy with the merging parties' top customers. Anticipating customer reactions earlier in the process will minimize the risk of agency delays or opposition to a divestiture buyer.

Finally — know thy regulator. Understand the details of both the process and substance of the remedy negotiations. The DOJ and the FTC, and their non-U.S. counterparts, process and vet proposed remedies in slightly different ways. Ensure that the business instincts on the antitrust remedy align with the agencies' preferred approaches and policies.

In summary, consider taking the time and effort to really know the antitrust risk of a particular transaction, and what could remedy it, and delve into real in-depth remedy analysis pre-signing. This up-front investment will shorten the regulatory review, and enhance your chances of getting your strategic deals through the regulatory process.

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[1] Jacob Gershman, Merger-Mania Brings Out the Antitrust Police, Wall St. J.: L. Blog (Dec. 11, 2015), http://blogs.wsj.com/law/2015/12/11/merger-mania-brings-out-the-antitrust-police/.

[2] Dep't of Justice, Applied Materials Inc. and Tokyo Electron Ltd. Abandon Merger Plans After Justice Department Rejected Their Proposed Remedy (Apr. 27, 2015), https://www.justice.gov/opa/pr/applied-materials-inc-and-tokyo-electron-ltd-abandon-merger-plans-after-justice-department.

[3] Memorandum in Support of Plaintiffs' Motion for A Preliminary Injunction at 37, Fed. Trade Comm'n

v. Staples, Inc., No. 1:15-cv-02115-EGS (D.D.C. February 19, 2016), ECF No. 178-4.

[4] Id.

[5] Id. at 38.

[6] Complaint at ¶ 8, United States v. Halliburton Co., No. 1:16-cv-00233 (D. Del. Apr. 6, 2016), ECF No. 1.

[7] Id. at ¶ 9.

[8] Id.

[9] F.T.C. v. Sysco, 113 F. Supp 3d 1, 73 (D.C.C. 2015).

[10] Id. at 74.

[11] See Dep't of Justice Antitrust Division, Antitrust Division Policy Guide to Merger Remedies (June 2011) https://www.justice.gov/sites/default/files/atr/legacy/2011/06/17/272350.pdf.

[12] See Fed. Trade Comm'n, A Study of the Commission's Divestiture Process 17, n.26 (1999) https://www.ftc.gov/sites/default/files/attachments/merger-review/divestiture.pdf

[13] Agency Information Collection Activities; Proposed Collection; Comment Request, 80 Fed. Reg. 2423-01 (proposed January 16, 2015) (available at https://www.ftc.gov/system/files/documents/federal_register_notices/2015/01/1501hsrdivestiturefrn1.pdf)

[14] See Bill Baer, Assistant Attorney Gen. Antitrust Division, Dep't of Justice, Remarks as Prepared for Delivery at the Global Competition Review Fourth Annual Antitrust Leaders Forum: Reflections on Elements of Effective Antitrust Enforcement (Feb. 6, 2015) (transcript available at https://www.justice.gov/opa/speech/assistant-attorney-general-bill-baer-delivers-remarks-global-competition-review-fourth)

[15] See Int'l Competition Network, Merger Remedies Guide (April 5, 2016), http://www.internationalcompetitionnetwork.org/working-groups/current/merger.aspx