PUBLIC

UNITED STATES OF AMERICA
BEFORE THE FEDERAL TRADE COMMISSION

COMMISSIONERS:	**Joseph J. Simons, Chairman** **Noah Joshua Phillips** **Rohit Chopra** **Rebecca Kelly Slaughter** **Christine S. Wilson**

In the Matter of **Otto Bock HealthCare North America, Inc.,** **a corporation.**	**Docket No. 9378**

RESPONDENT'S REPLY BRIEF

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The following abbreviations and citation forms are used in this Reply Brief:

CCAB	CC's Answering Appeal Brief
CCPF	CC's Proposed Findings of Fact
ID	Initial Decision
IDFOF	Findings of Fact in Initial Decision
PX	CC's Exhibit
RAB	Respondent's Appeal Brief
RPF	Respondent's Proposed Findings of Fact
RBR	Respondent's Post-Trial Brief
RRBR	Respondent's Post-Trial Reply Brief
RCCPF	Respondent's Replies to CC's Proposed Findings of Fact
Tr.	Hearing Transcript

INTRODUCTION[1]

The ID is fundamentally flawed from both a legal and factual perspective. CC's Answering Brief repeats the ALJ's erroneous findings, but fails to adequately respond to, or engage with, the issues raised by Respondent in this appeal. Relying solely on HHI calculations, CC asserts that this case is not a "close call," effectively arguing in favor of a standard for presumptions that may never be rebutted if HHI changes are high enough. Accepting that view would render well-developed merger analysis, including the *Merger Guidelines*, virtually meaningless.

CC is not as a matter of law entitled to a victory based on HHI calculations alone. Well-established law is very clear that, in unilateral effects cases involving differentiated products, the existence of non-merging firms with capacity to timely, likely, and sufficiently fill any competitive void alone should end the government's challenge to the transaction. CC glosses over this legal hurdle by instead pointing to outdated and unreliable *preferences* of a very *small* number of MPK customers and ignoring the critical issue of whether a "significant fraction" of customers consider Ottobock and Freedom MPKs as "next-best" choices *and* would not switch to rival MPKs following a post-Acquisition price increase by Respondent. The evidence is effectively indisputable that no such "significant fraction" exists. Indeed,

In addition, the MPK Divestiture dismantles CC's HHI-based case entirely because the planned divestiture results in no HHI increase. The ALJ erroneously failed to consider the MPK

[1] Capitalized terms not otherwise defined in this Reply Brief shall have the same meaning assigned in Respondent's Appeal Brief.

Divestiture in determining whether any change in HHI warrants a presumption of harm in this case. Even for a consummated merger, where, as here, there is empirical evidence of no actual post-merger harm, a planned divestiture should be considered *before* determining whether the government is entitled to a presumption. The competitive landscape has been preserved with Freedom operating entirely independent of, and competing vigorously against, Ottobock since closing, which brings this case in line with comparable unconsummated merger cases considering planned divestitures in calculating HHI. CC ignores this important point and asks that the MPK Divestiture be ignored in determining whether the government is entitled to a presumption of harm. The Commission should reject that view.

CC's responses to the other issues raised in this appeal are similarly unavailing. The Commission should vacate the ID and grant relief in the form requested by Respondent.

ARGUMENT

I. LACK OF UNILATERAL EFFECTS EVIDENCE ALONE PROVES THE ACQUISITION WAS LEGAL.

A. HHI Statistics Alone Should Not Give Rise to a Strong Presumption of Harm.

The Commission should decline to apply a strong presumption of unilateral harm based solely on market concentration for two reasons. *First*, "a strong presumption of anticompetitive effects based on market concentration is especially problematic in a differentiated products unilateral effects context," like the market alleged here. *U.S. v. Oracle Corp.*, 331 F. Supp. 2d 1098, 1122 (N.D. Cal. 2004). *Second*, HHI changes should not give rise to a presumption—let alone a strong one—in the absence of any correlation between market share and market power. *See, e.g.*, *ProMedica Health System, Inc. v. FTC*, 749 F.3d 559, 569-570 (6th Cir. 2014) (applying presumption of illegality due to "exceptional" correlation between market share and pricing power).

Here, there is no correlation between market share and pricing power. Undisputed evidence shows that Ottobock lacked market power even when it had a virtual monopoly on MPKs. IDFOF 488-489. Other factors further nullify any probability of consumer harm from the Acquisition, such as the ability of customers to quickly and easily switch to rival MPKs and the total lack of barriers to expansion. *See Hospital Corp. of Am. v. FTC*, 807 F.2d 1381, 1388-1389 (7th Cir. 1986). Therefore, it would be contrary to sound legal and economic principles to presume that any post-Acquisition change in market share will have unilateral effects in the MPK market.

B. The Acquisition Does Not Enhance Market Power, and Unilateral Harm is Unlikely.

1. The ALJ Did Not Conclude that MPKs Sold by Ottobock and Freedom are Close Substitutes.

The ALJ did not find that Ottobock and Freedom MPKs are "close substitutes." The ALJ found (erroneously) that: (i) C-Leg and Plié are the "two top choices for MPKs" for a significant fraction of customers; (ii) Ottobock and Freedom MPKs are "direct competitors"; and (iii) such competition has helped clinic customers negotiate lower prices and has spurred MPK innovation. ID 39-49. The ALJ did not consider what the "next-best choice" for these customers is or which MPK rivals they would turn to after a price increase. *Merger Guidelines* § 6.1. The distinction is critical, and the error is fatal.

The U.S. cola market is an illustrative example of a differentiated product market. *See ProMedica*, 749 F.3d at 569. Even though the top two choices for cola at a significant fraction of stores may be Coca-Cola and RC Cola, that fact alone sheds no light on whether those customers consider Coca-Cola to be the "next-best choice" to RC Cola, or vice versa. Common sense would indicate that Coca-Cola customers' "next-best choice" would likely be Pepsi whereas RC Cola's customers' "next-best choice" would likely be another value brand, like Shasta. And proper analysis of a hypothetical merger of Coca-Cola and RC Cola would require an assessment of the

critical question whether RC Cola uniquely constrains Coca-Cola's pricing and vice versa—not whether they are simply the "top two choices" for some customers. *See* David Scheffman & Joseph Simons, *Unilateral Effects for Differentiated Products: Theory, Assumptions and Research*, Antitrust Source (April 2010) (outlining similar illustration); Gregory J. Werden & George A. Rozanksi, *The Application of Section 7 to Differentiated Products Industries: The Market Definition Dilemma*, 8 Antitrust 40, 41 (Summer 1994) ("[T]here is no reason why the shares in any delineated market in a differentiated products industry are indicative of the relative importance of each merging firm as a direct competitor of the other.").

The *Merger Guidelines* and courts demand an analysis of the degree to which the merging products compete as well as the relative distance between those products and the offerings of non-merging parties. *U.S. v. H&R Block, Inc.*, 833 F. Supp. 2d 50, 81 (D.D.C. 2011) (adopting analysis from *FTC v. CCC Holdings, Inc.,* 605 F. Supp. 2d 26, 68 (D.D.C. 2009)); *Oracle*, 331 F. Supp. 2d at 1117-1118. Differentiated products, by definition, appeal variably to different customers; therefore, "a plaintiff must prove not only that the merging firms produce close substitutes, but also that other options available to the buyer are so different that the merging firms likely will not be constrained from acting anticompetitively." *Id.* at 1117. Indeed, "a plaintiff must demonstrate that the merging parties would enjoy a post-merger monopoly or dominant position," at least for some "significant" fraction of customers. *Id.* at 1118. The ALJ did not conclude that such a "significant" fraction exists in this case.

2. There is No Reliable Evidence that a Significant Fraction of Customers Consider C-Leg and Plié the Next-Best Choice.

The ALJ points to testimony of only four clinic employees for the proposition that the C-Leg and Plié are the "top two MPK choices" for those clinics. ID 41. The Commission should reject that testimony as unreliable and unfounded on the question of MPK choice because at least

three of these witnesses do not make decisions about MPK purchases. The ALJ recognized this point during his questioning of the witnesses at trial, but entirely ignored their lack of foundation in the ID:

.[2]

> ALJ: At the center, who makes the decision on what knee will be ordered?
>
> Senn: The practitioner.
>
> ALJ: Who's the practitioner?
>
> Senn: The clinician that's working directly with the patient.

Senn, Tr. 205-206.

> ALJ: And what is your involvement in purchasing the MPKs for your company? What's your level of involvement?
>
> Ford: I'm not – a high level. The clinicians are the ones who actually will make the final decision about the products, and they are the ones who place the orders.

Ford, Tr. 941-942. None of these witnesses are clinicians, and therefore none offer any factual support for the ALJ's erroneous finding. RAB 12, 15-16; RCCPF 565. The only witness relied upon for this point that actually chooses MPKs is Ell from Mid-Missouri, but his clinic only purchases 10-20 MPKs per year and certainly does not represent anywhere near a "significant fraction" of customers given that clinics purchase thousands of MPKs a year in the United States.

[2] Asar is the CEO of Hanger, which employs at least 800 clinicians, It was clear error for the ALJ to rely on the testimony of Hanger's non-prosthetist CEO as representative of

CCPF 3246. Moreover, there is insufficient evidence that Mid-Missouri would not turn to MPK rivals if Respondent increases MPK prices. RCCPF 530, 1159; RPF 747-776.

Reliance on such unreliable and non-representative small samples of evidence to establish much broader propositions have been specifically rejected in merger litigation. For example, in *CCC Holdings*, the court sharply criticized reliance on "a total of eighteen bidding contests out of approximately 400 that occurred during that time span" as too small a fraction to represent the "entire insurance market." 605 F. Supp. 2d at 70.

Further, in *H&R Block*, the court analyzed the extent of direct competition between merging parties by relying on *voluminous* evidence that H&R Block lowered prices and changed product offerings specifically to better compete with TaxACT. 833 F. Supp. 2d at 81-82. Here, there is no evidence that Ottobock ever lowered the price of the C-Leg 4 to compete with Plié, or that Plié put downward pricing pressure on C-Leg. RPF 607-616, 646-687. Ottobock primarily considers the prices of Össur's MPKs when setting C-Leg 4 prices. RPF 680-687. Moreover, the undisputed evidence shows that there is not a single feature in the Plié 3 that Ottobock had not already started implementing in 2012, more than two years *before* Plié 3's 2014 launch. RCCPF 1011.

Finally, there is no reliable econometric support for the conclusion that customers are unlikely to turn to rival MPKs after a price increase. The ALJ declined to credit CC's expert's GUPPI analysis for good reason. The foreign M&A employee that provided preliminary diversion estimates in an early draft deck, Alex Gück, testified that the numbers were nothing more than "[REDACTED] [REDACTED]" and were predicated on [REDACTED] [REDACTED] RCCPF 1362; *see U.S. v. AT&T Inc.*, 310 F. Supp. 3d 161, 235-237 (D.D.C. 2018), *aff'd*, 916 F.3d 1029 (D.C. Cir. 2019) (discrediting unreliable diversion estimates).

Ottobock's then-CEO confirmed the unreliability of these estimates at trial, testifying that there was " " about them and that they were based only on " ." RCCPF 1362-1364.

In reality, demand conditions prevent Ottobock from increasing MPK prices. RCCPF 803-806. When Ottobock had more-complete margin, cost, and pricing data from Freedom and could better assess diversion and recapture rates, . RCCPF 1362-1364; RPF 1540-1545. The U.S. executive with the most first-hand knowledge of these considerations testified that it would have made " " to . RCCPF 1362-1364, 1389. This fact is corroborated by empirical evidence that Respondent lowered MPK prices post-Acquisition. RCCPF 804.

3. Non-Merging Rivals Offer Close Substitutes for C-Leg and Plié.

The Commission should reject the notion espoused by CC that Össur, Endolite, and Proteor somehow do not present competitive alternatives to Ottobock and Freedom MPKs based on a small sample of self-interested, unreliable witnesses. RAB 12-13, 15-16. "Drawing generalized conclusions about an extremely heterogeneous customer market based upon testimony from a small sample is not only unreliable, it is nearly impossible." *Oracle*, 331 F. Supp. 2d at 1167 (citing *U.S. v. Sungard Data Sys.*, 172 F. Supp. 2d 172, 182-183 (D.D.C. 2001)); *see also CCC Holdings*, 605 F. Supp. 2d at 68-71. Further, the most persuasive evidence from clinics is not their mild preferences, but what they would do in the market in the face of a price increase. *See id.* The evidence shows that clinics could, and would, turn to rival MPKs if Respondent increases MPK prices. RPF 747-776.

Össur, Endolite, and Proteor each currently offer MPKs ({) that are comparable or better substitutes for the MPKs of the merging parties.

RPF 795, 807, 820-822, 892-896. The most significant characteristic identified at trial that constitutes a significant difference between MPKs is the lack of variable-resistance microprocessor control in *Freedom's* MPK. RPF 168-173. According to overwhelming clinical research and industry testimony, such control is the most important functionality in an MPK, and Plié does not have it. RPF 390-391. Instead it offers only fixed-resistance through the use of a pump and wrench. RPF 7. The fact that different MPKs use different fluids to provide variable resistance is a red herring. The testimony is uniform that that the clinical difference between an MPK and a non-MPK is variable resistance control via a microprocessor. RCCPF 994. Plié is the only MPK that lacks that critical feature.

Moreover, the ID does not cite any evidence regarding rival MPK products released since 2016.[3] The fact that some customers may have had problems with prior versions of Össur, Endolite, and Proteor MPKs says nothing of the reputations of the current products, nor [redacted] [redacted] [redacted]. RCCPF 1536, 1586-1592, 1666-1670; RPF 793-801, 818-823, 893-896. In *CCC Holdings*, the court was very clear that the fact that a few customers lack familiarity with a competitor's products does not lead to the conclusion that such products would not be a suitable replacement for the products of the merging parties. 605 F. Supp. 2d at 68-72 n.49. CC's criticisms of rival MPKs also ignores the fact that the most criticism levied against an MPK at trial was against Freedom's Plié.

At trial, Freedom executive, Mark Testerman, corroborated that Plié faced stiff competition from *all* MPKs, including Rheo, Orion, Linx, and Allux, and he also testified that the MPK market

[3] By analyzing each remaining rival piecemeal, rather than collectively, the ID also failed to follow the approach prescribed by the *Merger Guidelines* and well-established law. § 9; *CCC Holdings*, 605 F. Supp. 2d at 47.

is characterized by rapid innovation by *all* MPK manufacturers. Testerman, Tr. 1102-1264. Promotions like the "Ideal Combo" targeted *all* MPKs, not just C-Leg. RPF 631. Recent evidence shows head-to-head competition between Plié and rival MPKs. For example, Freedom considered the new Rheo to be a "serious" threat to its Plié business and in 2016 developed a strategy to position Plié against Rheo. RPF 634. In 2016, Plié was also losing share to Endolite's new Orion3 in key accounts. RPF 635-637. Indeed, Freedom has also had substantial competitive concern over the Allux MPK. RPF 211, 638-645, 919-920. When Testerman performed an analysis of reasons for the downturn of Plié sales in 2016, he identified five causes, including "very aggressive" pricing on Orion and the introduction of the Allux. *Id*. Freedom did not consider Ottobock's C-Leg to be a "top-five issue." RPF 644.

II. THE MPK DIVESTITURE WILL PRESERVE COMPETITION.

A. <u>The MPK Divestiture Precludes any Presumption of Harm.</u>

A challenged merger should be considered in conjunction with a planned divestiture for purposes of determining whether a structural presumption is appropriate. Both the ALJ and CC misconstrue and misapply the law on this point. CC argues that, because this is a consummated merger case, the MPK Divestiture is only relevant to the *remedy* that the Commission may order and/or as rebuttal evidence regarding the likelihood and significance of *continuing* anticompetitive effects after a presumption has been established. The Commission should reject that view.

United States v. General Dynamics Corp. confirms that likely effects on competition are forward looking, and that post-transaction facts should be considered. 415 U.S. 486, 504-506

(1974). In *United States v. Atlantic Richfield Co.*, the government argued for a structural presumption that ignored a planned divestiture. 297 F. Supp. 1061, 1067-1069 (S.D.N.Y. 1969). The court there rejected that argument and denied a presumption in the alleged market for which there was a planned divestiture. *Id.* In *FTC v. Arch Coal, Inc.*, the government argued *before* trial that a planned divestiture should be ignored. No. 1:04-cv-00534, ECF No. 67, slip op. at 2-3 (D.D.C. July 7, 2004). The court there rejected that motion and permitted evidence of the divestiture at trial. *Id.* at 4-5, 7-8. In assessing changes in market concentration after trial, the court included the planned divestiture and found a very weak presumption rather than the strong presumption that would have applied absent the divestiture. *FTC v. Arch Coal, Inc.*, 329 F. Supp. 2d 109, 114, 125, 129 (D.D.C. 2004). This decision was outcome-determinative as the defendant prevailed in that case. Significantly, although both cases are cited and discussed in Respondent's Appeal Brief, CC fails to even attempt to address or distinguish them.

The same principles articulated in these authorities apply with greater force here. CC filed a pretrial motion seeking to preclude evidence of the MPK Divestiture. The Commission denied that motion in its April 18, 2018 Order and allowed the evidence, concluding that, in a consummated merger, a planned divestiture can "impact . . . the *existence* or magnitude of likely post-divestiture competitive harms." CCAB 33 (emphasis added). The primary distinction between this case and *Arch Coal* is that inclusion of the planned divestiture in the court's market concentration calculation gave rise to a weak presumption in *Arch Coal*, but inclusion of the MPK Divestiture in this case would result in *no market change* and thus *no presumption* of competitive harm.

CC wrongly advocates for complete disregard of the MPK Divestiture when calculating HHI simply because the challenged merger is consummated. CCAB 32 n.9. This is not, however,

a case in which some harm to competition may have occurred after closing, but before completion of a divestiture, which is an issue the Commission recognized in ruling that the MPK Divestiture was not an affirmative defense *before* trial. Trial established, however, that there is *no* probability of anticompetitive effects because: (i) there is no evidence of actual competitive harm as Freedom has operated independently post-Acquisition—voluntarily upon closing and then by agreement; and (ii) the MPK Divestiture ensures that there will be no future harm. RAB 31; *see also* Argument IV, *infra* (explaining that evidence shows no empirical evidence of harm in alleged market). The result of an MPK Divestiture is that Ottobock will no longer control any of Freedom's MPK assets. RPF 1086-1089, 1118-1120.

CC cites no authority supporting its position that a post-transaction divestiture, combined with no evidence of anticompetitive effects until the time of suit, cannot entirely prevent a presumption of harm.[4] Thus, the Hold Separate Agreement, which was preceded by no actual harm to competition, combined with a subsequent MPK Divestiture, will guarantee that the Acquisition will not result in a substantially adverse effect on competition in the alleged market.

B. <u>CC's Criticisms of the MPK Divestiture Lack Merit.</u>

As stated in Argument II.A, *supra*, the burden should not shift to Respondent because a presumption is not appropriate. Regardless of burden allocation, CC failed to advance valid criticisms of the MPK Divestiture.

[4] CC's reliance on *United States v. Aetna Inc.*, 240 F. Supp. 3d 1, 63-72 (D.D.C. 2017) is misplaced. The defendant there did not, as a threshold matter, argue that the proposed divestiture should be considered in calculating HHI. In addition, the court refused to credit the proposed divestiture because of substantial doubt whether the divestiture would close at all because of, among other things, regulatory approvals for the divestiture buyer's acquisition of the relevant assets. Here, the only condition for closing the MPK divestiture is FTC approval.

CC's principal criticisms lack merit as follows.

First, foot and ankle products are not necessary to sell MPKs. Prosthetists do not make MPK purchasing decisions on the ability to obtain a free foot. They routinely mix-and-match MPKs from one supplier with feet from another supplier. RPF 1261; RCCPF 2441. Any marketing incentive, including bundling non-foot products or a straight discount, has the same effect. RPF 1262; RCCPF 2441. Freedom has proven that direct discounts increase sales without bundling. For example,

[5]

III. THE ID DOES NOT PROPERLY APPLY THE BURDEN-SHIFTING FRAMEWORK.

The burden-shifting framework applicable to horizontal merger cases as articulated in *United States v. Baker Hughes, Inc.* is well-accepted and established, but was not applied properly in this case by the ALJ. 908 F.2d 981 (D.C. Cir. 1990).

While the ALJ erroneously concluded that CC met its burden of proving that the Acquisition exceeds HHI thresholds to establish a highly-concentrated market, the ALJ failed to consider the totality of Respondent's evidence that the Acquisition will not have anticompetitive effects. He instead broadly recited and dismissed in conclusory fashion each of Respondent's arguments piecemeal and in complete isolation. Respondent produced at least six categories of evidence to rebut the CC's *prima facie* case. Each was dismissed in isolation without considering the totality of the evidence. That approach is inconsistent with *Baker Hughes*; *see also Arch Coal*, 329 F. Supp. at 158-159 ("Although defendants have not presented sufficient evidence to support a full defense based either on efficiencies from the proposed transactions or on Triton's weak financial and competitive condition, these are relevant considerations supporting the conclusion that the transactions are not likely to substantially lessen competition . . . .").

Moreover, after summarily dismissing the evidence produced by Respondent, the ALJ never addressed CC's burden of persuasion. The significance of the ALJ's failure in this regard is addressed in *Baker Hughes*:

> ***Imposing a heavy burden of production on a defendant would be particularly anomalous where, as here, it is easy to establish a prima facie case***. The government, after all, can carry its initial burden of production simply by presenting market concentration statistics. To allow the government virtually to rest its case at that point, leaving the defendant to prove the core of the dispute, would

> grossly inflate the role of statistics in actions brought under section 7.

908 F.2d at 992 (emphasis added). Here, the ALJ compartmentalized and then summarily dismissed Respondent's overwhelming rebuttal case without ever even acknowledging that Respondent's burden was solely one of *production*, not *persuasion*. In other words, the ALJ essentially acknowledged that Respondent produced rebuttal evidence as required under the burden-shifting framework, but then dismissed that evidence out-of-hand as unpersuasive without even addressing CC's persuasion burden. This error was unfairly prejudicial and infected the entire ID.

IV. THERE IS NO EVIDENCE OF ACTUAL POST-ACQUISITION HARM TO COMPETITION.

CC's claims of post-Acquisition harm are meritless. Freedom has operated independently from, and in direct competition with, Ottobock since closing. All the evidence is consistent that continuous and vigorous competition for MPK sales has occurred post-Acquisition. There is no evidence that [redacted]. RPF 1039-1073, 1540-1545; RCCPF 1476. The only direct evidence of post-Acquisition competition at trial showed Freedom trying *to take MPK share* from Ottobock. RCCPF 1476-1478.

Faced without actual evidence of harm, CC rehashes unproven allegations. For example, CC advances the bogus claim that [redacted]. RCCPF 1012, 1024, 1118-1129, 1456-1472. However, Freedom executives uniformly confirmed at trial that there have been no material advancements to the Plié 3 since its 2014 launch. RPF 595; RCCPF 1456-1472.

The evidence is clear that [REDACTED]. RCCPF 1449, 1452-1454. In any event, the rumors of [REDACTED]. RCCPF 1448-1450. The engineer developing Quattro testified that [REDACTED]. RCCPF 1448-1452. [REDACTED]

V. THE ALJ'S ACCEPTANCE OF CC'S ALLEGED MARKET IS ERROR.

A. <u>CC Fails To Rehabilitate Their Economist.</u>

The ALJ did not thoroughly scrutinize Dr. Scott Morton's opinions. For example, he credited Dr. Scott Morton as an *industry* expert despite her clear admission that this case was her first exposure to prosthetics. RCCPF 953. In addition, he failed to explain why Dr. Scott Morton's economic opinions should be credited despite the skepticism he expressed at trial regarding her methods and conclusions. *See, e.g.*, Tr. [REDACTED], 4043-4035; RCCPF 467.

CC's comment that Respondent did not advance a *Daubert* motion at trial is irrelevant. CCAB 6-7. Upon CC's oral motion to admit Dr. Scott Morton, rather than allowing a *voir dire* or even a response by Respondent, the ALJ declared that "any opinions that meet the proper legal

standards will be considered." Tr. 3858. Respondent's Post-Trial Brief sets forth the flaws in Dr. Scott Morton's opinion, which have been well-recognized in economic literature, and resulted in an illogical and unsupported market in this case. RBR 51-52; RAB 38-39.

B. CC's Alleged Market Is Not Supported By *Brown Shoe* Indicia.

CC fails to salvage the ID's flawed analysis of the *Brown Shoe* indicia. Regarding "peculiar characteristics," CC improperly points to the ALJ's generic finding that "a microprocessor 'allows the MPK to function, operate, and perform in a way that is different from how a mechanical knee functions, operates, and performs.'" CCAB 3 (quoting ID 22). But that finding is contradicted by other findings in the ID that "prosthetic clinics view MPKs as superior to mechanical knees for K-3 and K-4 patients *unless there are patient-specific reasons that a mechanical knee is more appropriate for an individual patient*." ID 19 (emphasis added).

Additionally, the evidence shows that Ottobock *does not* "look[] to only other MPKs when setting its MPK prices." CCAB 4. Ottobock (and other MPK manufacturers) must consider clinic profit margins for MPKs. RPF 316, 407, 432, 751. [redacted]

[redacted] Therefore, Ottobock sets prices primarily according to the fee schedule fixed by Medicare and private insurers. RPF 315.

VI. PROSTHETIC MARKET CONDITIONS CONSTRAIN MANUFACTURER PRICE INCREASES.

CC fails to rebut the reality that market dynamics prevent any correlation between MPK market share and pricing power. In addition to the ubiquity of rival MPKs, insurance reimbursement and sophisticated buyers prevent MPK suppliers from exercising unilateral pricing power. The ALJ's incorrect finding that "it does not logically follow that there is no room in the space between the price of the MPK and the ceiling for reimbursement for Respondent to impose

a price increase" totally ignores the critical and undisputed facts that most private insurers reimburse below that level and that clinics need that "space" to cover significant other costs associated with fitting MPKs. ID 59; RPF 419-437.

Sophisticated buyers also constrain price increases. Although the ALJ correctly appears to concede that Hanger is a particularly powerful buyer, all clinic customers are sufficiently sophisticated to prevent unilateral harm in the alleged MPK market. *Compare* RAB 21 *with* ID 55 n.27, CCAB 26-27. Indeed, the authorities cited by CC actually demonstrate how clinics are able to divert purchases away from Respondent in the face of a potential price increase. As CC points out, "[t]he ability of large buyers to keep prices down . . . depends on the alternatives these large buyers have available to them," and the Commission has to "examine the choices available to powerful buyers and how those choices likely would change due to the merger." CCAB 26 (citations omitted). Evidence from *all* clinics corroborate that they can credibly threaten to turn to any of a number rival MPKs to achieve competitive pricing. *FTC v. Sysco Corp.*, 113 F. Supp. 3d 1, 48 (D.D.C. 2015); *see also*

VII. CC FAILS TO UNDERCUT RESPONDENT'S FAILING FIRM DEFENSE.

A. <u>Freedom Was Not Able to Meet its Financial Obligations.</u>

CC ignores the undisputed reality that, at the time of the Acquisition,

As a result, Freedom could not meet its financial obligations. *Id*. Faced with this undeniable fact, Freedom's auditors stated in Freedom's audited financials:

The inclusion of this disclosure in the financial statements contradicts CC's claim that the auditors issued a

"clean" opinion. *Id.*; RRBR 110-114. While it is true that the statements contain some additional commentary about how Freedom *might* address the debt problem by obtaining an extension from its lenders, the auditor's "substantial doubt" regarding Freedom's ability to continue as a going concern stands unrebutted, but was ignored by the ALJ. *Id.*; ID 64-65.

CC also misstates the record on several other important points regarding Freedom's insolvency. *First*, Respondent does not rely "entirely" on Freedom's financial performance from 2012 to 2016. *Second*, the ALJ's reliance on the Kim Memo is misplaced. Freedom's CEO testified that It is stunning that CC would even question Respondent's criticism of the ALJ's reliance on this demonstrably unreliable piece of evidence. And, *third*, overwhelming evidence established that The fact that lender representatives did not testify is irrelevant. Substantial other evidence was introduced, and unrebutted, on this point. *Id.*

B. <u>Freedom Could Not Have Successfully Reorganized.</u>

The ALJ ignored the second element of the failing firm defense because Respondent satisfied it through unrebutted evidence that Freedom considered reorganization, but could not have done so successfully. ID 67-68; RRBR 116-119. CC's claim to the contrary by generic reference to "[r]ecord evidence" is thus misguided. CCAB 23.

C. <u>Freedom Exhausted Good Faith Efforts to Obtain Alternative Offers.</u>

CC fails to undercut Freedom's good faith efforts to obtain reasonable alternatives to the Acquisition. CCAB 24-26. The exhaustive efforts to obtain offers to purchase or refinance Freedom are detailed in a substantial trial record. RPF 1449-1489; RRBR 119-129. Freedom was not required to contact every conceivable purchaser. RRBR 125-126. The reality is that many small and large prosthetics companies knew Freedom was for sale, but had no interest in purchasing a failing company at a price above liquidation value when Freedom's own CEO believed the company had been [redacted] for years. RPF 1479, 1485.

VIII. THE PART 3 PROCEEDING IS UNCONSTITUTIONAL.

A. <u>Respondent's Constitutional Challenges Are Preserved.</u>

CC incorrectly claims that Respondent's challenges to the Part 3 proceeding are vague and waived. Part 3 rules do not require such challenges to be pled prior to trial. *See, e.g.*, 16 C.F.R. § 3.12. Respondent is entitled to *de novo* consideration by the Commission, and each challenge raised in this appeal is therefore timely. *See, e.g.*, *Lucia v. SEC*, 138 S. Ct. 2044, 2055 (2018); *In re 1-800 Contacts, Inc.*, Docket No. 9372, Opinion of the Commission at 12 (Nov. 7, 2018). Further, parties are not required to lodge due process objections until first being subjected to the challenged procedure. *See*, *e.g.*, *Hughes v. City of Cedar Rapids*, 112 F. Supp. 3d 817, 833 (N.D. Iowa 2015).

CC also makes the absurd claim that Respondent's challenges are not sufficiently clear because Respondent did not devote enough words to these arguments in its Appeal Brief. This argument lacks merit, as a threshold matter, because, as further explained *infra*, the arguments are clearly articulated and supported by authority for purposes of this appeal. In addition, CC should be estopped from arguing waiver on this basis as CC vigorously opposed Respondent's motion for an increase in the presumptive word limit for Appeal Briefs. The Commission denied

Respondent's motion following CC's opposition. *See* May 22, 2019 Commission Order. Respondent respectfully submits that this ruling was in error because this case presented a uniquely voluminous trial record, and Respondent was thus denied the opportunity to fully present all aspects of its case to the Commission. It would compound that error, be fundamentally unfair, and indeed an additional due process violation, to hold that any of Respondent's clearly process challenges are somehow waived simply because more words are not devoted to those challenges.

B. <u>CC's Responses to Respondent's Constitutional Challenges Lack Merit.</u>

CC's opposition to Respondent's constitutional challenges all fail for the following reasons.

First**,** application of different procedures in merger litigation initiated by FTC rather than DOJ lacks a rational basis and violates Respondent's right to Equal Protection under the Fourteenth Amendment. DOJ must prosecute its cases in federal court while FTC is allowed to prosecute cases through the materially-different administrative litigation process, which, among other things, deprives respondents of an Article III fact-finder in the first instance. The determination whether a party is subject to administrative litigation before FTC, rather than federal court in the case of DOJ, is based solely on the industry in which the party conducts business. CC argues that the 2002 FTC/DOJ Clearance Agreement is not formally in place, but that ignores the reality that FTC and DOJ effectively operate under its terms. There is no rational basis justifying this approach and the disparate treatment it inflicts on defendants. FTC should be required to prosecute its matters in federal court through the same process employed in DOJ merger litigation.

Second, application of different procedures between FTC and DOJ matters is also an arbitrary and capricious division of antitrust enforcement and does not reflect the intent of Congress. 5 U.S.C. § 706(2)(A); *Bedford Cty. Mem'l Hosp. v. Heckler,* 583 F. Supp. 367, 376 (W.D. Va. 1984), *aff'd and remanded sub nom.*, *Bedford Cty. Mem'l Hosp. v. Health & Human*

Servs., 769 F.2d 1017 (4th Cir. 1985). Congress created DOJ to represent the interests of the United States or an agency unless otherwise prescribed by law. 28 U.S.C. § 516. Congress created FTC to prevent persons or corporations from using unfair methods of competition and to investigate violations of antitrust statutes. 15 U.S.C. §§ 45-46. Congress did not intend the DOJ and FTC to arbitrarily and capriciously divide the procedure for antitrust enforcement by industry, therein creating the wide disparities in process and outcomes dependent on a company's industry discussed above.

Third**,** the Commission's post-hoc ratification of ALJ Chappell is insufficient to cure the violation of the Appointments Clause. Because ALJ Chappell was not originally appointed under the Appointments Clause, but only ratified by the Commission in 2015, and because he has powers similar to those of SEC ALJs, he is an unconstitutionally appointed "Officer[] of the United States." *Lucia*, 138 S.Ct. at 2053; *In the Matter of LabMD, Inc*., Docket No. 9357 (Sept. 14, 2015); 16 C.F.R. § 3.42(c)(1)-(6), (8). CC argues without authority that the Commission's subsequent ratification cures the problem with the appointment, but the Supreme Court left that question open in *Lucia*. 138 S.Ct. at 2055 n.6.

Fourth, ALJ Chappell's two-level protection from removal by the President is unconstitutional. RAB 44 (citing 5 U.S.C. §§ 7521 & 1202); *Free Enter. Fund v. Pub. Co. Accounting Oversight Bd*., 561 U.S. 477, 484 (2010). CC's reliance on *1-800-Contacts* is misplaced. Docket No. 9372, Opinion of the Commission at 58. There, the Commission upheld the validity of its own ALJ on the basis that the ALJ only performs adjudicative functions (*id.*); however, FTC Rule 0.14 provides that FTC "administrative law judges also serve as presiding officers assigned to conduct rulemaking proceedings." 16 C.F.R. § 0.14. CC cites no authority

upholding the FTC's removal provisions, and the Supreme Court has held that similar multi-layered removal processes are unconstitutional. *Free Enter. Fund*, 561 U.S. at 484.

And, ***fifth***, Part 3 procedures denied Respondent due process. *See Mathews v. Eldridge*, 424 U.S. 319, 334, (1976) (outlining the three factors in determining the due process required: (1) private interests; (2) government interests; and (3) risk of erroneous deprivation of private interests and/or the value of additional procedures). As stated in Respondent's Appeal Brief, the evidentiary, and other rules, strongly advantage CC over respondents, including for example, the fact that hearsay is readily admissible against respondents.

* * *

CONCLUSION

The ALJ's ID is fundamentally flawed. The Commission should reject it, and an enter an order proposed by Respondent in its Appeal Brief.

Respectfully submitted,

Date: July 19, 2019

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PUBLIC

UNITED STATES OF AMERICA
BEFORE THE FEDERAL TRADE COMMISSION

COMMISSIONERS: **Joseph J. Simons, Chairman**
Noah Joshua Phillips
Rohit Chopra
Rebecca Kelly Slaughter
Christine S. Wilson

In the Matter of **Otto Bock HealthCare North America, Inc.,** **a corporation.**	**Docket No. 9378**

INDEX OF ATTACHMENTS
TO RESPONDENT'S REPLY BRIEF

Attachment	Description
F	David Scheffman & Joseph Simons, *Unilateral Effects for Differentiated Products: Theory, Assumptions and Research*, Antitrust Source (April 2010)
G	Gregory J. Werden & George A. Rozanksi, *The Application of Section 7 to Differentiated Products Industries: The Market Definition Dilemma*, 8 Antitrust 40 (Summer 1994)
H	Federal Trade Commission, *The FTC's Merger Remedies 2006-2012: A Report of the Bureaus of Competition and Economics* (Jan. 2017)

ATTACHMENT F

The Antitrust Source, August 2010. © 2010 by the American Bar Association. Reproduced with permission. All rights reserved. This information or any portion thereof may not be copied or disseminated in any form or by any means or stored in an electronic database or retrieval system without the express written consent of the American Bar Association.

Unilateral Effects with Differentiated Consumer Products: A Response to Werden

David Scheffman and Joseph Simons

In the April 2010 issue of *The Antitrust Source*, we explained that the theoretical economic models underlying the Merger Guidelines' treatment of unilateral effects for differentiated products make a technical mathematical assumption ("differentiability") that leads to a mathematical result that the own-price elasticity of demand can be computed using only the margin (i.e., the "Lerner Equation").[1] This mathematical result, in turn, leads to the general result that *all* horizontal mergers involving "differentiated products" are predicted to increase prices due to anticompetitive unilateral effects, absent offsetting efficiencies. This extreme result is a mathematical theoretical curiosity, not an acceptable basis for a presumption.[2] As we explained, the technical assumption and its result are contradicted by empirical consumer and economic research and by everyday experience. In his June 2010 response to our article, Gregory Werden challenged some of our analysis with respect to research on consumer demand, asymmetric competitor responses, and the significance of our example of "kinked demand."[3] We now reply.

Research on Consumer Demand

In our article, we discussed research that establishes that the demand functions for consumer products are likely to have kinks, which violates the assumption of differentiability. Werden agrees that "formal theory of consumer behavior with asymmetric reactions does predict kinked demand curves for individual consumers."[4] Werden, however, challenges the empirical support for and/or the significance of kinks. He states: "Empirical research finds small differences between the demand elasticities for price increases and those for price decreases."[5] Yet Werden's statement is based on only one paper, which studied one product, toilet tissue, based on data from 341 households in Sioux Falls, South Dakota, and which used a model specific to that paper.[6] In our article we focused on sources from which basic, general conclusions could be drawn.[7]

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1 David Scheffman & Joseph Simons, *Unilateral Effects for Differentiated Products: Theory, Assumptions, and Research*, ANTITRUST SOURCE, Apr. 2010, http://www.abanet.org/antitrust/at-source/10/04/Apr10-Scheffman4-14f.pdf.

2 We do not take the position that mergers of competing brands of differentiated consumer products never lead to price increases. Individual mergers may very well do so. Rather, theory and empirical research do not support a presumption that such mergers, generally, are anticompetitive absent offsetting efficiencies.

3 Gregory J. Werden, *Unilateral Effects with Differentiated Consumer Products: A Response to Scheffman and Simons*, ANTITRUST SOURCE, June 2010, http://www.abanet.org/antitrust/at-source/10/06/Jun10-Werden6-24f.pdf.

4 *Id.* at 2.

5 *Id.* at 1 n.5.

6 Sangkil Moon et al., *Profiling the Reference Price Consumer*, 82 J. RETAILING 1, 4 (2006).

7 For example, one of our main sources was a survey of research on the theory and evidence relevant to asymmetric consumer responses. *See* Gurumurthy Kalyanaram & Russell S. Winer, *Empirical Generalizations from Reference Price and Asymmetric Price Response Research*, 14 MKTG. SCI. G161 (1995).

With respect to kinks specifically, Werden states: "Empirical evidence, however, indicates that individuals' demand curves do not actually exhibit sharp kinks at prevailing prices. Rather than a sharp kink, empirical research finds 'a region of price insensitivity for small increments around a reference price [so] a price change may not be noticed.'"[8] There are a number of issues with Werden's interpretation of the articles he cites for this statement. If price changes are "not noticed," there is little or no demand response and the demand curve is thus highly inelastic in that region. If this is the case, the Lerner Equation cannot be satisfied, since margins will not be consistent with highly inelastic demand. The primary paper cited by Werden estimates demand curves that have at least two kinks.[9] Around the current equilibrium price the demand curve is highly inelastic, and outside this range, demand is less elastic for price increases than decreases.[10]

Werden also argues that "with inevitable consumer heterogeneity, sharp kinks in individual demand curves are consistent with a smooth aggregate demand curve at the brand level."[11] This is a theoretical possibility. What is more likely is that there are a relatively small number of types of consumers (types driven by historical experience with prices that are likely to be common within groups of consumers). This is the typical approach in marketing research. In such a situation, for example, if some of the consumer types have kinks and/or highly inelastic sections ("latitude of price acceptance"), then the aggregate demand curve will have a number of "sharp" kinks.

Finally, Werden states: "Marketing scientists posited, and estimated, brand level demand curves with asymmetric aggregate price response and found a substantial range of prices within which there is no aggregate asymmetry."[12] This is also taken from a single paper. This paper assumes a model in which demand is "smooth," i.e., differentiable.[13] The paper also has the counterintuitive result that demand is more elastic for price cuts than price increases.[14]

What should be clear from this discussion is that there is enough evidence of asymmetric price responses by consumers to make the *assumption* of the Lerner Equation untenable.

Asymmetric Competitor Responses

Next Werden addresses our second example of why the Lerner Equation may not hold—asymmetric responses by competitors. Werden states:

> Scheffman and Simons mistakenly focus on "residual" demand curves. In fact, standard analysis of unilateral effects analysis with differentiated consumer products uses ordinary "Marshallian" demand curves. Marshallian demand curves are constructed under the assumption that all other prices are held constant, while residual demand curves incorporate responsive price changes by rivals.[15]

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[8] Werden, *supra* note 3, at 2.

[9] Gurumurthy Kalyanaram & John D.C. Little, *An Empirical Analysis of Latitude of Price Acceptance in Consumer Package Goods*, 21 J. Consumer Res. 408 (1994).

[10] "Three components of the linear model center on the PR (the reference price): a hypothesized *flat* [vertical] place equal in width to the latitude of acceptance around the reference price and two negatively sloping pieces, one on each side. *See id.* at 412 (emphasis added). Marketing researchers generally put price on the horizontal axis, so that "flat" means vertical for an economist's depiction of a demand curve."

[11] Werden, *supra* note 3, at 2.

[12] *Id.* at 3 n.14.

[13] "In this model, we incorporate *smooth* transitions of price elasticity between an 'inner' regime close to the benchmark and 'outer' regimes of gains and losses." Koen Pauwels et al., *When Do Price Thresholds Matter in Retail Categories?*, 26 Marketing Sci. 83, 88 (2007) (emphasis added).

[14] *Id.* at 92.

[15] Werden, *supra* note 3, at 3.

In fact, the theoretical economic models of differentiated products do compare the pre-merger equilibrium to the potential effects of the merger. The pre-merger equilibrium necessarily involves residual demands and reaction functions.[16]

More on the Assumption of Differentiability—Margins and Demand Elasticities

According to the Lerner Equation, there is an exact equation linking margins and own-price elasticity. However, economic theory, financial economics and accounting, and common sense make clear that the most important determinant of margins is cost structure, specifically the mix of fixed and variable costs. This is yet another reason why assumption of the Lerner Equation is not likely to be valid. There are many business models for consumer products firms (and for firms in other industries also). Some firms produce their products from primary inputs, e.g., primary food products, such as wheat and milk, for branded consumer food products, using highly automated (low variable labor) manufacturing processes. Typically, for such firms, a substantial percentage of their costs would be fixed. Other firms have other producers make their products for them, i.e., use contract manufacturing. For such firms, typically, a significantly smaller percentage of their costs would be fixed. Obviously, this comparison is much broader than the consumer goods industry. In many industries, firms vary significantly in their degree of vertical integration. Thus, margins will differ due to differences in cost structure, having nothing to do with demand conditions.

Firms also differ in the extent to which they are vertically integrated into distribution. Some self-distribute, with much of their costs being fixed, and others use third-party distribution, where most of their costs are variable. Again, margins differ due to cost structure, having nothing to do with demand conditions. For example, we could have two otherwise similarly situated firms—e.g., both selling corn flakes—that would have quite different cost structures and therefore quite different margins. One is vertically integrated in manufacturing and distribution, and one is not. Holding other things constant, the vertically integrated firm is necessarily going to have significantly higher margins than the non-integrated firm. But according to the fundamental prediction of theoretical differentiated products models (including Farrell-Shapiro's Upward Pricing Pressure, or UPP), other things equal, the firm with significantly higher variable costs should have significantly higher prices. Of course this is highly implausible. And it is not consistent with what we observe about actual products.

What is perhaps even more striking is that in the consumer goods products industry (among others), shifting between self-manufacture and contract manufacture occurs with some frequency. The theoretical differentiated products models, however, predict that such movements should lead to substantial changes in price—even though there is only a change in cost structure, with no change in demand. We are not aware of any evidence supporting the general conclusion of the differentiated products models. Finally, many industries, such as packaged software, have high margins. For example, a specific home financial management software product that is not one of the top sellers likely has high margins (since most costs are likely to be fixed), but it is implausible that such a product has relatively inelastic demand. Other examples include the corner hot dog vendor, restaurants, and men's and women's clothing stores.

Examples like these make clear that inferring demand elasticities from margins is not likely to be valid. Since the predictions of the various theoretical differentiated products models, includ-

[16] The use of residual demand is appropriate where competitors react to pricing of their rivals. *See* Joseph Farrell & Carl Shapiro, *Improving Critical Loss Analysis*, ANTITRUST SOURCE, Feb. 2008, at 7, http://www.abanet.org/antitrust/at-source/08/02/Feb08-Farrell-Shapiro.pdf. Of course, most mergers of interest to the antitrust authorities would fall into this category.

ing UPP, depend fundamentally on the Lerner Equation, those models cannot, as a matter of empirical economics or public policy, provide a basis for presumptions about anticompetitive effects. If the plaintiff in an antitrust case puts forward the theoretical differentiated products models and/or attempts to create a presumption of anticompetitive effects based primarily on margins and diversions, in our opinion this will likely stimulate a battle of economic experts, in which the plaintiff's expert will usually lose.[17]

Finally, Werden writes: "Because the psychology of retail shoppers is relevant only to consumer goods, I consider only mergers involving such goods, and I understand Scheffman and Simons to have done likewise."[18] We believe the arguments relating to our discussion of margins are also clearly relevant to the use of the Lerner Equation for industrial and commercial products and services.

Concluding Comments

We stand by the fundamental conclusions of our earlier article. To summarize, the theoretical economic models of product differentiation are based on a technical mathematical assumption (i.e., differentiability) leading to the Lerner Equation. The assumption and the Lerner Equation are not likely to be valid as a general matter. Thus, neither the Lerner Equation nor the models upon which it is based can be used to create general presumptions in merger analysis.

Werden raises arguments that at most indicate that in some specific circumstances the assumption of differentiability and the resultant Lerner Equation may hold close enough that the conclusions of the models may be approximately correct. We do not disagree that this may be the case in some specific circumstances. However, the weight of the existing research and relevant analyses indicate that, as a general matter, the assumption of differentiability and the resultant Lerner Equation are not likely to hold. This should not be surprising. What would be very surprising is that as a general matter with differentiated products each competitor necessarily uniquely constrains the prices of every other competitor.

As discussed in our earlier article, we agree that diversions between the merging parties may affect the incentives of the merged firm post-merger. However, this is the case for most horizontal mergers, since there will generally be diversions between the parties in the event of a small but significant nontransitory increase in price (i.e., a SSNIP). But, this does not lead to a presumption that the parties to the merger uniquely constrain each other's prices, since the constraints posed by other competitors may nonetheless make an anticompetitive price increase unprofitable. ●

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[17] This is borne out by the litigation of *Swedish Match* discussed in our previous paper. FTC v. Swedish Match, 131 F. Supp. 2d 151, 161 (D.D.C. 2000).

[18] Werden, *supra* note 3, at 1 n.6.

ATTACHMENT G

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Antitrust
Summer, 1994

Response
Gregory J. Werden George A. Rozanski

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THE APPLICATION OF SECTION 7 TO DIFFERENTIATED PRODUCTS INDUSTRIES: THE MARKET DELINEATION DILEMMA

In Columbia Steel, Brown Shoe, and Philadelphia National Bank, the Supreme Court established what remains Section 7's basic analytical approach to horizontal mergers. [1] Relevant markets are delineated, and the merging firms' shares and overall concentration are assessed within them. Other factors are considered as well, but the fate of a merger often hinges on the relevant market and consequent shares.

Economists have long argued that this approach is not well suited to differentiated products industries. Edward Chamberlin maintained that:

> "Industry" or "commodity" boundaries are a snare and a delusion—in the highest degree arbitrarily drawn, and, wherever drawn, establishing at once wholly false implications both as to competition of substitutes within their limits, which supposedly stops at their borders, and as to the possibility of ruling on the presence or absence of oligopolistic forces by the simple device of counting the number of producers included. [2]

One may object to nuance and tone in Chamberlin's comment but his basic observations about the limitations of delineated markets and market shares are unassailable and remain at the heart of merger litigation involving differentiated products.

James Keyte addresses this subject in the Fall 1993 issue of Antitrust. [3] He motivates the discussion with two cases decided on consecutive days last year in May: United States v. Gillette Co., 828 F.Supp. 78 (D.D.C. 1993), in which the Department of Justice alleged that the acquisition of Parker Pen by Gillette, which owned Waterman, would substantially lessen competition in "premium fountain pens," and Pennsylvania v. Russell Stover Candies, Inc., 1993-1 Trade Cas. (CCH) ¶ 70,224 (E.D. Pa. 1993), in which the State of Pennsylvania alleged that the acquisition of Whitman's Chocolates by a company controlled by Russell Stover would substantially lessen competition in "gift boxed chocolates sold nationally through chain drug stores and mass marketers." Our view of the important issues raised by these cases differs markedly from Mr. Keyte's, and we offer a constructive approach to the problem.

The Effects of Mergers in Differentiated Products Industries

Three characteristics common to many differentiated consumer goods industries complicate the competitive analysis of mergers. First, different products are not tightly clustered in terms of prices and product attributes; rather, products appear over a broad and fairly continuous range of prices and qualities. Second, competition is somewhat localized, because a consumer's second- (and third-) choice product most often is similar in price and product attributes to the first-

choice product. Third, competition is not ***41** entirely localized; some consumers' second (or third) choices are not so similar in price and product attributes to their first choices. We think that premium fountain pens, boxed chocolates, automobiles, and a host of other industries share these characteristics.

Competition in many differentiated products industries can be accurately described by a model with two essential attributes—the strategic variable for competition in the short term is price,[4] and firms act noncooperatively. The condition of equilibrium in such models is that firms are satisfied with their price choices, in that no firm could increase its profits by altering price, given the prices set by its rivals. In such models, all firms have some degree of market power, and all firms charge prices in excess of short-run marginal cost.

Such models predict that a firm would increase price if it merged with a "direct competitor," i.e., a rival firm selling a product to which some of the first firm's customers would switch in response to an increase in the first firm's price. After the merger, some of the profits one merging firm would lose as it increased price would be recaptured through increased sales by the other merging firm. This recapture effect provides a profit incentive to raise price above the premerger level. If each merging firm were a direct competitor of the other, the merger would result in price increases for products of both merging firms. The amount of the price increases would be determined in large part by the relative importance of each merging firm as a direct competitor with the other, i.e., by the familiar cross elasticities of demand.[5] Other determinants include the elasticities of demand and price-cost margins for the competing products of the merging firms.

A price increase for one of the merged firm's products would induce price increases for directly competing products of nonmerging firms. Price increases for those products would induce price increases for products directly competing with them, and so on, spreading the price effects of the merger through a broad range of products. The merged firm would be likely to increase prices substantially more than other firms, but price increases by nonmerging firms generally would contribute significantly to the total effect of the merger on consumers.

The foregoing is one of the "unilateral effects" described by the 1992 Merger Guidelines,[6] and it is the most plausible theory of anticompetitive effects of mergers in differentiated consumer products industries. It is also a permissible, if not traditional, rationale for challenging a merger under Section 7.[7] The utility of market delineation is quite limited in this context. In sharp contrast to the situation with homogeneous goods industries, there is no reason why the shares in any delineated market in a differentiated products industry are indicative of the relative importance of each merging firm as a direct competitor of the other. Also, shares in a narrow market tend to be misleading in that they ignore what may be substantial competition from outside the market, and shares in a broad market tend to be misleading in that they ignore the fact that competition is localized.

Market Delineation Within a Price and Quality Continuum

Defendants in merger cases involving differentiated products are apt to argue that, as a matter of law, no meaningful boundaries can be drawn within a price and quality continuum.[8] Defendants can cite cases supporting this proposition[9] but they cannot explain why this proposition makes any sense. Gillette is significant primarily because it rightly rejects this proposition,[10] and practitioners would be ill advised to take Gillette lightly.

Whether drawing any particular market boundary makes sense depends on the facts of the case and on the principles for market delineation applied. Many courts have applied, or cited approvingly, the Merger Guidelines' approach to market delineation.[11] The Guidelines define a market as a group of products and associated geographic area within which a profit-maximizing monopolist would raise price significantly. The Guidelines' Smallest Market Principle further states that the relevant market generally is the smallest group of products and area that constitute a market.[12] The Guidelines'

definition of a market does not preclude the delineation of a market within a broader price and quality continuum, and the Guidelines' Smallest Market Principle may in fact require it. [13]

The point may be illustrated in a simple example of spatial product differentiation. Spatial differentiation represents the extreme case of localized competition, with each firm competing directly only with its closest neighbors. Our example is also highly stylized and unrealistic. The essential point of the example, however, is entirely general.

Consider a road that spans the entire United States and has identical, independently owned gas stations located every five miles along its length. Assume that demand is uniformly distributed along the road so that the degree of competition faced by a station from its nearest neighbor on either side is the same for all stations. The merger of a group of contiguous stations would cause them to increase prices, and the profit-maximizing strategy would be to increase price at different stations in the group by different amounts. [14] The largest price increase would be for the station located at the center of the group. The price increases for each other station in the group would be less, the further its location from the center station.

Under the Guidelines' methodology, the relevant market delineated around any particular gas station would span a sufficient number of stations on either side of it so that a profit-maximizing monopolist would raise price significantly. The larger the group of stations, the larger would be the average profit-maximizing price increase. [15] If demand for gasoline were not too elastic, some segment of the road would be large enough to constitute a market. The smallest such segment would be the relevant market.

The mere fact of significant competition at the margin cannot be a sufficient basis for rejecting a proposed market, because it is not inconsistent with significant market power. [16] Product differentiation may make competition at the margin even less important. The profit-maximizing strategy may be to increase prices for marginal products little if at all, while prices of centrally located products are increased substantially.

There is some degree of arbitrariness ***42** in the relevant market delineated under the Guidelines, but lines must be drawn if market shares are to have any meaning in the differentiated products context. [17] Small shares in a national market would not be a sufficient basis for rejecting a merger challenge because competition is localized. Refusing to delineate somewhat arbitrary lines would, therefore, require abandoning the approach traditionally employed by the courts to assess the competitive effects and legality of mergers.

Delineating Narrow Markets in Differentiated Products Industries

Market boundaries are determined by consumer preferences, and consumer preferences are subjective—expressing idiosyncratic tastes for which there really is no accounting. Even if products differ in objectively measurable ways, willingness to pay for particular features is idiosyncratic. Modern economic theory has rejected notions of objective value and has adopted subjective consumer preferences as the starting point in analyzing price determination in markets. Antitrust law should follow this lead and not seek to impose objective values that consumers do not share.

Mr. Keyte would ignore subjective preferences. He asserts: “Prior to the Gillette decision, it appeared that the purely subjective preferences of consumers should play little, if any, role in market definition analysis.” [18] Mr. Keyte misinterprets the cases, however. He cites cases that stand only for the narrow point that strong preferences of just a particular group of consumers are not sufficient to delineate a market because the preferences of all consumers must be considered, unless a particular group can be discriminated against. Cases such as the recent U.S. Anchor Manufacturing, Inc. v. Rule Industries, Inc. clearly indicate that subjective consumer preferences are controlling. [19]

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Mr. Keyte incorrectly suggests that there is no good way to cope with significant differences in consumer preferences. If consumer preferences were known, it would be relatively simple to apply the Guidelines' definition of a market. One need only simulate the profit-maximization calculus of the hypothetical monopolist, taking into account consumer preferences and the gap between price and marginal cost. [20]

The problem, of course, is to determine consumer preferences. The primary approach taken by both sides in Gillette was to ask manufacturers and retailers of pens to express an opinion. Because such evidence likely will be mixed, the plaintiff, who must carry the burden of proof on market delineation, will have difficulty convincing the court. That was true in Gillette. [21] Moreover, manufacturers and retailers may only be guessing at consumer preferences.

A better approach is to develop quantitative evidence from consumers themselves. Such evidence can be developed from data on actual consumer purchases or from data generated through surveys asking consumers what choices they would make in hypothetical situations. An important advantage of the latter is that surveys can be designed to directly address the critical issue of how consumers would respond to specified prices. On the other hand, hypothetical choice data may be suspect because they are hypothetical. A variety of statistical techniques have been developed for analyzing choice and survey data and these techniques are widely used by businesses; indeed, relevant studies may already exist in the merging firms' files. [22] If not, such studies can be prepared for trial if there is sufficient time and money.

Mergers Without Markets?

Mr. Keyte infers from the Gillette litigation that the Department of Justice "would prefer to bypass market definition and focus instead on whether the products of the merging firms are 'particularly close substitutes"' and concludes that "the Gillette decision makes clear that a Section 7 plaintiff must still establish the relevant market as an essential predicate to a violation." [23] However, one should presume that the Department did what it preferred to do, and it did delineate a relevant market. [24] Consequently, the court had no occasion to consider whether market delineation is essential or even important.

While a court likely would dismiss a horizontal merger complaint that did not delineate a relevant market at all, litigants should consider focusing more directly on the nature and magnitude of the likely effects of the mergers. [25] With information about consumer preferences of the sort necessary for market delineation, and little more, it is possible to simulate the market equilibrium after a merger and thereby estimate a proposed merger's effects. [26]

Merger simulations solve two problems with the traditional market delineation-market share approach. First, with either broad or narrow markets, various products in a delineated market will not be equally good substitutes for each other. Second, with narrowly delineated markets, substitution to products outside the delineated market can be important. Market shares cannot reflect either fact but simulations can. Simulations also estimate the magnitudes of price increases for particular products and provide a basis for explicitly trading off cost reductions against price increases.

Defendants may succeed by sticking with the traditional market delineation-market share approach. They may argue successfully that no meaningful boundaries can be drawn within a price and quality continuum, and that shares are small in very broadly delineated markets. However, practitioners should be wary about arguing for ridiculously broad markets. Doing so may foreclose more sensible arguments, such as that the merging firms are not even in the same relevant market. [27] It may also undermine credibility generally, "like the thirteenth stroke of a crazy clock, which not only is itself discredited but casts a shade of doubt over all previous assertions." [28]

Conclusion

Mr. Keyte concludes that the "lesson of Gillette and Russell Stover appears to be . . . that the more choices available to consumers in industries with differentiated products, the more likely the market will be defined broadly or anticompetitive effects will not be found."[29] If so, that would be unfortunate. The lesson we prefer to take away is that it is difficult to successfully challenge mergers in differentiated products industries because traditional analytical tools do not work well in such industries. Better tools may yield better results.

Footnotes

Note 1. Gregory J. Werden and George A. Rozanski are economists in the Antitrust Division of the U.S. Department of Justice. Mr. Werden played a small role in the Gillette litigation, and Mr. Rozanski was the Justice Department's expert witness. The views expressed herein do not purport to reflect those of the U.S. Department of Justice.

1 United States v. Columbia Steel Co., 334 U.S. 495, 508, 512-13 & n.10 (1948) (first using the term "relevant market" and focusing on market shares); Brown Shoe Co. v. United States, 370 U.S. 294, 334, 343 (1962) (holding market delineation is a prerequisite in horizontal merger cases and emphasizing market shares); United States v. Philadelphia Nat'l Bank, 374 U.S. 321, 363 (1963) (holding market shares establish the presumptive illegality of horizontal mergers).

2 Edward H. Chamberlin, Product Heterogeneity and Public Policy, 40 AM. ECON. REV. (PAPERS & PROC.) 85, 86-87 (1950).

3 James A. Keyte, Premium Fountain Pens and Gift Boxed Chocolates: Market Definition and Differentiated Products, ANTITRUST, Fall 1993, at 19.

4 Over the longer term, the number of products and their attributes are also strategic variables but competition in these dimensions generally is less important for merger analysis.

5 For a detailed examination of the effects of mergers for a particular demand structure, see Gregory J. Werden & Luke M. Froeb, The Effects of Mergers in Differentiated Products Industries: Logit Demand and Merger Policy, J.L., ECON. & ORG. (forthcoming).

6 U.S. Dep't of Justice and Federal Trade Commission, Horizontal Merger Guidelines (1992) § 2.2, reprinted in 4 Trade Reg. Rep. (CCH) ¶ 13,104.

7 In Brown Shoe, the Supreme Court found that Congress "sought to create an effective tool for preventing all mergers having demonstrable anticompetitive effects." 370 U.S. 294, 319 (1962).

8 Mr. Keyte indicated sympathy for this proposition. Supra note 3, at 21. It also appears to have been asserted by Gillette. Defendants' Memorandum of Points and Authorities in Opposition to the United States' Motion for a Preliminary Injunction at 12-27; Gillette, 828 F.Supp. at 81.

9 Brown Shoe held that "[w]here the antitrust plaintiff articulates product differences along a spectrum of price and quality, the product market distinctions are economically meaningless." 370 U.S. at 326. A few other cases are similar. See Murrow Furniture Galleries, Inc. v. Thomasville Furniture Indus., Inc., 889 F.2d 524, 528 (4th Cir.1989); In re Super Premium Ice Cream Distrib. Antitrust Litig., 691 F.Supp. 1262, 1268 (N.D. Cal. 1988), aff'd without opinion, 895 F.2d 1417 (9th Cir.1990). A greater number of cases, including Russell Stover, 1993-1 Trade Cas. (CCH) at 70,091, rejected, as matters of fact, markets defined by reference to price and quality ranges. As Gillette emphasizes, the latter cases have no precedential significance. 828 F.Supp. at 82-83 & n.7.

10 828 F.Supp. at 81-82.

11 Cases adopting the Guidelines' approach include United States v. Archer-Daniels-Midland Co., 866 F.2d 242 (8th Cir.1988); and United States v. Country Lake Foods, Inc., 745 F.Supp. 669 (D.Minn. 1990). For cases quoting the Guidelines approvingly or applying the basic principles of the Guidelines without citing them, see Gregory J. Werden, The History of Antitrust Market Delineation, 76 MARQ. L. REV. 123, 206-09 & nn.523-36 (1992).

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12 The Guidelines' approach is elaborated by Werden, supra note 11, at 190-207; Gregory J. Werden, Market Delineation Under the Merger Guidelines: A Tenth Anniversary Retrospective, 38 ANTITRUST BULL. 517 (1993).

13 Mr. Keyte and the court in Gillette suggest that a relevant market within a price and quality continuum would be a submarket and that the basis for delineating it would be Brown Shoe's submarket criteria. Keyte, supra note 3, at 21; 828 F.Supp at 82. That is one alternative, but not one we endorse.

14 The 1982 and 1984 Guidelines (§ 2.11) assumed a uniform price increase, but the 1992 Guidelines (§ 1.11) consider the optimal, discriminatory price increase. Consequently, relevant markets may be much smaller under the 1992 Guidelines than under their predecessors.

15 Whether the average price for a particular group of contiguous stations would increase significantly is not the 1992 Guidelines' test for whether they constitute a market. The Guidelines, however, are not entirely clear as to which stations in the group must increase price significantly. We refer to their average price to avoid complex references to individual prices.

16 Price discrimination is not the explanation for this fact; the essential conclusions from the foregoing example hold even if uniform price increases are assumed.

17 Since the Guidelines delineate market boundaries despite significant competition at the margin, it was highly misleading for Mr. Keyte to assert that "the market definition analysis set forth in the government Merger Guidelines is premised, in part, on identifying significant gaps in the chain of substitutes." Supra note 3, at 21. Mr. Werden strenuously objects to this proposition for which Mr. Keyte (id. n.25) cited an unpublished version of Werden, supra note 11, as the sole support. The language Mr. Keyte seems to have in mind (Werden, supra note 11, at 195 n.464) expresses Mr. Werden's opinion that he would not necessarily delineate what is literally the smallest market under the Guidelines; rather he would use a natural market boundary, such as a marked gap in the chain of substitutes or a political boundary if the resulting relevant market were only "a little" larger than the smallest market (emphasis in original). None of Mr. Werden's writings supports Mr. Keyte's position.

18 Keyte, supra note 3, at 21, 22 (emphasis in original).

19 7 F.3d 986, 996-98 (11th Cir.1993) (market delineation based on "brand loyalty").

20 See Gregory J. Werden, Four Suggestions on Market Delineation, 37 ANTITRUST BULL. 107, 119-21 (1992) (discussing the critical number of loyal customers and elasticity of demand); Werden & Froeb, supra note 5 (discussing simulations with differentiated products).

21 In Gillette the Justice Department contended that buyers of premium fountain pens—those having 1992 suggested retail prices between $50 and $400—generally would not switch to other products in the event of a significant price increase. The court agreed with the Department that the relevant market did not include either higher-priced or lower-priced fountain pens; however, the court also agreed with the defendants that only a relatively small number of enthusiasts would not freely substitute from premium fountain pens to other types of comparably priced writing instruments in the event of a price increase. 828 F.Supp. at 81-84. Defendant's evidence on this point was affidavits from its own employees.

22 Such studies did exist in the Gillette case and were relied upon to some extent by the Justice Department. The studies directly addressed the issue of substitution among fountain pens but did not directly address substitution to other types of writing instruments.

23 Keyte, supra note 3, at 19, 21.

24 See 828 F.Supp. at 81. It is true, however, that the Department's economic expert in Gillette, Mr. Rozanski, did not delineate relevant markets in his testimony. It is also true that Gillette chose not to explore in Mr. Rozanski's deposition how he would have delineated markets.

25 Mr. Werden has argued elsewhere that market share presumptions should not be invoked in differentiated products industries; rather, the effects of mergers should be estimated in the context of economic models. See George A. Hay &

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Gregory J. Werden, Horizontal Mergers: Law, Policy, and Economics, 83 AM. ECON. REV. (PAPERS & PROC.) 173, 176-77 (1993).

26 Werden and Froeb, supra note 5, explore this approach and illustrate its application to hypothetical mergers of U.S. long distance carriers. The simulations they present assume a particular demand structure and constant marginal costs. The only input data required are the premerger market shares and prices and values of two demand parameters. One demand parameter relates to the cross elasticities of demand among products in a designated group, and the other is the elasticity of demand for the product group as a whole. Both parameters can be estimated with well-established econometric methods or guessed at in a pinch.

27 This point is elaborated in Werden, supra note 20, at 117-18.

28 A.P. Herbert, Rex v. Haddock: Is It a Free Country?, in UNCOMMON LAW 24, 28 (Barnes & Noble ed. 1993).

29 Keyte, supra note 3, at 22.

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ATTACHMENT H

The FTC's Merger Remedies 2006-2012

A Report of the Bureaus of Competition and Economics

January 2017

FEDERAL TRADE COMMISSION

THE FTC'S MERGER REMEDIES 2006-2012
A REPORT OF THE BUREAUS OF COMPETITION AND ECONOMICS

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Executive Summary

One of the Federal Trade Commission's primary tasks is to enforce Section 7 of the Clayton Act, 15 U.S.C. § 18, which prohibits mergers when their effect may be to lessen competition.[1] Most mergers do not raise competitive concerns, but some raise sufficiently significant competitive concerns that the Commission seeks to block them outright. For most of the mergers in which the Commission finds a competitive problem, harm to competition is likely to occur in only a subset of the markets in which the merging parties operate. In those situations, appropriate remedies may protect competition while allowing the merger to proceed. Recognizing that the efficacy of its remedies is critical to its antitrust mission, the Commission conducted a broad study of all of its merger orders from 2006 through 2012. This study expanded on the divestiture study the FTC completed in 1999.[2] This staff report summarizes the findings and provides best practices reflecting the learning of the study.

The current study evaluated the success of each remedy and examined the remedy process more generally. Staff used three methods to conduct the study. First, staff examined 50 of the Commission's orders using a case study method.[3] Similar to the method used in the 1999 Divestiture Study, staff interviewed buyers of divested assets and the merged firms. Staff also interviewed other market participants and analyzed seven years of sales data gathered from significant competitors. Second, staff evaluated an additional 15 orders affecting supermarkets, drug stores, funeral homes, dialysis clinics, and other health care facilities by examining responses to questionnaires directed to Commission-approved buyers in the relevant transactions. Finally, staff evaluated 24 orders affecting the pharmaceutical industry using both internal and publicly available information and data. In all, staff reviewed 89 orders and conducted more than 200 interviews, analyzed sales data submitted by almost 200 firms, examined responses to almost 30 questionnaires, and reviewed significant additional information related to the pharmaceutical industry.

In evaluating the 50 orders in the case study component, Commission staff considered a merger remedy to be successful only if it cleared a high bar—maintaining or restoring competition in the relevant market.[4] Using that standard, all of the divestitures involving an ongoing business succeeded. Divestitures of limited packages of assets in horizontal, non-consummated mergers fared less well, but

[1] This report uses the term "mergers" throughout, even though the specific transactions may be acquisitions, mergers, or other forms of combination.

[2] "A Study of the Commission's Divestiture Process," Bureau of Competition (August 1999) (hereinafter "1999 Divestiture Study"), https://www.ftc.gov/sites/default/files/attachments/merger-review/divestiture.pdf.

[3] The case study method of research accumulates case histories and analyzes them with a view toward formulating general principles. This method is used often in social science research. *See, e.g.,* Robert K. Yin, Case Study Research: Design and Methods (2009).

[4] Commission staff's assessment of the success or failure of the divestiture depended on whether competition in the relevant market remained at its pre-merger level or returned to that level within a short time. However, competition in a market is affected by many factors, and it is possible that competition might have lessened in certain markets even if the merger had not happened. Section IV.C. discusses the method for evaluating outcomes, including the standard by which Commission staff defined success, and the achieved outcomes.

still achieved a success rate of approximately 70%. Remedies addressing vertical mergers also succeeded. Overall, with respect to the 50 orders examined, more than 80% of the Commission's orders maintained or restored competition.

For the remedies involving supermarkets, drug stores, funeral homes, dialysis clinics, and other health care facilities evaluated as part of the questionnaire portion of the study, the vast majority of the assets divested under those 15 orders are still operating in the relevant markets. And, with respect to the 24 orders affecting the pharmaceutical industry, the majority of buyers that acquired products on the market at the time of the divestiture continued to sell those products. Additionally, all of the divested assets relating to products that were in development and not available on the market at the time of the divestiture were successfully transferred to the approved buyers.

The study also confirmed that the Commission's practices relating to designing, drafting, and implementing its merger remedies are generally effective, but it identified certain areas in which improvements can be made. Specifically, some buyers expressed concerns with the scope of the asset package, the adequacy of the due diligence, and the transfer of back-office functions. While the concerns raised may not have interfered with buyers' ability to compete in the relevant markets over the long term, they may have resulted in additional challenges that buyers had to work around or otherwise overcome. Staff has already taken various steps to address these concerns. They include asking additional targeted questions about remedy proposals to divest limited asset packages, asking more focused questions about financing, and monitoring the due diligence process even more carefully. Staff is also more closely scrutinizing buyers' back-office needs, and, in some cases, is considering additional order language. Finally, the study surprisingly revealed that there continued to be a reluctance among buyers to raise concerns with staff and independent monitors when they arose. Staff is increasing efforts to remind buyers of the benefits of reaching out to staff or monitors when issues arise.

Staff concludes this report with best practices, based on learning from the study.

I. Introduction

In the late 1990s, FTC staff embarked on what, at the time, was the first effort by an antitrust enforcement agency to evaluate systematically its merger remedy program. Staff evaluated 35 horizontal merger orders that the Commission issued from 1990 through 1994, relying on a case study method. In 1999, the Bureau of Competition issued its report concluding that "most divestitures appear to have created viable competitors in the market of concern to the Commission."[5] Although there was some criticism at the time that the 1999 Divestiture Study had not gone far enough in assessing the competitive effectiveness of the remedies, the idea of evaluating past orders was generally well received. Since then, antitrust enforcement agencies in other jurisdictions have conducted similar studies with largely similar results.[6]

The Commission made several changes in its merger remedy policies and practices in large part due to the findings of the 1999 Divestiture Study. For example, the Commission began requiring upfront buyers[7] for divestitures of less than an ongoing business[8] or assets that raised particular risks of deterioration pending divestiture. The Commission also shortened the default divestiture period for post-

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[5] 1999 Divestiture Study at 8. "The Study was not designed to conduct a complete competitive analysis of the relevant markets or draw definitive conclusions about how any of the 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." *Id.* at 9.

[6] DG Competition of the European Commission, MERGER REMEDIES STUDY (2005), http://ec.europa.eu/competition/mergers/legislation/remedies_study.pdf; UK Competition & Markets Authority, UNDERSTANDING PAST MERGER REMEDIES: REPORT ON CASE STUDY RESEARCH (updated July 2015), https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/448223/Understanding_past_merger_remedies.pdf; and Competition Bureau of Canada, COMPETITION BUREAU MERGER REMEDIES STUDY (2011), http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/vwapj/cb-merger-remedy-study-summary-e.pdf/$FILE/cb-merger-remedy-study-summary-e.pdf.

[7] The "buyer" is the entity that the Commission approves under its order to acquire divested assets. An "upfront buyer" is a buyer named in the proposed order after that buyer has negotiated a transaction agreement with the respondent and the Commission has approved that buyer and the terms of the transaction.

[8] The 1999 Divestiture Study described assets comprising an "ongoing business" as follows:

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

1999 Divestiture Study at 11. The present study uses the same criteria to define an ongoing business.

order buyers,[9] from a year or more to six months or less, and started appointing independent third parties more often to monitor complex remedies or those in highly technical industries. In addition, the Commission staff began interviewing buyers of divested assets six months to a year after the divestitures to discuss their progress and any issues that might have arisen.

Early in 2015, the Commission decided to evaluate the impact of the changes implemented since the 1999 Divestiture Study and to conduct another merger remedy study. The Commission designed the study to be more comprehensive in scope and broader in analysis than the 1999 Divestiture Study. As required by the Paperwork Reduction Act, 44 U.S.C. § 3501 *et seq*., the Commission sought public comment and approval from the Office of Management and Budget ("OMB"). OMB approved the project in August 2015.[10]

The study relied in large part on the willingness of market participants—respondents,[11] buyers of divested assets, other competitors, and customers—to share their experiences with the Commission's remedies and their impact on competition in the relevant market. During the study, over 200 market participants shared with staff their thoughts and observations.[12] To protect the confidentiality of the information discussed during those interviews and submitted to the Commission, this report does not contain any confidential information or identify the parties from whom information was received.

This study encompassed all 89 orders issued by the Commission from 2006 through 2012 in order to remedy the anticompetitive effects of a proposed or consummated merger.[13] For purposes of analysis, staff divided these 89 orders into three groups based, in large part, on the degree of experience the Commission has with the affected industry.

- Commission staff evaluated 50 of the orders—involving the broadest range of industries—using a case study method that relied on interviews of market participants and sales data. Staff

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[9] A "post-order buyer" is a buyer of divested assets approved by the Commission following the issuance of a divestiture order. As with upfront buyers, the Commission will set a deadline by which the divested assets must be transferred.

[10] Office of Management and Budget Control No. 3084-0166.

[11] This report uses the term "respondent" to refer to the parties to a merger order. Although the FTC also has the authority to obtain merger remedies in federal court, where a party to the order would be referred to as the "defendant," *see, e.g.*, *St. Alphonsus Med. Ctr.-Nampa, Inc., et al. v. St. Luke's Health Sys., et al.*, 778 F.3d 775 (9th Cir. 2015), all of the merger orders included in the study were issued by the Commission.

[12] Participation in the interviews was voluntary, and the rate of participation was high. Staff interviewed 193 market participants, including 42 respondents, 46 buyers, 49 additional competitors, and 56 customers. Staff also interviewed 14 monitors. Overall, about two-thirds of the proposed interviewees agreed to an interview: 80% of the merged firms, nearly 90% of the buyers, 80% of other competitors, and 45% of customers. In addition, well over half of the buyers that received questionnaires responded to them. The study relied, in large part, on the information obtained in these interviews and from the responses to the questionnaires. The staff appreciates the willingness of all parties who agreed to participate in the interviews and who responded to the questionnaires.

[13] Ninety-two merger orders were first identified, and that number was used in the Federal Register Notice, dated January 16, 2015, requesting comments on the proposed study. Upon further examination, however, staff determined that three of those 92 orders related to mergers that were abandoned for business or other reasons and were thus dropped from the study.

interviewed not only buyers and respondents, as had been done in the 1999 Divestiture Study, but also selected competitors and customers. For these orders, the Commission also went beyond the 1999 Divestiture Study by requesting seven years of sales data from significant market competitors and by compiling market shares based on that data.

- Staff evaluated another 15 orders involving industries with which the Commission is well familiar—supermarkets, drug stores, funeral homes, dialysis clinics, and other health care facilities—using responses to voluntary questionnaires sent to the buyers. The questionnaires focused on several issues that had arisen in prior divestitures in these industries, such as the scope of the asset package and the due diligence process.

- The final 24 orders reviewed involved the pharmaceutical industry, another industry about which the Commission is knowledgeable. These orders were evaluated based on internal expertise, information, and data, as well as information obtained from publicly available sources.

This report focuses primarily on the learning from the case studies, which delved more deeply into the implementation and outcome of the remedies reviewed than the other two parts of the study.[14] The study concluded that most of the remedies in the case studies successfully maintained or restored competition in the identified relevant markets. Section IV.C. explains the criteria for evaluating success and discusses the results of that analysis. The study also identified the concerns interviewees raised about certain aspects of the remedy process, which the Commission has already begun to address. This report summarizes those concerns below and discusses them in more detail in Section IV.D.

The study found that all remedies involving divestitures of assets comprising ongoing businesses succeeded, confirming that such divestitures are most likely to maintain or restore competition. The study also revealed that buyers of less than an ongoing business—buyers of "selected assets"—did not always succeed at maintaining competition, suggesting that the more limited scope of the asset package increases the risk that a remedy will not succeed. The study showed that, even with an upfront buyer, the Commission has not always eliminated the risk associated with divestiture of more limited asset packages.[15] Therefore, proposals to divest selected assets generally warrant more detailed Commission examination.

The 1999 Divestiture Study revealed that respondents sometimes may have proposed buyers that, though marginally acceptable, were less likely to provide robust competition. The new study showed that respondents in most cases proposed buyers likely to fully satisfy the Commission's criteria for strong, viable competitors. But because the success or failure of a divestiture depended, in part, on whether the buyer had adequate funding commitments to ensure success, the Commission will examine more closely, among other things, the source of the buyer's financing, its plans if the transaction does not

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[14] The case study findings are consistent with the findings of the other two parts of the study. The results compiled from responses to the questionnaires and review of pharmaceutical orders are summarized in Sections V and VI, respectively.

[15] The reason, of course, that the Commission is concerned about the success of a remedy in restoring or maintaining competition is to protect customers and ultimately end consumers. If a divestiture remedy fails, customers and consumers would likely be harmed.

meet its financial goals, what it has done in other instances when acquisitions have not met financial goals, and related issues.

For their part, most buyers appeared to understand the Commission's remedy process and expressed satisfaction with how it transpired. Some buyers, however, raised concerns about the limited time available for due diligence and the lack of access to respondents' facilities and employees. Although upfront buyers raised this concern more frequently than post-order buyers, several post-order buyers raised it as well. In some cases, the lack of access to facilities and employees during the due diligence process may have delayed the buyers' ability to compete in the relevant markets or increased the buyers' costs.

Some buyers identified unforeseen complexities in transferring "back-office" functions related to the divested assets,[16] regardless of whether the divested assets included those functions or the buyers developed them internally or obtained them from third parties. When respondents did provide those functions on a transitional basis until buyers could perform them on their own, some buyers believed the length of the transition services agreements was too short. In several cases, buyers took longer to transition away from respondents' information technology systems than anticipated, requiring a longer period of transition services than specified in, or available via, the orders.

In addition, some buyers raised questions about the length of supply agreements. Although extensions of supply agreements may not always be warranted, providing mechanisms for extending them may be helpful to accommodate unanticipated complexity in the limited cases where buyers need a temporary extension. Both respondents and buyers raised concerns about the operation of assets that respondents are sometimes required to hold separate from the remainder of their operations pending their divestiture and the role of the hold separate managers typically appointed in orders to hold separate.

Finally, despite the Commission's efforts since the 1999 Divestiture Study to encourage buyers to reach out to staff if they encounter difficulties, it appeared that buyers continue to be reluctant to bring issues to the attention of staff or the monitors when they arise.

The concerns identified by buyers did not necessarily affect the ability of any particular buyer in the study to maintain or restore competition, but they represent potential gaps and risks that may adversely affect merger remedies. Addressing these concerns does not require a change in the Commission's overall approach to remedies. It does, however, necessitate enhanced staff scrutiny, including asking additional questions of respondents and proposed buyers, and, in some instances, increased monitoring of the overall divestiture process. In certain cases, addressing these concerns may also require different order language. The Best Practices section at the end of this report describes the additional steps staff is now taking as part of the Commission's remedy process and provides information to respondents and buyers regarding additional issues they should consider during the course of the remedy process.

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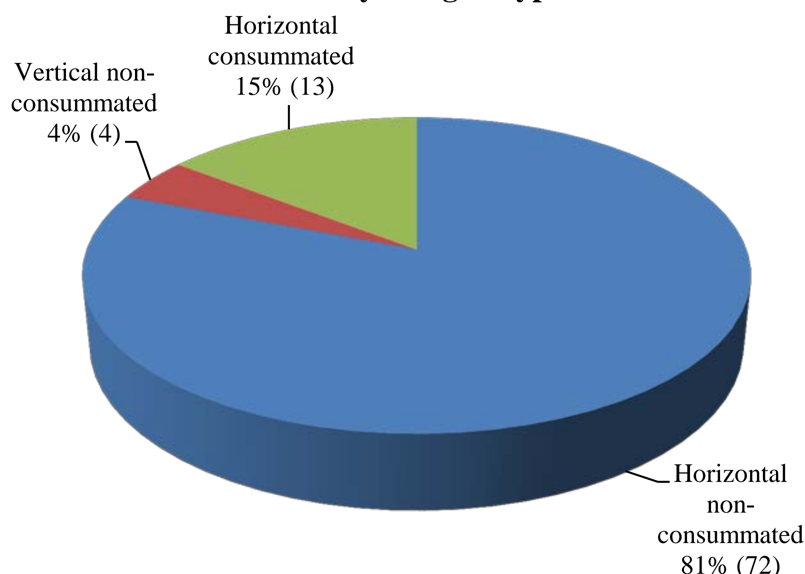
[16] "Back-office" functions refer to a variety of support functions such as legal, finance, accounting and tax, risk, insurance, environmental services, and human resources (and includes related personnel and books and records). They also encompass information technology systems and databases, used in connection with warehousing, sales, production, and inventory databases, as well as controls, processing, and operations software.

II. Overview

This study included 89 Commission merger orders from 2006 through 2012, affecting over 400 markets.[17] All of these were consent orders, although the Commission had begun litigation with respect to three of the mergers before the parties ultimately settled with a divestiture. The vast majority of the orders addressed horizontal concerns; only four involved vertical concerns. *See* Figure 1. Seventy-five of the underlying mergers were reportable under the Hart-Scott-Rodino ("HSR") Act, 15 U.S.C. § 18a; 14 were not. Of the 75 HSR-reported transactions, two were consummated before negotiations of a consent agreement began. Of the 14 that were not HSR-reported, 11 were consummated prior to consent negotiations.

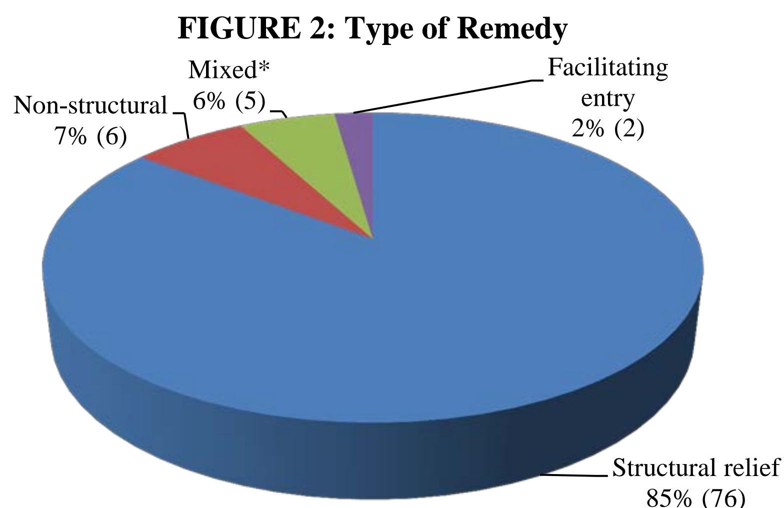
FIGURE 1: Percent of Orders by Merger Type and Consummation Status



The 89 orders covered an array of remedies, but most imposed structural relief. As shown in Figure 2, 76 of the 89 orders required structural relief, 74 of those required divestitures to remedy competitive effects in all affected markets, and two required restructuring of the underlying merger so that the acquirer did not purchase the overlapping assets. Five other orders addressed effects in multiple markets with divestitures in some markets, and non-structural relief in others. Six orders, of which four were vertical, required only non-structural relief. Two required relief other than divestiture that was designed to facilitate entry.

[17] The Commission explained how it selected this time period in the Federal Register Notice, dated January 16, 2015, requesting comments on the proposed study. The Commission initiated another 54 enforcement actions from 2006 through 2012, which did not result in a Commission order. These actions included preliminary injunction actions, administrative complaints, and actions with respect to transactions that were abandoned or restructured. *See* www.ftc.gov/competition-enforcement-database.

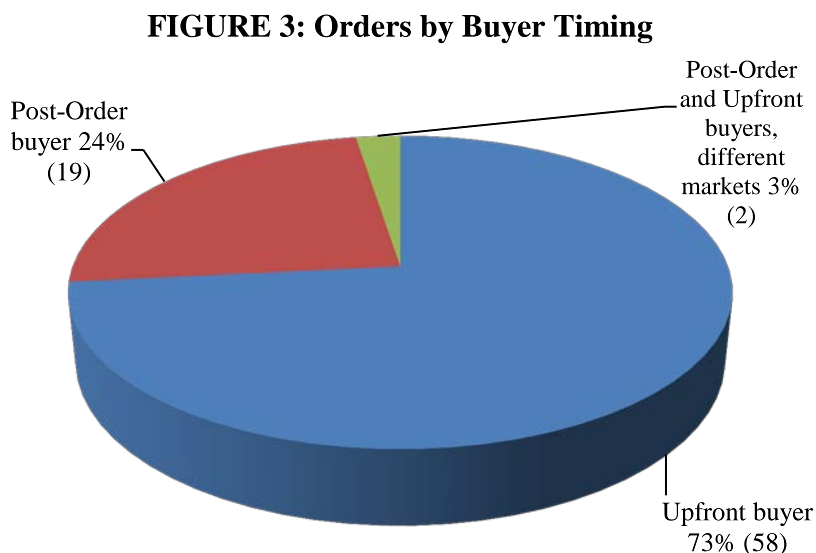
FIGURE 2: Type of Remedy



* "Mixed" represents an order with both structural and non-structural relief across different markets

As shown in Figure 3, 58 of the 79 orders requiring divestitures called for upfront buyers, 19 consisted of post-order divestitures, and two involved both an upfront buyer and a post-order divestiture in different markets. Under these 79 orders, the Commission approved 121 buyers; 79 of them were upfront, and 42 were post-order. The majority of the divestitures to upfront buyers were of selected assets; the majority of the post-order divestitures were of ongoing businesses.

FIGURE 3: Orders by Buyer Timing



The orders were divided into three groups based on staff's experience with the affected industries, and were evaluated using three different methods: a case study method for 50 orders, questionnaire responses for 15 orders affecting certain industries, and an assessment of 24 orders affecting the pharmaceutical industry using internal and publicly available information and data.

A. Case Studies

FTC staff reviewed 50 orders using a case study method consisting of interviews of market participants and analysis of limited sales data obtained from almost all significant competitors in each market. The orders covered 184 relevant markets, the widest range of markets of the three parts of the study, including chemicals, medical devices, databases, manufacturing products, consumer goods, oil and gas pipelines and terminals, satellites, road salt, and batteries. The goal of this part of the study was to interview each respondent, the buyers of divested assets (if divestiture was required), and various other competitors and customers in each relevant market. All told, FTC staff interviewed almost 200 market participants.

In addition, the Commission issued nearly 200 orders under Section 6(b) of the FTC Act, 15 U.S.C. § 46(b), requesting information from significant competitors in each of the relevant markets covered by most of the 50 orders.[18] The Section 6(b) orders sought annual sales data, in dollars and units, for each relevant market over a seven-year period—three years before the remedy, the year of the remedy, and three years after the remedy. Nearly all significant competitors in each market for which information was sought provided data. Staff analyzed all data obtained and calculated market shares before and after the transactions. The evolution of these shares provided another source of information about the effect of the remedy on competition in the affected markets and, for divestitures, the success of the buyers. Section IV discusses this analysis in more detail.

B. Questionnaires

Staff examined another 15 orders by requesting responses to focused questionnaires. These orders involved divestitures of supermarkets, drug stores, funeral homes, dialysis clinics, and other healthcare facilities. The Commission has conducted numerous investigations involving these industries and has imposed merger remedies in many of these investigations. As a result, the Commission understands the way competitors operate and what a viable divestiture package needs to include. Additionally, in a number of these industries, it was not practical to interview customers, many of whom are individual consumers. Instead of interviewing buyers and other market participants, staff sent questionnaires to the 43 buyers that acquired assets under these orders, focusing on several areas in which questions have arisen in the past about remedies in these industries: the due diligence process, the scope of the asset package, transitional services, and post-divestiture operations. Compliance with the questionnaire was voluntary. Twenty-seven buyers responded to the questionnaire either in writing or through an interview. Section V summarizes staff's findings.

C. Orders Affecting the Pharmaceutical Industry

The remaining 24 orders involved mergers in the pharmaceutical industry, most of which concerned prescription generic drugs. Other product markets covered were prescription branded drugs, over the

[18] The FTC did not send 6(b) requests where staff determined that sales data would not add in a meaningful way to staff's analysis.

counter drugs, and animal health drugs. The Commission has developed significant expertise in the pharmaceutical industry and follows a standard approach for evaluating these mergers and designing relief. In pharmaceutical orders, the Commission typically appoints an interim monitor to oversee the transfer of technology and production assets and to provide periodic reports to the Commission. The monitors' confidential reports contain information on how the respondents have complied with their obligations under the order, as well as updates on the buyers' progress securing FDA approval with the divested assets. Staff reviews these reports and frequently contacts monitors and buyers for additional information. Publicly available industry information, including FDA publications, also helps staff monitor FDA approval of buyers' drug products post-divestiture.

For this part of the study, staff compiled all relevant publicly available information, interviewed various highly experienced divestiture monitors, and conducted an in-house evaluation of the 24 pharmaceutical orders. Section VI summarizes the information reviewed and staff's conclusions.

III. The 1999 Divestiture Study

The 1999 Divestiture Study evaluated Commission merger orders from 1990 through 1994 that required a divestiture to remedy the anticompetitive effects of unlawful horizontal mergers. It excluded orders in vertical mergers, non-structural remedies in horizontal mergers, and several industry-specific orders. Staff employed a case study method for the 35 orders it evaluated, and sought to interview on a voluntary basis all buyers of the divested assets, respondents, and monitors. The overall goal was to determine whether the buyers of the divested assets had successfully acquired the assets subject to the divestiture order and were operating in the relevant markets. Thirty-seven of the 50 buyers agreed to talk to Bureau of Competition and Bureau of Economics staff, who also interviewed eight respondents and two Commission-ordered monitors. Staff requested sales data and limited financial information from buyers on a voluntary basis, but few participants submitted the requested data or information.

Through that study, staff determined that "most divestitures appear to have created viable competitors" in the relevant markets.[19] Staff also concluded that reliance on prospective buyers of divested assets to assist in determining the scope of the assets to be divested, though important, was sometimes misplaced. Buyers were not always knowledgeable enough about the market to reliably inform the proper scope of assets. In addition, a prospective buyer was often unwilling to ask for additional assets or assistance it might need out of fear of losing the deal or appearing less desirable as a buyer. Staff also learned that respondents often recommended marginally acceptable buyers and, on some occasions, engaged in post-divestiture strategic behavior aimed at minimizing the competitive impact of the buyer's entry into the market. Finally, the study highlighted that buyers frequently chose not to bring issues to the attention of FTC staff until it was too late to effectively resolve them, if they brought them to the attention of staff at all.

Based on this learning, the Bureau of Competition recommended changes to the divestiture process even before it had completed its study. The Commission began imposing a shorter divestiture period—reducing the amount of time from a year or more to four to six months—to reduce the time respondents

[19] 1999 Divestiture Study at 8.

held the assets to be divested; requiring upfront buyers more frequently to ensure that there were buyers for the package of assets to be divested; and, in technical markets or in orders that raised complex questions, more frequently requiring the appointment of an independent third party to monitor compliance.

FTC staff broadened its own due diligence so as not to rely principally on input from prospective buyers as to the scope of the divestiture package, by also soliciting input from other market participants, customers, and suppliers. Staff also began a more in-depth review of proposed buyers, including requiring prospective buyers to submit detailed written business and financial plans for the divested assets. In addition, the Bureau of Competition posted guidance concerning the remedy process on the FTC's website in an effort to make the process more transparent. Staff also ensured that they were accessible to buyers and encouraged them to reach out if issues arose. Finally, staff began conducting informal follow-up interviews with buyers of divested assets after the divestiture to see how the buyer was doing.

The improvements implemented as a result of the 1999 Divestiture Study continue to be a part of the Commission's remedy process today.

IV. FTC Orders Evaluated Using the Case Study Method

In this study, Commission staff evaluated 50 of the 89 Commission merger orders from 2006 through 2012 using the case study method, which compiled information obtained from interviews of respondents and other significant participants in each relevant market, including buyers if assets were divested, other competitors, and customers. Staff corroborated that information with market share information derived from the sales data obtained from significant competitors.

A. Overview

Commission staff evaluated the 50 case study orders in two ways. As described in more detail below, staff evaluated the competitive success of each remedy by determining whether the remedy had maintained or restored competition in the relevant market. The Commission's remedial goal for all merger actions is to prevent or eliminate the likely anticompetitive effects of a merger, maintaining the competition that would have been lost, or restoring the competition that was lost, from the merger.[20] Determining the success of an order, therefore, began with the broad question of whether the Commission's remedy had maintained or restored competition. Answering that question required understanding how market participants, including major customers, the respondent, the buyer of divested assets, and other competitors viewed the market post-divestiture. Staff used the information

[20] In vertical mergers, because the effects are not due to the actual loss of a competitor, the goal is to remedy the likely anticompetitive effects that would occur due to the vertical relationship that results, including the respondent's ability to foreclose competitors' access to a critical input or its ability to obtain confidential information about a competitor.

obtained in interviews together with market shares calculated using sales data to evaluate the success of the remedies.

The study showed that most of the Commission's remedies succeeded. Buyers typically acquired the assets needed to compete in the market and, with those assets, replaced the competition that would have been lost or had been lost as a result of the underlying merger. Customers told staff that buyers represented viable competitive alternatives to the respondents, and competitors confirmed that the buyers were competing in the relevant markets. The data corroborated their views.

That most remedies succeeded supports the Commission's general approach to merger remedies.[21] The Commission most often addresses the horizontal effects of mergers that harm competition in one or more relevant markets by ordering a divestiture. The study showed that the divestiture of assets comprising an ongoing business, which the Commission prefers, poses little risk. It also showed that it may be possible to remedy anticompetitive consummated mergers under certain, limited circumstances although the difficulties inherent in separating commingled assets to recreate a viable competitor are always a concern. Moreover, the four- to six-month divestiture period for post-order buyers introduced following the 1999 Divestiture Study—in contrast to the pre-1999 one-year or longer divestiture period—did not appear to have undercut respondents' ability to find approvable buyers. The appointment of independent third parties to monitor compliance with technical orders or those involving complex industries also appeared to have helped limit risks.

As part of its inquiry, staff also asked questions focusing on the process used to implement merger remedies. First, did the buyer of the divested assets obtain the assets required to be divested and all the ancillary rights and assistance required by the order? Second, did the buyer, or other market participants, have concerns about the process itself that staff should address in future matters? Staff explored these and related questions in the interviews with buyers and other market participants and examined whether the concerns raised may have affected the remedies' success. Although the interview responses supported the overall effectiveness of the Commission's remedy process, there were several significant findings, which are discussed in more detail in Section IV.D. and addressed in the Best Practices discussion in Section VII.

[21] The Bureau of Competition has provided guidance as to these policies on the Commission's website, and Commissioners and BC representatives have made speeches, written articles, and issued statements reflecting these policies over the years. *See, e.g.*, Fed. Trade Comm'n, Bureau of Competition, *Frequently Asked Questions About Merger Consent Order Provisions*, https://www.ftc.gov/tips-advice/competition-guidance/guide-antitrust-laws/mergers/merger-faq; Fed. Trade Comm'n, Bureau of Competition, *Statement on Negotiating Merger Remedies* (Jan. 2012), https://www.ftc.gov/tips-advice/competition-guidance/merger-remedies; "Retrospectives at the FTC: Promoting an Antitrust Agenda," Remarks of Chairwoman Edith Ramirez, ABA Retrospective Analysis of Agency Determinations in Merger Transactions Symposium, George Washington University Law School, Washington, DC, June 28, 2013; "The Significance of Consent Orders in the Federal Trade Commission's Competition Enforcement Efforts," Remarks of Deborah L. Feinstein, Director, Bureau of Competition, GCR Live, Sept. 17, 2013.

B. Description of the Orders

Table 1 summarizes the number and percent of orders by the type of merger and remedy imposed in the order.[22]

TABLE 1: Orders by Merger and Remedy Types

		Remedy Type	
		Structural	Non-Structural
Merger Type	Horizontal (46)	87%	13%
	Vertical (4)	0%	100%
	All (50)	80%	20%

As Table 1 shows, 80% of the 50 mergers were horizontal and remedied with structural relief.[23] All the vertical mergers were remedied with non-structural relief, while 13% of the horizontal mergers were also remedied with primarily non-structural relief. As will be discussed in more detail below, of the 46 horizontal mergers, ten were consummated; all of the vertical mergers involved non-consummated mergers.

Table 2 lists the characteristics discussed in this study, and, for the 40 structural remedies, shows the number of orders in which those characteristics occurred with respect to at least one market remedied by the order.[24] For some orders that cover multiple markets, there was an upfront buyer for some markets and a post-order buyer for other markets. Those orders are counted as having both an upfront buyer and a post-order buyer; therefore, the percentages in the table add up to more than 100%. The same was true for the type of asset package. Various orders covered multiple markets and required divestiture of an ongoing business in some markets and selected assets in others, resulting in the percentages in the table adding up to more than 100%.

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[22] Many orders involved multiple markets, and sometimes also involved different types of remedies in the different markets covered by the order. Thus, categories may contain fractional orders; for example, for an order with two markets and a structural remedy in one market and a non-structural remedy in the second, the category count of structural and non-structural remedies will each be 0.5. *See* Section IV.C.3. for a more complete description of this order measure.

[23] Two instances where the parties restructured the underlying merger before an order issued are classified as structural remedies, and two orders that required respondents to take steps to facilitate entry are classified as non-structural remedies. Table 1 shows that 80% of orders required structural relief, and all of these were horizontal.

[24] These characteristics are present in the orders, but the Commission may not have necessarily implemented them. For instance, 74% of the orders allowed the Commission to appoint a monitor, but the Commission did not appoint one in cases where it ultimately determined a monitor was unnecessary.

TABLE 2: Characteristic Counts and Percentages for Structural Remedies

Buyer Timing	%
Upfront Buyer	69%
Post Order Buyer	33%
Package Type	
Ongoing Business	40%
Selected Assets	67%
Other Characteristics	
Supply Agreement	48%
Transition Services	57%
Monitor	74%
Hold Separate Order	24%
Asset Maintenance Order	52%

About two-thirds of the 40 orders involving structural remedies had an upfront buyer. Merging parties divested selected asset packages in 67% of orders compared to 40% in which they divested ongoing businesses. About one-half of orders included a supply agreement provision that required the respondent to supply the buyer of the divested assets with a product (or input into production) at agreed-upon terms for a certain period. Nearly 60% of the orders included provisions requiring transition services, i.e., provisions in the order requiring the respondent to provide certain defined services to the buyer for a specified period.[25]

Table 2 shows that 74% of orders in the case study group included an option to appoint an independent third party to monitor certain provisions of the order.[26] The Commission issued hold separate orders and asset maintenance orders in 24% and 52% of the orders, respectively.[27]

C. Determining Whether a Remedy Succeeded

As discussed above, staff evaluated each remedy in two ways. The first was competitive outcome: whether the Commission successfully restored competition to, or maintained competition at, its pre-merger state. The second was procedural: whether interviewees revealed concerns about the

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[25] It is important to note that many of the characteristics in Table 2 were not independent of each other. For example, 82% of orders involving selected assets were in remedies that required an upfront buyer, while 63% of orders involving ongoing businesses were divested to post-order buyers.

[26] Most of these characteristics were not applicable to non-structural remedies. One characteristic that often appears in non-structural remedies, however, is the use of monitors. The option to appoint a monitor was included in 97% of orders that involved non-structural remedies.

[27] Hold separate orders may also include asset maintenance obligations.

Commission's remedy practices. In addition, staff combined these analyses to determine whether remedy process concerns affected outcomes. Discussed below are the standard used for judging success and the resulting analysis.

1. The Standard for Judging Success

The goal of any remedy is to preserve fully the existing competition in the relevant markets at issue, and each remedy was assessed based on the extent to which it achieved this goal.[28] The study assessed whether the remedy achieved the Commission's goal based on the following standards: success, qualified success, and failure.

- A remedy was rated as a success if competition in the relevant market remained at its pre-merger level or returned to that level within a short time (two to three years) after the Commission issued the order.

- A remedy was rated as a qualified success if it took more than two to three years to restore competition to its pre-merger state, but ultimately did so. Qualified successes also included markets in which buyers of assets were relatively quickly competitive, but for whom continuing success was difficult because of market shocks or situations in which the market evolved in a way not anticipated by the order.[29]

- A remedy that did not maintain or restore competition in the relevant market was rated as a failure. Failures happened either because the buyer of the assets never produced the product, or because the buyer (or possibly an expanded fringe competitor or a new entrant in the case of a non-structural order) never attained the competitive effectiveness of the pre-merger owner of the divested assets.

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[28] The Commission has broad discretion to impose remedies for acquisitions that are likely to substantially lessen competition in violation of Section 7 of the Clayton Act. *See, e.g.*, Polypore Int'l, Inc. v. FTC, 686 F.3d 1208, 1218-19 (11th Cir. 2012); Chicago Bridge & Iron Co. N.V. v. FTC, 534 F.3d 410, 441 (5th Cir. 2008); Olin Corp. v. FTC, 986 F.2d 1295, 1307 (9th Cir. 1993); Ekco Prods. Co. v. FTC, 347 F.2d 745, 753 (7th Cir. 1965).

[29] This assumes that the original owner of the assets would have been better able to anticipate and attend to these market changes. This but-for assumption cannot be tested.

2. The Method Used to Determine Whether a Remedy Was a Success

Evaluating a remedy's success required a comparison of competition (the competitive dynamic) in the pre-merger period with that in the post-remedy period.[30] Information from the underlying investigation of the matter allowed for assessing pre-merger competition in the relevant markets.

To gauge changes in competition post-order, staff identified significant customers and competitors for each matter and market, relying in part on the customers and competitors that the investigative team had identified and interviewed in the underlying investigation. Staff re-interviewed a select number of them, focusing on the competitive dynamics in the relevant market and, for those remedies involving a divestiture buyer, whether the buyer competed as effectively as the previous owner of the divested assets.[31] Staff focused on many of the same topics on which the investigative team had focused, including how firms competed in the relevant markets and customers' views on the strength and weaknesses of the various competitors. Staff also obtained sales information from significant market competitors, calculated market shares for many of the matters and markets, and used those market shares in conjunction with the information garnered in the interviews to evaluate the success of the remedy.

The method for evaluating success differed slightly for horizontal and vertical mergers, and for structural and non-structural remedies, because of the differing remedial approaches taken by the Commission to restore competition. For horizontal mergers with a structural remedy, the focus was the competitive significance of the buyer of the divested assets (i.e., the new competitor created by the Commission's order). The principal question was whether the buyer maintained the competition that existed in the market before the merger. For horizontal mergers with a non-structural remedy, staff attempted to determine whether the conditions created by the order to enhance the possibility of growth by smaller market incumbents or to promote entry appeared to work by evaluating both incumbent growth and new entry. Finally, for vertical mergers, where non-structural remedies, such as firewalls, were designed to inhibit behavior that could facilitate vertical foreclosure or the sharing of confidential business information, staff focused on, among other questions, whether respondents effectively monitored and enforced them. Despite these differences across order types, in all cases staff compared post-order competition to that in the pre-order period to determine whether the order maintained competition.

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[30] The correct comparison for evaluating the success of the remedy entails comparing the post-order period with the remedy to the but-for world of the post-order period without the merger, i.e., the merging parties both competing. Interview techniques do not allow for construction of that but-for world; therefore, staff assumed that competition would remain generally the same as in the pre-merger period had the merger not occurred. That is, for purposes of the study, the pre-merger world is treated as the but-for world.

[31] Topics covered during interviews with competitors and customers are available on the FTC's website, https://www.ftc.gov/policy/studies/remedy-study.

3. Measuring Results

For orders that addressed competitive harm in multiple markets, the characteristics and ultimate success of a remedy may differ across the affected markets. To account for this, staff used two different measures to count remedies when classifying them.[32]

- **Orders.** The first measure was to count the number of orders, referred to as the order measure. Some orders involved multiple markets where the classification of the order differed across markets. In these cases the category count was increased by the share (or fraction) of markets belonging to the particular classification. For example, if an order covered two markets, one where the remedy was structural and one where it was non-structural, staff counted this as half a structural order and half a non-structural order. Staff used the same approach when the success of a remedy varied across the different markets covered by the order.[33]

- **Buyers.** The second way, applicable only to remedies involving divestitures, counted the number of buyers, referred to as the buyer-outcome measure. In the forty orders requiring divestitures, the Commission approved 46 different buyers. Two were counted twice, however, because each acquired two different asset packages to remedy two different markets, with different results in each. Counting them twice brought the total number of buyer-outcomes to 48. Other buyers that acquired different asset packages to remedy effects in different markets were counted only once because the outcome was the same in each market.

4. Remedy Outcomes

Table 3 presents the remedy outcomes.[34] The first row includes all 50 orders, while the second row includes the 46 orders involving horizontal mergers. Because there are no buyers for non-structural orders or for orders involving restructured transactions, for these groups the results are reported using only the order measure. Overall, the results show that 83% of orders were at least a qualified success, while 17% failed because they did not maintain the level of pre-merger competition.[35]

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[32] A third alternative would have been to measure results at the remedied market level. For orders that remedy competitive harm in multiple markets, however, the characteristics and ultimate success of any remedy are likely similar across the different markets within the same matter, especially when the same product is involved but there are different geographic markets. Presenting results at the level of the relevant market would, therefore, overstate the impact of matters involving multiple markets.

[33] For example, if an order involved three markets, two of which were rated as successes and the third was rated as a qualified success, the count of orders that were successful increased by 2/3 while that for qualified successes increased by 1/3. This ensured that each order was counted only once and that all markets within the order were represented; however, it led to fractional counts in some tables.

[34] All vertical merger orders were judged successful.

[35] Twenty-four of the 50 orders were issued between 2006 and 2009, overlapping with the financial downturn in the economy. It is notable that 94% of the orders issued during this period were successes or qualified successes.

TABLE 3: Remedy Outcomes[36]

Type	Remedy Outcome Success	Qualified Success	Failure
All (50)	69%	14%	17%
Horizontal (46)	66%	15%	19%
Horizontal, Structural (40, 48)*	66%, 65%	15%, 15%	19%, 20%
Horizontal, Structural, Non-Consummated (32.3, 39)*	75%, 74%	6%, 7%	19%, 18%

(*orders, buyers)

The last two rows of Table 3 show outcomes for horizontal mergers with structural remedies and horizontal non-consummated mergers with structural remedies. For these subsets, the results reflect the order measure followed by the buyer-outcome measure. For horizontal mergers remedied with structural relief, the order measure shows that 66% of the remedies successfully maintained competition at pre-merger levels, while another 15% were qualified successes. The remedy failed in 19% of the orders evaluated. When measuring success by buyer-outcome, 65% of the buyer-outcomes were successful; 15% were a qualified success; and 20% failed. The last row of Table 3 excludes consummated mergers. While the subset of orders excluding consummated orders has a higher percent of orders judged a success than other subsets, the percent of orders judged at least a qualified success (81%) is similar.

5. Anticompetitive Effects of Consummated Mergers Can Be Successfully Remedied under Limited Circumstances

When a merger is consummated prior to antitrust review, the Commission may face significant challenges in crafting a remedy to resolve competitive concerns, depending on the status of the assets already combined into a single entity. It may be particularly difficult to restore the pre-merger state of competition if the merging parties have commingled, sold, or closed assets; integrated or dismissed employees; transferred customers to the merged entity; or shared confidential information. In these situations, remedial options may be severely limited, irrespective of whether the Commission accepts a consent order or seeks a remedy in court or in an administrative proceeding. Despite the challenges, the

[36] When evaluating the effectiveness of the Commission's remedy policy, results for "All" and "Horizontal" should be treated with caution because they may pool together mergers requiring remedies with different characteristics. For example, vertical mergers raise distinct concerns and require different remedies compared to horizontal mergers. Also, the remedy options for consummated mergers can be more limited than for unconsummated ones, as is discussed later in the report.

Commission required remedies for anticompetitive consummated mergers included in the case studies, and staff examined whether those remedies succeeded. Given the differences in remedying consummated versus non-consummated mergers, staff analyzed results separately for consummated mergers. Table 4 shows the results for all horizontal mergers remedied with structural relief, separately for consummated and non-consummated mergers.

Ten orders involved situations where the remedies were imposed post-consummation. Eight of these ten orders required divestitures, and nine buyers were approved under those eight orders. The two remaining orders did not require divestiture but required respondents to eliminate restrictions in their contracts with customers and employees that had prevented entry; in both of these orders, entry subsequently occurred, restoring lost competition.

TABLE 4: Remedy Outcomes for Horizontal Mergers with Structural Relief

	Remedy Outcome		
Type	Success	Qualified Success	Failure
Horizontal, Structural, Non-Consummated (32.3, 39) *	75%, 74%	6%, 7%	19%, 18%
Horizontal, Structural, Consummated (7.7, 9)*	26%, 22%	52%, 44%	22%, 33%

(*orders, buyers)

For consummated horizontal mergers, 26% were a success, 52% were a qualified success, and 22% failed, when using the order measure. When analyzing results by the buyer-outcome measure, 22% of buyers were successful, 44% were a qualified success, and 33% were failures in consummated structural orders.

Factors that contributed to the success of some remedies in consummated mergers included the lack of integration of the assets post-merger and the ability to alter contracts to facilitate the buyer's entry. In contrast, resurrecting a business when the assets were commingled post-merger was much more difficult and the remedy often failed.

6. Identifying Remedy Process Concerns

During the interviews, buyers of divested assets and occasionally other market participants discussed concerns that arose during the process. In most cases, the concerns did not prevent a buyer from competing in the market, although, in some cases, they may have delayed the buyer's entry or increased its costs. In evaluating the process with respect to each remedy, concerns were considered significant if they affected or could have affected the remedy's success in meeting the remedial goals of the order.

Table 5 presents the percentage of orders that had remedy process concerns for the different subsets of orders.[37] The first row includes all 50 orders. The results show that remedy process concerns arose in fewer than half of the orders.[38]

TABLE 5: Remedy Process Concerns

	Remedy Process Concerns	
Type	No	Yes
All (50)	58%	42%
Horizontal (46)	54%	46%
Horizontal, Structural (40)	54%	46%
Horizontal, Structural, Non-Consummated (32.3)	59%	41%

7. Relationship between Remedy Process Concerns and Outcomes

Staff categorized every market in each remedy by combining the evaluation of the competitive success with the presence or absence of significant process concerns. Accordingly, there were six possible categories for each remedy:

- Success/no significant process concerns
- Success/process concerns
- Qualified success/no significant process concerns
- Qualified success/process concerns
- Failure/no significant process concerns
- Failure/process concerns

[37] Vertical merger remedies raised no reported process concerns.

[38] Staff does not know the extent to which such concerns arise in more typical arm's length transactions in which the FTC is not involved.

Table 6 presents remedy outcomes for all 50 orders combined with the presence or absence of significant remedy process concerns using the order measure. Specifically, these results address the frequency of remedy outcomes given that the matter either had, or did not have, remedy process concerns. Table 6 shows that for matters for which there were no remedy process concerns, 85% of orders were successes or qualified successes. These results show that, although the failure rate was slightly higher where process concerns were identified, many remedies that experienced process concerns nevertheless succeeded, either fully or in a qualified manner.

TABLE 6: Remedy Outcomes and Presence or Absence of Process Concerns

Ratings		Remedy Outcome		
		Success	Qualified Success	Failure
Process Concerns	No	78%	7%	15%
	Yes	56%	24%	20%

D. Specific Concerns Regarding the Remedy Process

As discussed above, most of the Commission's remedies in the 50 orders examined using the case study method were successful, supporting the Commission's general approach to merger remedies. But the interviewees did raise some specific concerns about the Commission's practices relating to designing, drafting, and implementing its remedies. Although these concerns did not generally prevent buyers from maintaining competition in the relevant markets, as shown in Table 6 above, addressing these concerns would improve the remedy process and could improve the success rate of Commission orders. This section discusses these concerns, classifying them in three categories: defining the scope of the asset package, selecting the buyer, and implementing the remedy.

1. Defining the Asset Package

a. Introduction

The study found that all divestitures of ongoing businesses succeeded, whether the divestiture was to an upfront buyer or a post-order buyer. This finding reinforces what the Commission and staff have long known: divestiture of an ongoing business, which includes all assets necessary for the buyer to begin operations immediately, maximizes the chances that the market will maintain the same level of

competition post-divestiture. In other words, these divestitures pose little risk. That was the conclusion drawn in the 1999 Divestiture Study,[39] and this study confirmed it.

Although the Commission prefers divesting an ongoing business, respondents often offer to divest a more limited package of assets, which they assert will provide the right buyer with the necessary assets to maintain or restore competition in the relevant market. In general, the scope of selected asset packages varies widely. The selected assets may include everything but a manufacturing facility, which the right buyer will already have, or they may include only intellectual property that will enable a buyer to overcome barriers to entry. With such a selected asset package, the buyer could overcome entry barriers but may not necessarily replace the lost competition quickly. The buyer will need to integrate the divested assets into its own operation or make additional arrangements with third parties. These uncertainties inject risk into the remedy that does not exist when divesting an ongoing business that has operated successfully in the past.

Staff carefully scrutinizes these proposals and attempts to ensure that selected asset packages include all assets necessary to facilitate the buyer's entry into the relevant market. Since the last divestiture study, the Commission has typically required an upfront buyer when the asset package is less than an ongoing business to minimize the risk of failure. Identifying an upfront buyer ensures that an approvable firm exists to acquire the defined assets. It does not, however, guarantee that the identified buyer will or can become a robust competitor. As Table 7 reflects, the majority of selected asset divestitures succeeded. Even with an upfront buyer, however, they succeeded at a lower rate than divestitures of ongoing businesses.

TABLE 7: Remedy Outcomes for Horizontal, Structural, Non-consummated Mergers, by Asset Package

	Remedy Outcome		
Asset Package	Success	Qualified Success	Failure
Ongoing Business (14.3, 14)*	100%, 100%	0%, 0%	0%, 0%
Selected Assets (18, 25)*	56%, 60%	11%, 12%	33%, 28%
All (32.3, 39)*	75%, 74%	6%, 7%	19%, 18%

(*orders, buyers)

[39] In the earlier study, "[o]f the 37 divestitures that were studied, 22 were of assets that comprised an on-going business. Of those 22, 19 were viable in the relevant market virtually immediately after the divestiture…. Of the 15 divestitures of selected assets, nine resulted in viable firms." 1999 Divestiture Study at 11-12. The earlier study concludes that "divestiture of an on-going business is more likely to result in a viable operation than divestiture of a more narrowly defined package of assets and provides support for the common sense conclusion that the Commission should prefer the divestiture of an on-going business." *Id.* at 12.

b. Divestiture of an Ongoing Business Poses Little Risk

Fifteen orders in the study required divestiture of an ongoing business to 15 buyers equally distributed between upfront and post-order buyers. All of these divestitures of ongoing businesses succeeded and raised few concerns. The orders defined the asset packages properly to include all necessary assets, including, in several orders, out-of-market assets. The transition from respondents to buyers in these divestitures tended to be straightforward. Employees remained with the businesses, and customers continued to purchase the divested products resulting in little change in the relevant markets other than ownership.

Although successful, several buyers of ongoing businesses raised remedy process concerns relating to back-office functions. One buyer said it took longer to transition back-office functions than anticipated. Another had difficulties transitioning information technology systems. In none of these cases were the difficulties serious enough to interfere with the operations of the ongoing business.

c. Divesting Selected Assets Poses More Risk than Divesting an Ongoing Business, Even With an Upfront Buyer

Twenty-eight orders required the divestiture of 33 packages of selected assets to 32 different buyers.[40] Nine of the buyers of selected assets succeeded with few, if any, difficulties. Seven were upfront buyers; two were post-order. Divestitures of selected assets tended to succeed when buyers had similar existing operations, were knowledgeable about the relevant markets, and were familiar with customers. In some cases, the buyers possessed similar manufacturing facilities prior to the divestiture or had a complementary product line into which the divested business could easily fit. Successful buyers also acquired brand names, and key employees were transferred.

Fourteen additional buyers of selected assets succeeded to varying degrees but experienced complications. Eleven were upfront buyers; three were post-order. Some suffered from unanticipated gaps in the order or the purchase agreement, but these buyers were largely able to adjust their business plans to address these gaps and move forward. For example, one buyer noted that the order required a supply agreement, but did not specify where the respondent had to deliver the supplied product. As a result, the respondent delivered the product to a site that inconvenienced the buyer. Another buyer raised concerns about the limitations placed on its use of the intellectual property it acquired.

Some buyers identified limitations with respect to the scope of the asset package. One buyer felt that the respondent was able to bundle multiple related products, which the buyer could not do with its more limited product line, hindering its ability to compete for customers. Another buyer also stated that it was disadvantaged because it lacked a full line of products to compete with respondent. These buyers ultimately competed in the market, but they believe it took them longer than it might have with a fuller line.

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[40] Seven of these 28 orders addressed the effects of mergers that were consummated when the Commission orders issued; the Commission approved eight buyers under these seven orders.

In nine orders requiring divestiture of selected assets to ten buyers, the divestitures did not maintain competition. All involved upfront buyers. The reasons why the divestitures failed vary. In some cases, the selected asset package may have been too limited, preventing these buyers from competing with respondents offering a wider range of products, a difficulty the buyers could not overcome. In others, brand loyalty was greater than had been anticipated and the divestiture of only selected assets was insufficient to persuade customers to switch. In one case, operating the business using the divested assets as a new entrant in one market was so different from the buyer's operations in other markets that the buyer quickly exited the relevant market. Finally, in another case, employees and inventory did not transfer with the selected assets, and the buyer was unable to hire the right employees or obtain inventory under advantageous terms.

2. Selecting the Buyer

Under any order requiring a divestiture, the respondent's obligation is to divest to a buyer that the Commission approves. The 1999 Divestiture Study revealed that respondents sometimes proposed marginally acceptable buyers unlikely to offer robust competition. This study shows that respondents are now proposing stronger buyers that, in most cases, fully satisfy the Commission's criteria. Overall, respondents proposed buyers that were familiar with the market, dealt with many of the same customers and suppliers, had developed thoughtful business plans with realistic financial expectations and sufficient backing, and were well received by market participants.

A proposed buyer's commitment to the market is also essential. Although this can be difficult to assess, the Commission routinely attempts to do so by evaluating the proposed buyer's business plans for the divested assets as well as its historical results. The Commission looks for current involvement in adjacent or related markets, past efforts to enter the same or related markets, and the proposed buyer's employees' involvement with and knowledge of the same or related markets.

The Commission also examines the buyer's financial commitment to the market. It routinely evaluates the ability and means by which the proposed buyer intends to finance the acquisition of the assets, as well as its plans to compete in the market. The Commission examines any outside sources of funds, including private equity and investment firms, and the extent of their involvement and financial commitment. The study revealed that there were cases where the buyer's flexibility in investment strategy, commitment to the divestiture, and willingness to invest more when necessary were important to the success of the remedy. There were also cases where a buyer's lack of flexibility in financing contributed significantly to the failure of the divestiture.

3. Implementing the Remedy

Defining the package of divestiture assets and selecting the buyer are the most critical elements of a divestiture remedy. But interviewees contacted during the study raised concerns, many unforeseen at the time the orders were issued, with respect to other factors involved in the implementation of the remedy, specifically: the buyer's ability to conduct adequate due diligence; the transfer and retention of customers; and respondent's obligation to provide supply, transition services, and employee access. In addition, the study confirmed the importance of hold separates, but market participants raised some questions about the operation of the business during the hold separate period.

a. Due Diligence

Due diligence concerns are particularly troublesome in the divestiture context because of the expected competitive rivalry between the buyer and seller post-divestiture. In a more typical arm's length transaction, the seller cedes its position in the market and therefore may be more cooperative in resolving issues that arise during the process, especially because more complete due diligence can lead to a higher sales price. In a Commission-ordered divestiture, however, the buyer and seller will compete after the sale, and there are many reasons why the seller might not cooperate in resolving issues. It is thus critically important that the buyer conduct adequate due diligence to avoid surprises.

In both upfront and post-order divestitures, staff asks proposed buyers about their access to data, facilities, and employees during the divestiture process. Buyers have not typically raised problems with staff during the divestiture process itself. In the study, most buyers were satisfied with the due diligence process, but several buyers did raise concerns ranging from a lack of time for adequate due diligence to a lack of access to facilities and employees.[41] One buyer needed additional due diligence to enable it to learn major customers' buying patterns, which turned out to be a significant obstacle to winning sales. Some buyers did not have access to employees who understood the relevant products. Several other buyers of selected assets lacked adequate financial information—notably cost information—because the assets to be divested did not constitute a separately reporting business unit and the respondents had produced only pro forma, unaudited, financial statements.

The majority of these concerns arose in upfront divestitures of the acquired firm's assets. In several of these cases, the acquiring firm's counsel led the negotiations and buyers viewed the acquiring firm's counsel as limiting their access to information, facilities, and employees.

b. Attracting and Retaining Customers and Other Third-Party Relationships

Some divestiture buyers were unable to attract or retain customers. This failure sometimes resulted from a misunderstanding of customer buying behavior. In one case, customers evaluated suppliers of the relevant product only every few years. Because respondent had a broader portfolio of products, it made sales calls on important customers more frequently than the buyer, which had only the divested product, allowing the respondent to maintain closer relationships with customers who also purchased the relevant product. Another buyer anticipated slow growth because customer contracts in the relevant product opened only every few years. In another divestiture, sales were cyclical, and the buyer missed the year's buying cycle and could not make sales for almost another year.

Several buyers in the case study underestimated the strength of brand loyalty and the difficulty customers encountered in switching suppliers. In one case, the buyer did not receive the rights to either brand name from the merging parties and could not attract customers, even after lowering its price. For other buyers, the divestiture required that customers requalify the product, which delayed their efforts to win customers. Buyers that succeeded did so because they were able to solicit new customers when they were unable to persuade respondents' existing customers to switch.

[41] The previous study also raised concerns about the adequacy of buyers' due diligence. *See* 1999 Divestiture Study at 23, 32.

Because in some cases, customers might need to be persuaded to switch from a recognized supplier to a new one, some Commission orders imposed obligations on respondents aimed at encouraging customers to switch. Some orders required respondents to assign customer contracts to the buyer, and, if not assignable, to otherwise facilitate moving the customers to the buyer. In one such order, the respondent's efforts were not effective, but the buyer nonetheless was able to persuade customers to switch to it. Other orders required respondents to notify recently signed customers of their right to terminate their contracts early and without penalty or prohibited respondents from attempting to win back customers from the buyers by soliciting, inducing, or attempting to induce any customer transferred to the buyers pursuant to the order provisions for two years. Customers were most likely to switch when the buyers were familiar with the customers or had a prior relationship with them.

Sometimes the obstacles buyers faced stemmed from the need to rely on third parties in ways that were unknown at the time of the divestiture. In some cases, these third-party relationships complicated the buyers' abilities to compete, and, in certain cases, may have contributed to the buyers' failures. In several cases, the buyers needed approvals by governmental entities. In one case, this requirement slowed down the buyer's entry into the relevant markets despite the respondent's efforts to assist in the process. In another case, the respondent attempted to assist the buyer in securing third-party approvals, but the buyer was more adept at securing them than the respondent was because of its previous relationships with the regulators. In several cases, the buyer stepped into pre-existing relationships with third-party suppliers or landlords that may have included disadvantageous terms.

c. Other Obligations

Most merger orders impose additional obligations on the respondent beyond the divestiture to facilitate its success. For example, where a respondent is not required to divest back-office functions, it may be required to provide such services to the buyer on a transitional basis until the buyer can perform those functions on its own.

In orders requiring the divestiture of selected assets, when the buyer cannot enter the market immediately on its own, the respondent may be required to provide supply for a specific time while the buyer develops the capacity to produce the product or can independently source it from a third party. The respondent may also be required to supply a necessary input until the buyer can arrange to source it independently.

The Commission has always recognized that some of these additional obligations create short-term ongoing entanglements between the respondent and the buyer and has therefore tried to minimize them as much as possible in order to preserve competitive vigor between the two firms.[42] Buyers in the study expressed similar reservations with respect to continuing post-divestiture relationships with respondents. Several buyers said they wanted to terminate these obligations as quickly as possible, and, in at least one case, the buyer did not take advantage of post-divestiture supply obligations at all, specifically to minimize its dependence on the respondent. On the other hand, other buyers said that these agreements were too short.

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[42] *See, e.g.*, *id.* at 12-14.

i. Transition Services Agreements

When back-office functions are not part of the divested assets, a buyer must transition to its own systems or obtain them from a third party. Pending the transition, respondent is required to provide these services for a limited period. In most cases, the orders limited the time that respondent had to provide these services to a period staff determined was adequate but not so long as to perpetuate an undesirable continuing entanglement between the respondent and the buyer. Several buyers, however, said that, after they acquired the divested assets, they discovered they needed more time than anticipated to transition to their own systems, particularly when the transition required merging or replacing information technology systems.

ii. Supply Agreements

Many Commission merger orders require that respondents supply buyers with input or finished products for a specified period at no more than the cost incurred by the respondent. As noted above, supply agreements offer mixed incentives for buyers and respondents, and the study contained examples of the wide range of possible outcomes.

Supply agreements can provide the buyer with the ability to compete immediately in situations in which competition might otherwise be delayed or less effective; this was the typical outcome in matters that included these agreements. In one matter, the absence of a short-term product supply agreement may have slowed the buyer's competitive response. The buyer initially was unable to make significant sales of its own product and struggled as a competitor, in part because many large customers required lengthy product qualification testing before making purchases. Although the buyer eventually became a successful competitor, a short-term supply agreement with the respondent may have allowed it to compete more successfully while it obtained customer qualifications for its own product.

In a few instances, it appeared that buyers may have benefited from greater flexibility to lengthen the time respondents had to provide supply. Nevertheless, it is generally inappropriate to allow a buyer to become little more than a distributor for the respondent.

d. Hold Separate Orders

A hold separate order preserves the viability, marketability, and competitiveness of the assets to be divested pending divestiture. The hold separate order appoints individuals to oversee and manage the business independently of the respondent to eliminate the possibility that respondent can manipulate the assets pending divestiture.[43] It prevents the wasting or deterioration of the assets and the transfer of competitively sensitive information.

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[43] In a standard hold separate order, the Commission appoints a hold separate monitor, appoints (or enables the monitor to appoint) a hold separate manager, and identifies employees whose responsibilities include the held separate business. The monitor is an independent third party that monitors respondent's obligations under the hold separate order and oversees both the hold separate manager and the overall business pending divestiture. The hold separate manager manages the hold separate business on a day-to-day basis and is typically the same employee that managed the business of the hold separate assets prior

While hold separates for the most part succeeded, several buyers identified problems with the hold separate arrangement that may have diminished the competitiveness of the business during this period. One buyer believed that the hold separate business did not respond to market pressures, resulting in lost sales. Another buyer noted that the hold separate manager focused on production, not sales, and that even production occurred only on a per-order basis. This caused inventory depletion, which required the new buyer to quickly build up inventory to historical levels.

Another buyer indicated that it received outdated and inaccurate information about production and sales because the hold separate business had not updated the information in an accessible manner after the respondent closed on the underlying deal and transitioned its information to a single system. A different buyer could not identify historical customer prices and resorted to asking the customers what they had paid for the products.

Even when successful, buyers confirmed that the hold separate period can be a time of uncertainty. In particular, the risk of losing key employees during this period rises. While incentives paid to employees to remain during the hold separate period helped, they did not always ensure that important employees remained with the buyer after the divestiture. Another buyer found that the hold separate period was unsettling to employees and believed that the order's non-solicit provision, which prohibited respondent from re-hiring employees, helped retain employees. A monitor noted that the uncertainty around the business made it vulnerable to competitive pressure from rivals, especially during a critical renewal period that would determine the business's success in the following year.

Although respondents generally appeared to comply with their obligations under the hold separate orders, several respondents expressed concerns about order obligations. One respondent noted that the hold separate required it to negotiate additional transition services agreements and fulfill obligations under those agreements. Other respondents commented that, as is typical in any hold separate order, they had to establish systems that kept the hold separate employees from sharing information with respondents' other employees. They had to sequester employee teams and restrict organizational access and provide sophisticated employee training so that the employees understood the confidentiality provisions of the orders. Respondents indicated that segregating the appropriate information was difficult because, until implementation of the hold separate order, the same employees had been sharing information and technology with each other in a manner that the order now prohibited.

4. Communication

The interviews made clear that the remedy process could benefit from more communication among FTC staff, monitors when appointed, and buyers. Interviews with both buyers and monitors suggested that increased communication could help monitors be more effective. One buyer urged that staff more fully explain the monitor's role to the buyer and the circumstances under which the buyer should contact the monitor. Other buyers suggested that monitors should be encouraged to proactively and more regularly contact the buyers, rather than wait for buyers to raise problems. One monitor suggested that

to the enforcement action. Hold separate managers frequently become part of the buyer's management team after the divestiture.

respondents provide a business person point of contact, with decision-making authority to address concerns promptly.

Finally, the study also revealed that many buyers still do not raise concerns with staff or monitors when they arise. Some buyers appeared to have tried to overcome concerns without involving, or informing, the staff or the monitors. The 1999 Divestiture Study had a similar finding, and staff has attempted to be clear and consistent in advising buyers to contact staff if they have concerns that staff may be able to address. Therefore, staff was surprised to learn that buyers remain reluctant to raise concerns with them or with the monitors when they arise.

Overall, the interviews revealed the need for greater transparency regarding the remedy process. Specifically, participants suggested that the Commission publicize the criteria for approving buyers, for requiring buyers upfront, and for approving monitors.

V. Orders Examined Using Reponses to Questionnaires

Fifteen of the 89 orders in the study required divestitures of supermarkets, retail pharmacies, nuclear pharmacies, funeral homes and cemeteries, inpatient psychiatric hospitals, outpatient dialysis clinics, surgical centers, and imaging centers. As noted above, the Commission has considerable experience with remedies in these industries. Staff sent a focused questionnaire to each of the 43 buyers in these 15 orders. The questionnaire addressed several areas of concern, including the due diligence process, the scope of the asset package, transition services, and post-divestiture operations. It also asked for suggestions for improving the FTC merger remedy process. Compliance with the questionnaire was voluntary, and 27 buyers responded either in writing or through an interview.

Staff categorized a remedy as a success if the divested assets are still operating in the market identified in the complaint based on responses received and a review of publicly available sources. Thirty-four of the original 43 buyers continue to operate the divested assets, and some have even expanded, renovated, or otherwise improved those assets. Of the nine buyers that no longer own or operate the divested assets, five sold the assets to independent third-party firms that continue to operate the assets in the manner contemplated by the order. Overall, 39 of the divested businesses remain in the market.

Several buyers in different industries reported some of the same due diligence concerns as the case study buyers. They reported receiving limited information during the due diligence process or receiving information too late in the process. Some post-order buyers reported delays in the due diligence process, but attributed those delays to the process of working through a hold separate monitor rather than the respondent directly or because communications went through the acquiring firm even when the target held the assets pre-merger.

Buyers also reported concerns regarding the impact of an extended hold separate period on the competitiveness of the divestiture assets. This view is consistent with the Commission's concerns about extended hold separates and responses from buyers in the case studies. Several buyers noted that the lengthy hold separate period caused uncertainty among employees, resulting in low morale. Another buyer explained that a lengthy hold separate period can degrade the divestiture business making it more difficult for the business to continue as a viable competitor in the market.

Finally, several buyers considered the amount of information the FTC required to complete its review of the buyers and approve the divestitures to be burdensome.

VI. Pharmaceutical Orders Examined Using Information Already Available to the Commission

The remaining 24 orders involved pharmaceutical mergers, primarily manufacturers of prescription generic drugs. The divestiture of products marketed by both parties to the merger at the time of the divestiture—on-market products—was considered successful if the buyer sold the product in the market post-divestiture. Staff determined that after divestiture, buyers sold about three-quarters of the divested products in the market. For each divestiture relating to pipeline products, i.e. products in development, the divestiture was considered successful if all assets relating to those products were successfully transferred.[44] Staff determined that the assets relating to those pipeline products were all successfully transferred.

Of the total products divested in the 24 orders, 60 were on-market products, sold by both parties to the merger at the time of the merger. When neither party to the merger manufactured the divested product, and instead relied on a third-party contract manufacturer, the divestiture of marketing or distribution rights allowed the buyer to immediately replace the selling firm. Of the 60 on-market products, 18 involved contract manufacturing that did not require transferring manufacturing capability. In each of these 18 cases, the buyer was assigned the selling firm's distribution agreement or it found a replacement third-party manufacturer with available supply capacity. For all divestitures of an existing marketing or distribution agreement that did not transfer manufacturing capabilities, the buyers continued to sell the product in the market.

Of the remaining 42 on-market products that required manufacturing transfer, 31 were in tablet or capsule form. Buyers of 24 of these products continued to sell the products in the market, but the buyers of the remaining seven did not. Several of the buyers that were unable to sell the products faced ingredient supply problems; in other cases, the buyers decided not to invest in post-divestiture production and never completed the transfer to market a product of their own.

Eleven of the 42 on-market products in the study that required manufacturing transfer involved more specialized production facilities than those for oral solids. Buyers were able to sell only three of these 11 products in the market.

Table 8 shows that, for all of the divestitures that involved a transfer of manufacturing capabilities, the buyer replaced the acquired firm as to 27 products and failed to do so as to 15 products.

[44] Staff did not attempt to assess whether the buyer of assets related to pipeline products replaced the acquired firm, in part because there was no but-for baseline from which to compare the buyer's efforts with those of the acquired firm, nor did staff measure success by determining if the buyer succeeded in launching a product.

Table 8: On-Market Pharmaceutical Remedies

	Successful, no manufacturing transfer required	Successful, manufacturing transfer required	Failure, manufacturing transfer required
Oral Solid Generics (38)	18% (7)	63% (24)	18% (7)
Complex Generics (22)	50% (11)	14% (3)	36% (8)
All (60)	30% (18)	45% (27)	25% (15)

For 32 pharmaceutical product divestitures in the study, one or both of the merging parties had products in development. The goal of divestiture is to put the product development effort (including any pending regulatory filings) in the hands of a new firm with the same ability and incentive to bring the pipeline product to market. For all 32 of these products, there was a successful transfer.

For the majority of divestitures involving on-market drugs that were included in the study, buyers replaced suppliers and competed in the market. There were more risks, however, when the remedy required the buyer to establish a new production source, and the risk was higher still when the manufacturing process was more difficult.

As outlined in more detail in the Best Practices section below, staff has been incorporating its ongoing learning with respect to divestitures in the pharmaceutical industry. For example, in more recent orders involving generic drug overlaps, when evaluating whether proposed respondents should be required to divest the assets of the acquiring firm or the target firm, the Commission has required divestiture of the easier-to-divest products where possible, particularly when the product was manufactured under a third-party agreement that could transfer to a buyer.

VII. Best Practices

Incorporating learning from the study, these best practices describe what respondents and proposed buyers can expect during the remedy process. While not exhaustive, they specifically respond to concerns raised during the study and incorporate suggestions made by buyers, respondents, and monitors. They do not reflect significant changes to the Commission's current practice, but rather further refine the Commission's approach to remedies and the remedy process. In particular, the aim is to make clear to respondents and buyers what they will be required to do and show as the Commission evaluates proposed remedy proposals. Respondents proposing a remedy must demonstrate that the proposal will solve the likely competitive problem identified by the Commission. The Commission will not accept a remedy unless it determines that the remedy will address the competitive harm caused by the merger and serve the public interest.

A. Defining the Asset Package

1. Scope of Asset Package

Divestitures of selected assets in the study, even with upfront buyers, succeeded less often and raised more concerns than divestitures of ongoing businesses. This confirms the Commission's preference for divestitures of ongoing businesses. When parties propose divestiture of an ongoing business, the Commission must confirm that all aspects of an ongoing business are being divested. The respondent should:

- explain how the proposed business contains all aspects needed for it to operate on its own;
- explain how a buyer can acquire the ongoing business and begin competing right away;
- identify at least three potential buyers that it believes are interested and approvable if it proposes to divest an ongoing business in a post-order divestiture; and
- be aware that staff will talk with potential buyers and other market participants.

While parties may propose a divestiture of selected assets rather than a divestiture of an ongoing business, the Commission will accept such a proposal only if the respondent and the buyer demonstrate that divesting the more limited asset package is likely to maintain or restore competition. In a merger where the respondent proposes a selected asset divestiture as a remedy, the respondent should:

- explain why an alternative ongoing business divestiture is inappropriate or infeasible;
- demonstrate how the selected assets can operate as a viable and competitive business in the relevant market;
- explain what aspects of an ongoing business are excluded from the package and, for each aspect that is excluded, how a proposed buyer would be able to address that gap, at what cost, and how quickly; and
- provide the buyer with adequate time and access to employees, facilities, and information to conduct due diligence.

Where the respondent proposes a selected asset divestiture, a proposed buyer will need to demonstrate that it will be able to compete effectively in all affected relevant markets without all of the assets relating to an ongoing business. The buyer should:

- explain how it plans to maintain or restore competition with a selected asset package;
- assess what additional assets and services it will need to operate the selected assets as a viable and competitive business in the relevant market;
- explain how it will obtain these additional assets and services, at what cost, and how quickly; and
- document its cost and time estimates to obtain these additional assets and services.

The Commission will accept only a divestiture package that it deems sufficient to enable a buyer to maintain or restore competition. Accordingly, a proposal to divest selected assets as a remedy may need to include, for example, assets relating to complementary products outside of the relevant market; manufacturing facilities, even if the facilities also manufacture products outside of the relevant market; or use of applicable brands or trade names. The Commission may also require the respondent to engage

in certain other conduct, including, for example, facilitating the transfer of customers. If the Commission determines that a proposed asset package is inadequate to restore or maintain competition, it may consider alternative settlement proposals or seek to block or undo the merger.

2. Transfer of Back-Office Functions

The provision of back-office functions that relate to the product market and the assets being divested is often more important and more complicated than parties anticipate. Those functions must be assessed to determine whether a proposed buyer can perform them on its own or if they are otherwise easily obtainable. If a proposed buyer does not already have the capability to perform the functions itself or will not be able to access them through, for example, third parties, then the respondent will be required to provide them on a transitional basis. If the buyer does not have access to them because they are specialized and not readily available from third parties, then the respondent will have to divest the assets relating to the provision of these functions. Even if the respondent must divest assets that provide these functions, there may be a transitional period while the respondent is completing the transfer of the assets to the buyer, during which the respondent may be required to provide those services to the buyer while the buyer integrates the assets.

The successful transfer of these back-office functions is often essential for a divestiture buyer to compete in the affected market. To help assess the scope of back-office functions that the buyer will need and to ensure that the buyer has these functions, the respondent should:

- explain to staff and the buyer all back-office functions related to all relevant products, as well as all necessary personnel and documentation;
- ensure that the proposed buyer can conduct adequate due diligence to understand what back-office functions will be needed and the complexities involved in the transfer of such functions;
- make its information technology employees available to discuss and plan the transfer of the back-office functions with the buyer; and
- provide back-office functions to the buyer as needed on a transitional basis for a period sufficient to allow the buyer to transition all services, at no more than respondent's cost.

The buyer should:

- explain to staff the scope of back-office functions it will need to support the asset package and how it will provide or obtain these functions and at what cost; and
- explain the length of time it will need transition services and its options if the transition takes longer than expected.

B. Reviewing the Proposed Buyer

In general, the study revealed that respondents appeared to understand the remedy process and usually proposed approvable buyers. When proposing a buyer to staff, the respondent should:

- explain to staff how it selected the proposed buyer;
- share with staff any offering memoranda or other documents it intends to provide to potential buyers, prior to distribution; and

- be aware that staff will talk to potential buyers as well as other market participants.

In its communications with staff, the proposed buyer should:

- identify all sources of financing for the acquisition of the divested assets, including private equity or other investors, and explain the criteria it used for evaluating such sources;
- explain how it, and all entities providing financing for the transaction, reviewed and evaluated the transaction and formed the basis for authorizing it;
- provide detailed financial and business plans, with supporting documentation, to demonstrate its competitive and financial viability;
- explain the underlying assumptions of its financial and business plans, including contingency plans if sales and other financials do not meet projections;
- make management, sales and marketing representatives, and accounting and other representatives available to staff;
- explain the structure of the funding for the investment, including any limitations of the funds; and
- make representatives from the entities providing financing available for discussions with staff.

C. Implementing the Remedy

Some buyers raised concerns about implementation of the remedy. Some of these concerns could have been allayed with more time to conduct thorough due diligence. Other concerns included difficulty attracting and retaining customers, the length of transition services and supply agreements, and the operation of hold separate orders.

1. Due Diligence

The respondent should provide adequate opportunity for the buyer to conduct due diligence. Specifically, the respondent should:

- provide access to information, facilities, and employees at least to the extent it would in a typical arm's length transaction;
- provide staff information regarding the extent to which the buyer has taken advantage of due diligence opportunities;
- provide direct access to key employees who are identified in the order;
- if the acquired firm's assets are being divested to an upfront buyer, provide the upfront buyer direct access to the acquired firm's information, facilities, and employees; in this circumstance, the upfront buyer should not be required to work through the respondent's representatives; and
- in the case of a post-order buyer, provide the post-order buyer direct access to the hold separate business, including the hold separate monitor and the hold separate manager.

The buyer should ensure that it takes advantage of the due diligence process and conducts adequate due diligence. In particular, the buyer should:

- provide staff information regarding the specific due diligence efforts it undertakes and any concerns about any aspect of the diligence process;
- in the case of an upfront divestiture, access the acquired firm's information, facilities, and employees, directly, without going through the respondent's representatives; and
- in the case of a post-order divestiture, access the hold separate business, including the hold separate monitor and the hold separate manager directly, pending divestiture to a post-order buyer.

2. Customer and Other Third-Party Relationships

Some buyers in the study had difficulty attracting and retaining customers, while others stepped into complicated third-party relationships. Respondents and buyers should be prepared to take certain steps to facilitate the transition in these relationships. The respondent should:

- provide the buyer access to customers, and relevant third parties, early in the process;
- inform customers of the divestiture, of the buyer's identity, and, if applicable, of their right to terminate their contracts with the divesting firms, incorporating input from the buyer into such communication;
- when customer contracts are assignable, assign customer contracts to the buyer;
- when customer consent is required to assign contracts, take steps to assist the buyer in obtaining those consents, including encouraging customers to consent;
- when required, waive contract restrictions that prevent customers from switching to the buyer and allow customers to terminate their contracts early and without penalty; and
- assist the buyer in obtaining any necessary governmental and other regulatory approvals.

The buyer should:

- take advantage of its access to all third parties involved, including customers, suppliers, landlords, and others;
- review and understand customer and other third-party relationships, including customers' buying patterns, customer brand and product loyalty, and customer switching costs; and
- when the order allows customers to terminate their contracts with the respondent, provide input into the respondent's communication with the customers that informs customers of such right.

3. Transition Services Agreements

As discussed above, the respondent should be prepared to provide back-office and other functions for a limited period until the buyer can provide them itself. The respondent will be required to provide those services pursuant to an agreement between the respondent and the buyer that the Commission has approved and that the Commission will monitor. The respondent will be required to:

- provide transition services for a sufficient period until the buyer can perform these services on its own, at no more than respondent's costs, which respondent will be required to document;
- enable the buyer to extend the agreement for a reasonable period, when appropriate;
- enable the buyer to terminate such agreement early, without financial penalty; and

- provide for monitor oversight, when necessary.

The study found that buyers seek to end their reliance on respondents' transition services quickly. Despite this, a few buyers needed the full term of the agreements and one needed the transition services agreement extended beyond what was provided by the order. The buyer should thus keep staff apprised of its progress in transitioning services from the respondent.

4. Supply Agreements

As with transition services agreements, the Commission seeks to minimize the length of time that buyers rely on respondents. The study confirmed that buyers are also wary of relying on respondents for supply of product or inputs. At the same time, supply agreements can be critical, enabling buyers to enter the affected markets quickly. To provide a buyer with supply of product or input for a sufficient period, but not so long as to diminish the buyer's competitive incentives, a respondent will be required to:

- provide supply for a term that extends at least for the length of the product qualification process or the time needed to enable the buyer to manufacture the product on its own or obtain the inputs; and
- allow for an extension when it is clear that the buyer needs additional supply on a transitional basis.

The buyer should keep staff apprised of its progress in transitioning off the supply agreement.

5. Hold Separates

Where there is a need for a hold separate, the assets to be divested are vulnerable to growing stale and the possibility that competitors may make potential inroads during the hold separate period. The hold separate manager, typically experienced in operating the assets, is critical to the success of the ongoing business during the hold separate period. To help the hold separate assets stay competitive during this period, the respondent should:

- allow the hold separate manager open and direct access to staff, independent of the respondent and respondent's counsel; and
- authorize hold separate managers to respond to competitive pricing in the market, maintain levels of production that best position the business to compete in the long term, implement all planned capital investments, and otherwise compete in the market.

The respondent and hold separate monitor should work with staff, beginning as early as possible, to ensure that hold separate operations can be structured efficiently and effectively.

D. Orders in the Pharmaceutical Industry

To ensure the success of divestitures in the pharmaceutical industry, the respondent should:

- divest the easier-to-divest product wherever possible, such as products already made at a third-party manufacturing site;

- provide complete information upfront to the proposed buyer so that the buyer can be prepared to step into the respondent's place with key customers, including regarding any production problems or supply chain issues and more in-depth sales and costs figures;
- work with the proposed buyer to develop a comprehensive technology transfer plan and identify specific employees to oversee respondent's transfer to the new manufacturing facility; and
- retain a Commission-approved monitor prior to entry of the order to facilitate development of the technology transfer plan.

The proposed buyer should identify any necessary third-party contract manufacturers for divested products that the buyer will not manufacture in its own facilities, and provide detailed business plans for investment in products in development, including internal hurdle rates.

E. Communication

Communication with staff is critical at every stage of the remedy process. A buyer, or any other affected party, should bring issues or concerns to the attention of the staff or the monitor as soon as they arise. A buyer should:

- stay in contact with staff and the monitor, if appointed; and
- raise issues as they arise with staff or the monitor.

Respondents should be aware that staff will remain in contact with buyers at least until the respondents have fully divested all required assets and have provided all required supply and transitional services.

PUBLIC

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on July 19, 2019, I caused a true and correct copy of the foregoing Respondent's Reply Brief to be filed via the FTC E-Filing System and served via e-mail upon the following:

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