What the FTC’s Merger Remedies Report Means for Divestiture Sellers and Buyers

The Federal Trade Commission (“FTC”) recently issued updated best practices for sellers and buyers of assets to be divested in order to obtain antitrust approval for M&A transactions. The FTC included the guidance as part of a new report analyzing the FTC’s merger remedies in transactions from 2006 to 2012 (the “Report”).

1. Divestiture sellers and buyers should be mindful of the following:

   1. The FTC has a strong preference for divesting a complete ongoing business instead of select asset packages.

   2. The process for evaluating proposed divestitures and other remedies may become more protracted and burdensome, as the FTC increases its scrutiny of remedy proposals and encourages divestiture buyers to undertake more thorough diligence.

   3. Divestiture buyers with existing operations and facilities similar to those of the seller, in-depth knowledge of the relevant markets, complementary products or service lines, and familiarity with the divested business’ customer base will be preferred.

   4. Divestiture buyers should expect to answer questions affecting the buyer's competitive and financial viability, provide more detailed financial documentation, and explain all sources of funding, including contingency plans if sales do not meet projections.

The new best practices provide a primer for merging parties and divestiture buyers seeking FTC approval of transactions, including the types of questions the FTC will ask and what parties should do to win

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2. The 1999 Divestiture Study described assets comprising an “ongoing business” as follows:

   [T]he assets include most typically an established customer base, a fully staffed facility of some sort (a manufacturing facility or a retail operation) or an otherwise self-contained business unit that may have product contract packed, a manufacturing and/or sales force, perhaps a research and development team, and other assets that are included in the business, including ancillary agreements and third-party contracts. This type of divestiture should result in the almost immediate transfer of market share from respondent to buyer. Most of the packages of assets labeled as “on-going businesses” had not, however, actually been operated as autonomous businesses before the divestiture; nevertheless, they were characterized this way because the market share attributed to the assets could be transferred immediately and potentially for the long-term. A buyer could buy and be operational the next day, selling to all of the same customers.
approval of a proposed remedy. Fried Frank’s Merger Remedies Tip Sheet provides a concise presentation of the new guidance.

I. The Report’s Findings

The Report expands on a prior FTC study completed in 1999 by examining all 89 final agency orders issued between 2006 and 2012. The FTC analyzed 50 of the 89 orders using a case study method that relied on interviews of market participants (merging parties, divestiture buyers, and third-party competitors) and sales data.

The FTC concluded that 83% of the orders in this study successfully maintained or restored competition in the relevant markets. Notably, the FTC found that 100% of the divestitures involving ongoing businesses were successful, while orders requiring divestitures of a limited package of assets had a 70% success rate.

These data confirm the FTC’s long-standing preference for divesting an entire business over select asset packages.3 As a result, parties should expect that the process associated with the FTC’s evaluation of a divestiture proposal will be faster and less burdensome if an ongoing business is being sold.

For “vertical deals” in which customers and suppliers (rather than competitors) merge, the Report noted that all of the FTC’s orders, each of which required conduct remedies rather than asset divestitures, were successful.4 In vertical mergers, the FTC’s goal is to remedy anticompetitive effects arising from the merged firm foreclosing competitors from access to a critical input or a key customer, or having access to confidential information of competitors who are also customers rather than to replace a lost competitor. The Report cited effective monitoring and enforcement of firewalls as contributing to the success of vertical remedies.

The FTC staff used a less-extensive methodology to analyze the 15 mergers that involved the funeral home, healthcare, drugstore, and supermarket industries because the agency has extensive experience in those markets. In those 15 mergers, there were 43 divestiture buyers and 39 of the 43 divested businesses remain in the market – a 90% success rate.

Finally, the FTC reviewed 24 mergers from the pharmaceutical industry by analyzing its own internal data and publicly available information. Overall, the FTC concluded that approximately 75% of pharmaceutical product divestitures were successful. Where the divestiture required the buyer to establish a new production or manufacturing source, success rates decreased due to the greater difficulty in transitioning the manufacturing process. The FTC’s best practices for pharmaceutical merger remedies now explicitly favor easier-to-divest products, such as products manufactured by a third party. Previously, merging firms were generally free to divest either the buyer or the target’s product in the overlap market at issue. Going forward, the FTC’s preference for divestiture of third-party manufactured products could in some cases result in larger divestitures, which may impact deal value and risk allocation in merger agreements.

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3 The Report’s findings are also consistent with the government’s litigation victories in Staples/Office Depot, Sysco/US Foods, Humana/Aetna, and Cigna/Anthem, where federal courts rejected the merging parties’ proposed remedies.

4 In contrast, only 13% of the horizontal mergers between competitors examined in the Report were not resolved through divestitures.
The FTC also identified areas for improvement in the remedy process. Specifically, the Report revealed that divestiture buyers have complained of inadequate asset packages, insufficient time and access for proper due diligence, and challenges with the transfer of back-office functions (e.g., IT systems, personnel).

II. Special Considerations for Divestiture Sellers, Buyers, and Private Equity Firms

The FTC’s first divestiture study led to a number of significant reforms to the agency’s approach to remedies, such as requiring upfront buyers in a much larger percentage of transactions, shortening the time period to consummate post-order divestitures to six months, appointing independent monitors more often, and establishing a program to follow-up with buyers of divestiture assets. While the new Report has confirmed that the FTC’s approach to merger remedies is generally effective, the Report’s findings are likely to lead to significant changes as well. Going forward, divestiture sellers and buyers should expect changes in the following areas of the divestiture process:

- **Enhanced scrutiny of divestitures of limited assets:** Proposals to divest selected assets (as opposed to a full ongoing business) will undergo even greater scrutiny to ensure that the limited package of assets is sufficient to restore competition and allow the buyer to operate a viable business.

- **Back-office functions must be included:** The FTC will devote more time to ensuring that the divestiture buyer will be able to establish in a timely manner the necessary back-office functions to support the manufacturing and sales efforts, and in some cases may require that a divestiture package include these services.

- **More detailed financial information:** The FTC will require divestiture buyers to provide more detailed financial documentation and explain all sources of funding, including contingency plans if sales do not meet projections. The FTC will pay closer attention to the sources of, and limitations on, funds available to a proposed buyer and how funding may affect the buyer’s competitive and financial viability.

- **Longer due diligence periods:** The FTC will seek to ensure that divestiture buyers have completed sufficient due diligence and had access to key information, facilities, and employees. This may further delay the already prolonged review process in transactions where the FTC requires an “upfront buyer” (i.e., where the buyer of the divestiture assets must be identified and approved by the agency before the merging parties can consummate their transaction).

- **Significant business expansions will be viewed cautiously:** The failed remedies in Hertz/Dollar Thrifty and Albertsons/Safeway both involved massive expansions of the divestiture buyers’ businesses, even though the buyers had extensive industry experience. Going forward, such expansions will face significant scrutiny.5

5 The Report does not cover the FTC’s two most recent divestiture miscues: divestitures in connection with Hertz’s acquisition of Dollar Thrifty and Albertsons’ acquisition of Safeway. Hertz divested its Advantage Rent-A-Car business to Franchise Services of North America (“FSNA”), which operated a small U-Save rental car business, and Macquarie Capital (USA), Inc. which provided financing in return for approximately 50% equity in the company. Less than a year after the settlement announcement, FSNA’s operating subsidiary filed for bankruptcy, citing inadequate capitalization and unfavorable lease terms from Hertz. Similarly, Haggen Holdings filed for bankruptcy after it acquired 148 of the 168 stores that were divested pursuant to an order approving Albertsons’ acquisition of Safeway. Haggen, which owned only 18 stores prior to the acquisition, alleged that

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• More frequent communication with buyers: The FTC staff (and independent monitors where applicable) will be more proactive in reaching out to divestiture buyers to ensure that the divestiture process is proceeding as expected.

The additional scrutiny will likely lead to a more protracted and burdensome divestiture process. As a result, divestiture sellers may place an additional premium on buyers who are able to navigate the process quickly. This may make private equity firms, especially firms with investments in related industries, attractive as divestiture buyers. While private equity buyers are likely to be subject to more scrutiny than strategic buyers on market knowledge, as experienced deal makers, they have access to capital and have the ability to quickly develop business plans, conduct due diligence, and receive approvals from investment committees. The possibility of an expedited process could be appealing to a seller seeking to complete an already extensive regulatory review. Furthermore, the FTC’s emphasis on divesting entire ongoing businesses may create additional acquisition opportunities for private equity firms.

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Albertsons engaged in “coordinated and systematic efforts to eliminate competition and Haggen as a viable competitor in over 130 local grocery markets in five states,” and “made false representations to both Haggen and the FTC about Albertsons’ commitment to a seamless transformation of the stores into viable competitors under the Haggen banner.” Although not included in the Report, these two failed remedies will also significantly impact how the FTC will evaluate divestiture buyers going forward.

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