The M&A LAWYER

May 2010 ■ Volume 14 ■ Issue 5

Recent Enforcement Activity Reveals More Regulatory, Flexible Approach to Merger Remedies

BY PHILLIP A. PROGER, J. BRUCE MCDONALD, AND DAVID P. WALES

*Phillip Proger is head of the Jones Day Antitrust Practice and is a member of the Editorial Board of **The M&A Lawyer**, Bruce McDonald was a Deputy Assistant Attorney General in the Antitrust Division of the U.S. Department of Justice, and David Wales was Director (Acting) of The Bureau of Competition of the Federal Trade Commission. All three are partners in the Washington, D.C. office of Jones Day. Contact: paproger@jonesday.com or bmcdonald@jonesday.com or dpwales@jonesday.com.*

With a year of merger challenges now on the scorecard, several trends suggest that the new federal antitrust enforcers have brought to Washington a little change of their own, which is affecting how they "fix" anticompetitive mergers. Enforcement actions by the new Department of Justice and Federal Trade Commission suggest greater flexibility and a willingness to use "conduct" remedies for mergers in addition to traditional divestiture remedies. A more hands-on or "regulatory" approach to merger remedies by the DOJ and FTC could have upsides as well as downsides for companies contemplating mergers with antitrust problems.

As we forecasted in our previous article[1], in their first year enforcers at the DOJ and FTC have kept busy, even without large-scale deal activity. The agencies have investigated transactions below the Hart-Scott-Rodino (HSR) thresholds and deals that already have closed. In the past 14 months, the DOJ and FTC together have challenged about 20 mergers, either through lawsuits or negotiated settlements; about half of these challenges have involved non-HSR-reportable or consummated transactions. The majority of the DOJ and FTC challenges have been fairly uncontroversial, horizontal mergers that would leave only a handful of competitors in the market after the deal. What is new, however, is that the agencies, especially the DOJ, are taking a more complex, regulatory approach to merger remedies than they have in the

CONTINUED ON PAGE 3

Article REPRINT

Reprinted from The M&A Lawyer. Copyright © 2010 Thomson Reuters. For more information about this publication please visit www.west.thomson.com

WEST®

© 2010 Thomson Reuters. This publication was created to provide you with accurate and authoritative information concerning the subject matter covered, however it may not necessarily have been prepared by persons licensed to practice law in a particular jurisdiction. The publisher is not engaged in rendering legal or other professional advice, and this publication is not a substitute for the advice of an attorney. If you require legal or other expert advice, you should seek the services of a competent attorney or other professional.

For authorization to photocopy, please contact the Copyright Clearance Center at 222 Rosewood Drive, Danvers, MA 01923, USA (978) 750-8400; fax (978) 646-8600 or West's Copyright Services at 610 Opperman Drive, Eagan, MN 55123, fax (651)687-7551. Please outline the specific material involved, the number of copies you wish to distribute and the purpose or format of the use.

For subscription information, please contact the publisher at: west.legalworkspublications@thomson.com

West LegalEdcenter

LOG ON.
LOOK UP.
LEARN.

Quality legal training and CLE - online, anytime

westlegaledcenter.com
1.800.241.0214

WEST®
Part of Thomson Reuters

Editorial Board

CHAIRMAN:

PAUL T. SCHNELL,
Skadden, Arps, Slate, Meagher & Flom LLP
New York, NY

MANAGING EDITOR:

CHRIS O'LEARY

BOARD OF EDITORS:

BERNARD S. BLACK
University of Texas Law School
Austin, TX

FRANCI J. BLASSBERG
Debevoise & Plimpton
New York, NY

DENNIS J. BLOCK
Cadwalader, Wickersham & Taft
New York, NY

ANDREW E. BOGEN
Gibson, Dunn & Crutcher LLP
Los Angeles, CA

H. RODGIN COHEN
Sullivan & Cromwell
New York, NY

STEPHEN I. GLOVER
Gibson, Dunn & Crutcher LLP
Washington, DC

HERBERT HENRYSON II
Wolf, Block, Schorr andSolis-Cohen LLP
Philadelphia, PA

EDWARD D. HERLIHY
Wachtell, Lipton, Rosen & Katz
New York, NY

VICTOR I. LEWKOW
Cleary Gottlieb Steen & Hamilton LLP
New York, NY

PETER D. LYONS
Shearman & Sterling
New York, NY

DIDIER MARTIN
Bredin Prat
Paris, France

FRANCISCO ANTUNES MACIEL MUSSNICH
Barbosa, Mussnich & Aragão Advogados,
Rio de Janeiro, Brasil

PHILLIP A. PROGER
Jones, Day, Reavis & Pogue
Washington, DC

PHILIP RICHTER
Fried Frank Harris Shriver & Jacobsen
New York, NY

PAUL S. RYKOWSKI
Ernst & Young
New York, NY

FAIZA J. SAEED
Cravath, Swaine & Moore LLP
New York, NY

CAROLE SCHIFFMAN
Davis Polk & Wardwell
New York, NY

ROBERT E. SPATT
Simpson Thacher & Bartlett
New York, NY

ECKART WILCKE
Lovells
Frankf1urt, Germany

GREGORY P. WILLIAMS
Richards, Layton & Finger
Wilmington, DE

WILLIAM F. WYNNE, JR
White & Case
New York, NY

The M&A Lawyer
West LegalEdcenter
610 Opperman Drive
Eagan, MN 55123

© 2010 Thomson Reuters

One Year Subscription ■ 10 Issues ■ $488.00
(ISSN#: 1093-3255)

For authorization to photocopy, please contact the Copyright Clearance Center at 222 Rosewood Drive, Danvers, MA 01923, USA (978) 750-8400; fax (978) 646-8600 or West's Copyright Services at 610 Opperman Drive, Eagan, MN 55123, fax (651) 687-7551. Please outline the specific material involved, the number of copies you wish to distribute and the purpose or format of the use.

This publication was created to provide you with accurate and authoritative information concerning the subject matter covered. However, this publication was not necessarily prepared by persons licensed to practice law in a particular jurisdiction. The publisher is not engaged in rendering legal or other professional advice, and this publication is not a substitute for the advice of an attorney. If you require legal or other expert advice, you should seek the services of a competent attorney or other professional.

Copyright is not claimed as to any part of the original work prepared by a United States Government officer or employee as part of the person's official duties.

recent past, including using conduct remedies in addition to traditional asset divestitures and employing tools like "up-front buyer" and "crown jewels" remedy provisions.

Structural Versus Conduct Remedies

When the DOJ or FTC concludes that a merger is anticompetitive, it usually must choose between two options: seek to block the merger in court or negotiate a remedy with the parties that will allow them to consummate the transaction if they agree to take steps intended to restore competition. The agency often seeks to block mergers only after remedy negotiations have failed, where the agency is unable to develop a remedy it finds sufficient and to which the parties will agree. In most merger remedy negotiations, the agency will seek a "structural" solution, whereby the combining companies divest to a new competitor the assets associated with one of their overlapping business lines. Structural remedies contrast with "conduct" or "behavioral" remedies, which also are intended to preserve competition, but through requirements that the merged firm commit to take certain business action or refrain from certain business conduct going forward.

In the past, the agencies generally have reserved conduct remedies for those few "vertical" deals they have challenged, where the merging parties are not horizontal competitors but compete at different levels of distribution. Recently they have become more common.

Conduct remedies might include a requirement that the merged firm take certain steps to lower entry barriers, erect a firewall to protect competitively sensitive information, or commit not to discriminate against competitors in the market that rely on the merged firm for supply, distribution, or other inputs. More extreme examples might include commitments to refrain from competing in some way that allows smaller competitors to expand in the market.

If given a choice between the two, most merger or acquisition parties would elect conduct remedies over structural ones. Despite the fact a conduct remedy imposes ongoing and sometimes onerous requirements, a conduct remedy does allow the parties to retain the assets or more of the assets originally intended to be combined in their deal. In contrast, when an asset divestiture is the only remedy on the table, as usually has been the case, settlement negotiations may reach an impasse if the agency seeks a divestiture of important assets that would undercut the value of the proposed transaction. Therefore, if the settlement package can combine both structural and conduct remedies, the government and the parties may have more flexibility to reach an agreement that satisfies everyone and allows the transaction to proceed.

While during the Clinton administration the antitrust agencies were somewhat more willing to use conduct remedies, during the Bush administration both agencies strongly favored structural relief, believing them more effective and less troublesome than conduct remedies. This is reflected in the DOJ's 2004 Policy Guide to Merger Remedies:

> **Structural remedies are preferred to conduct remedies in merger cases because they are relatively clean and certain, and generally avoid costly government entanglement in the market…A conduct remedy on the other hand, typically is more difficult to craft, more cumbersome and costly to administer, and easier than a structural remedy to circumvent.**

In contrast, enforcers in other jurisdictions, such as the European Commission, generally have been more open to conduct remedies. As the EC explained in its Notice on Remedies, it will consider whether conduct remedies are appropriate on a "case-by-case basis."

Recent actions by both the DOJ and FTC indicate they have not abandoned structural relief as the primary remedy, but suggest they may be more flexible and willing to consider conduct remedies. As one senior DOJ staff member recently explained, the new Assistant Attorney General, Christine Varney, is deciding merger enforcement matters more on a "case-by-case basis" and has encouraged staff to be "more innovative and creative."

© 2010 THOMSON REUTERS

Recent Merger Remedies

We discuss below some recent examples of mergers in which the government relied on conduct remedies in lieu of, or in addition to, structural remedies.

Ticketmaster/Live Nation (DOJ). In January 2010, despite predictions by some that the DOJ would seek to block the deal outright, the agency allowed Ticketmaster to acquire Live Nation, its most significant competitor in concert ticketing and related services, in exchange for a package of structural and conduct remedies. The structural relief included a requirement that Ticketmaster license on favorable terms its platform for ticketing services to one rival and to divest its platform for ticketing handled by concert venues to another. Most notably, the decree also prohibits a range of conduct by the combined Ticketmaster/Live Nation for ten years, including forbidding retaliation against concert venue customers that choose to switch to another ticketing service and "explicitly or practically" tying sales of ticketing services to concerts or artists that the combined company promotes. The DOJ explained that the conduct remedies were designed to prevent Ticketmaster from impeding "effective competition from equally efficient rivals" and to lower entry barriers to new competitors.

Although structural consent decrees typically contain limited, short-term requirements for the merged company to assist the purchaser of the divestiture assets with technology transfer, manufacturing start up, or employee retention, they normally have not contained ongoing restrictions on the company's ordinary course business practices. The Ticketmaster decree thus is a change from recent precedent.

This change in approach may have allowed Ticketmaster and Live Nation to complete a transaction that the DOJ otherwise would have sought to block in court. Without the conduct remedies included here, the DOJ might have sought broader asset divestitures, beyond what Ticketmaster would accept, or concluded that settlement was not possible. And presumably Ticketmaster preferred accepting this package of structural and conduct remedies over defending its deal in court, as it accepted the DOJ's resolution.

Election Systems & Software (DOJ). In March 2010, the DOJ announced a consent decree with Election Systems & Software (ES&S), which in 2009 had acquired Premier Election Solutions. The DOJ alleged that the deal was anticompetitive because it combined two of the largest U.S. voting equipment systems suppliers. ES&S agreed to a settlement containing both structural and conduct remedies.

Under fairly traditional consent decree provisions, ES&S agreed to divest certain Premier voting equipment assets to a third party, such that both ES&S and the company acquiring the assets could compete to supply and service Premier systems. ES&S also agreed to provide transition services and parts to the purchaser of the divested assets for a limited period of time. However, the consent decree also contains a restriction on ES&S' conduct over the next ten years. Specifically, ES&S is prohibited from bidding for new installation of voting equipment or on procurements to replace more than 50% of a customer's installed equipment. According to the DOJ, this provision will give the purchaser of the divested assets "the greatest incentive to invest in the development of new Premier products."

The Bush administration DOJ frowned on orders that restrict the ability of the merged company to compete. The 2004 DOJ merger remedies guide states that "[r]estricting the merged firm's right to compete in final output markets or against the purchaser of the divested assets, even as a transitional remedy, is strongly disfavored." In the ES&S case, the new DOJ departed from past practice and employed a conduct remedy because it concluded that the conduct restriction was necessary for the divestiture remedy to work. The DOJ's alternatives could have been to seek more extensive divestitures or to block the deal.

Cisco/Tandberg (DOJ). In March 2010, the DOJ announced that it would not challenge Cisco System's proposed acquisition of Tandberg USA. Cisco and Tandberg were among the few competitors in the market for a new type of high-definition videoconferencing system known as "telepresence." The European Commission had also inves-

© 2010 THOMSON REUTERS

tigated the transaction and cleared it after Cisco agreed to certain conduct remedies, including commitments to lower entry barriers in the market by adopting open standards for its products. Although the DOJ did not seek the same remedies from Cisco, it issued a statement explaining that it had closed its investigation based in part on the conduct remedies obtained in Europe.

The Gazette/Daily Mail (DOJ). In March 2010, the DOJ also settled litigation begun under the Bush administration to challenge the combination of two newspapers in Charleston, West Virginia. The Gazette and Daily Mail had for decades competed with independent newsrooms, while sharing printing, distribution, advertising, and subscriptions functions through a joint entity. After the Gazette took control of the Daily Mail and moved towards closing that newspaper, the DOJ filed its action. The DOJ's 2007 complaint sought to rescind the transaction and restore the Daily Mail to its prior competitive condition, a structural solution.

The March 2010 settlement does not require rescission and allows the joint ownership to remain, but seeks to restore independent and robust competition between the two newsrooms through certain conduct requirements and five new contracts between the newspapers. The contracts are incorporated in the decree and require DOJ approval for modification.

The requirements of the 135-page consent decree are very detailed. For example, the new contracts specify governance and voting rights held by each newspaper, the number of new Daily Mail newsroom employees, and the number of Daily Mail editions that must be published. The contracts create monetary incentives to motivate competition by the Daily Mail and discourage the owner from taking action that might result in closing the newspaper. The consent decree additionally requires editorial independence of the two newspapers, prohibits discrimination against the Daily Mail in circulation or advertising activities, forbids closing the Daily Mail without DOJ approval, and launches a six-month, 50-percent-off subscription discount to expand Daily Mail readership.

The newspaper situation is unusual. Even if the two publications had been returned to separate ownership, they would have shared some functions. Nevertheless, the decree's regulatory approach is consistent with this agency's greater comfort with conduct remedies.

PepsiCo/Pepsi Bottlers (FTC). In February 2010, as a condition for allowing carbonated soft drink company PepsiCo to complete a $7.8 billion acquisition of its two largest bottlers and distributors, the FTC required that PepsiCo establish a firewall between itself and the bottlers to prevent the exchange of certain competitively sensitive information. In addition to distributing PepsiCo products, the bottlers distributed competing products from Dr Pepper Snapple Group. The firewall was designed to prevent PepsiCo from obtaining sensitive information about its competitor through the bottlers.

Conduct remedies, including firewalls, have been more common in vertical acquisitions like that by PepsiCo of its bottlers. However, in recent years firewalls rarely were used, even in matters that raised the same potential information-sharing concerns as those in PepsiCo. The PepsiCo case is one sign that the FTC now is more inclined to use firewalls as one remedy.

Up-Front Buyer Provisions

While the FTC has a history of requiring in certain deals the identification of buyers for divested assets "up front," before the transaction can close, the DOJ rarely used this provision. An up-front buyer is one that has been tentatively approved by the agency and has executed an acquisition agreement with the seller before the agency accepts the proposed settlement and allows the parties to consummate the deal. In most divestiture settlements, the parties are allowed to consummate the deal first and then find and negotiate an agreement with the buyer of the divestiture assets. As the FTC explained in its Statement on Negotiating Merger Remedies, it will usually require an up-front buyer where the package of assets to be divested comprises less than an autonomous, ongoing business, to minimize the risk the parties will fail to find an acceptable buyer or the buyer will fail to use the assets to fully restore competition.

© 2010 THOMSON REUTERS

The settlement reached in Ticketmaster/Live Nation suggests that the DOJ may be reviving its use of up-front buyers. Rather than giving the parties time after the merger to identify a buyer of the divestiture assets and enter into a sale agreement, the DOJ consent decree identifies the buyers up front and, in the case of one, prevents Ticketmaster from completing the Live Nation acquisition until it has an agreement to sell the divestiture assets. This use of an up-front buyer provision is consistent with the FTC's policy of requiring up-front buyers in situations like this, as the decree's ticketing platform license did not include the associated hard assets that would comprise an autonomous, ongoing ticketing business.

Some have speculated that AAG Varney may be more comfortable with up-front buyer provisions from her time as a former FTC Commissioner. And this may not be the only new tool Varney imports to the DOJ.

Crown Jewels Provisions

Historically, the DOJ rarely employed "crown jewels" provision—a commitment by the merging companies that, if the particular divestiture package to which they have agreed cannot be sold, they will divest a more significant package of assets instead. The FTC frequently used crown jewels provisions in the 1990s, but less so in the past decade. The 2004 DOJ merger remedies guide criticizes crown jewels provisions, saying they can result in an agreement on an insufficient primary divestiture package. The manual also notes the risk that potential purchasers will game the arrangement, refraining from buying the primary divestiture package in hopes of forcing a sale of the crown jewels. During the Bush administration, the DOJ rarely used remedy provisions that provided for potential alternate divestiture packages.

In its July 2009 consent decree allowing the acquisition by Sapa of Indalex, the DOJ used a "crown jewels" provision for the first time in many years. Sapa and Indalex competed in the manufacture of aluminum sheathing, which is used for coaxial cable. To settle the DOJ's concerns about their combination, the parties agreed to divest one of two identified aluminum sheathing manufacturing facilities. The consent decree required that, if an acceptable purchaser could not be found for either facility, the parties had to divest a much larger Indalex plant, which makes aluminum sheathing and other products; that is, they would have to sell the "crown jewels."

The DOJ's use of crown jewels in Sapa/Indalex may mean that the agency will require this provision more often in future deals.

Observations

A more regulatory but flexible approach to merger remedies may bring both benefits and costs to merging parties, with potential impacts on deal structure, deal timing, compliance costs, and ultimately whether a tough merger can get done.

Deal structure. One clear upside to increased use of conduct remedies is that in some cases the availability of a conduct remedy will reduce or eliminate the asset divestitures the government will demand. While conduct remedies will not completely replace asset divestitures to protect competition, in particular cases a conduct remedy could to some extent substitute for divestitures, so that the merged company can retain assets that it otherwise would have had to divest to resolve the government's concerns.

In some cases, however, this change in approach could mean that the government will require a conduct remedy in addition to a structural remedy that arguably should have been sufficient to protect competition. In other words, the government could use the conduct remedy to supplement the divestiture, rather than replace it, thereby leaving the merging parties with extra burden. Whether this has happened in any particular case will be difficult to evaluate from the outside.

Deal timing. Of course, more complex, regulatory merger remedies can delay closing a deal. Conduct remedies generally tend to be messier and more complicated than straightforward divestitures. Because conduct restrictions can last as long as ten years, the agency and merging parties must carefully consider all of the intended and potential unknown consequences of the restric-

 © 2010 THOMSON REUTERS

tions. As a result, negotiating conduct decrees can take longer.

Up-front buyer provisions especially can delay. Not only must the terms of the decree be worked out prior to closing, the parties must also finalize an agreement to sell the divestiture assets to a specific purchaser. Finding an interested buyer and negotiating that deal can take months. Moreover, the pressure on the merging parties to consummate the deal provides additional bargaining leverage to the potential purchasers who can slow negotiations to obtain more favorable deal terms.

Compliance costs. Although all merger remedies impose some costs on the merging parties, ongoing oversight of a conduct remedy by the antitrust authorities can increase the costs for the company not only in dollars, but also in loss of flexibility to make business decisions and disruption of the business. In most conduct decrees, the agency will oversee the merged company and have expanded access to its business people and records for the term of the decree.

Getting deals done. In the right cases, the most important effect of greater use of conduct remedies is that the conduct remedy may make the difference in getting the deal through without litigation. More flexibility in merger remedies should decrease the risk that the government and the parties will not agree on a remedy and end up in court. Many companies gladly would accept the added delay and costs associated with such remedies if they can complete a deal that would otherwise have risked an agency challenge.

Conclusion

While policymakers and commentators may debate the relative merits of structural and conduct remedies, the increased availability of conduct remedies should help solve the practical problems faced by some merging parties in getting deals through antitrust review. In some cases, adding conduct provisions to a remedy package will make it possible to get the deal done, even if with some increased costs.

NOTES

1. "An Early Look Into Merger Review In the Obama Administration," The M&A Lawyer, November/December 2009 (Vol. 13, No. 10).

© 2010 THOMSON REUTERS