Working Party No. 3 on Co-operation and Enforcement

AGENCY DECISION-MAKING IN MERGER CASES: FROM A PROHIBITION DECISION TO A CONDITIONAL CLEARANCE

-- Note by the United States --

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More documents related to this discussion can be found at www.oecd.org/daf/competition/agency-decision-making-in-merger-cases.htm

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This document and any map included herein are without prejudice to the status of or sovereignty over any territory, to the delimitation of international frontiers and boundaries and to the name of any territory, city or area.
1. Global merger activity has recently reached historic levels in terms of number, size, and complexity. In FY 2015, there were 67 proposed mergers valued at more than USD 10 billion (United States dollars), more than twice as many as in 2014. Last year, there were 280 transactions worth more than USD 1 billion, nearly double the number of deals exceeding that value threshold in FY2010. A number of these mergers involved close competitors in already concentrated industries. In the U.S., mergers are reviewed by either the Antitrust Division of the U.S. Department of Justice (DOJ) or the Federal Trade Commission (FTC) (together, the Agencies). If the reviewing Agency concludes that a transaction would be anticompetitive, it will carefully consider whether to go to court to block that transaction or, alternatively, whether to allow the transaction to proceed because there is an adequate and enforceable remedy.

2. This submission briefly describes (i) the legal standard and process for merger review in the U.S.; (ii) legal presumptions concerning market shares and concentration; (iii) the goal of merger remedies; and (iv) crafting effective remedies to preserve or restore competition. It concludes with examples of recent Agency merger investigations involving complex remedies.

1. The legal standard and review process.

3. Section 7 of the Clayton Act prohibits mergers whose effect “may be substantially to lessen competition, or to tend to create a monopoly.” Under this standard, as interpreted by the Supreme Court, the Agencies seek not only to stop imminent anticompetitive effects, but to be forward-looking and stop potential restraints on competition “in their incipiency.”

4. When investigating a transaction, the Agencies obtain facts and other information from many sources, including the parties, customers, and competitors. This information is considered, along with all other available information relevant to the merger, when an Agency is deciding whether to seek to prohibit a merger.

5. The Agencies do not have the unilateral power to prohibit a merger. DOJ must ask a federal trial court to block a merger, or to order a remedy after consummation. The FTC may also go into federal court or ask an administrative law judge to block the merger (if it has not already been consummated) or order a remedy. If the latter, the FTC gets to review the administrative law judge’s decision, win or lose. Decisions of the federal trial court, and of the FTC, are reviewable by the federal courts of appeals.

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1. We use the term merger for ease of exposition, but this encompasses mergers, acquisitions, and other forms of consolidation.


6. The Agencies’ authority to require a remedy that resolves the competitive problem has been affirmed by the U.S. courts. For instance, after the Commission conducted a trial and imposed a remedy in *Polypore Int’l Inc. v. FTC*, the Court of Appeals upheld the divestiture order, citing numerous U.S. Supreme Court cases. “The relief in an antitrust case must be ‘effective to redress the violations’ and ‘to restore competition.’”

7. The Agencies do not decide to “clear a merger subject to remedies.” Rather, an Agency’s decision to settle is a decision to accept the remedy as a resolution of the unlawful merger. The Agencies do not conduct a “market test,” as that term is understood by other enforcers, although they do informally obtain views of market participants as part of their investigation of the merger and any proposed remedies. Once the reviewing Agency has determined to accept a consent, it has procedures for inviting third party/public views about proposed remedies in settlements: DOJ follows the procedures of the Antitrust Procedures and Penalties Act (APPA); the FTC has rules providing for a period of public comment on a proposed settlement.

8. In cases that are not settled, however, courts may be called upon to analyze both the original transaction and any proposed remedy. Recently, in *FTC v. Sysco*, as further discussed below, the trial court agreed with the FTC’s decision to reject a proposed remedy, holding that once the FTC had successfully established that the merger would likely harm competition, the defendant had failed to carry its burden to prove that its proposed remedy would solve the problem.

2. Presumptions concerning market shares and concentration.

9. The Supreme Court in *Philadelphia National Bank* clarified Section 7 by establishing a presumption that “a merger which produces a firm controlling an undue percentage share of the relevant market, and results in a significant increase in the concentration of firms in that market” is unlawful. This presumption has been incorporated into the Agencies’ 2010 Horizontal Merger Guidelines. As noted in those Guidelines, “[m]ergers that cause a significant increase in concentration and result in highly concentrated markets are presumed to be likely to enhance market power, but this presumption can be rebutted by persuasive evidence showing that the merger is unlikely to enhance market power.”

10. Merging parties often try to justify their mergers by claiming efficiencies and other procompetitive benefits will result from the merger. If these benefits are uncertain or do not sufficiently offset the potential harms, the Agencies view these mergers with great skepticism.

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5 686 F.3d 1208 (11th Cir. 2012).
6 Id. at 1218-19.
3. **The goal of merger remedies.**

11. A successful merger remedy must effectively preserve (or restore, in the case of a consummated merger) competition in the relevant market. The Agencies have each issued guidance setting forth their approach to analyzing remedies, as described in the U.S. submission to the June 2011 WP3 roundtable on *Remedies in Merger Cases.*\(^{12}\) There should be a close, logical nexus between the proposed remedy and the alleged violation—the remedy should fit the violation and flow from the theory or theories of competitive harm.

12. When either of the Agencies has determined to challenge a transaction, the parties frequently urge the reviewing Agency to accept some form of settlement, typically asset divestitures, but, less often, they may also offer conduct commitments or supply agreements. Whether a settlement can be reached typically depends on the parties’ willingness to divest assets or provide other relief that resolves the anticompetitive problems that have been identified by the reviewing Agency.

13. The Agencies thoroughly review every settlement offer, but are skeptical of offers consisting of conduct commitments or asset divestitures that only partially remedy the likely harm. They will not settle antitrust violations without a high degree of confidence that a remedy will fully protect consumers from anticompetitive harm.

4. **Crafting effective remedies.**

14. As the Agencies have described in their guidance documents, speeches, and other papers,\(^{13}\) the most effective remedy for a horizontal merger is divestiture of one of the two parties’ standalone businesses in the affected markets. That said, there are a number of considerations that may factor into the Agencies’ case-by-case evaluation of a merger remedy’s effectiveness.

15. Whether a remedy is acceptable depends on the particular markets involved. In the Agencies’ experience, acceptable remedies tend to share certain features. An acceptable remedy in a horizontal merger almost always needs to be structural, i.e., preserving an independent competitive force in the marketplace, rather than behavioral, i.e., simply placing limits on the merged firm’s ability to use or profit from increased market power. The structural relief should involve divesting standalone business units rather than simply product lines stripped from an infrastructure that the merging parties intend to retain. Moreover, the divested business needs to be fully capable of preserving the competitive dynamic in the market. The buyer of the divested business must be established and financially sound, and it must evince an intent to use the divested business to compete in the market, as gleaned from the Agencies’ review of any proposed buyer’s business plans and financial projections. Lastly, the divestiture needs to be free of long-term entanglements (e.g., supply or intellectual property (IP) licensing arrangements) between the buyer and the merged firm, save for some supply or IP licensing arrangement that may be necessary during a transition period. If these goals are achieved in a well-designed enforceable remedy, the Agencies are generally willing to settle the matter.


\(^{13}\) Id.
16. Complex settlements, especially where an asset package is cobbled together from separate assets from each party to the merger, present more risk, and the Agencies’ confidence that the settlement will preserve competition will be lower. Consumers should not have to bear the risk that a complex settlement may fail to preserve competition. Consequently, in some situations, a well-structured settlement can preserve competition. In other situations, however, there may be no settlement that can remedy a transaction in the Agencies’ judgment. In such cases, the Agencies will not hesitate to challenge the transaction.

17. As explained in the earlier cited reference materials, the Agencies use a number of tools to minimize the chance of ineffective remedies. In particular, the Agencies may appoint monitors – both to help design and enforce remedies – especially when the parties must undertake complicated steps, such as supplying a critical input, transferring technical information, etc. Because monitors can apply their special expertise and experience to the particular case, and can be more closely and directly involved with specific activities, the Agencies have concluded that monitors are a particularly valuable mechanism to help assure effective remedies.

18. The remainder of this submission provides examples from recent Agency decisions either to seek to prohibit completely a proposed transaction, or to accept a remedy as a settlement of their competitive concerns.

5. Mergers Challenged by the Agencies.

5.1 FTC v. Sysco and FTC v. Staples

19. In two recent cases, the FTC went to court and successfully blocked mergers in which the parties had offered divestitures that the FTC concluded were inadequate. In FTC v. Sysco Corp.,14 the proposed merger of Sysco and U.S. Foods would have combined the two largest providers of broadline foodservice distribution services to national customer accounts – e.g., large hotel chains. Both firms served their national customers from networks of distribution centers. The FTC also alleged that the merger would unlawfully reduce competition in certain discrete local markets. The parties offered a divestiture of a limited number of distribution centers to a regional company, and argued that the buyer would be well-positioned to grow and become competitive. The FTC rejected the offer. After a lengthy court hearing, the judge held that the FTC made its main case, and that the firms had failed to carry their burden to prove that their proposed solution would adequately remedy the competitive harm. He enjoined the merger pending the conclusion of the FTC’s administrative trial.15

20. In FTC v. Staples,16 the FTC opposed the proposed merger of Staples and Office Depot, the two largest suppliers of consumable business supplies (pens, paper, etc.) sold to large national business customers. Such customers negotiate nation-wide contracts and expect fast delivery to their far-flung locations. In this case, rather than offering a divestiture of physical assets, the parties offered a divestiture of a limited number of customer contracts to an office supply wholesaler, and argued that with this amount of business, the buyer would be able to compete. The FTC determined that the offer was inadequate and sued to stop the transaction. Following a lengthy court hearing, the judge found that the FTC had established its case and enjoined the merger pending the conclusion of the FTC’s administrative trial.17

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15 Following the court’s ruling, the parties abandoned the transaction.


17 The parties then abandoned the transaction. Throughout the investigation, FTC staff cooperated with staff of the antitrust agencies in Australia, Canada, and the European Union. The Canadian Competition Bureau
5.2 **Halliburton/Baker Hughes**

21. In April 2016, DOJ sued to block Halliburton, the largest oilfield services company in the United States, from acquiring its closest rival, Baker Hughes. Along with Schlumberger, these companies are the “Big Three” in this business because they are by a wide margin the largest globally integrated oilfield services companies. Over 90% of Halliburton’s revenues derive from products and services that are also sold by Baker Hughes, and the same is true for Baker Hughes’ revenues with respect to Halliburton. The investigation revealed serious antitrust problems in numerous markets representing billions of dollars of revenue: the merger would cause a substantial lessening of competition in 23 product and service markets alleged in DOJ’s complaint, covering most of the major steps needed to explore formations, to drill oil and gas wells, and to complete those wells.

22. In many of these markets, the merger would have left the industry with just two dominant suppliers. In eight of the markets alleged in the complaint, the post-merger Halliburton and Schlumberger would have over 90% of U.S. sales. In nine other markets, two firms would have a combined share above 70%. And in two of the markets—offshore stimulation vessels and offshore liner hanger systems—the merged Halliburton alone would have a share above 80%.

23. In addition to these very high market shares, Halliburton and Baker Hughes, along with Schlumberger, drive innovation in these markets, often leading the way in developing next-generation technology to solve the most challenging problems facing the oil and gas industry. DOJ alleged, for example, that Baker Hughes had hundreds of active research projects and launched 160 new products in 2014 alone, generating over USD 1 billion in revenue. The Big Three are unique in many respects, and are often the only suppliers qualified to bid on difficult projects involving offshore or deep onshore wells where products must function in high temperatures and at high pressures.

24. The parties were well aware of the antitrust risks of their transaction. Halliburton prevailed upon Baker Hughes to undertake the venture only with a threat of a costly and disruptive hostile takeover battle and a promise of three things: (i) a premium on the price of Baker Hughes’ shares; (ii) a commitment to divest assets representing up to USD 7.5 billion in sales; and (iii) a reverse breakup fee payment to Baker Hughes of USD 3.5 billion if the merger could not be completed.

25. From the start Halliburton publicly claimed that it could fix any and all competition concerns, in the United States and around the world. DOJ carefully examined the proposed remedies, but concluded that no remedy could preserve the lost competition. The parties presented a complicated array of piecemeal divestitures and entanglements that involved selling or licensing a miscellaneous array of assets. The Big Three would become a Big Two, in the U.S. and globally. Halliburton mostly would keep the more successful product lines and sell assets related to the less successful product lines to a third party. Moreover, Halliburton would keep for itself critical company-wide assets and personnel that supported those product lines, because these common assets were shared with other parts of Halliburton or Baker Hughes. They would keep the infrastructure essential to making each firm successful and just sell off some pieces—like selling part of a building while removing the heating system, the electrical wiring, and some of the foundation.

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18 DOJ’s complaint is available at [https://www.justice.gov/atr/file/838661/download](https://www.justice.gov/atr/file/838661/download).

filed an application to block the transaction with Canada’s Competition Tribunal on the same day the FTC filed an administrative complaint in this matter.
26. In addition, the merged Halliburton would be acting on behalf of the buyer of this array of assets for the foreseeable future. Contracts and licenses would not immediately be conveyed to the new owner. Customers could not be compelled to work with a new supplier, so a complicated and lengthy customer-by-customer negotiation would be required. Halliburton also would hold back certain IP used by the divested product lines and would limit the uses to which other IP could be put. To make matters worse, Halliburton would be transferring fewer than half of over 400 facilities currently used or relied upon by the divestiture assets, causing enormously disruptive relocation of employees, equipment and, in some cases, major operations to new facilities. DOJ concluded that the remedy would eliminate a formidable rival – Baker Hughes – and replace it with a smaller, weaker rival that was not the equivalent of Baker Hughes.

27. A final concern was that the proposed remedy would require DOJ and the court to devote substantial resources over many years to supervise a remedy so complicated and convoluted that it would require unprecedented resources to oversee it. DOJ would take on responsibilities more often associated with an energy sector regulator, a role for which a law enforcement agency is not well-equipped.

28. The Agencies in appropriate circumstances negotiate solutions to otherwise anticompetitive mergers. Those settlements typically involve limited, discrete and clean divestitures. But not every merger can be resolved by a settlement. In Halliburton/Baker Hughes, the anticompetitive concerns were pervasive, the affected markets were numerous, and any remedy would be incomplete, complex and risky. Customers and competition should not have to bear the risks of a failed or inadequate remedy. DOJ sued to block the acquisition, and on 1 May 2016, the parties abandoned it.¹⁹

5.3 Superior/Canexus

29. In Superior/Canexus, the FTC was concerned that the proposed merger would eliminate competition between the largest and third-largest producers and sellers of sodium chlorate.²⁰ Extensive discussions were held in which the parties attempted to assemble a package of plants that could provide nationwide supply of sodium chlorate to customers in locations across the country. Ultimately, however, the parties and the FTC could not reach agreement on the particular assets to be divested. When the FTC then voted to authorize the staff to go to court to seek an injunction, the parties abandoned the transaction.²¹

5.4 Applied Materials/Tokyo Electron

30. In April 2015, Applied Materials Inc. and Tokyo Electron Ltd. abandoned their plans to merge after DOJ informed them that their remedy proposal failed to resolve DOJ’s competitive concerns. The parties were the largest and second-largest providers of non-lithography semiconductor manufacturing equipment. The proposed merger would have combined the two largest competitors with the necessary know-how, resources, and ability to develop and supply high-volume non-lithography semiconductor manufacturing equipment.

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¹⁹ DOJ cooperated closely with the European Commission, Australia, Brazil, and Mexico in reviewing this proposed merger.

²⁰ See https://www.ftc.gov/enforcement/cases-proceedings/161-0020/superiorcanexus-matter.

²¹ The FTC and the Canadian Competition Bureau collaborated in this investigation.
31. The parties offered to divest their overlapping tool lines, but DOJ’s investigation revealed that competition was not focused on existing products. The parties competed by racing to be the innovator. To replicate existing competition, the divestiture buyer needed to have the same capacity to innovate. DOJ was not convinced that the proposed buyer was so qualified. Just selling off one party’s product line was not sufficient to preserve existing competition with respect to the development of equipment for next-generation semiconductors.22

6. Mergers Determined by the Agencies to be Acceptable Subject to Substantial Remedies

6.1 ABI/Grupo Modelo

32. DOJ had concerns when Anheuser-Busch InBev SA (ABI), the largest American beer company, proposed to acquire Grupo Modelo S.A.B. de C.V. (Modelo), the largest Mexican beer company and third largest brewer of beer sold in the US. ABI and MillerCoors, the other large American beer company, often engaged in interdependent pricing rather than vigorous competition. Modelo, a much smaller third firm, often acted as a disruptive force, declining to follow ABI’s price increases. Modelo’s presence forced ABI to innovate.

33. ABI initially offered a woefully inadequate remedy: some behavioral conditions placed on the merged firm and a long-term supply arrangement that would have put the importer of Modelo products totally at the mercy of ABI. This proposed vertical “fix” to a horizontal merger failed to create an independent, fully-integrated brewer with permanent control of Modelo brands in the US.

34. When DOJ sued, ABI consented to substantial structural relief. ABI agreed to divest and/or license to Constellation Brands, Inc. (Constellation) (i) a perpetual and exclusive license to Corona Extra, the #1 import and #5 best-selling brand in the US, and nine other Modelo brands; (ii) Modelo’s newest and most technologically advanced brewery in Mexico, near the Texas border; (iii) Modelo’s interest in Crown Imports, LLC (Crown), a Modelo/Constellation joint venture that imported, marketed, and sold Modelo beers in the US; and (iv) other assets, rights, and interests necessary to ensure that Constellation could compete in the US using Modelo brands, independent of a relationship with ABI and Modelo.

35. In addition, to ensure that Constellation could meet current and future demand for Modelo brands in the US independently of ABI, Constellation, which was made a party to the settlement and court order, committed to expand the new brewery in Mexico. ABI also agreed to various transition services and interim supply commitments to assist Constellation, and agreed not to interfere with Constellation’s retention of employees at the divested brewery. Other requirements to ensure that Constellation would become an effective competitor limited ABI’s ability to interfere with beer distribution contracts, and created firewalls within ABI to protect Constellation’s confidential business information during the transition services and supply agreements.

36. As a result of the settlement, Constellation now owns Modelo’s U.S. business and a state-of-the-art brewery in Mexico sufficient to supply U.S demand today and into the future. Under the new owner, Modelo beer sales have grown dramatically in the U.S.23

22 During the investigation, the division cooperated with the Korean Fair Trade Commission, China’s Ministry of Commerce, Germany’s Federal Cartel Office and competition agencies from several other jurisdictions.

6.2 US Airways/American Airlines

37. When DOJ investigated the US Airways/American Airlines merger, it had to choose between seeking an injunction that would preserve a sub-optimal status quo or accepting a settlement that potentially would improve on that less-than-perfect competitive dynamic. Those are not easy choices. DOJ’s complaint in 2013 emphasized that competition in the airline industry at the time of the merger was far from dynamic. The legacy airlines too often acted like oligopolists, softening the intensity of their competition and setting their fares and their fees in interdependent fashion. They were profiting at the expense of travelers. Congestion—slot controls and gate constraints at critical airports—prevented entry and expansion by low-cost carriers that could have improved the competitive situation.

38. An injunction blocking the merger would have prevented further consolidation, but it would have done nothing to upset this unhealthy status quo. On the other hand, by removing bottlenecks to competition—securing divestitures of slots at congested airports, including Washington’s Reagan National and New York’s LaGuardia, and divestitures of gates at five other concentrated airports—the settlement that was eventually negotiated opened up key markets to further competition. The consent decree also took advantage of the fact that restrictions on Dallas’s Love Field—a closer-to-downtown-Dallas alternative to the bigger Dallas-Fort Worth—were about to be lifted, strengthening the impact of the gate divestiture there.

39. Substantial benefits to competition have already accrued at those airports. In the years following the 2014 remedy, low-cost carriers used the divested slots and gates to expand services at Reagan National, LaGuardia, Chicago’s O’Hare and Los Angeles’ LAX. On routes affected by the divestitures, prices have fallen by around 20% and passenger volume has expanded by around 40%. At Dallas airports, the number of originating passengers soared—from roughly 200,000 in 2013 to almost 1.2 million in 2015—and fares plummeted—by as much as 30% on flights to popular destinations like New York and Washington, D.C. Though problems remain in the airline industry, DOJ believes that its actions secured tangible benefits for the flying public in many markets across the country.

6.3 FTC v. Ardagh

40. In July 2013, the FTC challenged Ardagh’s proposed acquisition of the U.S. glass bottle manufacturing business of St. Gobain, alleging two product markets: the production and sale of mass-produced glass beer bottles, and the production and sale of glass bottles for alcoholic liquor. Ardagh proposed to acquire all of St. Gobain’s U.S. production. During the pre-trial stages of the case, extensive discussions took place between the FTC staff and the firms over the scope of a proposed divestiture. Ardagh asserted that a limited divestiture of several plants would allow a new firm to compete and thus solve the competitive problem. The FTC developed facts, however, showing that for numerous large customers, including the largest mass-market beer producers and large craft brewers as well, any effective competitive alternative to the combined firm would need to have more plants, and a broad geographic reach. Before trial, Ardagh reached agreement with the staff to divest its six U.S. bottle production plants (and thus keep what it was buying from St. Gobain). When the FTC staff confirmed that the identified buyer would get the plants, existing management, and existing customer contracts, the Agency agreed to the settlement and ended the litigation.

