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The views expressed herein are those of the Staff of the Bureau of Competition and do not necessarily reflect the views of the Commission or of any individual Commissioner.

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Executive Summary

This Report[1] discusses the Commission's on-going Divestiture Study. It evaluates the results of numerous interviews, conducted in a case-study format, for insights into the Commission's divestiture orders and divestiture process. It discusses the enforcement policies reflected in those orders and in the divestiture contracts undertaken between the respondents and proposed buyers. This description of divestiture policy and practice is intended to give persons inside and outside the Commission a common framework in which to discuss both general divestiture policies and their application to specific cases. That policy will continually evolve in response to the facts of specific cases and the Commission's conclusions about the effectiveness of its orders.

Since passage and implementation of the Hart-Scott-Rodino Antitrust Improvements Act of 1976, 15 U.S.C. § 18a ("HSR Act"), the Commission's on-going Divestiture Study is the first systematic review of orders requiring divestiture that seeks to determine how well buyers of divested assets have fared operating the assets they acquired as a result of the Commission's order. The Study was designed to investigate whether there were systemic reasons why some of the post-HSR divestitures failed to achieve the Commission's remedial objectives.

The Study includes the Commission's orders, issued from 1990 through 1994, that required divestiture to remedy anticompetitve effects resulting from a merger or acquisition. It focuses primarily on the buyers of divested assets, because divestiture orders are fundamentally different from both other orders imposed by the Commission and remedies commonly ordered by courts or other agencies. Typically an order requires the respondent or defendant to perform certain actions. Although a divestiture order mandates that the respondent perform an action (divestiture of identified assets), disposal of the assets is not sufficient by itself to accomplish the objectives of a Commission order. The divestiture must be to a suitable entity -- one that can replace the competition lost as a result of a merger -- and the Commission must be able to approve both the buyer and the manner of divestiture. This post-order approval process is required because maintaining or restoring competition is as much a function of who the buyer is and the circumstances under which it is acquiring the assets from the respondent as it is a function of what assets are divested. Consequently, insights from the on-going study (and the policies they have fostered) concern the effects on the buyer of provisions in divestiture orders and provisions in divestiture contracts, and the business plans of the buyers of divested assets.

The Study has suggested some rules of thumb about what kinds of divestiture orders are most likely to be successful. The Study also provides a picture of the dynamics of the divestiture process. The case studies describe an informational and bargaining imbalance between the

[1] This Report is a public version of the report on the Divestiture Study submitted by staff to the Commission. The Commission determined to make the results of the Divestiture Study public and invite comments from the public to facilitate a discussion of the results. In order to maintain the confidentiality of the participants in the Study, the Report does not identify buyers of divested asset or respondents by name. Buyers are, instead, identified by a randomly assigned number and are referred to as "Firm [Number]."

respondents on the one hand and the staff and the buyers of divested assets on the other hand, particularly where the buyers have never operated in the industry and never operated the to-be-divested business. The buyer's disadvantage translates into an obstacle to creating effective remedies because the staff has relied to a large extent on buyers and potential buyers to inform itself about the adequacy of the assets that are included in the divestiture package. This imbalance is exemplified by the many buyers that told of similar mistakes, of difficulties with technology transfers, and of inadequate assistance from respondents. In addition, the interviews have produced examples of how buyers have overcome problems with their divestitures in unique ways.

The Report recommends that the Commission include a variety of order provisions and divestiture procedures to correct the informational and bargaining imbalance. Thus, negotiations between staff and respondents may focus more on the question of whether risks of a failed divestiture will be reduced than on whether a particular provision was included in a previously issued order. With this greater understanding of the incentives of respondents and buyers of divested assets, the discussion of order provisions and divestiture contracts can focus on the issues that are inherent in the divestiture process without impugning the integrity of any party.

Partly as a result of the Study, staff has begun recommending provisions that may provide greater assurances that the divested assets will be viable and that they will be able to compete in the market in which the Commission has found a competitive problem. In more recent orders, the Commission has, among other things:

- reduced the time it allows for respondents to complete their divestiture obligation;
- required the divestiture of related assets to ensure the viability of the divested business;
- limited the scope and duration of any on-going relationships between the buyer of the divested assets and the respondent;
- limited the rights of respondents to revoke rights granted under the divestiture contracts;
- relied less on the assessment of potential buyers about the viability of assets included in a divestiture order;
- required persons acquiring assets to submit an acceptable business plan for those assets;
- required that respondents facilitate the transfer of knowledgeable staff to the buyer;
- used auditor trustees to monitor the transfers of technology to the buyer and the technical assistance provided by the respondent;

- provided for the redivestiture of certain types of assets where the buyer fails to exploit them; and

- provided for the divestiture of additional assets by a divestiture trustee where the respondent has failed to fully divest assets within the time required by the order.

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I. Divestitures Since the HSR Act

Prior to the passage of Title II of the Hart-Scott-Rodino Antitrust Improvements Act of 1976 ("HSR Act"),[2] the federal antitrust agencies were often unaware of corporate mergers before they occurred and were frequently unable to fully restore competition following anticompetitive mergers. Thus, despite the many litigated victories by the antitrust agencies following the passage of the Cellar-Kefauver Amendments to the Clayton Act in 1950, doubts were raised about the efficacy of the remedies obtained in these post-merger lawsuits.[3]

Congress sought to address the problem of failed divestitures through the premerger notification required by the HSR Act. This section of the Report begins with a description of the Congressional objectives that led to passage of the Act and is followed by a description of how the antitrust agencies developed remedial policies that are responsive to the various concerns outlined in the legislative history.

A. Objectives of the HSR Act

The legislative history of the HSR Act identifies two types of problems that were addressed by the HSR Act: interim harm to competition and the inability to fully restore competition.[4] The first is the loss of competition that follows an unlawful merger. Elzinga and

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[2] The premerger notification program was established by Title II of the Hart-Scott-Rodino Antitrust Improvements Act of 1976, section 7A of the Clayton Act, 15 U.S.C. § 18a. It is commonly known and referred to in this Report as the "HSR Act" or "Act." The regulations that implement the Act became effective on August 30, 1978.

[3] Elzinga's classic study showed that 35 of 39 pre-HSR orders, issued in cases involving mergers that occurred prior to 1960, did not establish an independent competitor in a timely fashion. Kenneth G. Elzinga, "The Antimerger Law: Pyrrhic Victories?" 12 J. LAW & ECON. 43 (1969). Rogowsky came to the same conclusion after examining 104 divestiture orders that were issued between 1969 and 1980. R. Rogowsky, *A E[illegible] S[illegible] A[illegible] R[illegible]*, Dissertation Thesis, U. Va. (1982). He ranked over 80 percent of the orders as unsuccessful. Both studies found, on average, the divestitures occurred more than five years after the anticompetitive acquisition had been consummated.

[4] The Senate Report on the proposed legislation emphasized the need for a more effective antitrust remedy than post- acquisition divestitures in merger cases when it quoted then Assistant Attorney General Thomas Kauper:

> [D]ivestiture of stock or assets after an illegal merger is consummated is frequently an inadequate remedy for a variety of reasons:
>
> Assets may be scrambled, making re-creation of the acquired firm impossible. Key employees may be lost. The goodwill of the acquired firm may be dissipated, making it a weaker competitive force after divestiture.

(continued...)

[4] (...continued)

> Moreover, divestiture is normally a painfully slow process, and in some cases might never occur. Locating an appropriate buyer willing to purchase at a reasonable price is frequently difficult. Firms under divestiture orders may deliberately delay to reap the benefits of the unlawful merger. During these delays, anticompetitive consequences grow.

Senate Report No. 94-803, 94th Cong., 2d Sess (1976), "The Antitrust Improvements Act of 1976," Report of the Committee on the Judiciary to Accompany S. 1284, Part 1 ("Senate Report") at 65.

[5] *S* note 3, *,* .

[6] Even when all the employees remain on the job and the machinery is moved to a new location, firms sometimes find it very difficult to reestablish effective production. *S , . .,* the description of difficulties the Borden company faced when it transferred the manufacturing of Liedekrantz cheese in V. Marquis and P. Haskell, THE CHEESE BOOK 23 - 24 (1965); and the similar story when R. J. Reynolds attempted to expand its aluminum foil division by buying Archer Products, a gift wrapping firm, in R. Miles, COFFIN NAILS AND CORPORATE STRATEGIES (continued...)

the business eliminated by the merger. Accordingly, for these divestitures of less than an entire business, there is less assurance that the purchaser will acquire a viable business entity, much less one that will be able to maintain fully the competition that existed prior to the merger.

1. Early post-HSR divestiture policies at the FTC

In fiscal 1979, the Commission began the HSR Act era by requiring ten divestitures in eight orders. A review of these orders shows the following:

- All of the divestitures were subject to the prior approval of the Commission.
- The time permitted the respondent to divest varied from one year to two years from the date the order became final with an average time of more than 16 months from the date the order became final.
- Six of the ten divestitures expressly required the respondent to maintain the viability of the assets to be divested.
- Only one of the sets of assets to be divested was required to be held separate by the respondent pending the divestiture.
- None of the orders authorized the Commission to appoint a trustee to divest the assets if the respondent failed to divest within the period required by the Commission.
- None of the orders authorized the Commission to require the divestiture of additional (crown jewel)[8] assets if the respondent failed to divest within the period required by the Commission.

Respondents successfully divested within the required time period in seven of the eight cases; however, in the two orders requiring two sets of assets to be divested, the respondent in each case failed to make a timely divestiture in one of the two. Thus, three of the ten divestitures were late.

In the following six years, fiscal year 1980 through fiscal year 1985, the Commission entered an additional 37 final orders in merger cases. Eleven of the ordered divestitures were completed after the time required in the Commission's orders. All of these divestitures eventually occurred, however, including one that was subject to lengthy litigation and the

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[8] Crown jewel provisions are provisions in an order that provide authority to divest additional assets if the defendant fails to divest within the time period required by the order. In general, the additional assets supplement those in the initial divestiture provision to ensure the saleability of the divestiture package by potentially enlarging the pool of acceptable buyers. For example, where only a product line is required to be divested, the crown jewel provision might require the divestiture of the entire division that makes that product and other products.

[9] *L P C .,* FTC Docket No. C-2956, 93 F.T.C. 308 (1979) (Decision and Order), , 554 F. Supp. 504 (D. Ore. 1982), , 754 F.2d 1445 (9th Cir. 1985), , 654 F. Supp. 962 (D. Ore. 1987) (Commission ordered to reopen order and consider modification), , 846 F.2d 43 (9th Cir. 1988) (district court's order not appealable), , 112 F.T.C. 547 (1989) , 1990-2 Trade Cas. (CCH) ¶ 69,166 (D. Ore. 1990) ($4 million civil penalty reimposed), , 967 F.2d 1372 (9th Cir. 1992).

[10] The total effect of the Commission's merger enforcement effort under the HSR Act was presumably much greater than is reflected in these numbers. In 1979, for example, 14 transactions were abandoned after the Commission issued a request for additional information pursuant to the HSR Act. Moreover, the requirement of premerger notification is likely to have deterred still other parties from undertaking mergers that would receive premerger scrutiny and would be likely to be blocked. *S ,* W. Baer, "Reflections on Twenty Years of Merger Enforcement under the Hart-Scott-Rodino Act," 65 Antitrust Law Journal 825 (1997).

[11] Some of these injunctions matters were ultimately resolved by final Commission orders requiring divestitures, others were either prohibited by the court or abandoned by the parties either before or after litigation of the preliminary injunction action.

[12] *S , . ., F T T (F N*

- to agree to the appointment of a divestiture trustee if the respondent failed to divest within the time required by the order; and,

- to seek and obtain the prior approval of the Commission before acquiring other businesses within the complaint market.[13]

The structure of the Commission's orders in this period, however, exhibits a great deal of variety. In part, this was a consequence of the fact the Commission did not have the experience to determine which provisions, if any, should routinely be included. Also, the case specific negotiations provided parties a forum in which to argue that particular provisions should not be imposed in their case. If a transaction seemed to present a serious threat of competitive harm, but also included significant elements of litigation risk, and the divestiture appeared as if it could be readily accomplished, it may have been most effective to accept a consent order even if it did not contain the most desirable structure. The structure of orders during this period was made more difficult to understand when parties argued the precedential effect of inconsistent settlements. Some parties successfully resisted order provisions on the grounds that it was unfair to impose provisions on them when other orders did not uniformly contain such provisions.

3. Licensing remedies

In the early 1990s, the Bureau of Competition began experimenting with a new type of remedy in merger orders that required the divestiture (or license) of intangible rights in order to facilitate entry by a new competitor. The so-called "licensing remedy" was a departure from existing policy in two ways. First, the effectiveness of the remedy depended largely on the resources, technology, and business ability of the licensee to exploit the intangible rights. Initially, at least, this remedy made no attempt to preserve the "organic integrity" of the business eliminated by the merger. Second, the remedy did not immediately establish a competitor with production capability, customers and market share; instead, it facilitated entry into the market.

C. Authorization of the Divestiture Study

In 1995, the Bureau of Competition and the Bureau of Economics staff developed a project to analyze the efficacy of the Commission's existing divestiture orders. This project combined on-going research efforts by the Compliance Division of the Bureau of Competition and the Economic Policy and Analysis Division of the Bureau of Economics.[14] The limited data

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[13] *M M L*., FTC Docket No. C-3053, 96 F.T.C. 116 (1980) (Decision and Order).

[14] Despite the success of the HSR merger enforcement program, at least a few orders had not resulted in effective relief. For example, in one case the buyer scrapped the divested assets and resold them for a profit rather than go into business. *F*, FTC Docket No. 9148, 102 F.T.C. 1700 (1986) (Decision and Order), , 107 F.T.C. 403 (1986), , 1988-1 Trade Cas. (CCH) ¶ 67,950 (M.D. Ga. 1988), *&*

(continued...)

[14] (...continued)
[illegible], 849 F.2d 551 (11th Cir. 1988), [illegible], 858 F.2d 746 (11th Cir. 1988). In *R[illegible]-P[illegible] S.A.[illegible]*., FTC Docket No. C-3287, 113 F.T.C. 329 (1990) (Decision and Order), Rhone-Poulenc was required to offer a license to any applicant, but no applicants came forward. In another case, the respondent failed to find an acceptable licensee as required by the order. *I[illegible] M[illegible] S.A.*, FTC Docket No. C-3301, 113 F.T.C. 742 (1990) (Decision and Order), [illegible], 117 F.T.C. 473 (1994).

[15] Pursuant to the Paperwork Reduction Act, 44 U.S.C. § 3501 - 3520, the Commission could contact only nine participants before obtaining authority from the Office of Management and Budget to conduct a more extensive study. The pilot study was designed as a case history study, based primarily on open-ended telephone interviews with the buyers of divested assets in each of the nine cases selected for the study. The buyers were cooperative and forthcoming, providing helpful details about the divestiture process from their perspective. *S*[illegible] W. Baer, "Report from the Bureau of Competition," American Bar Assn, Section of Antitrust Law, 1998, for a discussion of the results of the pilot study.

[16] The Commission published its request to conduct the expanded study in the Federal Register on October 31, 1996. In March 1997, OMB granted approval to conduct the study for an initial period through July 1998. In August 1998, OMB granted a renewal of that approval for a period ending on December 31, 1999.

agreements helped or hurt the particular buyers. The case studies allow the staff to refine its identification of order and contract terms and buyer characteristics so as to increase the likelihood that a divestiture remedy will succeed.

1. Almost all required divestitures occurred

Divestitures occurred in each of the 35 orders included in the Study. In some of the orders, multiple buyers were involved. For example, in cases where retail locations were ordered to be divested, there might have been a different buyer for each site. In a case where the assets to be divested included more than one product line, there might have been a different buyer for each line. As a result, in the 35 orders covered by the study, the Commission approved fifty divestitures.[17] As noted, we were able to study 37 of the fifty.

2. Three-quarters of the divestitures studied appear to have been successful

The Study also examined whether, after acquiring the assets, the buyer was able to operate in the relevant market and what effect, if any, the buyer has had in that market. The Study was not designed to conduct a complete competitive analysis of the relevant markets or draw definitive conclusions about how any of these markets are performing. Instead, it attempted to draw conclusions about whether the buyer of the divested assets was able to enter the market and maintain operations.[18] As a result, the interviews focused on more immediate questions: how quickly was the buyer able to begin operations in the market, what was the sales volume of the buyer at the time of divestiture and afterwards, what prices was the buyer charging, has the buyer introduced new products, does the buyer believe that the respondent has reacted to the buyer's entry in the market, and does the buyer consider the divestiture successful. The Study

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[17] In a few orders, there were additional divestitures required that never occurred. In *P*, the order was reopened and modified to eliminate the requirement that the respondent divest five out of the six retail outlets identified in the order. *P*, FTC Docket No. 9228, 113 F.T.C. 372 (1990) (Decision and Order) (modified May 21, 1993; January 28, 1994). The *S.C. J* order was reopened and modified on November 8, 1993, to eliminate the requirement that respondent divest rights to the Renuzit air freshener business outside the United States. Dial, the buyer of the U.S. business, had no operations outside the United States and did not want or need the foreign assets. Following a showing that no other firm was interested in purchasing solely the foreign rights and in consideration of the complaint's allegation of a United States geographic market, the Commission relieved S.C. Johnson of its obligation to divest those foreign rights. *S.C. J & S, I.*, FTC Docket No. C-3418, 116 F.T.C. 184 (1993) (Decision and Order), , 116 F.T.C. 1290 (1993). But these are certainly exceptions, not the rule. Most required divestitures happened in the manner approved by the Commission.

[18] Staff has, however, been mindful of the fact that the success or lack of success of a particular divestiture may be attributable, at least in some part, to competitive conditions that existed at the time the relief was ordered.

[19] Ravenscraft and Scherer, for example, suggest that "roughly a third" of their sample of private transactions were viewed as failures by the acquiring firms. D. Ravenscraft and F.M. Scherer, MERGERS, SELL-OFFS, AND ECONOMIC EFFICIENCY 192-93 (1987). Michael Porter's contemporaneous review of the acquisitions puts the failure rate much higher. He found "more than half" the acquisitions he studied were sold off because they did not meet the acquiring firm's expectations. Porter, "From Competitive Advantage to Corporate Strategy," HARV. BUS. REV. 45 (May-June 1987).

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[20] One additional buyer was entitled to technical assistance post-divestiture but chose not to use it, relying on its own know-how instead.

[21] Of course, those are the very cases in which these continuing relationships were most responsible for the inability of the buyer to compete viably in the market. In seven out of

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Section II.C. below, the information obtained from the case studies allows for some understanding of which types of relationships can be productive and what protections can be written into the Commission's orders or required in the divestiture contracts to maximize the usefulness of the relationships.

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[21] (...continued)
the nine cases labeled "not viable," some sort of relationship between respondent and buyer survived post-divestiture and in some way contributed to the nonviability of the divested assets.

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Although these general findings point toward types of divestitures that should be preferred, they do not provide specific guidance on how to formulate remedies in individual cases where more limited relief is pursued. Accordingly, the Study has examined the individual divestitures to assist in the staff's understanding of problems faced by the buyers of divested assets and how specific provisions of orders and divestiture contracts have helped or hurt the buyers.

C. The Study presents a new view of the dynamics of the divestiture process,

the divested assets were a bargain and they were afraid some other buyer would be chosen by respondent if they haggled. Second, many buyers, including large, apparently sophisticated, multinational corporations, seemed to be unaware of major economic factors in the businesses they were buying. Accordingly, they sometimes agreed to pay too much for the assets that they were acquiring or did not insist upon the transfer of necessary additional assets.

The lessons learned from the Study about the dynamics of the divestiture process have led the staff to alter its role in the process. To a greater or lesser extent, it had assumed a balance of bargaining power and information existed between the respondents and the buyers of divested assets. That presumed balance provided the staff and the Commission with a justification for accepting respondent's proposal when they were accepted by buyers. If the buyers signed purchase agreements and did not complain about what they received, that was evidence that the orders were likely to achieve their intended results. To be sure, the proposed divestiture remedy, the buyer, and the divestiture contract were examined carefully, but the presumption was that the buyer was in a position to adequately defend its interests. The Study suggests that the staff must attempt to balance the bargaining power between the buyers and respondents in order to protect the remedies that the Commission orders.

2. Obstacles to effective divestitures

a. Respondents

Respondents generally did what was required of them by the orders and little more. The buyers, however, reported three kinds of activity that respondents engaged in that could lessen the competitiveness of divested assets in the hands of the buyers: (1) respondents urged the Commission to define too narrowly the package of assets to be divested; (2) respondents urged the Commission to divest the assets to weak buyers; and (3) respondents took actions that diminished the viability of the business acquired by the buyers.

(1) Respondents urge limited divestiture packages

The divestiture package in consent orders is initially defined in a negotiation between the Commission staff and the respondent. With the benefit of the hindsight offered by the Study, it appears that some of the divestiture packages were not adequate to fully achieve the remedial purpose of the Commission's orders.

- **Firm 5** [25] purchased the right to produce three products made by respondent and the equipment on which the products were made, as the order required. It objected, however, that the order should have included a fourth product, which would have given Firm 5 a full line. Firm 5 attempted to negotiate the purchase of the rights to the fourth line from respondent, but respondent refused because the order did not require it. Firm 5 contended

[25] To maintain the confidentiality of the participants in the Divestiture Study, none is identified by name. Instead, each buyer is referred to by a randomly assigned number.

that the order's failure to assure that the buyer would have access to a full line of products made it more difficult for the buyer to compete.

- **Firm 14** acquired from the respondent the technological specifications to produce a product related to Firm 14's product. The order also required respondent to supply critical raw material to Firm 14, but only on a limited basis. Firm 14 stated that it was fatally disadvantaged by the order's limitation on respondent's supply obligations. The restricted supply of indispensable materials prevented the buyer from securing a customer base that might have made the business viable.

- **Firm 22** acquired the assets that respondent was required to divest. The divestiture package, however, primarily involved assets that operated in a market unrelated to the complaint market. Firm 22 pursued the unrelated market to the exclusion of the market the Commission was concerned about.

(2) Respondents may propose weak buyers

Respondents are responsible for finding and proposing an acceptable buyer of the to-be-divested assets and completing the divestiture by the order's deadline. They are not required to choose the person likely to be the strongest buyer, and many buyers reported they had the impression they were chosen because respondent did not expect them to be a strong competitor.[26]

- **Firm 9** acquired the rights to manufacture a product from respondent, but was unsuccessful in its efforts to compete in the sales of that product. Firm 9 believed that it was chosen in part because it was a start-up company with no operational experience. Respondent and Firm 9 made a successful divestiture proposal on the grounds that the president of Firm 9 had significant expertise in the technical aspects of the complex production process and had the business backing of a successful venture capital firm. While the fact that Firm 9 failed does not necessarily mean that the Commission should not have approved the divestiture application, it appears that a firm with more business experience and more funds could have coped better with the problems that caused Firm 9 to fail.

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[26] Of course, the Commission is not required to accept whatever buyer respondent proposes. In fact, the Commission may disapprove a marginally acceptable buyer if a better buyer might be available. For example, where a proposed divestiture to an incumbent in the market would reduce concentration some but not enough to remedy the loss of competition, the Commission has denied the application for divestiture. In reviewing the Commission's decision in *I* [illegible], *I*[illegible]., 106 F.T.C. 312 (1985) to approve a proposed divestiture of a pipeline interest to Teco instead of Valero, the pipeline partner, the district court in *W* [illegible] *T*[illegible] *T*[illegible] *L.P.* [illegible] *. E* [illegible] *C* [illegible]., 1989-1 Trade Cases (CCH) ¶68,424 at 60,334 (W.D. Texas 1988), [illegible] 907 F.2d 1554 (5th Cir. 1990), [illegible] 499 U.S. 906 (1991), stated that "the FTC was entitled to consider which of the competing applications -- Teco's or Valero's would better serve the remedial purposes of the Consent Order." That is, the Commission could approve the better applicant.

critical, even indifference by the respondent to the buyer's success may make the divested business fail.

In contrast to a Commission-ordered divestiture, the buyer and the seller in a commercial sale of a business either have or can construct incentives that provide both with incentives for a successful transfer of the business. For example, where the owner of a business is licensing technology, it has a natural reason to help the buyer successfully enter the business and maximize its sales. The licensor normally benefits from higher sales of the buyer because the licensor will realize higher royalties. Even where the seller makes an outright sale of its interests, the buyer has many ways in which it can tie its payments to the success of the transfer of the business operations. The buyer can use milestone payments based on the successful transfer of technology or insist on loans from the seller that are secured solely by the acquired assets. Similarly, the seller can protect itself by a license termination provision if the buyer does not live up to its obligations.

This section begins with an extended discussion of transactions in which the buyers' lack of information led them to make mistakes when they acquired the divested assets. As noted earlier, the case studies indicate that the buyers had access to less accurate information about the to-be-divested assets than staff had supposed, and the buyers' interests in the assets were not as fully aligned with the Commission as staff had supposed. This discussion is long because the tendency of buyers to make mistakes is so counterintuitive that it requires elaboration to understand the fundamental quality of the errors. The extended discussion of buyer's knowledge is also warranted because that lack of knowledge feeds into other problems faced by buyers and by the staff's reliance on buyers. Lack of knowledge explains, in part, the findings of the

manufacturing costs for the several years that would be required to develop an alternative supply.

- **Firm 8** was a large, successful, diversified company with little manufacturing experience. Because it was one of the likely buyers of the to-be-divested assets, Firm 8 played a role in defining the package of assets to be divested. Firm 8 and other potential buyers asserted that they would be satisfied if respondent were required to divest a key input in the production of the product of concern to the Commission rather than the entire firm respondent was acquiring. Firm 8, which distributed this product, argued that the production process itself was uncomplicated and that it would be better off buying its own production machinery.

  The order required respondent to divest inputs of the buyer's choosing. Firm 8 found that the inputs it selected from respondent's stockpile were defective. In addition, the production machinery it acquired (independent of the order) was inappropriate. As a consequence, it was unable to enter the market of concern to the Commission as quickly as it had intended.

- **Firm 14** was a successful, medium-sized firm that manufactured a single product. It acquired from the respondent technological specifications to manufacture a product related to its single product, machinery to produce the product, and limited rights to acquire amounts of one critical raw material needed to make that product.

  Firm 14 found that the machinery was incompatible with its production process and did not meet federal regulatory standards without certain modifications. Firm 14 was concerned that modifying the machinery would be uneconomic. It also discovered that it could not obtain the critical raw materials it needed for certain products. Respondent would not supply them because the order did not require it to do so. Without the ability to sell these other products, the business could not be profitable. Ultimately, the company abandoned the project entirely.

- **Firm 5,** like Firm 14, was a successful, medium sized, single product manufacturing firm. It acquired from respondent the exclusive right to produce a line of products, rights to acquire production machinery, and technical assistance to operate the machinery. Firm 5 had a choice of production machinery and chose a set that respondent offered at a lower price.

  Firm 5 found that the machinery it chose did not operate as efficiently as the machinery it did not select and that the technical assistance it received was not effective. Firm 5 was, however, able to overcome these problems and manufacture the line of products.

- **Firm 9** was a newly formed corporation headed by an individual with technical expertise in the product and funded by a venture capital company. It acquired from respondent the exclusive right to produce the product and entered into a supply contract with respondent that was to cover the period needed until Firm 9 could develop its own capacity.

Respondent did not deliver the finished product for over a month after the acquisition. Although some compensation was paid, Firm 9 never recovered and went out of business.

- **Firm 16** was a large, successful, technologically sophisticated, diversified manufacturing company. It acquired the rights to a product in development and a supply of the product. The product fit the marketing and sales portfolio of the company well.

  After it acquired the rights, Firm 16 found that it did not have the capability to produce the product. It had made the acquisition without consulting production personnel about the specialized technology needed to produce this product.

In some of these divestitures, the buyers might have avoided the mistakes they made by
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[27] Not all buyers had this perception. Several demanded and received terms that they considered to be advantageous and were not explicitly required by the orders.

would be in their interest. The Study suggests that many of those buyers took those positions because they feared that if they insisted on more favorable terms the respondents would divest the assets to some other bidder.

The buyers of divested assets have been very frank about the mistakes that they have made, and none has even suggested that it knowingly misled the Commission. Nevertheless, it seems likely that buyers knew at the time of negotiations that some contract terms put them at a disadvantage. Presumably, they did not foresee the precise harm; rather, they assumed that they did not need the added protection. They traded away a potential advantage in return for a lower price, or for some other favorable term, or out of fear that some other bidder would be selected. Regardless of the reason, the result has been that some buyers have acquiesced to terms that increased the risks that the Commission's order sought to minimize, while insisting that those terms were not needed.

The insistence on terms that weakened the competitiveness of some buyers was not due to inadvertence; rather the buyers made considered decisions to take risks. It is clear that the buyers considered these issues, because the staff initially opposed specific terms that, in retrospect, could have been foreseen as possibly harmful to the buyers. Staff opposed the terms, not because it had greater knowledge about the businesses, but because of its remedial bias against continuing relationships between competitors. Only because the firms had convinced the staff that they would be good and effective buyers of the to-be-divested assets (a fact that appears to have been true in most cases) was the staff persuaded that the Commission should permit the departures from its institutional bias. The following are cases where divestiture provisions that normally have been opposed by the Commission were accepted at the buyers' urging:

- **Firm 1** and respondent negotiated a divestiture contract that included a provision requiring Firm 1 to sell by-products from the divested plant to the respondent. Staff initially opposed that provision, but Firm 1 argued that taking over the facility was complex, and it needed the assurance for its business plan that the by-products would be sold. Staff ultimately accepted this argument as reasonable, but, in retrospect, it might have been better had staff interpreted this as a sign that Firm 1 had not sufficiently studied the market.

- **Firm 4** negotiated a supply agreement with the respondent that included a limit on the time respondent would supply a necessary component to Firm 4. Staff initially opposed the time limit and argued for a longer supply contract with an option to terminate but Firm 4 argued that it would have an alternative supplier in time. Staff was concerned that the divestiture might fail if Firm 4, contrary to its expectations, was unable to qualify an alternative supplier within the time period. Because staff had no industry specific knowledge, it eventually agreed to support the divestiture contract with the limited supply agreement. Firm 4 suffered competitively when it found it had no replacement supplier at the end of the supply contract.

- **Firm 8** insisted that it could become a more effective competitor if respondent were required to spin off some of its stockpile of key inputs, rather than spin off the fledgling competitor that respondent was acquiring, which was the alternative staff was

considering. Firm 8 also insisted that it did not need to have a transfer of manufacturing technology. Firm 8's subsequent problems in selecting from the stockpile of inputs and

[28] Other buyers in the Study have, however, sought Commission assistance. Firm 4 complained when it had no replacement supplier at the end of the period specified in the divestiture contract. Firm 5 complained that it should have had the right to acquire an associated product to complete its product line. In these two cases, the buyers' complaints were clearly beyond the scope of the applicable order.

business. Although its business was profitable, the divestiture to Firm 22 did not accomplish the remedial purposes of the order.

- **Firm 13** also had a different objective from the Commission's. It acquired the divested assets as part of a multi-year plan to create a business that it would be profitable to resell. It placed few demands on its managers, and thus the assets had little competitive vigor.

- **Firm 7's** acquisition of divested assets should have created a strong competitor. In its interview, Firm 7 described the problems it had encountered in the course of the divestiture, including the realization that it had lost the opportunity to compete on price as a result of failing to stockpile raw materials. Nevertheless, the manager of Firm 7 indicated that the firm's major objective of the transaction had been achieved: Firm 7 now has a complete line so it can compete more effectively on selling its other products. The fact that Firm 7 could not directly challenge respondent for the market in the divested product was of less interest to Firm 7.

The divestiture process should be designed in a way that makes it more likely that the buyer will compete, rather than cooperate, with the respondent after the divestiture is complete. Methods must continue to be developed for reviewing divestitures to distinguish those buyers who are likely to compete from those who are likely either to cooperate or to use the assets for other purposes.

c. Complexities of technology transfers

It is almost always difficult to transfer a business technology unless the individuals who implement the technology also transfer to work for the buyer.

- **Firm 8**, having had no previous manufacturing experience, assumed that with the aid of consultants it could assemble a plant to manufacture the divested product; it thus

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[29] *S , . .,* D. Abell and J. Hammond, STRATEGIC MARKET PLANNING 103-133 (1979).

one reason why divestitures of on-going businesses succeeded more often than divestitures of selected assets. Where an entire business is divested with the personnel who operate it, the knowledge will pass as part of the transaction. Finding ways to make successful and effective

[30] *S P*[illegible], note 17, [illegible].

[31] Where stores have become unviable because of actions by the respondent, the Commission has obtained civil penalties or additional divestitures, or both. *S , . ., FTC . S. M , I .*, Civ. No. 4:97CV01830CEJ (E.D. Mo. 1997) (consent judgment).

[32] The threat of civil penalties for noncompliance with its obligations under the order may provide some incentive for respondents to comply with the order. The Commission has sought and obtained civil penalties in cases where the respondent has failed to divest in a timely fashion *(L P ,* note 9, *; FTC . R A C .*, Civ. No. 98CV00484 (D.D.C. 1998)), where respondent has allowed assets to deteriorate before the divestiture is accomplished *(*see

access to the facilities of both the respondent and the buyer and no concerns about informing the Commission. This is particularly true in cases involving supply agreements in which the respondent agrees to supply in-puts or finished product to the buyer and in cases involving the transfer of complex technology.[34] Recently, the Commission has appointed individuals with technical knowledge of the industry to perform those functions that cannot be accomplished by either the parties individually or the Commission. With the combination of their technical knowledge and their unrestricted access, they can resolve disagreements between the respondent and the buyer and determine whether the respondent is performing its obligations, a matter which may be unclear to the buyer.

This independent observer has generally had a beneficial effect by his or her presence. The auditor trustee creates a basis for trust between parties that do not naturally have a community of interest. Also because of their technical backgrounds, the auditors have sometimes found ways to implement the obligations that the parties themselves had not thought of.

The respondent and the buyer know that the auditor has no reason not to inform the Commission if the auditor believes that the obligations are not being fulfilled. The respondent cannot retaliate against the auditor for filing a truthful report with the Commission. The auditor is also well positioned to report to the Commission if the buyer is failing to follow the business plan submitted to the Commission or otherwise is failing to comply with any conditions of the divestiture.

(2) Require divestiture of a crown jewel if respondent fails to divest during the divestiture period

The case studies suggest that the inclusion of a crown jewel provision may have an impact on the incentives of respondents.[35] To avoid divestiture of the crown jewel, the respondent has an incentive to propose initially a package of assets that is adequate to create a viable competitor and for which an acceptable buyer will be found.

There are several grounds for including a crown jewel. The crown jewel gives the Commission the assurance that should no acceptable buyer be found for the to-be-divested assets, there is a larger, more saleable, package for which an acceptable buyer can be found. In addition, by maintaining the possibility that the respondent may have to divest the crown jewel

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[34] The Commission has also used auditor trustees to monitor hold separate agreements, which are designed both to create an entity that actually competes with the respondent before the divestiture occurs and to create a firewall to prevent the respondent from learning about the operations of the held-separate entity. When properly framed, hold separate agreements can reduce both pre- and post- divestiture competitive harm.

[35] An appropriate crown jewel provision requires divestiture of a freestanding business with a customer base. No respondent subject to a crown jewel provision has ever failed to divest within the time required by the order.

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(1) Assure that the buyer has access to accurate information

The case studies illustrate that the inherent complexity of a business prevents buyers from fully understanding a business before taking over its operation and frequently even after taking it over. However, some of the buyers could have obtained much better information through more thorough due diligence. Had Firm 16 consulted with its production personnel, it would have discovered that it could not produce the product. Firm 7 should have known that the product it was buying had been banned by one state and would require reformulation before it could be sold. In contrast, as noted above, Firm 2 actually tested its capacity to manufacture the product during the due diligence period. Firm 23 went even further and required respondent to make significant modifications to restore the to-be-divested business before it would sign a contract to buy the assets. It is important, therefore, that proposed buyers be given adequate time and an opportunity to conduct full due diligence, because the information buyers gain can greatly improve the likelihood that the divestitures will succeed.

Given that many buyers appear to bid against themselves (probably for fear that respondent may select another bidder), it is not sufficient that buyers merely be given an opportunity to conduct due diligence. Buyers may be reluctant to take full advantage of the opportunity. This perceived inequality in bargaining power may be reconciled in appropriate cases by taking one or more of the following steps:

1. Require the buyer, as a condition of Commission approval, to submit an acceptable business plan for the assets. Developing a persuasive business plan requires a proposed buyer to consider the full operation of the divested business. The business plan also provides a framework for the staff to consider whether the proposed buyer has fully considered the operation of the business. For example, the production people in Firm 16 would have had to be consulted to develop cost projections and presumably would have indicated they could not manufacture the product.

2. Require the buyer, as a condition of Commission approval, to have final and executed contracts with third parties who will supply any necessary inputs or provide services that the proposed buyer does not intend to undertake itself. The case studies indicate some tension concerning the circumstances in which this requirement is suitable. On the one hand, where the buyer is inexperienced and needs the capacities of a knowledgeable manufacturer or distributor, the staff needs assurance that the buyer will have access to such capabilities. On the other hand, buyers frequently lack essential knowledge before they buy. That is how Firm 1 ended up in an unfavorable contract under which it was bound to sell by-products for less than market value. That is also how Firm 9 ended up with the same distributor as the respondent. That distributor decided that since it had a monopoly it could make more money from Firm 9's product by price discriminating and selling it only to the smaller group of customers who could use only Firm 9's product.

The staff must scrutinize third party contracts with great care. In both of the above cases, there were signs of potential problems. Giving monopoly power to Firm 9's distributor invited abuse. Permitting sales of a significant portion of output to respondent should be discouraged unless there is clear proof that it is necessary or harmless. Respondents, too, will take advantage of their greater knowledge of the economics of the transaction. Moreover, as previously noted, buyers may be willing to give back to the respondent some of the benefits of the divestiture package because they assume they will still be getting a bargain. The Commission should therefore reject suspect contracts and insist on divestitures that establish a more independent business operation.

3. Assure that the buyer fully understands the requirements of the Order. The case studies and the experience of the Bureau of Competition have shown that some respondents have proposed deals to the buyers that transfer less than is required by the order and that buyers have not all been aware that their divestiture contract provided them with less than they were entitled to. Informing the buyer of the terms of the order 8TTneTj3nn(thatectlea3)l n(thatoua3eTj3 s5TT

[37] The insight about the critical role of the buyer is not new in the Divestiture Study. It was, for example, one of the major points in Elzinga's 1969 article. *S* note 3, , at 61-66.

(a) The knowledge and experience of the buyer makes a difference

As noted above, the weakness of some of the buyers appears to have resulted from their lack of knowledge. Some paid too much. Some were dependent for assistance on the respondent. Many made other mistakes. The most successful buyers appear to be the ones that know the most about what they were buying.

Frequently, the most knowledgeable and best buyer was the fringe competitor or an entrant extending geographically. Firm 25, for example, who bought a stand alone production facility, already owned another facility in a different geographic market. It took over the new facility, expanded its capacity, and aggressively captured market share without any transitional problems. Firm 32 did essentially the same in a different, but related industry. It installed new operating policies and almost immediately began increasing market share.

In other cases, suppliers or distributors knew enough to be very good buyers. In one case in the study, the order provided an opportunity for the buyer to learn about the industry before it was required to invest in a plant to use the technology it was licensing. The buyer obtained a license to technology from respondent and then was given a number of years in which to build the plant; in the meantime it was supplied with product by respondent. Over that time, it was able to understand the market and did not have to rely on new technology that it did not fully understand.

(b) The degree of the buyer's commitment to the market may make a difference

The staff has insisted on a demonstration of commitment by would-be buyers.[38] Consider the history of Firm 19, which acquired the right to sell a branded product and entered into a supply contract with respondent for a period of time in which the buyer was to develop its own production. Staff discouraged a proposal that would have allowed the buyer to borrow the money from respondent. Had that loan been allowed, the buyer might have made profits during the period of the supply contract and then walked away from the deal with a net profit when the supply arrangement ended. Instead, staff recommended the divestiture contract only after the owner of Firm 19 personally guaranteed the financing. With such a commitment, the only way the buyer could expect to recoup his investment was to plan to operaterecoup iIiell i(thn0he)TjvpturedEto borrow

[38] The term "commitment" is used in the sense that it is used in game theory: an action taken by a party that makes it difficult for that party to alter its position later. *S , . .,* M. Porter, COMPETITIVE STRATEGY 102 - 105 (1980).

they more often have technical expertise that can make them less dependent on assistance from

[40] That is why, for example, crown jewels typically require the inclusion in the divestiture of a full operating unit.

The case studies indicate the buyer may not know what questions it should ask when it is seeking technical assistance. Firm 8, for example, did not know how to pick the right production machinery or raw materials. Firm 5 and Firm 14 each made mistakes when they had choices on which machines to buy. One way to cure the problem of not knowing what questions to ask is to view the equipment in operation. This has the advantage of communicating all of the procedures that are not covered in the manual and provides a benchmark against which to check how well the buyer's machine is working. Again, it is a method of redressing the imbalance of information that favors the respondent and disfavors the buyer.

- Respondent must grant the buyer the right to seek to hire selected people from the merged firm who have important knowledge.

Sometimes there is no fully adequate substitute for experienced personnel. It is the essence of why the transfer of on-going businesses has such a high success rate even though the buyers of those operations also made frequent serious mistakes in their divestiture contracts. The knowledge of individuals can be equally important in technology transfer divestitures. Firm 24's experience provides a small but illustrative example. Firm 24 included a number of former managers of the firm that respondent had acquired. Respondent delivered a set of technical drawings for the product. Because of their previous experience, the former managers knew that some sets of drawings were missing despite protestations that all had been handed over. Firm 15 showed that simply having the right to hire could have the desired effect. It found by interviewing the sales personnel it was entitled to hire that it learned enough about how the operation had been conducted that it did not need to hire any additional employees.

While neither the order nor the contract can require a person to accept work with the buyer, terms in the order or the contract may make it more likely that such persons will accept work with the buyer by waiving nondisclosure or noncompetition agreements and by offering incentives in the form of vesting pension rights and paying bonuses. The order or the contract may also include provisions that effectively preclude the respondent from continuing to employ the individuals and/or rehiring them for a period of time.[41]

d. Summary

Many of the recommendations derived from the Divestiture Study for formulating better divestitures are discussed above, but some topics warrant further iteration here:

1. The order, the divestiture contract, the buyer, and the buyer's business plan should be evaluated in terms of whether the divestiture will restore competition in the complaint market. This means the divested entity must have the same potential and incentives to expand and innovate as the firm that disappeared. It should not

[41] Precluding a person from continuing to work for the respondent is based on the same principle as the noncompetition clause, that is, that the individual's knowledge was gained in association with the intangible property that is being sold and that the value of that property is diminished if the employee is allowed to work for a person who is not the holder of the property.

[42] Some of the buyers in the Study discussed with staff their concerns in connection with the amount of time that elapsed between the time they signed an agreement with respondent and the time the agreement was finally approved by the Commission. One interviewee specifically discussed the problems associated with the deterioration of the to-be-divested assets that occurred before an acceptable buyer was approved.

[43] The 12 months from the time the order became final often became 15 months from the time the respondent negotiated the terms of the order and executed the Agreement

1995, to six months after the order became final in fiscal year 1996, and three months after the order became final in fiscal years 1997 and 1998.[45]

B. Orders in pharmaceutical cases

Contemporaneously with the Divestiture Study, the Commission entered a series of orders against pharmaceutical and health product companies.[46] These orders included new provisions, such as the auditor trustee and the redivestiture requirement (if the buyer fails to gain FDA approval to produce the divested product, the product reverts to respondent and respondent must redivest). The new provisions in these pharmaceutical orders suggested solutions for more widespread problems identified in the Divestiture Study. At the same time, the case studies helped to develop remedial ideas for the pharmaceutical orders.

The pharmaceutical orders played an important role in the development of the divestiture remedies because they posed, in a more obvious form, some of the difficulties found in the Study. The pharmaceutical mergers proposed to combine very large companies that operated in many markets but posed serious antitrust concerns in only one or two markets. Generally there were no manufacturing assets or employees that were dedicated to the products that were to be divested because the products were manufactured in plant that produced many products. Consequently, it was impossible to divest an ongoing business if the divestiture was to be limited to the products that created competitive concerns. Even more troublesome was the fact that the Commission could not be assured that the buyer would be able to produce the product until the buyer received FDA approval, an approval process that might take years. Consistent with the Commission's efforts to allow firms to realize efficiencies through mergers, staff explored ways of protecting competition while permitting the mergers.[47]

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45 *S* W. Baer, "Report from the Bureau of Competition," American Bar Assn, Section of Antitrust Law, 1998.

46 *R H , L* ., FTC Docket No. C-3809, (May 22, 1998) (Decision and Order); *A H P* , FTC Docket No. C-3740, 123 F.T.C. 1279 (1997) (Decision and Order); *G -G L* ., C-3725 (Mar. 24, 1997) (Decision and Order); and *G* , FTC Docket No. C-3586, 119 F.T.C. 815 (1995) (Decision and Order).

47 The acceptance of licensing remedies in these cases is part of a broader Commission policy to support innovation and efficiencies through its merger enforcement program. The 1997 revisions to 1992 Horizontal Merger Guidelines further explained circumstances in which a demonstration of merger specific efficiencies could overcome a presumption that a proposed merger was unlawful. These revisions were based in part on the earlier Commission report on "Competition Policy in the New High-Tech, Global Marketplace." One of its major conclusions was that including efficiencies in its analysis of mergers was appropriate under the antitrust laws and was beneficial for the economy. The greater sensitivity to efficiencies has supported the growth of licensing remedies and other partial divestitures that facilitate new entry in a market while also permitting merging parties to seek the benefits from mergers. The Divestiture Study has provided some insights into why some of these orders have (continued...)

[47] (...continued)
been more effective than others.

The search for solutions that permit companies to seek synergies and other efficiencies from mergers and also prevent competitive harms will continue on a case-by-case basis. In each industry, the adequacy of a proposed divestitures will be measured by the risks associated with the transfer of a competitively viable business. This cannot result in a fully uniform set of orders because the risks and burdens of the orders will vary with the facts of particular transactions. Only the objective remains the same: to maintain the competition that otherwise would be eliminated by the merger. The case studies provide insights into how divestitures can maintain or create viable and competitive entities that meet that objective.