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REMEDY OPTIONS IN MERGER CASES

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Thank you. It is a great pleasure to be here at the invitation of the Detroit Chapter of the Federal Bar Association. At the outset, I would like to emphasize that today I am speaking only for myself, not for other commissioners nor for the Commission as a whole.

Today I would like to talk about remedies -- more particularly, remedies in merger cases. Selection of a proper remedy is a problem in virtually every merger case, whether the merging firms are hospitals, health equipment suppliers or companies in any other industry. Recently, the Commission has been exploring ways to make our remedies in cases involving anticompetitive mergers more effective. Our interest was kindled by the recent failure of several Commission divestitures that were ordered years ago.

This has proved to be a surprisingly difficult area. Although we certainly have not solved all the problems, we have

made significant progress in developing a policy that can be consistently applied.

Before discussing new options, let me briefly review the Commission's traditional practice in developing a merger remedy. The staff typically would identify a competitive problem, and where the acquiring company was willing, the staff would negotiate a consent agreement. In such an agreement, the acquiring firm would promise to sell overlapping assets within a specified period of time after the merger, but too often its enthusiasm for divestiture would wane as soon as the merger was completed.

In a number of cases, one of which I will describe in more detail, the acquiring firm's willingness and incentive to live up to its divestiture commitment disappeared as soon as the merger was completed. The acquiring firm, having already swallowed up its former competitor, would drag its feet. This not only delayed the restoration of competition, but sometimes also resulted in a gradual deterioration of the assets to be sold,

which reduced the likelihood of a successful divestiture. The problem was simply that once the merger went through, the acquiring firm had every incentive to delay and had few incentives to complete the promised divestiture.

Recently, at the Commission, we have insisted on the inclusion of provisions in consent agreements to reverse this perverse incentive structure. These provisions include hold separate arrangements that require the assets to be kept intact for divestiture, trusteeship clauses that provide for a forced sale in the event that the acquiring firm does not find a buyer, and crown jewel clauses that add assets to a divestiture package to make sure that it is saleable.

One approach that initially seemed to offer serious possibilities as an all-purpose solution to the lack of appropriate incentives under traditional Commission orders is called "fix-it-first". As our staff explored that policy, however, we found that it has been difficult to apply on a consistent basis. Fix-it-first is relatively draconian, and in

cases where it works a real unfairness, it is difficult for an enforcement agency to adhere to the policy. A fairness exception, however, has the tendency to become the rule rather than the exception because parties always have a reason why a merger needs to be done quickly.

I. WHY HAS THE COMMISSION NEEDED NEW MERGER REMEDIES?

Delays and the absence of sound incentives have caused problems with traditional Commission consent orders, which were merely promises by the acquiring party to divest sufficient assets to restore competition diminished by the merger. The Commission is still coping with problems caused by acceptance many years ago of such promises without adequate safeguards to ensure that they were carried out. I am going to talk about one case, Owens-Corning Fiberglas Corporation, as an example of a recurring problem.

The OCF matter actually began more than ten years ago with the acquisition on April 20, 1977, by Owens Corning Fiberglas Corporation of the assets of the Lloyd A. Fry Roofing Company.

Prior to the acquisition, OCF was the nation's largest manufacturer of asphalt roofing products, and Fry was the largest privately held producer of such products. The Commission investigation indicated that the market was highly concentrated, and the Commission found reason to believe that the merger would have an anticompetitive effect, particularly in the West. OCF consented to entry of an order requiring it to divest four asphalt roofing plants in Oregon, Washington, California, and Utah within two years. The order was entered on March 30, 1981. Owens-Corning Fiberglas Corp., 97 F.T.C. 249 (1981).

As it turned out, OCF failed to divest the four plants within the agreed upon two-year period. The Commission then sued OCF in federal district court for civil penalties for violation of the order. Subsequently, OCF consented to a federal court judgment, requiring it to pay a civil penalty of $800,000, and also requiring the appointment by the district court of a trustee to sell the plants within a nine-month period. Federal Trade Commission v. Owens-Corning Fiberglas Corp., Civ. No. 84-

7635 (N.D. Ohio July 27, 1984). The judgment was entered in July 1984. Although the civil penalty case was successful, more than three years had elapsed between entry of the Commission's consent order and the district court order.

The trustee for the OCF assets was appointed in August 1984, and was able to find only one purchaser for the asphalt roofing plants. That company, U.S. Roofing, planned to make a de novo entry into the asphalt roofing business. It was the brainchild of an individual who had managed to secure private financing. Although it was a close call whether the firm would succeed and replace the competition lost as a result of the acquisition of the Lloyd A. Fry Roofing Company, the Commission decided that U.S. Roofing could survive and compete, and it approved the divestiture on November 1, 1985.

Under the terms of the district court's final judgment, the court conducted a de novo review of the Commission's decision to approve a divestiture. This occurred because the trusteeship was imposed as part of a settlement of a civil penalty proceeding

in district court. In February 1987, the court overturned the Commission's decision and rejected U.S. Roofing as a suitable buyer of the asphalt roofing plants. Federal Trade Commission v. Owens-Corning Fiberglas Corp., Civil No. 84-7635 (N. D. Ohio Feb. 2, 1987).

The Commission decided not to appeal the district court order, but that does not mean that we were satisfied with the outcome. The consent order in the Owens Corning Fiberglas matter had many failings, but a problem common to many unsuccessful consent orders is that the package of assets to be divested do not attract widespread buyer interest. Looking back, it is difficult to be certain why the assets did not attract buyer interest. Demand for roofing plants may not have been strong, but it is far from certain that the proposed sale was doomed from the outset. Some buyers were in the market in the early 1980's, but they eventually found something else. If there had been a highly motivated seller, the roofing plants might very well have

been sold and might have offered renewed competition in the industry.

II. HOW CAN DIVESTITURE ORDERS BE MORE EFFECTIVE?

Although we have had problems with consent orders, I am not prepared to abandon orders as a remedy in merger cases. Instead, I prefer to identify the problems with past orders and craft provisions to avoid the same mistake. We have identified several problems and have developed several solutions for those problems. One problem is that some acquiring firms have delayed effecting a sale once a merger is completed. A trusteeship clause, requiring a forced sale after a designated period, addresses this problem. In other situations, the assets have deteriorated during the search for a buyer, but a hold separate agreement addresses this problem. Finally, a difficult problem is that a package of assets may not attract buyer interest because the package lacks some asset essential to make the enterprise successful. A "crown jewel" clause allows the Commission to add assets to a package of assets to be divested to make the package more marketable. These

are all solutions that the staff at the Commission has developed to overcome specific problems, and all have considerable promise in making divestiture orders effective.

Under a hold separate agreement, the acquiring firm agrees to hold the acquired assets together as an independent and on-going business pending divestiture and to keep it separate from the firm's other businesses. The agreement may apply to the entire acquired entity or to discrete business units such as a subsidiary or possibly a division. Such agreements require that the acquiror not mingle these assets with its own and that it keep the business going so that a new owner can step in and take over a viable entity. Provisions to prevent the replacement of key employees and executives are sometimes needed.

A trusteeship provision is fairly simple and should become a routine part of FTC divestiture orders. Basically, the clause provides that if the acquiring firm does not sell the assets within a fixed period of time, a trustee will be appointed to sell the assets. No limitation as to price or terms is imposed

on the trustee. Moreover, the Commission retains authority to approve or disapprove any sale negotiated by the trustee. This authority gives the Commission the opportunity to assess whether the new owner will supply the competition lost as a result of the merger and to reject bids from pure asset liquidators.

A "crown jewel" provision has been included in a few recent Commission orders, and although it is not yet standard, has a great deal of promise as an enforcement provision. These clauses are designed to ensure that the asset package offered for sale will attract buyers. Under a crown jewel clause, if the original asset package fails to sell promptly, then other, highly desirable assets are taken from the acquiror and added to the divestiture package in order to attract buyer interest.

Often an acquiring company will express optimism about effecting a procompetitive sale of a group of assets. Even if the Commission staff questions whether those assets will sell, there is an impetus to accept the proposal because the Commission does not want to force a company to sell off anything more than

is necessary to maintain competition in the relevant market. "Crown jewel" clauses provide flexibility and incentive in this situation. The clauses gives us the flexibility to allow the acquiring firm an opportunity to try to sell off its proposed package of assets, but reassures the Commission that if the proposed divestiture fails to occur, then the package of assets can be sufficiently sweetened to make the sale. In addition, a crown jewel clause gives the selling firm a strong incentive to exert every possible effort to sell the asset package it proposed.

The Justice Department has used one clause that the Commission has not yet attempted to obtain -- namely, an agreement by the merging parties that they will not raise any claim of hardship as a grounds for requesting that a district court modify the decree. I think we should give serious thought to adding a clause of this sort to our consent orders in merger cases. I suspect that some of our troubles with agreements to divest have come about because the incentives have too often been

weighted in favor of stalling and delay in the hopes that in a few years a Commission, perhaps one composed of new members, will be more sympathetic.

These clauses are only examples of the types of provisions that our staff has developed to ensure that a divestiture agreement in a consent order will be a success. But success in achieving divestiture is not our only concern. Just as importantly, the Commission must evaluate whether a proposed divestiture is likely to succeed in restoring competition lost as a result of a merger. In reviewing mergers under the Hart-Scott-Rodino Act, most of our efforts have gone into evaluating whether a proposed transaction is likely to reduce competition, but the staff generally obtains information about trends in the relevant industry, the success or failures of other entrants, fringe firms with potential interest in and expertise for expansion, and other pertinent circumstances. While the Commission can never, and should never, attempt to replace free market decisions with its own guesses, it has the tools to

provide a realistic assessment whether a divestiture proposal has a serious prospect of success.

III. IS FIX-IT-FIRST AN EFFECTIVE REMEDY?

"Fix-it-first" is a relatively new remedial approach in merger cases. The term "fix-it-first" does not have a precise, uniformly accepted meaning. In its purest form, it seems to mean that the antitrust enforcement agency will seek a preliminary injunction to block a merger unless the parties present it with a merger without anticompetitive consequences. The term has also been used to describe a merger remedy in which the parties agree to effect a divestiture without a formal order more or less contemporaneously with the merger.

Although "fix-it-first" has some superficial appeal, it suffers from the problem that it is unnecessarily harsh in some situations. Because of this harshness, the policy is difficult to adhere to in all cases, and once an exception is made it becomes too easy for enforcers to expand the exception to include politically sensitive cases that require a tough approach.

The Federal Trade Commission has relatively little experience with fix-it-first, which was an innovation of the Department of Justice. Although I cannot speak first-hand about the Department's experience in the development of the policy, the Commission staff has recently reviewed the policy as part of a broader examination of merger remedies. Sandy Litvak, formerly the Assistant Attorney General for the Antitrust Division, publicly described the then-new policy at a speech in late 1980.[1] He took the position that the merging firms had the responsibility to divest the assets needed to cure any antitrust problems and that the Department would no longer accept promises of future divestitures as part of consent orders.

From the outset, merging firms argued strongly, and sometimes successfully, that the policy was too harsh. In the Baldwin-United/MGIC case, the Department issued a press release,

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[1] Remarks by Sanford M. Litvack, Assistant Attorney General, Directions in Antitrust Division Enforcement, before the Fourteenth New England Antitrust Conference, at 5-8 (November 14, 1980).

explaining a departure from the general fix-it-first policy.[2] Since the subsidiary to be divested had a history of independent operation, the divestiture appeared to be easy to accomplish, and Baldwin claimed that it was on the brink of business failure, an exception was allowed. Fairness and ease of divestiture thus were formally recognized as an exception to the policy.

Although the fairness exception to the fix-it-first policy may have been a justifiable accommodation to the interests of the parties, the Department was criticized for making exceptions without such clear justifications.[3] In particular, the big steel merger between LTV and Republic was cleared on the basis of a consent order containing promises of future divestiture. There, it was not so clear that the assets could easily be divested, but insistence on a premerger solution to the competition problems might have been unpopular in an industry that had

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[2] DOJ Press Release, February 8, 1982.

[3] Taylor, Bending of the 'Fix-It-First Rule' in Mergers Drawing Criticism to Justice Department, Wall Street Journal, February 9, 1983, at 33, col. 4.

suffered an economic decline and severe unemployment as a result of foreign competition.

Since the early 1980's, the Department appears to be applying fix-it-first on an _ad hoc_ basis. In some recent cases, the Department has accepted consent decrees, and in others it apparently has obtained fix-it-first remedies.

My reason for recounting the Justice Department's experience with fix-it-first is to make the point that the policy is not a panacea for all the problems of crafting a merger remedy. The term has a catchy ring, but it is too easy to seize on it as the easy solution to the extraordinarily difficult problem of developing a workable merger remedy.

The big drawback of fix-it-first is its rigidity in placing a solution to antitrust issues at the top of the list of issues that the parties must resolve. The "fairness" exception to the Department's fix-it-first policy evolved because it is difficult always to insist that curing antitrust problems should outweigh other legitimate interests. Some transactions depend on tax

consequences that may be lost if the deals are not consummated by a date certain. Other acquisitions are time critical for a host of reasons, such as a founder's estate planning or business conditions. When time is critical, if antitrust enforcers insist on a premerger fix, the selling party may unfairly be deprived of the full value of his assets by being forced either to make a distress sale or to forego the merger altogether.

IV. WE NEED STRONG REMEDIES AND WE NEED ACCOUNTABILITY

The Commission is committed to developing effective approaches to solving the competitive problems posed by mergers. We have started to use some new approaches and our efforts are continuing. Although I should emphasize again that I do not speak for the Commission as a collegial body, I do think that a consensus on some issues appears to be emerging.

If we have learned anything from our experience, I think it is that we should not accept any consent order that does not contain strong, enforceable provisions guaranteeing that the promised divestitures will be made. One of the most difficult

decisions that the Commission can make is to initiate federal court litigation to enjoin a merger if there is any real prospect of a peaceful accommodation. This is particularly true if the case is complex and difficult and the outcome uncertain. Although it is easy to declare victory and accept a toothless consent order, _OCF_ and other cases demonstrate that we are better off fighting than ducking the issue. Whether a preliminary injunction case is won or lost, it is decided clearly and quickly without the large and fruitless expenditure of staff resources that were consumed in the _OCF_ matter between 1981 and 1987.

In my view, our past problems with some consent orders do not justify abandonment of orders in favor of fix-it-first. Experience with fix-it-first demonstrates that it is well nigh impossible to impose the policy consistently for all divestitures. I strongly favor issuing consent orders in all cases where the staff and parties have worked out a solution to the competitive problems of a merger. As I see it, when the parties begin to talk with the FTC staff concerning either the

nature and extent of antitrust problems or possible remedies, a critical point has been reached, requiring a formal Commission review of the action.

While a Hart-Scott-Rodino filing is pending before the Commission, the merging parties may independently identify an antitrust issue and resolve independently to correct it. If so, the parties may chose to withdraw the filing (upon the abrogation of any contracts that gave rise to an obligation to file) and on their own to resolve antitrust problems. If the parties refile a competitively unobjectionable premerger notification, then I doubt that the Commission would ever challenge the transaction.

An important difference exists, however, between a purely private decision to correct an antitrust problem and a solution worked out after consultation or negotiation with the Commission or its staff. Whether a party responds to a gentle staff suggestion or formally negotiates an agreement after the staff advises that it will recommend that the Commission seek to enjoin a transaction, the fact is that governmental pressure has been

brought to bear in order to change a private business decision. Once that pressure has been applied, I believe that the Commission should seek a public order, primarily as a check on the Commission's own discretion.

If the Commission decides to file a district court action for a preliminary injunction or to issue an administrative complaint, the federal courts ensure that the Commission properly applies Section 7 of the Clayton Act and Section 5 of the FTC Act. Settlements between the Commission and the parties are not subject to federal court review, and the only possible check on the Commission's discretion is Congressional scrutiny. The Commission's consent order process ensures that the settlement will be public and affords an opportunity for public comment and for Congressional review.

One potential problem with insistence on consent orders is that orders take time. Probably the best feature of the fix-it-first remedy is that it forces the parties to locate and come to terms with a purchaser of the divested assets right away while

they are most anxious to complete the merger. This has the beneficial side effects of reducing the uncertainty for the employees of the divested segment and reducing the likelihood that key employees or important customers will defect during the search for a buyer. Under current Commission rules, a comment period of 60 days occurs during acceptance of the consent order, and a 30-day period (sometimes concurrent) is for comment on the proposed divestiture. One possibility is to reduce the length of the comment period for consent orders in merger cases. In light of the short deadlines in Hart-Scott-Rodino matters, shortening the comment period may well be appropriate.

V. CONCLUSION

Cases like OCF clearly demonstrate that traditional consent orders that merely record promises of future divestiture may cause more problems than they solve. Once the merger has been consummated, the incentives of the parties to divest wane, and the parties may actually stall in the hope of avoiding divestiture altogether. It is difficult sometimes to evaluate

whether a group of assets will be attractive to purchasers or not.

The appropriate way to resolve these problems with past orders is to address them one by one. Hold separate agreements, trustee clauses and "crown jewel" provisions appear to solve the most prominent problems with consent orders. I see no reason to try a wholly different approach, such as fix-it-first, which itself has a whole set of problems.

After considering our options, I think that we should continue to obtain consent orders as the general rule. We must insist on strong guarantees that a promised divestiture will take place. Simple promises of future divestiture have caused us so much trouble that I am inclined to think that, win or lose, we are better off filing for a preliminary injunction to block the merger than accepting a toothless consent agreement.