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# "Fixing" A Deal: Lessons from Agency Guidance and Recent Litigation

Occasionally, the agencies [1] that regulate competition in the United States view a proposed transaction [2] as likely to concentrate the business in a particular product segment or geography too highly in the hands of too few. In that case, the parties to the transaction may offer a "fix" to solve the agencies' concerns about overconcentration. Recent agency guidance and litigation offer insight into how such fixes can be structured to maximize the odds of getting either the agencies or a court to accept the fix, permitting the deal to close. Counsel and the parties to a transaction should consider the scope, character, and timing of any potential remedies to address competition concerns, consistent with the agency guidance and recent cases summarized below, when evaluating the deal economics and negotiating the terms of transaction agreements.

**"Fixable" Problems and Negotiations with the Agency**

A "fix" generally refers to a remedy to address agency concerns that the merger will reduce competition to a level the agency finds unacceptable. Although the agencies' competition concerns take a variety of forms, as do fixes, [3] this article focuses on structural fixes (*i.e.*, divestitures) that remedy an agency's concern that a transaction will reduce competition in a marketplace such that there will not be a sufficient competition to deliver low prices and quality service to consumers.

Offering a divestiture is a common means of attempting to relieve the concerns of the agencies. Merely agreeing to divest assets, however, is not sufficient to gain agency approval. The agency wants to be sure that the buyer of the divested assets will operate those assets successfully enough to replace the pre-transaction competition between the parties to the transaction. The challenge is that to determine whether a remedy will succeed, the parties, the agency, and (if litigated) the court must necessarily engage in predicting the future. The agencies attempt to do this according to certain principles, and many mergers are permitted based on divestiture remedies. If the agency predicts correctly, then all is good for competition. But if the agency gets it wrong and the merger ends up in court, the judge must determine whether the agency has predicted the future correctly or not. If the judge believes, rightly or wrongly, that the agencies have no particular axe to grind and are simply focused on protecting consumers, then the agency has significant advantage in the litigation. In addition, in a close call, a judge may feel that the interest in protecting consumers from diminished competition (or keeping the status quo) outweighs the interest in allowing two companies to merge.

Do the agencies get it right? A recent FTC report (discussed below) suggests that the agencies are often right when they drop their opposition to a merger based on a proposed remedy. There is no basis, however, on which to evaluate the agencies' track record when they do not agree to a proposed remedy. When they do not agree, the merger parties either abandon their deal or pursue it in the face of an agency lawsuit to block the deal. There is only one published legal decision in which a court held that a remedy was sufficient over the challenging agency's objection. [4] Ultimately, there is no way to evaluate whether the agencies have been right or wrong in their decisions to reject remedies that never occurred.

One vantage point from which to consider the agencies' ability to predict divestiture success is the historical viewpoint. Moreover, understanding the agencies' views about the characteristics of successful remedies is the place to start in

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structuring a divestiture. Recent cases also provide insight into how courts will analyze a remedy proposal the agencies oppose. These are discussed below.

**Recent FTC Remedy Report**

In January 2017, the FTC released a report resulting from its study of 89 merger remedies it (rather than a judge) approved between 2006 and 2012, titled “The FTC’s Merger Remedies 2006-2012: A Report of the Bureaus of Competition and Economics.” [5] The FTC used a variety of methodology to examine recent settlements, including case studies—involving interviews of market participants (including the merger parties, competitors, and customers)—for 50 of the 89 merger orders. For the balance, FTC engaged in a more cursory analysis, using either voluntary questionnaires or internal information and publicly available data. The report focuses primarily on the 50 case studies. Of those 50 deals, the FTC reported that 83% were either a “success” (69%) or a “qualified success” (14%), while 17% were a “failure.” [6] Notable (but not necessarily surprising) in the results was that the FTC found remedies to be more successful when imposed pre-consummation (75% deemed a “success”) as opposed to post-consummation (only 26% a “success”).

Aside from reaching a conclusion that the FTC gets a passing grade for the studied consent orders, the report shares best practices for parties to consider when pursuing a merger remedy. The report breaks these considerations down into three categories: defining the asset package, reviewing the proposed buyer, and implementing the remedy.

***Defining the package: better to serve the whole pie than just a slice***. *All* divestitures in the FTC study that involved an ongoing business—rather than select assets—scored as a success. Indeed, the FTC prefers divestitures of ongoing businesses to divestitures of select assets (*e.g.*, the sale of customer contracts or a portion of a plant). A best practice for any divestiture, where possible, is to demonstrate to the FTC that the package contains all pieces needed to operate as an independent competitive supplier in the relevant market. When the divestiture involves only select assets, the divesting party should make clear what aspects of an ongoing business are missing, and through what means the buyer can plug the holes quickly enough to keep the business from sinking. For example, a divestiture buyer that is already in the marketplace might have the assets necessary to compete and therefore might not need (or want) certain of the seller’s assets.

The FTC study flagged back-office functions as an oft-overlooked aspect of a divestiture package. The divesting party will have to explain to the FTC staff all of the back-office functions related to bringing the subject goods or services to market and the divesting party and buyer will have to demonstrate that the buyer has those capabilities. If such functions are particularly specialized or complex, the divesting party should make available its staff to discuss or even provide on a transitional basis these necessary functions.

Merger parties should keep in mind that although divesting select assets may make more economic sense, the FTC will likely be skeptical of a divestiture package that does not include divesture of an ongoing standalone business unit.

***Selling the buyer—getting the agency to swipe right.*** A divesting party should pitch the package and buyer to the FTC as it would its own board or management. The FTC will want to know how a divesting party selected a proposed buyer and how the deal will be financed. The FTC also will want to see results of diligence related to the deal that might provide indicia of the buyer’s financial and competitive viability. As part of its own diligence, the FTC will likely reach out to other market participants (including customers, regulators, other prospective buyers). Finally, the FTC will want to see the divestiture buyer’s business plan for operating the assets and replacing the lost competition. A buyer that has experience in the industry is more likely to be acceptable to the FTC than one without the same history in the industry. The divesting party and the proposed buyer therefore must work as a team in engaging the FTC to fully address any concerns.

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***Implementation—selling more than a house of cards.*** With so much focus on sculpting the right package and presenting the buyer to the FTC, parties sometimes struggle when it comes time to execute the divestiture. The FTC's study brought to light concerns from buyers related to implementation of an approved merger remedy. Although divestitures should be the same type of arms-length transaction that brought the merging parties together, sometimes divestitures end up being more elbow-length, when the divesting party needs to lock arms with the buyer to keep it from stumbling. Such assistance might take the form of access to customers, suppliers, or other relevant third parties. The buyer may also require transitional services for back-office functions. The FTC is wary about such assistance and tries to limit the amount of time in which the buyer is reliant on the divesting party. Via compliance reports or a monitor, the FTC will closely track the buyer's progress and its interactions with the divesting party.

The key to any divestiture negotiation with the FTC is forthright communication by and between all parties throughout the process, from development to implementation. [7]

**The Antitrust Division's Guide to Merger Remedies**

In its 2011 Policy Guide to Merger Remedies, [8] the Division shared its approach to evaluating proposed merger remedies. The guiding principle for the Division's approach to merger remedies is, similar to the FTC's, preserving or quickly restoring competition in the relevant market.

Like the FTC, the Division prefers divestitures of ongoing business units rather than select assets. Proposing a package of select assets is not necessarily destined for rejection, but it will take more time and effort and the right set of circumstances to convince the Division that the package will leave the buyer in a competitive posture. For example, if a buyer already has industry know-how, established customers and suppliers, and administrative and IT infrastructure, it will be easier for merging parties to convince the Division that the buyer may need only a factory to quickly and effectively compete in a given market, not the whole guts of the business that currently operates that factory. Due to the sensitive nuances inherent in select asset sales, merging parties will almost always need an upfront buyer for a proposal that includes anything less than an ongoing business.

Just as parties may be able to negotiate an appropriate divestiture of select assets, there are times where the Division (or the FTC) will require *more* than an ongoing business. The example in the policy manual is an industry where a supplier cannot effectively compete without a full suite of products. There, although the merger in question may threaten competition in only one product line, an effective remedy may require divestiture of the at-issue product line and several others. The same principle may apply to geographic coverage. Even though the Division has identified an antitrust problem in a limited geography, it may be necessary to sell assets that compete outside the scope of the identified problem.

Timing also is an important consideration—the earlier parties engage on a potential remedy, the greater the flexibility in structuring the divestiture package. “Fix-it-first” remedies are pre-consummation structural solutions that often allow parties to tailor the divestiture package to a specific proposed buyer. If a proposed pre-consummation remedy entails transitional services or other post-consummation assistance to the buyer from the seller, the Division will require, in most cases, a consent decree complete with enforcement provisions to hold the parties to the agreed upon solution. Where the parties do not have an upfront buyer, the Division may require certain provisions to increase the likelihood of a sale post-consummation. This can include a “crown jewel” provision whereby the divesting party sweetens the pot if a suitable buyer cannot be found for the agreed upon package. The Division may also reserve the right to appoint a selling trustee to conduct the divestiture sale if the parties cannot find a suitable buyer on their own within the agreed upon timeframe.

The Division's criteria for approving a proposed buyer is set out in a three-part test. First, the divestiture must not itself cause competitive harm (*e.g.*, selling to a large market participant in a concentrated market will likely not be acceptable). Second, the buyer must employ the divested assets in the relevant market. This can be evidenced through the buyer's business plans or other documentation evidencing intent to use the assets to compete in the relevant market. Third, the

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buyer must be a viable competitor in the relevant market after the transaction closes. The Division will conduct a “fitness test” of the buyer to confirm whether it has sufficient capital and know-how to compete effectively in the relevant market. Merging parties can ease Division concerns over a particular buyer by demonstrating that it cast a wide net (through, *e.g.*, an RFP shopped by an investment bank or consulting firm) and otherwise treated the sale as an arms-length deal.

The Division, along with the FTC, view merger remedies through the wide lens of competition. The focus is on whether and how the remedy will preserve or restore competition, not on how the remedy will affect the buyer and seller. The enforcement agencies settle a great number of merger cases through the divestiture framework outlined above. However, when agreement cannot be reached on a particular divestiture package, the enforcement agencies have not hesitated to bring suit to challenge the underlying merger and the adequacy of a proposed remedy. In September 2016, Renata Hesse, then the acting head of the Division, stated, “[w]e, as antitrust enforcers, have been engaging in the general public’s dialogue about antitrust by litigating more cases in the public forum of the courthouse rather than settling them in the professional halls of the antitrust agencies.” [9] What that means is that in close calls, the DOJ has chosen to litigate more often than it would have in the past, when it would have been more likely to drop its opposition to a close call merger.

**Litigating a Remedy**

When parties pursue a merger that includes a proposed remedy over an agency’s objection, the agency must file a lawsuit to block the transaction. The court must then decide, among other issues, whether the agency is correct in its assertion that the proposed remedy will not replace the competition that will allegedly be lost if the merger is permitted. Although, in reviewing mergers, the agencies apply a test that is often quoted as a standard for evaluating mergers, the test reflects the agencies’ flexibility in studying mergers in their particulars and does not offer assistance to a court in assessing divestiture buyers. Perhaps as a result, courts often focus more on attempting to discern the views of the parties and the buyer about the divestiture buyer’s likely success, drawing from the parties’ internal documents.

***Legal Standard By Which a Court Assesses the Sufficiency of a Proposed Remedy***

In other areas of the law, it is helpful to begin with the legal standard to determine exactly what needs to be proven on a point of law. This approach, however, is not helpful when the goal is to determine what a merger remedy should look like because there are few cases providing such guidance and an effective remedy is highly dependent on the facts of the marketplace, the assets at issue, and the identity of the divestiture buyer.

As noted above, assessing whether a divestiture buyer will replace the alleged lost competition from a merger is an exercise in predicting the future. Courts have little to guide this necessarily speculative endeavor, however, the law regarding proof of entry in merger cases is one potential standard by which to judge a divestiture. A divestiture buyer, after all, is a new entrant (or expander) with the advantage of customers or assets that other new entrants do not have. The court in the Staples/Office Depot case stated that the merging parties must prove that the entry or expansion of competitors will be “timely, likely and sufficient in its magnitude, character, and scope to deter or counteract the competitive effects of concern.” [10] The court also held that the relevant time frame for consideration is two to three years. [11] Even this standard, however, provides little practical guidance to a court.

The agencies’ Horizontal Merger Guidelines (the “Guidelines”) are the source of the “timely, likely and sufficient” standard, [12] but the Guidelines offer little detail. With respect to timeliness, the Guidelines state that entry should be “rapid enough that customers are not significantly harmed by the merger,” but do not specify a period of time or the degree of harm that the agencies deem insignificant [13] though prior versions of the Guidelines adjudge entry over two years. With respect to likelihood, the Guidelines simply provide that entry satisfies this factor “if it would be profitable, accounting for the assets, capabilities, and capital needed and the risks involved.” [14]

The Guidelines provide a little more specificity in stating that entry by a firm that will “replicate at least the scale and strength of one of the merging firms is sufficient,” and entry “by one or more firms operating at a smaller scale may be sufficient if such firms are not at a significant competitive disadvantage.” [15] Thus, while an entrant that will replicate the scale and strength of one of the merging firms is sufficient, smaller scale is also acceptable. How much smaller, however, is not discussed except that the difference in scale must not put the entrant at a “significant” advantage (with “significant,” again, undefined).

The lack of specificity reflects the agencies’ flexible approach of evaluating each merger on its own facts, but the very flexibility that the agencies and parties value in the merger review process means that the agencies’ standard provides little more than some directional signals to parties or to a court.

Assuming that the agencies’ “timely, likely and sufficient” standard applies equally to divestiture buyers as other entrants, what does it mean for the buyer to be “sufficient in its magnitude, character, and scope” to counteract the alleged anticompetitive effects of the merger? If it does not replicate the scale of one of the merging parties, how much smaller can it be and still satisfy this standard? These and other unanswered questions give a judge precious little to go on in wrestling with the question of whether the merger should be permitted over the agency’s objection. Perhaps as a result, judges have focused on the general views of the employees of the merger parties and the buyer about whether the merger is likely to succeed rather than assessing whether the agency has sustained its burden of proof with respect to each of its objections to the divestiture buyer.

***Arch Coal***

As noted above, we are aware of only one case in which a court has approved a merger over an agency’s objection based on the divestiture remedy offered by the parties. This case was *United States v. Arch Coal*. [16] In that case, Arch Coal sought to buy a subsidiary of New Vulcan Holdings. The subsidiary operated two coal mines and Arch Coal proposed to divest one of them. The court held that given the divestiture, the transaction would not substantially lessen competition. There is no discussion in the case of whether the buyer was likely to be able to replace the lost competition from the merger in an acceptable amount of time, perhaps because the buyer was already a coal mine operator and the divested asset was a functioning coal mine for which the divestiture buyer would simply take over operations (*i.e.*, an ongoing business). In any event, the case does not provide much insight into how courts will evaluate the timeliness, likelihood, or sufficiency of competition from a divestiture buyer.

***FTC v. Staples/Office Depot***

The recent decision blocking the merger of Staples and Office Depot illustrates a court’s approach to evaluating entry, and perhaps, a fix. [17] The FTC alleged that the merger of the two parties would give the resulting company 80 percent of the alleged market for office supplies sold to large businesses. The parties disputed the alleged market definition and other aspects of the FTC’s challenge, but they also offered a divestiture remedy. They 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 claimed that this divestiture was “woefully inadequate,” raising several objections. Five of those objections are discussed here (the sixth is not available in the public version of the brief). First, FTC observed that Staples and Essendant had no binding agreement for the divestiture or the transition services they contemplated. According to FTC, this alone was a sufficient basis to reject the remedy. Second, the contemplated divestiture was largely comprised of customer contracts that FTC characterized as “short-term.” Thus, the customers could easily switch to Staples when the contract expired. Third, Essendant was a wholesaler and did not compete with Staples and Office Depot for sales to large business customers. According to FTC, this meant that the divestiture “by definition” would not replace the alleged lost competition caused by the merger. Fourth, Essendant would not acquire an entire business operation, but

only assets it could use to build its operation. FTC claimed that this inability to match Staples on "day one" required rejection of the proposed remedy. Fifth, Essendant would be dependent on transition services from Staples to get the divestiture business up and running.

These arguments illustrate the FTC's approach to challenging a merger remedy. This battle is also useful in understanding how courts approach the analysis of whether divestiture buyers will replace lost competition, at least where the divestiture buyer is a new entrant. In the trial, the FTC listed a number of "weaknesses" that it claimed would preclude Amazon Business from replacing the competition allegedly lost due to the merger. These included Amazon Business's alleged lack of RFP experience, no commitment to guaranteed pricing, lack of desktop delivery, and others. The court gave significant weight to Amazon Business documents that showed a number of the company's plans to build the capabilities it would need to be successful in supplying large businesses with their office supplies, and found that these documents largely substantiated FTC's objections. Accordingly, the court held that Amazon Business was not likely to be able to replace the "lost" competition within a three-year window.

Similarly, the court in *FTC v. Sysco* cited a number of internal party documents—and those of proposed divestiture buyer—in its agreement with the FTC that the parties' proposed fix would not effectively cure the alleged competitive harm resulting from the proposed transaction. [18] The parties and buyer's documents cited the competitive advantages of having a broad national scale in the foodservice distribution market, one that the buyer would still not attain even post-divestiture, according to the court. [19] Indeed, the court discounted arguments at trial that the divestiture package was appropriately sized to effectively remedy the threat of competitive harm in light of internal documents that the court interpreted as suggesting the contrary. [20]

***Summary of These Decisions***

The decisions discussed above turn largely on the buyer's internal documents. This is presumably in part because the "standard" offered the courts little else to go on. For example, in Staples/Office Depot, one of FTC's objections to Essendant as a divestiture buyer was the claim that customers who got switched to Essendant by the divestiture would immediately switch back to their former supplier as soon as their divested short-term contracts expired. Applying the legal standard to that objection, the court would have had to decide whether a sufficient number of customers were sufficiently likely to switch away from Essendant such that the magnitude, character, and scope of Essendant's competition would be insufficient to replace the alleged lost competition. Is that satisfied by a showing that 30% of customers are more than 50% likely to switch? Does it matter which customers are likely to switch? The standard provides no guidance.

Perhaps because of the amorphousness of this standard, the courts tended not to focus on whether FTC had sustained its burden of proof with respect to each of its objections. Instead, judges likely relied on their understanding of the perfunctory views expressed in the internal documents of the parties and the buyer about whether the merger is likely to succeed. Indeed, the courts are appropriately skeptical of witnesses' ability to remember and testify to the material context of internal communications without bias during a trial. Judges may discount even credible testimony as a result, and focus more on what the words on the paper suggest in the nuanced context of an antitrust trial.

**Keys to a Successful "Fix"**

It is clear from the above that while the enforcement agencies offer guidelines and best practices for a hypothetical divestiture package, in practice it is often difficult to structure a package that will overcome the shape shifting standard that leaves courts picking through the thorny weeds of discovery rather than challenging the integrity of the agencies' objections. Merging parties are best served by engaging the agencies pre-consummation (and pre-litigation) and assembling a divestiture package that provides consumers with a competitively viable alternative in the relevant market.

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There are several measures that practitioners may take pre-consummation to strengthen the likelihood of approval or defense of a merger remedy package. Being mindful of the preference for divestitures of an ongoing business, the divesting party and the buyer need to understand fully what is necessary to avoid spoiling the value of the assets. Knowing the agencies prefer a Goldilocks buyer (*i.e.*, one that is neither too small nor too large for stepping into the competitive void), merging parties should identify a potential buyer that is capable of competing profitably in the relevant market but not so large that the divestiture brings the same harm to consumers as that which it was intended to remedy.

Agencies are likely to examine the permanence of the fix—*i.e.*, whether the buyer will be able to retain the business after customers are free to shop around. Where merging parties already command brand loyalty (or at least where there is a perception of brand loyalty), the agencies (and courts) are likely to be skeptical of any fix that involves a buyer that does not offer a similar degree of brand recognition, quality of service, or other intangible attributes that may affect competitive viability. This is less of a concern in markets with high measures of demand elasticity (*i.e.*, where consumers are particularly price sensitive).

The divesting party and identified buyer can also be proactive in preparing a successful defense in anticipation of litigation. Because courts tend to place a great deal of weight on the parties' internal documents, parties should be thoughtful in their documentation of specified goals and internal evaluation of the divestiture package in order to provide the court with a clear indication of the parties' intent and subsequent action plan post-divestiture. Implicit or explicit skepticism about the ability of a buyer to step into the shoes of the seller and cure any alleged harm to competition resulting from the merger in internal business documents can cause irreparable harm in a courtroom. This is all the more reason for seller and buyer to work together prior to and throughout the agencies' investigation and potential litigation of a proposed fix.

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Footnotes

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1 This article uses the term agencies to refer to the Federal Trade Commission (FTC) and Department of Justice Antitrust Division (Division), the two federal agencies with jurisdiction to investigate the competitive effects of certain transactions. They divide their jurisdiction based on the affected industries. States attorneys general and other agencies may also be involved in merger review in specific sectors, such as telecommunications.

2 This article uses the terms mergers, deals, transactions, and acquisitions interchangeably.

3 Merger remedies fall into two categories: structural; and conduct-based (also referred to as behavioral). Structural remedies restructure the relevant market, the classic mechanism to do so being a divestiture; conduct remedies, on the other hand, augment incentives or otherwise alter the ability of the combined entity to behave anticompetitively post-merger. This paper focuses on the merger remedy historically preferred by antitrust enforcers: divestitures.

4 *See United States v. Arch Coal*, 329 F. Supp. 2d 109 (D.D.C. 2004) (discussed *infra* § IV.B).

5 Fed. Trade Comm'n, *The FTC's Merger Remedies 2006-2012: A Report of the Bureaus of Competition and Economics* (Jan. 2017), available at https://www.ftc.gov/system/files/documents/reports/ftcs-merger-remedies-2006-2012-report-bureaus-competition-economics/p143100_ftc_merger_remedies_2006-2012.pdf.

6 A "success" rating was earned where the remedy maintained or quickly restored competition in the relevant market; a "qualified success" ultimately restored competition after several years. A remedy failed if it did not maintain or restore competition. *See id.* at 15-16. Among other problems, the FTC's report assumes that the incumbent owner of divested assets would have succeeded, but provides no

empirical basis for this assumption. Therefore, it is likely that the report overstates, to some degree, the failure rate.

7 For additional insight into the Commission’s approach to divestitures and other remedies, see Federal Trade Commission, *Negotiating Merger Remedies: Statement of the Bureau of Competition of the Federal Trade Commission* (Jan. 2012), available at https://www.ftc.gov/system/files/attachments/negotiating-merger-remedies/merger-remediesstmt.pdf.

8 U.S. Dep’t of Justice, *Antitrust Division Policy Guide to Merger Remedies* (June 2011), available at https://www.justice.gov/sites/default/files/atr/legacy/2011/06/17/272350.pdf.

9 Renata Hesse, *And Never the Twain Shall Meet? Connecting Popular and Professional Visions for Antitrust Enforcement*, Remarks at the 2016 Global Antitrust Enforcement Symposium, Washington, DC (Sept. 20, 2016).

10 *See FTC v. Staples, Inc.*, 190 F. Supp. 3d 100, 133) (D.D.C. May 10, 2016) (quoting *United States v. H&R Block, Inc.*, 833 F. Supp. 2d 36, 73 (D.D.C. 2011)).

11 *See id*.

12 *See H&R Block*, 833 F. Supp. 2d at 73 (quoting Guidelines § 9).

13 Guidelines § 9.1.

14 *Id.* § 9.2.

15 *Id.* § 9.3.

16 329 F. Supp. 2d 109 (D.D.C. 2004).

17 *FTC v. Staples, Inc.*, 190 F. Supp. 3d 100 (D.D.C. 2016).

18 *See FTC v. Sysco Corp.*, 113 F. Supp. 3d 1, 64-69.

19 In addition, a prolonged reliance on the parties by the buyer via the proposed transition services agreement cut against the parties’ assertion that the buyer would be a strong and independent competitor post-divestiture. *See id.* at 64-70.

20 *See id.* at 67-68.

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