Daniel P. Ducore

August 2, 2018

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President
American Antitrust Institute
1025 Connecticut Ave. NW
Suite 1000
Washington, DC 20036

Re: ***U.S. Department of Justice Antitrust Division's Settlement in Bayer/Monsanto***

Dear Dr. Moss:

The U.S. Department of Justice Antitrust Division (Division) announced its settlement with agricultural biotechnology firms Bayer AG and Monsanto Company on May 29, 2018. The settlement resolved its objections to that $66 billion merger with a proposed broadly drafted divestiture of most of Monsanto's crop protection businesses to BASF SE. The $9 billion divestiture, by which BASF would acquire Bayer's position in genetically modified seeds and seed traits, foundational herbicides, other crop seeds, and related research and development efforts appears to be as robust a divestiture as might be imagined. It is also the largest divestiture ever obtained by either the Division or the Federal Trade Commission (FTC).

Throughout the Division's investigation, the American Antitrust Institute (AAI) and others had urged the Division to challenge the deal as simply "too big to fix," and when the settlement was announced AAI criticized the remedy for raising "execution risk." At AAI's invitation, this letter discusses the broad scope of the remedy, the risks that remain, and some suggestions for how the Division should continue to review this particular remedy in the years following its implementation and share its learning with the public.[1]

It is obviously too soon to assess whether this remedy will fully maintain the competition in these critical agriculture products that the Bayer-Monsanto deal would eliminate. Every remedy raises risks about the scope of divested assets, the particular buyer, and implementation of the remedy, and the Division appears to have done everything possible to reduce those risks, requiring broad extensive divestitures, and adding some unusual provisions that will *inter alia* allow BASF to reach out during the first year for additional assets if it needs them. But a more fundamental risk – what AAI calls "execution risk" – is that BASF, even if it obtains everything that was considered necessary and relevant when the remedy was

[1] The author recently retired from the FTC after more than 25 years as Assistant Director of the Bureau of Competition's Compliance Division. . That Division oversaw all the FTC's competition remedies – merger and non-merger – and spearheaded *The FTC's Merger Remedies 2006-2012, A Report of the Bureaus of Competition and Economics (Merger Remedies Report)* (2017). *See* https://www.ftc.gov/reports/ftcs-merger-remedies-2006-2012-report-bureaus-competition-economics. The author thanks Naomi Licker for useful suggestions to an earlier draft. The views in this letter are the author's own.

negotiated, will fail to step in for Bayer and compete with the new Bayer-Monsanto as strongly as Bayer had competed with Monsanto before the deal.

The Bayer/Monsanto divestiture settlement offers a timely opportunity for the Division itself to monitor the remedy as it progresses and assess its results. When a large merger that threatens competitive harm in a major sector of the U.S. economy is resolved by a divestiture rather than a challenge to stop the deal, and when that divestiture appears to be as complete a remedy as any recent settlement, a close assessment of the remedy's outcome may shed light on the question whether any merger is indeed "too big to fix." The Division should share its assessments to the greatest extent confidentiality requirements allow.

The case filings themselves – the Complaint, Proposed Final Judgment (PFJ), and the Competitive Impact Statement (CIS)[2] – set out the Division's allegations about the merger's likely competitive harm, and the specifics of what Bayer/Monsanto must do to remedy that harm. Assessing the remedial risk is difficult without access to the confidential information from all three parties that the Division had available to it, but both the broad reach of the PFJ and some assumptions that the Division and the parties likely have made in reaching this settlement provide an outline. There are ways the Division can monitor the progress of the remedy, both in the normal course to assure full compliance with the decree, but also to assess how effective the BASF divestiture is in addressing the alleged competitive harm from the merger over a longer time. Finally, some unique scope and procedural aspects of the PFJ are worth discussing as well.

I. Alleged Violations

The Division's Complaint alleges likely anticompetitive effects in 17 markets, which the CIS groups into four broad categories. These are: 1) genetically modified (GM) seeds and traits for three important row crops: cotton, canola, and soybeans; 2) foundational herbicides, which are Bayer's and Monsanto's propriety herbicides that are paired with their GM seeds (Bayer's Liberty® glufosinate ammonium, paired with Bayer's LibertyLink® seeds, and Monsanto's perhaps better known Roundup® glyphosate, paired with its Roundup Ready® seeds; 3) seed treatments, which are applied to seeds to protect against specific threats, such as insects, nematodes, etc., and 4) five specific vegetable seeds: carrots, cucumbers, onions, tomatoes, and watermelons.

In the GM seeds and traits markets, the Complaint alleges a loss of head-to-head competition between Bayer and Monsanto, increasing already-high concentrations in the three specific row crops, discussed separately for seeds and for traits. The Complaint also alleges that the future benefits of Bayer's and Monsanto's competition in research efforts would be lost to farmers.

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[2] *See* U.S. v. Bayer AG and Monsanto Company, https://www.justice.gov/atr/case/us-v-bayer-ag-and-monsanto-company. *See also*, for AAI's generally consistent view of the competitive effects, the two letters it submitted to the Division during the merger investigation. . July 26, 2017, joint letter of AAI, Food & Water Watch, and the National Farmers Union to Acting Assistant Attorney General Andrew Finch, https://antitrustinstitute.org/sites/default/files/White%20Paper_Monsanto%20Bayer_7.26.17_0.pdf, and an October 3, 2017, supplemental letter, https://www.antitrustinstitute.org/sites/default/files/AAI-FWW-NFU_MON-BAY%20addendum.pdf.

In foundational herbicides, the Complaint alleges that the merger would create presumptively anticompetitive increases in concentration, combining Monsanto's "dominant" 57% share with Bayer's 7%. Although the two products are now off patent, other competitors' products have not prevented Bayer and Monsanto from maintaining branded price premiums. As the CIS describes, the merger also eliminates competition between the two firms to continue developing next-generation weed management systems.

In seed treatments, the Complaint alleges a loss of head-to-head competition (treatment for nematodes), and two vertical foreclosure effects, from: 1) combining Monsanto's strong position in corn seeds with Bayer's strong position in seed treatment for corn rootworm, and 2) combining Monsanto's strong position in soybeans with Bayer's position in fungicide seed treatments for soybean sudden death syndrome.

Finally, the Complaint alleges the merger lessens competition in the five vegetable seeds – the CIS notes that Monsanto is the leading seller of these seeds, and Bayer is the fourth largest.

In all markets, the Complaint alleges anticompetitive effects through the loss of head-to-head competition and likely price increases in certain inputs, all leading to higher prices, lower quality, and reduced customer choice. Further, the current four-firm competition to innovate would be harmed by the loss of Bayer as the "emerging threat" to Monsanto's dominance.[3] The Complaint alleges that entry by other firms would not prevent these anticompetitive effects and that no verifiable merger-specific efficiencies would offset the harm.

II. Proposed Final Judgment

The CIS describes the divestitures broadly as requiring Bayer to divest its business in each relevant market as well as additional complementary assets, because Bayer does not operate each of these businesses as truly separate stand-alone businesses. The remedy here is in stark contrast to that proposed by the parties and rejected by the Division in *U.S. v. Halliburton and Baker Hughes.*[4] In addition to divestiture in the head-to-head markets, Bayer must divest other products to address the vertical foreclosure concerns, along with intellectual property and "research capabilities" and "pipeline products," to allow BASF to replace Bayer as an innovator in each relevant market. Bayer must also divest other products to give BASF "the scale and scope" to complete.[5]

The divestiture assets are defined broadly as Bayer's "global businesses" in each product line and all tangible assets, all manufacturing plants, all research and development facilities, and all other facilities. These are essentially worldwide divestitures but with some specific exclusions for non-overlap products in geographic markets where the products are uniquely suited (Asia, Brazil). All related patents,

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[3] *See* Complaint at ¶¶ 59 et. seq.

[4] *See* that complaint, at https://www.justice.gov/atr/file/838661/download. The deal was abandoned before trial. In particular, compare the Bayer/Monsanto divestiture with how the Division described what Halliburton and Baker Hughes had offered, *Baker Hughes* complaint at ¶¶ 8-10 and ¶¶ 73-79. "[A] collection of assets selected from various Halliburton and Baker Hughes business lines," (¶ 8) that would "fail to transfer intact businesses to the buyer." (¶ 74).

[5] This discussion does not intend to capture all the details. See PFJ at II for a complete definition of the assets to be divested.

trademarks and trade names must go, along with all contracts, licenses, permits and related government approvals. Almost all of Bayer's research facilities are included in the divestiture.

At BASF's request, Bayer must supply or toll manufacture certain products, to allow BASF to compete immediately while it ramps up its own production.[6] The CIS also explains that BASF will take on almost four thousand Bayer employees, and BASF will have the opportunity to recruit additional employees from Bayer without interference from Bayer.

The Stipulation and Order contains a fairly standard hold separate obligation, although the divestiture is likely to occur so quickly that these provisions will not likely operate for long.

The PFJ contains a firewall to prevent improper information exchanges between Bayer and BASF[7] and has the routine compliance inspection provisions[8] and required notice of future acquisitions.[9] The PFJ requires appointment of a monitoring trustee to oversee both the immediate divestiture of assets and also any ongoing transition services and supply agreements. It also contains the provisions (now routinely required) that the Division in any enforcement action may establish a violation by meeting the "preponderance of evidence" standard, and that if the Division prevails (or settles) it may seek reimbursement for its legal and expert costs.[10]

Several aspects of this remedy are unusual. First – perhaps reflecting the Division's efforts to reduce any "asset package risk" to near zero – within the first year following divestiture, BASF may obtain any additional assets (any that had not been identified or defined in the PFJ) if such assets have been "previously used by" the Divestiture Businesses and are "reasonably necessary" for the businesses continued competitiveness. These determinations are to be made by the Division in its sole discretion.[11] Although the broad scope of the definitions seems to reduce this category to a *de minimis* one,[12] nonetheless it is rare that either the Division or the FTC has provided for the buyer's reaching back to obtain additional assets. The reach-back is limited, however, and wouldn't include assets that don't meet the provision's albeit broad test.

Second, inclusion of BASF as a party in the decree is quite unusual. BASF signed the Stipulation, and is named in the PFJ and CIS, although it is not a named defendant in the Complaint. In Paragraph XI, Bayer is prohibited from reacquiring any divested assets (itself not unusual), but BASF is prohibited from acquiring any competing assets from Bayer unless the Division approves. Further, BASF may not expand any collaboration agreements with Bayer absent the Division's approval. The firewall provision runs against both Bayer and BASF. The Division has thus required both Bayer/Monsanto and divestiture buyer to comply with the forward-looking remedy provisions, and presumably BASF itself decided that the risk of running afoul of the Division was sufficiently low that it did not object to being bound.

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[6] *See* PFJ at IV. G. (p. 22).
[7] PFJ at IX (p. 36).
[8] PFJ at X (p. 38).
[9] PFJ at XII (p. 39).
[10] PFJ at XIV (p. 41).
[11] PFJ at IV.F.(2) (pp. 21-22). The parties must negotiate any supplemental agreement, which must be approved by the Division, within 30 days.
[12] Had either the Division or BASF identified any such potential additional assets, presumably they would have been included in the PFJ.

Given the breadth of the Complaint and PFJ, even the above, distilled discussion is lengthy. But the breadth of the assets to be divested, BASF's ability to reach back for more, inclusion of complementary assets to give BASF scale and scope, broadly-drafted employee provisions, and the general and routine monitoring, access, and enforcement provisions shows that Bayer is essentially giving up to BASF its agricultural crop protection businesses in exchange for being allowed to retain Monsanto's. It is hard to imagine how a settlement could have been drafted more broadly. There does not appear to have been any fine-tuning to accede to the defendants' desire to retain any particular products,[13] lines of business, research assets, etc. Accordingly, the risk that the asset package itself is inadequate seems low. Put differently, it's hard to identify anything that BASF *might* need that it isn't getting.

III. What are the Risks?

As mentioned earlier, the remedy appears to fully address the three usual risks raised by any divestiture: 1) "asset risk" (whether the divested assets are insufficient to create a robust competitor); 2) "buyer risk" (whether the buyer lacks critical assets not included in the assets, or otherwise lacks financial or management resources); and 3) "implementation risk" (whether the asset transfer fails for unanticipated reasons).[14] The Division appears to have obtained a divestiture that reduces these risks as much as possible.

The overarching and remaining risk is how, and how rapidly, BASF will be able to step into Bayer's shoes and offer its current and future customers existing products and newly developed products, and restore the competition lost in this merger. That is, will BASF fail to "execute" its business plans successfully and thus fail to replace Bayer as the leading competitor to the former independent Monsanto. As the CIS describes, the Division considered BASF to be the only acceptable acquirer for this divestiture, based on the information the Division had from BASF and the merging parties (and others). As in any divestiture review, the most critical information includes the financial and business plans of the proposed acquirer, as well as the views of customers, possibly other competitors, and indeed other firms with other relationships to the industry. All that information is confidential, but it seems clear from the CIS that the Division was fully satisfied that BASF has the industry skills, background, and understanding to succeed. These are areas that the Division fully explored as part of its investigation.

IV. Ongoing Assessment – What the Division Might Look For

The Division surely has fully explored what customers and others think now, but BASF's future in these markets is now in its own hands. Whether it brings new products to market as quickly as Bayer would have, whether it hits production problems that create new concerns for customers, and whether over the long run the market remains as competitive as it had been (and would have been) are questions that will be answered only over time. These questions can be explored by the Division in the years following

[13] Other than the few identified specific ex-U.S. products.

[14] These three risks are interrelated. A 'complete business' divestiture will reduce the risk that a buyer will fail to obtain all needed assets and relationships, and will greatly reduce the risk that the divestiture itself will not proceed smoothly. Similarly, a buyer that fully understands the markets, has deep financial resources and has developed a robust business plan will reduce the risk that the asset package may have failed to include some important piece. Finally, a proposal to divest a complete business to a well-prepared and well-financed buyer will reduce implementation risk.

implementation of the remedy. In that regard, some areas that the Division can consider monitoring include the following.[15]

- **Basic decree compliance** – The Division will undoubtedly assure, both directly and through the monitoring trustee's efforts, that Bayer delivers all the divestiture assets and businesses to BASF as required in the PFJ. As part of that oversight, the Division should assure that BASF takes full advantage of the one-year reach back provision and employee hire opportunities. That is, BASF should avoid overlooking assets and employees that, in hindsight, it should have taken.

- **BASF's ongoing performance, compared to its plan** – The Division presumably has the planning documents and other information that BASF produced during the investigation. This information was the basis for the Division's determination to accept BASF (and only BASF) as the buyer. And BASF is required to submit an affidavit early in the process explaining the steps it's taken to comply, as well as follow-up affidavits if any changes in those steps occur. Any sales projections, new product introduction timelines, etc. should allow the Division to compare BASF's actual performance on a specific basis, to assess how well BASF is doing in the markets. The Division (and monitoring trustee) may want to discuss with BASF its progress, especially if results in some areas seem to be below projections.

- **Pipeline products and R&D** – Accepting that neither BASF's nor Bayer's own projections are guarantees of product introduction schedules, nevertheless the Division can see if BASF is proceeding on schedule for all the pipeline products. In particular, if BASF abandons any particular effort, the Division can explore the reasons. They may include overall changes in market demand, or they may be due to an unexpected product launch by Bayer/Monsanto. Is BASF continuing to fund R&D efforts?

- **General sales and pricing levels** – The Division of course should continue to examine public information on sales, prices, etc. But Bayer/Monsanto and BASF should be in a position to provide the Division with regular sales information (quarterly, annual, or whatever seems appropriate in the industry) to let the Division assess whether BASF is indeed stepping into Bayer's shoes in these markets. Publicly available sales information for the products themselves can be used to assess all firms' market position. Although market share is not in itself the sole indicator of competition, nevertheless important trends may be revealed.

  Similarly, the Division can monitor pricing in these products (from customers, public data, and the firms' submissions) and look for any unusual price movements, which might indicate retained market power in Bayer/Monsanto. The Division should also be aware of market-wide cost increases, and anything else that might explain price movements.

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[15] The FTC's 2017 *Merger Remedies Report* took a broader look at the industries addressed in the remedies issued during those years. Through interviews with buyers, the merged firms, customers, some suppliers, and some other competitors, the bureaus assessed how "successful" each remedy had been. No one test could answer the question, but, as for merger investigations themselves, a broadly designed approach allowed the staff to reach useful conclusions. For a discussion of other past examples, and a caveated conclusion that merger remedies generally do not adequately preserve competition, see Kwoka, Jr., J., *Does Merger Control Work? A Retrospective on U.S. Enforcement Actions and Merger Outcomes*, 78 ANTITRUST LAW JOURNAL No. 3, 619 (2013), and Kwoka, Jr., J, MERGERS, MERGER CONTROL, AND REMEDIES, MIT Press, 2015.

- **Customer and competitor views** – The Division should attempt to assess the views of the major customers in these markets, to see if customers see BASF as a robust competitor. How does post-merger pricing compare to pre-merger pricing? Have any customers left the former Bayer products for Monsanto's and vice versa, and if so why? Has BASF retained customer loyalty generally, especially for pipeline products as they are introduced? Competitors too may be able to evaluate BASF's post-merger role in the market. These discussions should be open-ended, to allow third parties to give their candid views of how competition is playing out in these markets going forward compared to pre-merger.

The above are only general ideas, and they are not novel. The Division need not conduct any formal inquiries, but the scope of the discussions would look much like the initial stages of a merger investigation.[16] Although third parties would not be compelled to cooperate, nevertheless it is likely that the same parties who cooperated during the investigation itself would be willing to help the Division continue to review the markets' performance.

V. Conclusion

Short of blocking the merger, as AAI had urged, the Division has obtained a significant, broadly drafted divestiture to a large firm that is well familiar with the industry. Accordingly, the three recognized risks – "asset risk," "buyer risk," and "implementation risk" – seem as low as possible.

The larger question – the execution risk – usually unanswerable in the short term, is how well BASF will do in replacing Bayer as a major competitor, and innovator in the markets. Building on the confidential industry and business information that the Division already has, the Division should continue to monitor BASF's efforts, using specific sales data, overall industry statistics, and continuing input from the parties, customers, and others, to assess how successful this divestiture is.

Every divestiture poses the risk that the buyer will fail to offer competition equal to what the pre-merger markets were experiencing. The Bayer-Monsanto remedy presents the opportunity to see well how an aggressive remedy succeeds in protecting competition. The Antitrust Division should take that opportunity and report on what it learns.

Dan Ducore

[16] The FTC's *Merger Remedies Report* demonstrated the value in conducting these reviews.