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UNITED STATES OF AMERICA
BEFORE THE FEDERAL TRADE COMMISSION
OFFICE OF ADMINISTRATIVE LAW JUDGES

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

COMPLAINT COUNSEL'S CORRECTED POST-TRIAL BRIEF

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INTRODUCTION

Section 7 of the Clayton Act prohibits mergers that create the incentive and ability for merged firms to raise prices and sidestep competition from innovative new products that threaten their profits, but would benefit consumers. In most cases, courts must rely on only pre-merger evidence to predict whether a merger will harm consumers. Here, the evidence is clear that Otto Bock HealthCare North America, Inc.'s ("Otto Bock") acquisition of FIH Group Holdings, LLC ("Freedom") will result in significant anticompetitive effects. Respondent's post-merger plans remove all doubt. For years, Freedom challenged Otto Bock's market dominance in the U.S. microprocessor knee ("MPK") market. After buying Freedom, Respondent's top executives set out their plans for the future of Freedom's Plié 3 and its next-generation microprocessor knee, the Quattro, dubbed the "C-Leg 4 Killer" due to its singular focus on Otto Bock's flagship MPK. Their **{** [redacted] **}** was to discontinue the product or **{** [redacted] **}** For Quattro, they developed a plan to reposition it **{** [redacted] **}** These are precisely the consumer harms that Congress sought to prevent when it enacted Section 7.

Consummated on September 22, 2017, the Otto Bock/Freedom merger (the "Merger") created a behemoth that now controls more than **{** [redacted] **}** percent of the U.S. MPK market. The intense, pre-Merger rivalry between Otto Bock and Freedom had resulted in lower prices, rapid innovation, and higher-quality products for U.S. prosthetic clinics and amputees. By ending this competition and preventing the intensification of the rivalry that Freedom's Quattro launch would have created, Respondent violated Section 7 of the Clayton Act and Section 5 of the FTC Act, and harmed consumers. This illegal Merger will continue to harm consumers until this Court fully restores the competition that was lost when Otto Bock eliminated Freedom as an

independent challenger to its market dominance.

Complaint Counsel has proven, through an enormous body of evidence, that Otto Bock's acquisition of Freedom violates the antitrust laws. At trial, Complaint Counsel clearly established that the Merger is presumptively illegal by demonstrating the combination of Otto Bock's share of approximately **{ }** percent of the U.S. MPK market with Freedom's share of more than **{ }** percent significantly increases concentration in an already highly concentrated market. The market share and concentration levels calculated by Complaint Counsel's expert are accurate and use real world sales data from every seller of MPKs in the United States. Respondent's own ordinary course market share analyses, generated over several years and presented at the highest levels of each company, corroborate Complaint Counsel's market shares. Even the calculations of Respondent's own expert, using his faulty product market definition, result in concentration levels that far exceed the thresholds in the case law and the *Merger Guidelines* that establish a presumption that Respondent's Merger is likely to enhance market power and therefore illegal.

There is no dispute between the parties that the proper geographic market in this case is the United States. While the parties' dispute on product market does not affect the conclusion that the merger is presumptively illegal (it is under both sides' definitions), Complaint Counsel has clearly demonstrated that the appropriate definition is the manufacture and sale of MPKs to U.S. prosthetic clinics. The record is clear that the Court should exclude mechanical knees from the relevant product market because they function very differently than MPKs, provide less safety and performance, are used by different patients, and have significantly different sales prices and insurance reimbursement amounts than MPKs. In the ordinary course of business, Otto Bock and Freedom, as well as other market participants, analyze the U.S. MPK market

separately from markets for mechanical knees. Testimony and documents from MPK manufacturers show that they do not view mechanical knees as significant competitors, and mechanical knee manufacturers confirm they do not compete with MPKs. Evidence from several sources establishes the critical fact that in negotiations between U.S. prosthetic clinics and MPK manufacturers, mechanical knees do not play a role in setting MPK prices. The hypothetical monopolist test performed by Complaint Counsel's economic expert confirms the reality that clinic customers would not switch to mechanical knees in the face of a price increase on the MPKs they purchase to meet the medical needs of the amputees they serve.

Complaint Counsel has proven that the Merger violates Section 7 not only by establishing an extremely strong presumption that the Merger is illegal, but also with an enormous amount of direct evidence that the Merger will result in unilateral anticompetitive effects. The trial record is replete with evidence showing that Otto Bock and Freedom competed head-to-head and aggressively prior to the Merger, creating significant price and quality benefits for U.S. prosthetic clinics and amputees. For example, Freedom's Plié 3 launch in 2014 directly challenged Otto Bock's dominant market position and resulted in significant share gains for Freedom and lower prices from both companies for customers. In response, Otto Bock launched the C-Leg 4, which had the stated goal to {[redacted]} Respondent's documents and testimony show that the C-Leg 4 initially took significant business away from the Plié 3, to which Freedom responded by lowering its prices and developing aggressive promotions. Freedom's response enabled it to claw back share from Otto Bock and, in the process, customers benefitted greatly from the vigorous competition that continued up until the time of the Merger.

Moreover, the trial record shows that Otto Bock intended to eliminate a close competitor, knowing full well that acquiring Freedom would insulate Otto Bock from competition to the detriment of consumers. Long before the Merger, Otto Bock was aware that Freedom was developing the Quattro to target its C-Leg 4 business. After performing substantial due diligence on Freedom, Otto Bock determined that acquiring Freedom constituted a {[redacted]} Another important reason Otto Bock decided to acquire Freedom was to control its MPK market share, which was the {[redacted]}

From Otto Bock's perspective, its rationale for acquiring Freedom made sense and proved accurate, because after the Merger when it had full access to the Quattro project, Otto Bock verified that Quattro was, in fact, a "serious threat" to the C-Leg 4. Thus, in November 2017, a month and a half after the transaction closed, Respondent's top executives developed a plan to reposition Quattro away from the C-Leg 4, to "minimize cannibalization" and prevent the intense competition that would have occurred between those products absent the Merger. The November plan called for either discontinuing the Plié 3 or raising its price. An internal diversion analysis showed Otto Bock's plan for the Plié 3 made business sense because executives determined that Otto Bock would recapture no less than {[redacted]} percent, and as much as {[redacted]} percent, of all Plié sales lost if the merged firm discontinued the product.

The only thing that stopped Otto Bock's plans from taking full effect was the Complaint filed in this case and the related decision by Respondent to enter into a hold separate agreement to avoid the need for a federal court proceeding seeking an injunction to hold the companies apart. Absent this litigation, there is no doubt that Otto Bock would have already acted upon its

plan to raise the price of the Plié 3 to U.S. clinic customers. Even with this litigation ongoing, irreversible consumer harm has occurred. Freedom planned to launch an upgraded version of its Plié 3, called the **{ }** in October 2017, but Otto Bock scuttled those plans, depriving customers of those product enhancements and the increased competition that would have been introduced without the Merger. Testimony from Respondent's executives also shows that the Merger (and litigation to unwind it) has contributed to delays in Freedom's Quattro development and projected launch date. Thus, this illegal Merger has already harmed consumers.

Respondent has failed to rebut Complaint Counsel's extremely strong *prima facie* case, much less produce evidence that would overcome the overwhelming additional evidence of anticompetitive effects that Complaint Counsel presented at trial. None of Respondent's arguments about product market can rebut the presumption that the Merger is illegal, because, by Respondent expert's own admission, the transaction is presumptively illegal even under his improperly broad market definition.

Respondent has failed to demonstrate that new entry or expansion will prevent the clear harm that Complaint Counsel has proven will occur. It takes several years to develop and launch a new MPK, even for current MPK sellers, and it typically takes new entrants into the U.S. MPK market several years to build a reputation that allows them to compete effectively. The record is clear that no company is positioned to enter the U.S. market with a new MPK for the next several years—even Respondent's expert testified that he could not identify any entrants likely to enter in a timely fashion. Similarly, expansion by existing market participants will not prevent harm from the Merger. Össur's Rheo MPK functions very differently than the C-Leg 4 and Plié 3, which function more like each other. Moreover, Otto Bock expects Quattro to be a significantly

better product and compete more closely with the C-Leg 4 than Össur's Rheo, and Freedom had planned to price the Quattro lower than the C-Leg 4 and Rheo. Therefore, Össur cannot replace the competition lost by eliminating Quattro as a competitor to the C-Leg 4. Despite selling MPKs in the United States for more than a decade, Endolite has struggled to gain significant market share and suffers from quality and reputational issues, and Nabtesco and DAW each have microscopic MPK sales and limited customer recognition, making them incapable of replacing the competition lost by eliminating Freedom.

Respondent has also failed to prove that the Merger will result in significant cognizable efficiencies. At trial, Respondent did not submit evidence of any substantiated, verifiable, merger-specific efficiency that would likely result from this Merger and be passed on to consumers. Rather, Respondent submitted the testimony of its expert witness who, rather than performing a rigorous independent analysis, simply relied on incomplete, early-stage integration work performed by Otto Bock and its outside consultant that never even reached the stage of "setting a synergy target" for any claim. The flaws in Respondent expert's work are so serious and numerous that the record does not support a finding that *any* cognizable efficiencies will result from the Merger, much less that it would result in cognizable efficiencies that would outweigh the clear anticompetitive harm Complaint Counsel has shown will occur.

Respondent also failed to meet its extremely high burden to prove that Freedom was a failing firm because the record is clear that, prior to the Merger, Freedom was able to meet its near-term financial obligations, it had never seriously considered filing for bankruptcy protection, and it had several options other than an anticompetitive sale to Otto Bock for moving forward. The Freedom sales process focused solely on garnering the highest price for the company, even if a sale to the highest bidder ran afoul of Section 7. Sworn testimony shows that

several companies were interested in buying Freedom, but never approached because it was determined they likely would not pay as much as a company like Otto Bock. Many of these firms remain interested in buying all of Freedom. Moreover, at the time of the Otto Bock transaction, Freedom had another offer in hand from Össur that would have resulted in a less anticompetitive merger than the sale to Otto Bock. These facts make it impossible for Respondent to meet its high burden.

In the face of the enormous body of evidence showing that its Merger is anticompetitive, Respondent has made a "Hail Mary" attempt to cast off a limited set of hand-selected Freedom assets in the hopes of escaping the need to fully remedy its illegal Merger by selling an ongoing Freedom business, the "natural" remedy to a Section 7 violation. From the time it filed its Answer, Respondent has promised a divestiture that would "address[] any conceivable anticompetitive effect" in the U.S. MPK market. It never did so. While "complete divestiture of all pre-merger assets is the usual remedy for a Section 7 violation," Respondent has submitted **{** [redacted] **}** lack important assets that **{** [redacted] **}** would need to restore competition lost by the Merger, and **{** [redacted] **}** has several critical terms that remain uncertain and need to be negotiated.

Respondent has failed to meet its burden to show that **{** [redacted] **}** "sufficiently non-speculative" and would "replace the competitive intensity lost as a result of the merger." **{** [redacted]

[redacted]

And critical aspects [redacted] are contingent on further negotiations, including which specific employees each buyer could seek to hire [redacted] the scope and cost of any transition services Respondent would provide, and a host of other terms.

Based on record evidence, [redacted] includes Freedom's facilities or equipment used to develop and make MPKs. [redacted] would transfer ownership of all of Freedom's intellectual property used to develop its Quattro MPK, and [redacted] places restrictions on licensed IP that would prevent any buyer from using key technology to develop next-generation MPKs and related products, such as a microprocessor ankle. To that end, [redacted] explicitly restrict which Freedom employees the buyer can seek to hire or leave that issue unresolved. [redacted] would not have the opportunity to hire a large number of Freedom employees performing "critical" work on its Plié and Quattro that Respondent internally identified as "difficult to replace." In addition, [redacted] divest any of Freedom's prosthetic foot products, including those regularly used by Freedom to drive its

MPK sales. Otto Bock refuses to sell these products because evidence shows that it wants to keep Freedom's Kinterra and other feet **{** [redacted] **}**. Respondent withholds these assets despite Otto Bock's own CEO at the time of the Merger testifying at trial that **{** [redacted] **}** would not be able to compete as effectively as Freedom had pre-Merger if it does not acquire any of Freedom's foot products.

Complaint Counsel has proven, beyond a doubt, that Otto Bock's acquisition of Freedom violated Section 7 of the Clayton Act and Section 5 of the FTC Act—a remedy is therefore justified and required to prevent the Merger from continuing to harm competition. Complaint Counsel respectfully requests the Court issue its Proposed Order, which would divest an ongoing Freedom business to a qualified buyer and fully restore competition in the U.S. MPK market.

ARGUMENT

Section 7 of the Clayton Act bars mergers "the effect of [which] may be substantially to lessen competition, or to tend to create a monopoly" in "any line of commerce or . . . activity affecting commerce in any section of the country." 15 U.S.C. § 18 (2012). "As the statutory language suggests, Congress enacted Section 7 to curtail anticompetitive harm in its incipiency." *In re Polypore Int'l, Inc.*, No. D-9327, 150 F.T.C. 586, 2010 WL 9549988, at *8 (F.T.C. Nov. 5, 2010) (citing *Chi. Bridge & Iron Co. v. FTC*, 534 F.3d 410, 423 (5th Cir. 2008)). "Congress used the words '*may be* substantially to lessen competition' . . . to indicate that its concern was with probabilities, not certainties[.]" *FTC v. Penn State Hershey Med. Ctr.*, 838 F.3d 327, 337 (3d Cir. 2016) (quoting *Brown Shoe Co. v. United States*, 370 U.S. 294, 323 (1962)) (emphasis in original). Thus, a merger violates Section 7 if it "create[s] an appreciable danger of [anticompetitive consequences] in the future. A predictive judgment, necessarily probabilistic and judgmental rather than demonstrable, is called for." *FTC v. H.J. Heinz Co.*, 246 F.3d 708, 719 (D.C. Cir. 2001). "Even in a consummated merger, the ultimate issue under Section 7 is whether anticompetitive effects are reasonably probable in the future, not whether such effects have occurred as of the time of trial." *Polypore*, 150 F.T.C. at *8 (citing *United States v. Gen. Dynamics Corp.*, 415 U.S. 486, 505-06 (1974)). Courts typically assess whether a merger violates Section 7 by determining the relevant product market, the relevant geographic market, and the merger's probable effect on competition in those relevant markets. *See United States v. Marine Bancorp.*, 418 U.S. 602, 618-23 (1974); *see also U.S. Steel Corp. v. FTC*, 426 F.2d 592, 595-96 (6th Cir. 1970).[1]

[1] Courts often rely on the Merger Guidelines framework to assess how acquisitions may harm competition. PX08040 (U.S. Dep't of Justice & Federal Trade Commission, Horizontal Merger Guidelines (2010)) [hereinafter *Merger Guidelines*]; *see, e.g., ProMedica Health Sys., Inc. v. FTC*, 749 F.3d 559, 565 (6th Cir. 2014); *FTC v. Tronox Ltd.*, No. 1:18-cv-01622, 2018 WL 4353660, at *12 (D.D.C. Sept. 12, 2018); *FTC v. Sysco Corp.*, 113 F.

Courts analyze Section 7 cases using a burden-shifting framework consisting traditionally of three steps. *See, e.g., In re Polypore, Int'l, Inc.*, No. 9327, 149 F.T.C. 486, 799-801 (F.T.C. Mar. 1, 2010) (Chappell, A.L.J.). "First, the government must establish a prima facie case that an acquisition is unlawful." *Id.*; *see also Heinz*, 246 F.3d at 715; *United States v. Baker Hughes, Inc.*, 908 F.2d 981, 982 (D.C. Cir. 1990); *FTC v. ProMedica Health Sys., Inc.*, No. 3:11 CV 47, 2011 WL 1219281, at *53 (N.D. Ohio Mar. 29, 2011). If the government can show "that a transaction will lead to undue concentration in the market for a particular product in a particular geographic area, the government establishes a presumption that the transaction will substantially lessen competition." *Polypore*, 149 F.T.C. at 850 (quoting *Baker Hughes*, 908 F.2d at 982).

Respondent can then attempt to rebut the presumption "by producing evidence to cast doubt on the accuracy of the government's" evidence. *Polypore*, 149 F.T.C. at 800; *see also Chi. Bridge*, 534 F.3d at 423; *Baker Hughes*, 908 F.2d at 982. The stronger Complaint Counsel's *prima facie* case, "the greater Respondent['s] burden of production on rebuttal." *In re OSF Healthcare Sys.*, No. 9349, 2012 FTC LEXIS 76, at *46 (Apr. 4, 2012); *see also Heinz*, 246 F.3d at 725; *In re ProMedica Health Sys., Inc.*, No. 9346, 2012 WL 1155392, at *12 (F.T.C. Mar. 28, 2012). If Respondent successfully rebuts the *prima facie* case, the burden shifts again to the government, which has the ultimate burden of persuasion. *Chi. Bridge*, 534 F.3d at 423; *Baker Hughes*, 908 F.2d at 983; *ProMedica*, 2011 WL 1219281, at *53.

At trial—through an enormous body of witness testimony, ordinary course documents, and empirical evidence from its economic expert—Complaint Counsel established an extremely strong *prima facie* case that the Merger is unlawful. Indeed, *Respondent's* own economic expert also concluded that the Merger is presumptively illegal by a wide margin. Complaint Counsel

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Supp. 3d 1, 39 (D.D.C. 2015); *FTC v. Bass Bros. Enter., Inc.*, Nos. C84-1304, C84-1311, 1984 WL 355, at *24 (N.D. Ohio June 6, 1985).

buttressed its *prima facie* case with evidence of vigorous head-to-head competition between Otto Bock and Freedom for the sale of MPKs and Respondent's explicit post-Merger plans to discontinue Freedom's Plié 3 or raise its price in the United States and to extinguish the heightened competition set to emerge with the launch of Freedom's Quattro. Respondent's attempts to rebut Complaint Counsel's strong *prima facie* case failed. The trial record shows that remaining MPK suppliers will not prevent the competitive harm resulting from the loss of Freedom as an independent competitor and entry will not be timely, likely, or sufficient to prevent harm to consumers. Likewise, Respondent did not prove any cognizable efficiencies or that Freedom was a "failing" or even "flailing" firm at the time of the Merger. Finally, Respondent did not prove that **{** [redacted] **}** would restore competition lost from the Merger and cure the Merger's anticompetitive effects.

I. Background

A. Overview of Respondent and the Merger

Otto Bock is a Minnesota corporation headquartered in Austin, Texas. (CCFF ¶ 1). It employs approximately six hundred people in the United States and, in addition to Austin, has locations in Salt Lake City, Utah; Louisville, Kentucky; Sacramento, California; and Southern California. (CCFF ¶¶ 2-3). Otto Bock provides "upper and lower limb prosthetics, orthotics, mobility solutions, and medical-related services to customers" in the United States and around the world. (CCFF ¶ 4). Otto Bock is the dominant manufacturer and supplier of MPKs in the United States, (CCFF ¶ 7), a position it has held since it launched the first version of its C-Leg in 1999, (CCFF ¶ 1008). Today, Otto Bock sells the C-Leg 4 in the United States. (CCFF ¶ 6).

Otto Bock's parent company—Otto Bock HealthCare GmbH—was founded in 1919 and has its headquarters in Duderstadt, Germany.[2] (CCFF ¶ 11). Otto Bock HealthCare GmbH employs over seven thousand employees worldwide and operates in fifty countries. (CCFF ¶ 12). {[redacted]} (CCFF ¶ 16).

Freedom was founded in 2002. (CCFF ¶ 20). Prior to the Merger, it had its headquarters in Irvine, California and employed approximately 150 people. (CCFF ¶ 25). The company began by selling carbon fiber feet and later introduced its first MPK, the Plié, in 2007. (CCFF ¶¶ 21, 23). Today, Freedom manufactures and sells the Plié 3—its only prosthetic knee on the market at the time of the Merger and "the only American-made" MPK—as well as a range of high-quality prosthetic feet and ankles. (CCFF ¶¶ 23-24). Its next-generation MPK, the Quattro, is in development, (CCFF ¶ 30), {[redacted]} (CCFF ¶ 32). Prior to the Merger, Freedom was privately owned. Its two largest shareholders were Health Evolution Partners ("HEP"), its majority shareholder, and Parker Hannifin, its largest minority shareholder. (CCFF ¶¶ 25, 34).

On September 22, 2017, Otto Bock acquired Freedom for an acquisition price of approximately {[redacted]} million. (CCFF ¶ 109). The Merger was not reportable under the Hart-Scott-Rodino Act. (CCFF ¶ 110). In late September 2017, after receiving a complaint from outside counsel for a large clinic customer, (CCFF ¶¶ 115-116), the FTC began its preliminary investigation into the Merger. (CCFF ¶ 114). On December 19, 2017, Otto Bock and the FTC entered into a Hold Separate and Asset Maintenance Agreement. (CCFF ¶ 145). On December 20, 2017, the FTC filed its Complaint alleging that the Merger substantially lessened competition

[2] Post-Merger, Otto Bock HealthCare GmbH changed its legal designation and name to Otto Bock SE & Co. KGaA. (CCFF ¶ 19).

in the relevant market in violation of Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18, and is an unfair method of competition in violation of Section 5 of the FTC Act, as amended, 15 U.S.C. § 45. (CCFF ¶ 176). The administrative hearing in this case commenced on July 10, 2018 and lasted through October 4, 2018. (CCFF ¶¶ 253, 256).

B. Industry Background

1. General Background

An estimated 1.9 million individuals in the United States live with the loss of a limb, including slightly more than 350,000 transfemoral, or above-the-knee, amputees. (CCFF ¶ 303). Most people who require an above-the-knee amputation suffer from vascular disease, a traumatic injury, cancer, or were born with a congenital deformity. (CCFF ¶ 304). Above-the-knee amputees typically receive a prosthetic leg that includes a prosthetic knee component. (CCFF ¶ 339).

According to Respondent's public website, "[i]n general, there are two kinds of prosthetic knees: non-microprocessor (or 'mechanical') and microprocessor. Mechanical knees all use a mechanical hinge to replace your knee joint. How quickly or easily the hinge swings is often controlled by friction, some type of hydraulic system or a locking mechanism. Microprocessors, on the other hand, provide a more sophisticated method of control to a prosthetic knee. These more complex knee joints are designed to help you walk with a much more stable and efficient gait that more closely resembles a natural walking pattern." (CCFF ¶ 356). As Respondent goes on to explain, "[t]he internal computer monitors each phase of your walking pattern (your 'gait cycle') using a series of sensors. The continuous monitoring and control of fluid allows the processor to make adjustments in resistance so you can walk more efficiently at various speeds and walk more safely down ramps and stairs." (CCFF ¶ 364).

MPKs provide amputees enormous, verified clinical benefits, (CCFF ¶¶ 617-48), but they are far more expensive than mechanical knees. (CCFF ¶¶ 701-06). Amputees typically rely on insurance to cover the cost of an MPK. (CCFF ¶¶ 372-76). Insurers will not pay for high-priced MPKs unless there is solid, documented evidence that an amputee will benefit from an MPK, rather than a much lower cost mechanical knee. (CCFF ¶ 496-514). To understand how the U.S. MPK market functions, and how this Merger will harm consumers, it is important to understand the fundamentals of how medical professionals prescribe, insurers reimburse for, and clinics purchase MPKs from manufacturers like Otto Bock and Freedom.

2. Fundamentals of the Prescription and Reimbursement of MPKs and MPK Competition

In the United States, two important, but separate, processes determine (1) how medical professionals prescribe MPKs to patients and how insurers decide whether to reimburse clinics for fitting an MPK on a patient, and (2) how clinics go into the marketplace to purchase MPKs they need to fit on patients who have been prescribed an MPK and have insurance coverage. Understanding the differences between these two processes, and the fact that the Merger significantly affects the second process, but not the first, is important to understanding how Otto Bock's acquisition of Freedom will harm consumers.

In the first process, several different players in the U.S. healthcare system collectively determine whether it is medically appropriate to prescribe and reimburse the fitting of an MPK on a particular amputee. (CCFF ¶¶ 400-29). The interplay among surgeons, prosthetists, patients, and insurers determines whether a given patient receives an MPK or a mechanical knee—with decisions driven primarily by the medical ethics of healthcare professionals, preferences of patients for the feel of different prosthetic knees, and reimbursement regulations established by insurers. (CCFF ¶¶ 392-561). The price that a clinic must pay out-of-pocket for a

particular MPK, and the general difference in out-of-pocket prices for MPKs and mechanical knees paid by clinics, do not play a significant role in whether a particular patient is prescribed an MPK or mechanical knee. (CCFF ¶¶ 524-29). The evidence shows that this decision is based on what healthcare professionals determine is medically best for the patient and justifiable to the patient's insurer. (CCFF ¶¶ 392-523). Otto Bock's acquisition of Freedom does not significantly affect how medical professionals determine what is best for patients, whether patients prefer MPKs or mechanical knees, or how insurance companies determine whether to reimburse clinics for MPKs.

The Otto Bock/Freedom Merger does significantly alter how U.S. prosthetic clinics negotiate competitive prices and terms with manufacturers for the MPKs that their prosthetists need to fit on patients who would benefit medically from walking on an MPK. In the United States, prosthetic clinics that treat amputees who have been prescribed an MPK must go into the marketplace to purchase them directly from manufactures. (CCFF ¶ 563). Clinics pay MPK manufacturers upfront for purchases and wait for a patient's insurer to reimburse them at a later date for the cost of the MPK, as well as other costs associated with fitting a lower-limb prosthesis. (CCFF ¶¶ 372, 377). Clinics receive a fixed amount from insurers, (CCFF ¶¶ 380-83), so it is important to clinics to purchase MPKs from manufacturers at the lowest prices possible. (CCFF ¶ 575). Market forces determine the outcomes of negotiations between clinics and MPK manufacturers. Each clinic's bargaining leverage turns largely on its ability to play the few manufacturers selling high-quality MPKs in the United States (including Otto Bock and Freedom) against each other to obtain the lowest prices and the best terms possible. (CCFF ¶¶ 581-96). By eliminating Freedom as an independent competitor that clinics can purchase from

or use to negotiate better terms from Otto Bock and other MPK suppliers, the Merger significantly undermines the bargaining leverage of clinics in these negotiations.

a) Fundamentals of the Prescription by Healthcare Professionals and Reimbursement by Insurers of MPKs in the United States

The process by which healthcare professionals and insurers, respectively, prescribe and cover MPKs determines which specific K3/K4 amputees receive MPKs, and ultimately it is a process that is largely unaffected by the Merger. In the United States, there are two steps to determine the eligibility of a K3/K4 amputee for an MPK. First, a patient's healthcare professionals (*i.e.*, his or her surgeon and/or prosthetist) determine whether an MPK (rather than a mechanical knee) is the best medical option for the patient. (CCFF ¶¶ 392-93, 430-87). Second, the patient's insurance provider determines whether to reimburse a prosthetic clinic for fitting the patient with an MPK (rather than approving only a mechanical knee). (CCFF ¶¶ 394-99, 488-523). If both a patient's medical team and insurer determine an MPK is appropriate, and the patient is comfortable wearing one, the patient will be prescribed an MPK, the prosthetist at his or her clinic will fit the patient with one, and the patient's insurer will reimburse the clinic for the cost of fitting the patient's entire lower-limb prosthesis. (CCFF ¶¶ 392-561).

Several categories of healthcare professionals play a role in determining whether fitting a K3/K4 amputee with an MPK is medically appropriate. The surgeon, who performs the amputation, or another medical doctor, must write a prescription for a prosthetic knee. (CCFF ¶¶ 402-04). The prosthetist at the clinic to which the amputee is referred post-surgery typically plays a critical role in evaluating the amputee's ability to ambulate and which type of lower-limb prosthesis would be optimal for the patient. (CCFF ¶¶ 411-17, 430). These two healthcare professionals, sometimes along with others (*e.g.*, a patient's physiatrist), work initially to determine a patient's K-level by evaluating his or her strength and ability to ambulate. (CCFF ¶¶

431, 433-39). Healthcare professionals in the United States know that insurers typically do not provide reimbursement to clinics for fitting MPKs on K0, K1, or K2 patients. (CCFF ¶¶ 440-44). Therefore, only amputees identified as K3 or K4 ambulators (and sometimes K2 patients who would become K3 ambulators with a particular prosthesis) are considered *candidates* for an MPK by their healthcare professionals. (CCFF ¶¶ 445-46, 427, 557).

To determine whether an MPK is medically appropriate for a particular K3/K4 patient, healthcare professionals consider several factors, beyond just K-level, that inform whether an MPK would provide substantial benefits over a mechanical knee. (CCFF ¶¶ 447-87). Among other factors, they evaluate (1) a patient's age, overall health, and fitness; (2) the activities in which the patient engages or desires to engage; (3) the degree to which the patient stumbles, falls, or experiences other negative consequences when wearing a mechanical knee; and (4) the patient's comfort with an MPK. (CCFF ¶¶ 461-87). If a patient's healthcare professionals determine an MPK would provide significant medical benefits over a mechanical knee (*i.e.*, she would fall or stumble less, engage in more activities, or otherwise experience improved health or quality of life), they will prescribe an MPK and the clinic treating her will evaluate whether insurance is likely to cover the MPK. (CCFF ¶¶ 428, 445-87).

U.S. insurers typically determine whether an amputee's clinic should receive reimbursement for an MPK based on evaluating whether the clinic has documented evidence that an MPK is a "medical necessity" relative to a lower-cost product, such as a mechanical knee. (CCFF ¶¶ 496-514). Although medical necessity requirements vary to some degree based on the policy, in general, insurers require clinics to document evidence showing that a patient will experience significant, health, safety, or quality of life benefits by wearing an MPK rather than a mechanical knee. (CCFF ¶¶ 515-19). This evidence includes physicians' notes, narrative

justifications of medical necessity from the prosthetist, and/or completed PAVET forms (or the like). (CCFF ¶¶ 515-19). If a clinic cannot document medical necessity, an insurer will deny coverage for an MPK, and approve coverage only for a mechanical knee. (CCFF ¶¶ 520-23).

In the United States, the vast majority of K3/K4 patients who are prescribed an MPK by medical professionals and have insurance coverage for an MPK receive and wear one. (CCFF ¶¶ 531-37). That does not mean every K3/K4 amputee receives, or from a medical perspective should receive, an MPK. K3/K4 amputees typically wear a mechanical knee when their insurance company denies coverage for an MPK or their medical professionals determine that an MPK is not medically appropriate given an amputee's specific health or lifestyle characteristics. (CCFF ¶¶ 538-55). For example, some amputees engage in activities or work that is not conducive to wearing an MPK, such as fishing or farming, where exposure to water or dust, or general wear and tear, are problematic for wearing a high-tech MPK. (CCFF ¶¶ 543-44, 549, 554-55). Those patients typically wear a mechanical knee when engaging in such activities. In addition, even K3/K4 amputees who may become eligible for an MPK are typically fitted with a mechanical knee for their initial and temporary prostheses, worn during the post-surgery recovery process. (CCFF ¶¶ 556-58). Finally, a small number of K3/K4 amputees simply prefer the feel of a mechanical knee, particularly when they have worn one for many years. (CCFF ¶¶ 559-61).

Ultimately, the Merger does not affect which K3/K4 amputees are likely to be prescribed or receive reimbursement for MPKs in the future. The U.S. healthcare system sorts K3/K4 amputees into two buckets: those with an MPK prescription and insurance coverage, and those who only have access to or prefer a mechanical knee. (CCFF ¶¶ 530-61). U.S. prosthetic clinics need to go into the marketplace to purchase MPKs to fit on patients who want and would benefit

medically from an MPK. Patients are not switched from MPKs to mechanical knees based on the prices paid by clinics for those two classes of products. (CCFF ¶¶ 525-29). Clinics cannot simply provide a mechanical knee to patients who would benefit medically from an MPK. (CCFF ¶ 524).

b) Fundamentals of Competition among MPK Suppliers for Sales of MPKs to U.S. Prosthetic Clinics

A prosthetic clinic must go into the marketplace and purchase MPKs to fit on those patients whose prosthetists and other medical professionals determine would benefit medically from an MPK and have insurance coverage, ensuring the clinic will not lose money. (CCFF ¶¶ 430-523, 562-67). If patients qualify for MPKs, clinics do not try to switch them to mechanical knees over the recommendations of medical professionals; they purchase MPKs for those patients, because to do otherwise "would be a disservice to the patients and poor patient care." (CCFF ¶¶ 565-66). Clinics typically purchase MPKs directly from manufacturers, (CCFF ¶ 563), and the prices and terms on which MPKs are sold in the United States are established in one-on-one negotiations between clinics and manufacturers. (CCFF ¶ 569).

Although MPK manufacturers publish list prices, the price each clinic actually pays is individually negotiated and is almost always well below the published list price. (CCFF ¶ 570). Clinics generally negotiate MPK sales prices with manufacturers at least once per year during contract renewals, although manufacturers also offer lower prices to respond to competitive pressure from other MPK manufacturers at other times. (CCFF ¶¶ 571-73). The record shows that by discounting their MPK prices, MPK manufacturers are able to generate greater sales at the expense of other MPK manufacturers, and that clinics increase their MPK purchases from manufacturers that offer more favorable pricing. (CCFF ¶ 574). Price matters to a clinic because the lower the price of an MPK, the higher the clinic's margin, (CCFF ¶¶ 575-76), which clinics

use to provide better patient care, improve their facilities and patient support services, and train their clinical staffs, (CCFF ¶ 577-79, 1437-45).

A clinic's bargaining leverage in negotiations with an MPK supplier turns on its ability to credibly threaten to switch some portion of its purchases to another MPK. (CCFF ¶¶ 581-86). During negotiations with MPK manufacturers, clinics often use a competitor's MPK prices to negotiate lower prices. (CCFF ¶¶ 583-84, 587). According to Mr. Carkhuff, Freedom's Chairman, {[redacted]} (CCFF ¶ 584). Clinics regularly play MPK manufacturers, including Otto Bock and Freedom, off each other to negotiate lower MPK prices, (CCFF ¶¶ 587, 590-93, 595-96), because the ability to switch to competing MPKs provides clinics bargaining leverage, (CCFF ¶¶ 588, 590-93, 595-96). For example, at trial, Mark Ford, President and Managing Partner of Prosthetic & Orthotic Associates, testified that he has used the presence of Freedom's Plié 3 in negotiations with Otto Bock to get better pricing for the C-Leg 4. (CCFF ¶ 591). Mr. Ford testified that having both Freedom and Otto Bock allows him to "negotiate with both companies knowing there are alternatives, that our clinicians are both – are comfortable with both alternatives, so it allows us to negotiate." (CCFF ¶ 593).

Mechanical knees do not play a role in negotiations between manufacturers and clinics purchasing MPKs. The record is clear that MPK prices do not respond to price changes for non-microprocessor knees, (CCFF ¶¶ 597-98, 600, 602-04), and mechanical knee prices do not respond to prices charged for MPKs, (CCFF ¶¶ 599-601). MPK manufacturers do not consider the price of mechanical knees when setting their MPK prices. (CCFF ¶¶ 602-04). For example, Stephen Blatchford, Executive Chairman of Blatchford, which does business in the United States

as Endolite, testified that {[redacted]} (CCFF ¶¶ 602-03).

The Merger does not affect how doctors and prosthetists decide which patients would benefit medically from wearing an MPK, rather than a mechanical knee, or how insurers determine which patients to cover for an MPK. *See supra* § I.B.2.a. But, as explained above, it does significantly harm clinics that previously preferred to buy Freedom's MPKs or used Freedom to negotiate lower prices from Otto Bock and other MPK manufacturers. As the Commission has held in the past, prices that emerge from negotiations are a function of each side's bargaining leverage, and a merger may increase an acquirer's bargaining leverage by removing an important competitor. *See ProMedica*, 2012 WL 1155392, at *32. This Merger increases the combined firm's ability to impose higher prices on U.S. clinics in negotiations by removing Freedom as an independent competitor.

II. Respondent's Consummated Merger is Presumptively Unlawful by a Wide Margin

Complaint Counsel has proven that Respondent's Merger led to "undue concentration in the market for a particular product in a particular geographic area"—the manufacture and sale of MPKs to prosthetic clinics in the United States—"establish[ing] a presumption that the transaction will substantially lessen competition." *Polypore*, 149 F.T.C. at 850 (Chappell, A.L.J.) (quoting *Baker Hughes*, 908 F.2d at 982). Complaint Counsel's market definition is unassailable. Respondent itself has consistently, and at all levels of both Otto Bock and Freedom, defined the market in which they used to compete as the U.S. MPK Market. (CCFF ¶¶ 717-28). For example, in November 2017, after the Merger, top executives at Otto Bock

performed **{** **}** concluded that Otto Bock controlled a **{** **}** percent share of the **{** **}** market, while Freedom controlled **{** **}** percent. **{**

} Similarly, shortly before the Merger, an independent Freedom analyzed the **}** in which its Plié 3 competed to include only three other products, all MPKs, with Otto Bock's C-Leg accounting for a **{** **}** percent share and Freedom's Plié accounting for **{** **}** percent. **{**

[redacted]

[redacted]**}**

There is no dispute on geographic market definition—both sides agree it is the United States—and Respondent's ordinary course U.S. market share analyses consistently exclude mechanical knees. *See, e.g.*, (CCFF ¶¶ 718-19, 829-31). If the Court were to do nothing more than calculate HHIs based on Otto Bock's and Freedom's own analyses of the MPK market in which they viewed themselves as competing, those concentration calculations would trigger a strong presumption that the Merger is illegal. When the enormous body of evidence confirming not only Complaint Counsel's relevant market definition, but also the anticompetitive impact of the Merger is considered, there is no doubt that the Merger violates Section 7.

A. The Relevant Product Market is Microprocessor Prosthetic Knees

The relevant product market refers to the "product and services with which the defendants' products compete." *United States v. Anthem, Inc.*, 236 F. Supp. 3d 171, 193 (D.D.C. 2017), *aff'd* 855 F.3d 345 (D.C. Cir. 2017). The Supreme Court established the "basic rule for defining a product market"[3] in *Brown Shoe*: "The outer boundaries of a product market are determined by the reasonable interchangeability of use or the cross-elasticity of demand between the product itself and substitutes for it." *Brown Shoe*, 370 U.S. at 325. Stated another way, a product market includes all goods that are "reasonable substitutes." *Sysco*, 113 F. Supp. 3d at 25 (citing *FTC v. Cardinal Health*, 12 F. Supp. 2d 34, 46 (D.D.C. 1998)); *FTC v. Staples, Inc.*, 970 F. Supp. 1066, 1074 (D.D.C. 1997) (hereinafter "*Staples 1997*")); *see also United States v. H&R Block, Inc.*, 833 F. Supp. 2d 36, 51 (D.D.C. 2011) (holding "courts look at 'whether two products can be used for the same purpose, and, if so, whether and to what extent purchasers are willing to substitute one for the other'") (internal citation omitted). Whether goods are "reasonable substitutes" depends on two factors: cross-elasticity of demand and "functional interchangeability," which refers to whether buyers view similar products as substitutes. *Sysco*, 113 F. Supp. 3d at 25; *see also Staples 1997*, 970 F. Supp. at 1074 ("Whether there are other products available to consumers which are similar in character or use to the products in question may be termed 'functional interchangeability.'"). For "cross-elasticity of demand between products," one should consider "the responsiveness of the sales of one product to price changes of the other." *United States v. E.I. du Pont De Nemours & Co.*, 351 U.S. 377, 400 (1956) (hereinafter "*du Pont 1956*"); *Sysco*, 113 F. Supp. 3d at 25. For example, "[i]f an increase in the price for product A causes a substantial number of customers to switch to product B, the

[3] *FTC v. Staples, Inc.*, 190 F. Supp. 3d 100, 116–17 (D.D.C. 2016) (hereinafter "*Staples 2016*").

products compete in the same market." *Sysco*, 113 F. Supp. 3d at 25; *see also du Pont 1956*, 351 U.S. at 400. Evaluating whether an increase in the price for MPKs would cause a substantial number of customers to switch to mechanical knees is an essential part of defining the product market in this case.

A relevant market definition "does not need to include all of the firm's competitors; it needs to include the competitors that would 'substantially constrain [the firm's] price-increasing ability.'" *FTC v. Advocate Health Care Network*, 841 F.3d 460, 469 (7th Cir. 2016) (citations omitted); determination of the relevant product market "is a matter of business reality—a matter of how the market is perceived by those who strive for profit in it." *Staples 1997*, 970 F. Supp. at 1079 (internal quotations and citation omitted); *see also FTC v. Coca Cola Co.*, 641 F. Supp. 1128, 1132 (D.D.C. 1986). Courts frequently define relevant product markets using two analyses—the *Brown Shoe* practical indicia and the hypothetical monopolist test. *See, e.g.*, *Sysco*, 113 F. Supp. 3d at 27–34; *Staples 2016*, 190 F. Supp. 3d. at 118–22.

In *Brown Shoe*, the Supreme Court identified a series of "practical indicia" that courts have used to determine the relevant product market. *See Sysco*, 113 F. Supp. 3d at 27–33; *FTC v. CCC Holdings Inc.*, 605 F. Supp. 2d 26, 38–44 (D.D.C. 2009); *FTC v. Swedish Match*, 131 F. Supp. 2d 151, 159–165 (D.D.C. 2000); *Cardinal Health*, 12 F. Supp. 2d at 46–49; *Staples 1997*, 970 F. Supp. at 1075–80; *see also H&R Block*, 833 F. Supp. 2d at 51–60. These practical indicia include "industry or public recognition of the [relevant market] as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors." *Brown Shoe*, 370 U.S. at 325; *see also United States v. Aetna Inc.*, 240 F. Supp. 3d 1, 21 (D.D.C. 2017); *Sysco*, 113 F. Supp. 3d at 27; *H&R Block*, 833 F. Supp. 2d at 51.

Courts and the Commission also rely on the approach prescribed by the *Merger Guidelines* to define the relevant product market—the hypothetical monopolist test. *See, e.g.*, *Advocate*, 841 F.3d at 468–69 (applying the hypothetical monopolist test to define a relevant geographic market); *ProMedica*, 2012 WL 1155392, at *14 (citations omitted); *Polypore*, 150 F.T.C. at *11; *see also Sysco*, 113 F. Supp. 3d at 33–34; *Staples 2016*, 190 F. Supp. 3d at 121–22; *Merger Guidelines* § 4. The hypothetical monopolist test defines a relevant product market in economic terms, by asking whether a monopolist of a particular group of substitute products could profitably impose a "small but significant non-transitory increase in price" ("SSNIP")—typically 5 percent—over those products, or whether customers switching to alternative products would make such a price increase unprofitable. *Merger Guidelines* §§ 4.1.1–4.1.2; *see also CCC Holdings*, 605 F. Supp. 2d at 38 n.12. The *Merger Guidelines* instruct that in determining the bounds of the relevant product market, it is appropriate to apply first the hypothetical monopolist test on a candidate market comprised of at least one product of each merging firm. *Merger Guidelines* §§ 4.1.1–4.1.3. If enough customers would switch to products outside the candidate market in the face of a SSNIP to render the price increase unprofitable, the candidate market is too narrow. *Merger Guidelines* §§ 4.1.1–4.1.3. Additional products should be added to the candidate market only until a hypothetical monopolist could profitably impose a SSNIP—at which point, a relevant antitrust product market has been defined. *Merger Guidelines* §§ 4.1.1–4.1.3.

Applied to the facts here, both the *Brown Shoe* "practical indicia" and the hypothetical monopolist test clearly demonstrate that MPKs sold to U.S. clinics constitute a distinct relevant product market in which to assess the competitive effects of the Merger—and mechanical knees are properly excluded from the market.

1. *Brown Shoe* Practical Indicia Demonstrate MPKs Are a Relevant Product Market

The *Brown Shoe* practical indicia point to a distinct relevant product market consisting only of MPKs. First, MPKs have "peculiar characteristics and uses" that clearly distinguish them from mechanical knees. (CCFF ¶¶ 607-700). The microprocessors in MPKs provide unique functionality for amputees who wear them, resulting in significant safety, health, and quality of life benefits mechanical knees cannot match, as demonstrated by a large body of clinical research. (CCFF ¶¶ 617-700). Second, MPKs are used by a distinct subset of K-3 and K-4 amputees that prosthetists have determined are healthy enough and regularly engage in activities that make wearing an MPK a medical necessity. For this distinct class of end-user, if a prosthetic clinic can obtain insurance reimbursement for an MPK, the patient will almost always receive one instead of a mechanical knee. (CCFF ¶¶ 531-37). Third, manufacturers sell MPKs to clinics at prices that are much higher than mechanical knees, and insurance companies reimburse clinics at rates that are far higher than mechanical knees. (CCFF ¶¶ 701-11). Fourth, in one-on-one negotiations between MPK manufacturers and their clinic customers, MPK prices are sensitive to prices of other MPKs but not mechanical knees. (CCFF ¶¶ 712-16). Clinics play MPK manufacturers off each other to negotiate lower MPK prices, but cannot credibly threaten to substitute mechanical knees for MPKs. (CCFF ¶¶ 712-16). Fifth, industry participants, including Respondent, other MPK manufacturers, mechanical knee manufacturers, prosthetic clinics, and others recognize MPKs as a separate market from those in which mechanical knees are sold (*i.e.*, in the language of *Brown Shoe*, MPKs are an economic entity that is distinct from mechanical knees). (CCFF ¶¶ 717-66). Sixth, MPKs are sold by highly specialized personnel who possess deep knowledge about MPKs to assist prosthetists with fittings and to provide clinics a variety of educational and other services they find valuable. (CCFF ¶¶ 1676, 1680-81,

1685, 1687, 1692-1705). Collectively, these practical indicia establish MPKs as a separate relevant product market for purposes of assessing the Merger's impact on competition.

a) MPKs Have Peculiar Characteristics Not Possessed by Mechanical Knees

MPKs possess unique physical attributes as well as provide patients with significant safety and performance benefits beyond what mechanical knees can achieve. MPKs provide amputees who wear them unique functionality compared to non-microprocessor knees. Otto Bock's own website explains that "there are two kinds of prosthetic knees: non-microprocessor (or "mechanical") and microprocessor," with MPKs providing a "more sophisticated method of control to a prosthetic knee." (CCFF ¶ 607). Freedom's CEO at the time of the Merger, David Smith, testified that MPKs and mechanical knees are "completely different products" and distinguished them from each other by explaining "[o]ne is rudimentary and one is sophisticated. One doesn't allow mobility and ambulation and one does." (CCFF ¶ 608). William Carver, President and COO of College Park, which manufactures mechanical knees, testified that the microprocessor in an MPK acts as the "brain" and is **{** [redacted] **}** while a mechanical knee requires manual adjustments by a prosthetist to adapt to new environments. (CCFF ¶ 613). As Freedom highlights in ordinary course documents, mechanical knees are on the **{** [redacted] **}** and MPKs are on the **{** [redacted] **}** (CCFF ¶ 616).

A large body of clinical research demonstrates that amputees who wear MPKs experience significant safety, health, and quality of life benefits over those who wear mechanical knees. Dr. Kenton Kaufman of the Mayo Clinic, a "[v]ery highly respected" member of the MPK clinical research community, testified that "[t]he published articles have shown improved safety, [MPKs]

have improved mobility, better satisfaction, and one of the recent articles show[s] that in a ten-year time frame they would have less arthritis." (CCFF ¶¶ 617, 622).

One recent and important clinical study comparing the benefits of MPKs over mechanical knees, called the RAND report, concluded that "compared with NMPKs [non-microprocessor knees], MPKs are associated with meaningful improvement in physical function and reductions in incidences of falls and osteoarthritis." (CCFF ¶ 635). Published in 2017, the study found that "there is strong evidence suggesting that compared with [non-microprocessor knees], MPKs are associated with improvements in walking speed, gait symmetry, and the ability to negotiate obstacles in the environment[.]" (CCFF ¶¶ 632, 636). As a result of these improvements, patients wearing MPKs experience "fewer falls and lower incidences of osteoarthritis in the intact limb." (CCFF ¶ 637). MPK manufacturers find the RAND report valuable and reliable. For example, Maynard Carkhuff, Freedom's Chairman and former CEO, agreed at trial that the importance of the RAND report includes establishing that MPKs are safer than mechanical knees and provide greater stability for patients, which together helps lower healthcare costs associated with falls. (CCFF ¶ 638).

At trial, Dr. Kenton Kaufman of the Mayo Clinic testified about another clinical study that shows that MPKs are not only medically superior to mechanical knees for the K3 and K4 patients who currently have access to insurance coverage for them, {[redacted]} which would greatly grow the size of the U.S. MPK market. (CCFF ¶¶ 948-52). As Dr. Kaufman wrote, {[redacted]

[redacted]

Numerous other peer-reviewed studies prove the many safety and performance benefits that MPKs provide amputees over mechanical knees. (CCFF ¶ 641) (clinical study showing that MPK users improve their gait mechanics and stability as compared to mechanical knees); (CCFF ¶¶ 642-43) (clinical studies showing that microprocessor knee users have increased ability to walk on difficult terrain as compared with mechanical knee users and that MPK users experience fewer falls as compared with mechanical knee users); (CCFF ¶ 645) (clinical study showing that "there is evidence to suggest that [MPKs] provide greater ambulatory safety and improve environmental obstacle negotiation when compared to [mechanical knees]); (CCFF ¶ 645) (clinical study showing that "MPK use may significantly reduce uncontrolled falls by up to 80% as well as significantly improve indicators of fall risk."). As a result of these safety and performance benefits of MPKs over mechanical knees, the clinical research has also found that MPK users engage in more physical activity than mechanical knee users and experience overall improvement in quality of life. (CCFF ¶ 644).

Dr. Kaufman testified that the key findings of his research on MPKs "are a recurring theme that the patients have more safety, they have improved mobility, and they have better quality of life" when they wear an MPK instead of a mechanical knee. (CCFF ¶ 646). Jason Kahle of the University of Southern Florida and Prosthetics Design & Research similarly testified that, based on his research of MPKs, the reduction in stumbles and falls is "the biggest benefit of a microprocessor knee" and is "the reason why microprocessor knees are paid for by both CMS and most insurance companies." (CCFF ¶ 648).

Both Freedom and Otto Bock routinely use published clinical studies to educate their customers on the benefits of MPKs over non-MPKs and to market their products. For example, Freedom's website includes a "Microprocessor Knee Literature Review" which collects and summarizes academic articles "in an effort to understand where the research in [MPKs] has been focused and to determine where significant outcomes exist." (CCFF ¶ 672). The materials tout the conclusions of MPK clinical studies, stating that, "research has been able to show that the [MPK] user feels more stable on stairs, inclines, and uneven terrain, while reducing the cognitive demand required for walking." (CCFF ¶ 672). Additionally, Otto Bock has regularly provided customers with clinical research and other documentation discussing the benefits of MPKs relative to mechanical knees **{** [redacted] **}** (CCFF ¶¶ 685-86). Andreas Kannenberg, Otto Bock's Executive Medical Director of North America, testified that Otto Bock provides these materials because **{** [redacted] **}** (CCFF ¶ 686).

The results of these clinical studies, as well as the opinions of the clinical researchers themselves, are not merely of academic interest. Prosthetists consider these clinical studies when

deciding whether to fit a patient with an MPK or a mechanical knee, and in practice, prosthetists testify that they observe the clinical benefits of MPKs in the patients they fit with them. (CCFF ¶¶ 618-20). Clinic customers agree that MPKs provide more safety and stability than mechanical knees, leading to fewer stumbles and falls. (CCFF ¶ 653). Clinic customers also agree that MPKs allow patients to more easily traverse everyday environmental barriers, such as curbs, steps, and slopes, as well as walk in crowded areas. (CCFF ¶ 654). Mark Ford, President and Managing Partner of Prosthetic & Orthotic Associates, attributes this benefit of MPKs to their ability to "accommodate variable cadence," which enable MPKs to behave "much more fast and more responsively than a mechanical knee." (CCFF ¶ 654); *see also* (CCFF ¶ 655) (Keith Senn of Center for Orthotics & Prosthetic Care testifying that "from my observation, [MPKs users are] able to have a much better gait, which means to walk better, as well as amputees go, to be able to improve their gait."). In addition, clinic customers testified that MPKs are associated with fewer health risks, such as back pain and osteoarthritis, compared to mechanical knees. (CCFF ¶ 656). For example, Rob Yates, President and CEO of Jonesboro Prosthetic & Orthotic Laboratory, testified that the documented benefits of MPKs include "a lower incidence of complications from, you know, compensatory gait deviations, such as low back pain, sound side complications from arthritis, and other involvement that could present on the sound side." (CCFF ¶ 656).

Testimony and ordinary course documents from Respondent also demonstrate the benefits of MPKs relative to mechanical knees. For example, Maynard Carkhuff, former CEO and current Chairman of Freedom, testified that Freedom markets its Plié MPK as improving the stability of stance for amputees while ascending or descending stairs, relative to mechanical knees. (CCFF ¶ 657). In an ordinary course document titled {[redacted]

[redacted]

- [redacted]
- [redacted]
- [redacted]
- [redacted]
- [redacted]

[redacted]

[redacted] **sor** [redacted] **}** (CCFF ¶ 671) (internal Freedom presentation with slides titled "What makes MPC Knees different?" and listing numerous benefits of MPKs over non-MPKs).

Similarly, Otto Bock documents and the testimony of its executives demonstrate that MPKs provide important clinical benefits for patients that mechanical knees do not offer. For

example, Scott Schneider, Otto Bock's Vice President of Government, Medical Affairs, and Future Development, testified that, "[m]icroprocessors are proven to have stumble recovery, making them very, very safe. They also [allow] for more cadence variance, so walking fast or slow, so the computer can adjust to those speed differences. Microprocessors can enable people to have more comfort because it gives them additional features and benefits that they do not have to overcompensate with their muscular structure." (CCFF ¶ 674). Additionally, in a document titled **{** [redacted] **}** (CCFF ¶ 682); *see also* (CCFF ¶ 684) (advocating to Medicare representative that for K2 patients, MPK features such as "stumble recovery and improved stability while ambulating on all terrains create a solid foundation for improvement of overall function and mobility"); (CCFF ¶¶ 674-75).

Other MPK manufacturers also highlight the benefits of MPKs over mechanical knees. For instance, Endolite cites "greater stability," "less effort," "improved gait," "reduced compensation," and "greater patient satisfaction" among the benefits of its Orion 3 MPK over mechanical knees. (CCFF ¶ 695); *see also* (CCFF ¶¶ 693-94, 696). In describing the economic case for the Rheo Knee, Össur similarly explains that the use of MPKs is "associated with increased quality of life and improved mobility in transfemoral amputees, as measured by

transitioning from nonmicroprocessor, mechanical knees." (CCFF ¶ 690); *see also* (CCFF ¶¶ 688-89, 691-92).

b) MPKs Have Distinct End-Users from Mechanical Knees

Several different players in the U.S. healthcare system collectively determine whether it is medically appropriate to prescribe and reimburse the fitting of an MPK on a particular amputee. (CCFF ¶¶ 400-429). As described in Section I(B)(2) above, prosthetists evaluate the medical necessity of fitting an MPK by evaluating a number of factors about a patient, including his or her health and ability to engage in a number of different activities. (CCFF ¶¶ 411-417, 430). When a prosthetist determines that an MPK can improve the safety, health, or quality of life of an amputee, the clinic will seek reimbursement from an insurance provider to ensure the amputee receives the knee he or she needs from a medical perspective. (CCFF ¶¶ 447-87). Insurance providers such as Medicare and private payers typically only reimburse for MPKs when the prosthetist indicates that an MPK is medically necessary for a K-3 or K-4 amputee. (CCFF ¶¶ 488-514, 520-21). To meet insurance requirements, clinics have internal procedures to ensure that their prosthetists fit MPKs only on amputees that meet coverage eligibility criteria. (CCFF ¶¶ 515-19). Thus, not every K3 or K4 amputee receives an MPK, only those with documented proof that an MPK is a medical necessity over a mechanical knee. (CCFF ¶¶ 538-55). Once an individual is deemed to medically need an MPK and the clinic expects the patient's insurance will reimburse for the MPK, mechanical knees are no longer a substitute because they do not provide the tremendous health, safety, and quality of life benefits of MPKs.

c) MPK Sales Prices to Clinics and Insurance Reimbursement Amounts Differ Significantly From Those of Mechanical Knees

MPKs are significantly more expensive than mechanical knees, indicating MPKs constitute a separate market. *See Staples 2016*, 190 F. Supp. 3d at 119–120 (discussing distinct

pricing and negotiating practices as evidence of relevant product market); *Aetna*, 240 F. Supp. 3d at 28 ("distinct prices" may be considered in assessing the boundaries of a market) (citing *Brown Shoe*, 370 U.S. at 325). For example, the average sales price of MPKs in 2017 was approximately **{ }** per unit, while the average sales price of mechanical knees was only approximately **{ }** (CCFF ¶¶ 705-06); *see also* (CCFF ¶¶ 701-04).

Similarly, reimbursement rates paid to clinics by insurance providers are much higher for MPKs than for mechanical knees. As calculated by Respondent's own economic expert, Dr. Argue, the Medicare reimbursement rate for MPKs ranged from approximately $26,000 to $35,000, while the Medicare reimbursement amount for non-MPKs range from $5,000 to $8,000. (CCFF ¶ 711); *see also* (CCFF ¶¶ 707-10). Jack Sanders, Senior Clinical Program Consultant at United Healthcare, testified that **{ }** (CCFF ¶ 709). Similarly, Vinit Asar, CEO of Hanger, testified that MPKs are **{ }** (CCFF ¶ 708).

d) In Negotiations between Clinics and Manufacturers, MPK Prices Are Not Sensitive to Mechanical Knee Prices

MPKs and mechanical knees are in separate product markets because there is no "responsiveness of the sales of one product to price changes of the other." *du Pont 1956*, 351 U.S. at 400. Otto Bock and Freedom, as well as other MPK suppliers, "make pricing and marketing decisions based primarily on comparisons with rival [MPKs], with little if any concern about possible competition" from mechanical knees. *Coca Cola Co.*, 641 F. Supp. at 1133. MPK manufacturers have testified that when mechanical knee prices fluctuate, they do not

change the prices of their MPKs in response. (CCFF ¶ 755-56, 758). For example, Stephen Blatchford, Endolite's Executive Chairman, explained at trial that, **{** [redacted] **}** (CCFF ¶ 758). Consistent with this testimony, countless Otto Bock and Freedom documents reference competition from other MPKs, no, or almost no, documents that discuss pricing for MPKs make even a reference to mechanical knee pricing. *See, e.g.*, (CCFF ¶¶ 724, 731-32, 1035-1055). Respondent's exclusive focus on other MPK competitors in documents discussing pricing and promotion strategy decisions is "strong evidence" of a distinct relevant market. *See H&R Block*, 833 F. Supp. 2d at 53.

The fundamental question in market definition in this case is how would clinic customers respond to a price increase for one of the merged firm's MPKs, and "to what extent purchasers are willing to substitute" mechanical knees for MPKs to avoid such a price increase? *H&R Block*, 833 F. Supp. 2d at 51 (internal citation omitted); *Merger Guidelines* § 4. Clinic customers have testified that, in negotiations with manufacturers for the price of MPKs, MPK prices do not respond to price changes of non-microprocessor knees. (CCFF ¶¶ 597, 599, 713). Clinic customers testified that mechanical knees play no role in their negotiations with MPK manufacturers—they cannot threaten to switch to mechanical knees to negotiate lower MPK prices. (CCFF ¶¶ 598, 601, 713, 716). For example, Keith Senn, President and COO for Kentucky of the Center for Orthotic & Prosthetic Care, testified that he has never threatened to shift the clinic's MPK purchases to mechanical knees as a negotiating tactic because the shift "would be a disservice to patients and poor patient care." (CCFF ¶ 598).

Further, there is no evidence in the record that medical professionals have moved patients from MPKs to mechanical knees (or vice versa) based on the prices that clinics pay for MPKs or mechanical knees. (CCFF ¶ 525, 716). Prosthetists have an ethical obligation to fit patients with

products that best meet their medical needs. (CCFF ¶ 524, 814). While clinics and their prosthetists are willing to select among high-quality MPKs that would all meet a patients' medical needs, (CCFF ¶ 574), no clinic customer testified that its prosthetists had ever switched a patient from an MPK to a mechanical knee based solely on price. (CCFF ¶ 526-28, 716). Prosthetists testified that the choice between fitting a patient with an MPK or a mechanical knee (if insurance coverage were available for both products) is a clinical decision and not based on the relative prices a clinic pays for MPKs and mechanical knees. (CCFF ¶ 529). For example, when asked if his prosthetists would stop fitting patients with MPKs if the price of MPKs went up by $1,500, **{** [redacted] **}** (CCFF ¶ 529) In fact, Dr. Argue, Respondent's economic expert, could not identify any clinic customers that have switched from fitting MPKs to mechanical knees in response to pricing in the past. (CCFF ¶ 715).

e) The U.S. Prosthetics Industry Recognizes MPKs Are Sold in a Separate Market from Mechanical Knees

Respondent, other MPK manufacturers, mechanical knee manufacturers, and the prosthetic industry at large view MPKs as a separate market from those in which mechanical knees are sold.

(1) Respondent Recognizes MPKs Are Sold in a Separate Market from Mechanical Knees

In the ordinary course of business, Otto Bock and Freedom consistently evaluate a separate U.S. MPK market, in which they calculate shares for themselves and their MPK competitors, but never mechanical knees. Otto Bock consistently characterizes the market that its microprocessor knee, the C-Leg, competes in, as a microprocessor knee market. (CCFF ¶ 717). Matthew Swiggum, Otto Bock's CEO at the time of the Merger, testified that Otto Bock internally generates market share estimates of the U.S. MPK market on a regular basis. (CCFF ¶ 967). Indeed, Otto Bock's ordinary course documents are rife with market share analyses, all depicting an MPK-only market, and estimating shares for Freedom, Otto Bock, and a small number of other MPK manufacturers. (CCFF ¶ 718) (January 2015 internal U.S. MPK market share analysis estimating Otto Bock to have { } percent share, Freedom to have { } percent share, and Össur and Endolite to have { } percent and { } percent shares, respectively); (CCFF ¶ 720) (November 2015 internal U.S. MPK market share analysis estimating Otto Bock to have { } percent share, Freedom to have { } percent share, and Össur and Endolite to have { } percent and { } percent shares respectively); (CCFF ¶ 722) { } Otto Bock's ordinary course U.S. MPK market share analyses make their way to the highest levels of the company. For example, a July 2017 memo that Otto Bock executives prepared for the company's owner, Hans Georg Näder estimated Otto Bock's MPK market share in the United States as { } percent. (CCFF ¶ 721).

Freedom executives have also consistently analyzed the MPK market separate and apart from mechanical knees. For example, in 2017, an internal Freedom document examined the { } and calculated market shares for only the Plié and three other

MPKs: C-Leg, Rheo, and Orion. (CCFF ¶ 727); *see also* (CCFF ¶¶ 967-975). These MPK-only market share analyses inform important and strategic business decisions at Freedom. For example, Maynard Carkhuff, Freedom's Chairman and former CEO, testified that {[redacted]} (CCFF ¶ 728).

In addition to these ordinary course market share analyses, it is apparent from other documents and testimony that Respondent views only other MPKs as competitors to the C-Leg and Plié. For example, in setting the price of its C-Leg 4, Otto Bock looked at the prices and reimbursement rates {[redacted]} (CCFF ¶ 731). Similarly, Mark Testerman, Freedom's Vice President of Sales, testified that when Freedom sets the price of the Plié 3, Freedom is "looking at trying to take share form all other microprocessor knees," only "look[s] at pricing of the Plié 3 versus those knees," and does not take into account the pricing of mechanical knees. (CCFF ¶ 735). {[redacted]} (CCFF ¶ 736). As these documents and related testimony show, Otto Bock and Freedom do not view mechanical knees as significant competitors to their MPKs.

(2) The Rest of the Industry Also Recognizes MPKs Are Sold in a Separate Market from Mechanical Knees

The rest of the U.S. prosthetics industry also views MPKs as competing in a separate market from mechanical knees. For example, insurers, including Medicare and private payers,

rely on L-Codes to classify similar products together and to determine reimbursement amounts. (CCFF ¶¶ 742-44). Microprocessor knees and mechanical knees qualify for different sets of L-Codes, such that the aggregate reimbursement amounts from Medicare are significantly different for the two classes of products. (CCFF ¶ 746). L-Code 5856 covers "endoskeletal knee-shin system, microprocessor control feature, [and] swing and stance phase[.]" (CCFF ¶ 748). L-Code 5856 applies to the Plié 3, C-Leg 4, Rheo 3 and Orion, but not any mechanical knees. (CCFF ¶ 749); (CCFF ¶ 3067-72) (Freedom recommends that customers seek reimbursement for the Plié under L-Code 5856, for microprocessor swing and stance knees.); (CCFF ¶ 3069) (Freedom has published recommended L Codes for the Plié 3 with HCPCS code L5856 (microprocessor control feature, swing & stance phase) on its website); (CCFF ¶ 750).

Other MPK manufacturers, such as Össur and Endolite, also view MPKs as a distinct market. {[redacted]} (CCFF ¶ 754). Össur does not look at the price of mechanical knees when setting the price of its MPKs. (CCFF ¶ 755). Blatchford's Executive Chairman, Stephen Blatchford, testified that Endolite "only look[s] at other MPKs" and not mechanical knees when analyzing competition for the Orion 3 because "the price point is completely different" and "customers don't tend to think of [the two types of knees] in the same way." (CCFF ¶ 602, 756).

Similarly, mechanical knee manufacturers and other industry participants confirm that mechanical knees do not compete against MPKs. (CCFF ¶¶ 760-766). {[redacted]}

[redacted] (CCFF ¶ 763). Surgeons and prosthetists also attest to the vast differences between MPKs and mechanical knees. For example, Lieutenant Colonel Dr. Benjamin Potter, the Chief Orthopedic Surgeon for the Amputee Patient Care Program at Walter Reed National Military Medical Center, testified that it is usually in a patient's best interest to receive a microprocessor knee. Dr. Potter testified at trial that, "I would say at this point it's medical fact that they can provide improved function." (CCFF ¶ 649). Tracy Ell, Owner and Chief Prosthetist of Mid-Missouri Orthotics and Prosthetics, testified that the "[i]nherent stability of the microprocessor knees are far superior than mechanical knees." (CCFF ¶ 653). Clinical researcher, Dr. Kaufman of the Mayo Clinic, testified that relative to MPKs, mechanical knees are "outdated" and based on "World War II technology." (CCFF ¶ 646). Cascade, a distributor of mechanical knees, also testified that the microprocessor knee category is distinct from the mechanical knee category. (CCFF ¶ 766).

f) MPKs Are Sold By Specialized Vendors

To sell MPKs effectively requires highly specialized personnel who possess deep knowledge about MPKs to assist prosthetists with fittings and to provide clinics a variety of educational and other services they find valuable. (CCFF ¶¶ 1676, 1678, 1686-87, 1692, 1695, 1697-98). According to Mark Ford, President of Prosthetic and Orthotic Associates, information that he receives from MPK manufacturers' sales forces "is very helpful because it's going to optimize the performance of those components for that specific patient." (CCFF ¶ 1701). Clinic customers also require other specialized non-sales services from MPK vendors, (CCFF ¶ 847)

and technical support to assist with troubleshooting of MPKs, which customers describe as "extremely important." (CCFF ¶ 1711-12, 1714).

In order to provide the requisite support and education that clinics demand, successful manufacturers employ direct sales models to sell their MPKs in the United States. (CCFF ¶ 1676) (Össur executive testifying that a direct sales force is "absolutely necessary" to sell MPKs to U.S. clinics); (CCFF ¶ 1676) (Freedom's Chairman testifying that any manufacturer who wants to sell MPKs effectively in the U.S. has to have a sales force to interact with prosthetists and patients). As Otto Bock's CEO at the time of the Merger explained, a "[c]ompetent sales organization with customer knowledge, market knowledge, competitive insight, and the clinical application of the device with patients" is essential to competing effectively in the MPK market. (CCFF ¶ 2823). Indeed, Otto Bock's sales representatives visit Hanger's clinics, Otto Bock's largest customer, more than 2,000 times per year. (CCFF ¶ 1689).

By contrast, many mechanical knee manufacturers rely on distributors to sell their less sophisticated products. (CCFF ¶ 703, 766). As the CEO of Ohio Willow Wood explained, when it uses distributors it "is handing off some of the responsibility for sales or education or after-sale support in exchange for a discount." (CCFF ¶ 2878) While evidence shows it would be problematic for a company trying to compete in the U.S. MPK market to rely primarily on distributors rather than a direct sales force, (CCFF ¶¶ 2885, 2887, 2889, 2893-96), selling mechanical knees that way does not raise the same problems, (CCFF ¶ 2892).

Thus, Complaint Counsel has shown that each of the six *Brown Shoe* practical indicia addressed above supports a conclusion that MPKs are in a separate relevant product market from mechanical knees. That conclusion is supported by record evidence establishing that a hypothetical monopolist of only MPKs would be able to profitably impose a price increase to

clinics. Together, these two analyses prove that the relevant product market in which to analyze the effects of the Merger is the sale of MPKs to clinics.

2. The Hypothetical Monopolist Test Shows That the Sale of MPKs to Prosthetic Clinics is a Relevant Product Market

The hypothetical monopolist test asks if a hypothetical profit-maximizing firm were the only seller of a set of products in a candidate market, would that firm likely be able to impose a SSNIP profitably on at least one product sold by the merging firms. *Merger Guidelines* §§ 4.1.1-4.1.3. To answer this question, the hypothetical monopolist test focuses on "customers' ability and willingness to substitute away from one product to another in response to a price increase . . . ." *Merger Guidelines* § 4. Here, the applicable question is whether a hypothetical monopolist, owning all (or some subset) of the MPKs in the marketplace, could profitably impose a SSNIP on all—or even just Freedom's Plié or one of Otto Bock's MPKs—because if it could, MPKs would constitute a relevant product market. Complaint Counsel's economic expert, Dr. Scott Morton, proved that the answer to this question is yes. (CCFF ¶ 767-773). As a result, Dr. Scott Morton showed that the appropriate relevant product market in which to analyze the likely competitive effects of the Merger is the manufacture and sale of MPKs sold to clinics. (CCFF ¶ 767).

To inform her analysis, and as prescribed by the *Merger Guidelines*, Dr. Scott Morton conducted a critical loss analysis to test the profitability of imposing a SSNIP on either Freedom's Plié or one of Otto Bock's MPKs. *See Merger Guidelines* §§ 4.1.3 ("Critical loss analysis asks whether imposing at least a SSNIP on one or more products in a candidate market would raise or lower the hypothetical monopolist's profits."). To perform the critical loss test, Dr. Scott Morton used Respondent's own margin data and internal diversion analysis for the Plié 3 and Otto Bock's MPKs, which Otto Bock used to analyze the likely competitive effects of

acquiring Freedom. (CCFF ¶¶ 777, 783-86). Through the critical loss analysis, Dr. Scott Morton confirmed that imposing a SSNIP on one of the combined firm's MPKs would, in fact, be profitable. (CCFF ¶¶ 790-91). As a result, Dr. Scott Morton concluded that a candidate market consisting of only Otto Bock's MPKs and Freedom's Plié 3 constituted a relevant product market. (CCFF ¶¶ 790-91).

The hypothetical monopolist test "is iterative, meaning it should be repeated with ever-larger candidates until it defines a [relevant market]," but once a candidate set of products passes the test, the analysis can stop.[4] *Advocate*, 841 F.3d at 468 (internal citation omitted). The reason that a hypothetical monopolist controlling only Freedom's Plié and Otto Bock's MPKs could profitably impose a SSNIP is because the margins that Respondent earns on its MPKs are very high (well over {[redacted]},[5] and, according to Respondent's own analysis, the diversion between its MPKs is very high as well (C-Leg would recapture at least {[redacted]} percent[6] of all Plié 3 sales, and likely far more). (CCFF ¶ 782). According to the *Merger Guidelines*, "The higher the pre-merger margin, the smaller the recapture percentage necessary for the candidate market to satisfy the hypothetical monopolist test." *Merger Guidelines* 4.1.3 (also stating that "Diversion ratios between products sold by one merging firm and products sold by the other merging firm

[4] If enough customers would switch to products outside the candidate market in the face of a SSNIP to render the price increase unprofitable, the candidate market would be too narrow. *Merger Guidelines* §§ 4.1.1-4.1.3. Additional products should be added to the candidate market until a hypothetical monopolist could profitably impose a SSNIP—at which point, a relevant antitrust product market has been defined. *Merger Guidelines* §§ 4.1.1-4.1.3. Here, no more products are required to be added to Dr. Scott Morton's candidate market because her analysis shows a hypothetical monopolist could profitably impose a SSNIP on clinics if it owned only Freedom's Plié and Otto Bock's MPKs.

[5] Respondent's expert testified that he and Dr. Scott Morton used "very similar margins" in their critical loss analyses. (CCFF ¶¶ 789, 778, 780-81). (The applicable contribution margin used by Dr. Scott Morton was {[redacted]}; Dr. Argue's was {[redacted]}).

[6] Both Dr. Scott Morton and Respondent's expert used a diversion rate of {[redacted]} percent in their respective analyses. (CCFF ¶¶ 779, 782). Ordinary course evidence shows that the diversion from Plié 3 to Otto Bock's MPKs is at least 40 percent, but likely much higher. (CCFF ¶¶ 1394-99).

can be very informative for assessing unilateral price effects,[7] with higher diversion ratios indicating a greater likelihood of such effects.").

Dr. Scott Morton's conclusion that it would be profitable for a hypothetical monopolist to impose a SSNIP on either Freedom's Plié or one of Otto Bock's MPKs is perfectly consistent with Respondent's internal analysis of the likely competitive effects of the Merger. During due diligence of Freedom, Otto Bock's then-CEO suggested Otto Bock should evaluate the benefits {[redacted]} (CCFF ¶ 805). In analyzing whether it would be profitable to raise the price of Plié or discontinue selling the product altogether (the equivalent of an infinite price increase), Otto Bock estimated the percentage of Plié 3 sales it would recapture with increased C-Leg 4 sales. Otto Bock determined that it would recapture at least 50 percent, and as much as 70 percent, of all lost Plié 3 sales with increased sales of Otto Bock MPKs. (CCFF ¶ 806). This analyses remained consistent throughout the due diligence process, and ultimately became a focal point of Otto Bock's integration plans once it had acquired Freedom and the Plié 3. In November 2017, nearly two months after the Merger, Respondent's executives made a recommendation for the Plié 3 to [redacted]} which would {[redacted]} (CCFF ¶ 804). This recommendation made business sense because, according to Otto Bock's CEO at the time, he was, and remains, confident that Otto Bock could recapture at least 50 percent of any lost Plié sales. (CCFF ¶ 1398).

[7] Because the candidate market Dr. Scott began with consisted of only the merged firm's products, the hypothetical monopolist test in that setting is identical to an analysis of unilateral effects likely to result from the Merger. Thus, "higher diversion ratios" present in this case indicate a greater likelihood that the hypothetical monopolist will successfully and profitably impose a SSNIP on either the Plié or one of Otto Bock's MPKs when both are under its control.

In order to account for evidence indicating that other MPKs sold in the United States compete significantly with Respondent's Plié and C-Leg, Dr. Scott Morton also analyzed the effects of the Merger in the broader relevant market for all MPKs. (CCFF ¶ 958). By the design of the hypothetical monopolist test, if a hypothetical monopolist could profitably raise price on the Plié or an Otto Bock MPK when it owned only those products, it would necessarily be able to impose a SSNIP[8] on clinics if it owned even more products, including all MPKs.[9] Dr. Scott Morton's conclusion that a hypothetical monopolist controlling all MPKs would be able to profitably impose a SSNIP on clinics for either Freedom's Plié or one of Otto Bock's MPKs is corroborated by voluminous testimony from clinics that they would not switch to mechanical knees in response to an MPK SSNIP. (CCFF ¶¶ 795-801). Specifically, testimony from prosthetists and clinic owners shows that they would not deny patients a product they deem a medical necessity and switch them to a mechanical knee as long as the clinic could fit the patient with an MPK without losing money. (CCFF ¶¶ 807-28). Indeed, MPK purchasing data shows that clinics would still earn a profit fitting lower-limb amputees with MPKs even after a SSNIP. (CCFF ¶¶ 824-28). Therefore, if a hypothetical monopolist tried to impose a SSNIP on one of Respondent's MPKs, it would be profitable to do so, because clinics would not switch to

[8] By adding additional MPKs such as the those manufactured by Össur, Endolite, DAW, and Nabtesco, the hypothetical monopolist would simply recapture a greater percentage of sales it otherwise would have lost to products outside the candidate market when it controlled only Freedom and Otto Bock's MPKs. Thus, Dr. Scott Morton concluded that if the narrow candidate market of Otto Bock's MPKs and Freedom's Plié 3 is a relevant antitrust market, then "a wider market consisting of all microprocessor knees sold in the United States is also a relevant market." (CCFF ¶ 792).

[9] Dr. Scott Morton provided market share estimates for both a U.S. MPK market and a "narrower market" excluding high-end and low-end MPKs. (CCFF ¶¶ 957-59). Dr. Scott Morton's broader market includes sales in the United States of all Otto Bock MPKs, Freedom's Plié, Endolite's Orion, all Össur MPKs, all DAW MPKs, and all Nabtesco MPKs. (CCFF ¶ 958 [11.11.2pm]). Dr. Scott Morton's "narrower market" includes only sales in the United States of Otto Bock's C-Leg, Freedom's Plié, Össur's Rheo (not including sales of its Rheo XC), Endolite's Orion, each of DAW's MPKs, and Nabtesco's Allux. (CCFF ¶ 959). Dr. Scott Morton concluded that both of these markets passed the hypothetical monopolist test, as a SSNIP could necessarily be imposed on either the Plié or one of Otto Bock's MPKs in each of them. (CCFF ¶ 792).

mechanical knees to defeat it. As a result, mechanical knees are properly excluded from the relevant product market. (CCFF ¶¶ 795-801).

3. Respondent's Alleged Relevant Product Market is Unsupported by Evidence and Based on a Flawed Understanding of How the U.S. Prosthetics Industry Works

Respondent's assertion that the relevant product market must include MPKs *and* all K3/K4 mechanical knees is contradicted by overwhelming evidence showing MPKs are sold in a separate market from mechanical knees. By including all mechanical knees used by any K3 or K4 amputee, Respondent exposes its fundamental misunderstanding of (or intentional effort to confuse) how the U.S. prosthetics industry works. Market definition requires an evaluation of how market participants would respond to a price change for MPKs. *See, e.g.*, *du Pont 1956*, 351 U.S. at 400 ("An element for consideration as to cross-elasticity of demand between products is the responsiveness of the sales of one product to price changes of the other."); *Merger Guidelines* § 4. Specifically, it requires an evaluation of how a price increase by MPK manufacturers to clinics that purchase MPKs would cause substitution to other MPKs and potentially mechanical knees. Dr. Argue, Respondent's expert, did not even attempt to evaluate, as the law requires, how an increase in prices paid by *clinics* to MPK manufacturers would affect whether K3 or K4 *amputees* would be fit with more mechanical knees in response.

To reach his conclusion that the market includes any knee—MPK or mechanical—that any K3 or K4 patient purchases, he relies on faulty logic and no sound economic principle. Respondent's expert started with a casual observation that some amputees are sufficiently active that they are categorized as K3 or K4 under the Medicare classification system, (CCFF ¶ 433), and then makes the equally casual observation that some amputees that Medicare categorizes as K3 or K4 wear an MPK and others wear a mechanical knee. Using those two observations, he leaps to the conclusion that MPKs and mechanical knees must be substitutes for one another for

everyone in the K3/K4 group, as if there are not differences among members of this class of patients that affect their choice of knee. Stated another way, Dr. Argue assumes a market for all K3/K4 *patients* exists and any knee worn by any K3/K4 patient should be included in that market. He does not, as the case law and *Merger Guidelines* instruct, determine whether a hypothetical monopolist of certain *products* could impose a price increase on its customers, *Sysco*, 113 F. Supp. 3d at 33; *Merger Guidelines* § 4.1.1, which in this case are the clinics that buy MPKs directly from Otto Bock, Freedom, and other MPK manufacturers. (CCFF ¶ 563). There is absolutely no basis in law or economics to analyze the relevant market using Dr. Argue's approach. The proper approach, under the law, the *Merger Guidelines*, and basic microeconomics, is the analysis Complaint Counsel's expert undertook to evaluate the "cross-elasticity of demand" between MPKs and mechanical knees, which requires evaluating "the responsiveness of the sales of one product to price changes of the other." *du Pont 1956*, 351 U.S. at 400. That is why the hypothetical monopolist test starts with at least one product from each of the merged firms, and then applies an "iterative" process of adding "products" until a hypothetical monopolist controlling all of them could profitably impose a price increase on "at least one product sold by one of the merging firms" to clinics. *Merger Guidelines* § 4.1.1.; *Advocate*, 841 F.3d at 468. Dr. Argue never performed this exercise. (CCFF ¶¶ 2936-2945) (describing numerous flaws of Dr. Argue's critical loss analysis, including several unsupported or inappropriate assumptions and failure to calculate any predicted loss).

Given the way the U.S. prosthetics industry works in actuality, Respondent expert's conclusion that the market should be defined as *any* knee that *any K3 or K4 patient may wear* makes no sense. Unlike in Dr. Argue's theoretical world, the evidence shows that in the real world, different individuals within the K3/K4 universe have widely varying levels of health

strength, mobility, work environments, activities they want to engage in, and, importantly, insurance coverage. (CCFF ¶¶ 447-487). Based on these differences, healthcare professionals determine MPKs are medically optimal for some K3/K4 patients, and mechanical knees are best for others. (CCFF ¶¶ 447-448). Insurers determine some K3/K4 amputees meet their medical necessity requirements, while others do not. (CCFF ¶ 418). There is no market for all products bought by any K3 or K4 patient because different K3/K4 patients have access to different choices. Dr. Argue completely ignored that the U.S. healthcare system sorts K3/K4 patients into two groups: (1) those with an MPK prescription and coverage for an MPK and (2) those without. (CCFF ¶¶ 427-429). The first group does not view mechanical knees, and their inferior technology, as substitutes for the high-tech MPKs that their medical professionals have prescribed and insurers have covered to improve their health, safety, and quality of life. (CCFF ¶¶ 531-537, 602). The second group has no ability to choose an MPK, since they do not have a valid prescription and/or insurance coverage. (CCFF ¶¶ 520-523). For the few patients who might have access to an MPK but prefer a mechanical knee, there is no evidence that a change in the price of an MPK *paid by the clinic* would affect those patients' decisions. (CCFF ¶¶ 559-561).

Quite simply, there is no evidence that the price paid by a clinic for an MPK would ever cause a patient to change his or her mind about wanting an MPK,[10] a prosthetist to switch his or her patient to a mechanical knee, or an insurer to deny coverage for an MPK. *See,* (CCFF ¶¶ 716, 3039). A large body of evidence shows that, as long as a clinic can fit a patient with a valid

[10] The fact that patients are not sensitive to changes in prices paid by their healthcare providers, in this case the clinics that fit them with MPKs, is a phenomenon that is common in other merger cases in the healthcare sector. *See, e.g.*, *Advocate*, 841 F.3d at 471 ("Insured patients are usually not sensitive to retail hospital prices . . . ."). The focus of relevant market definition in mergers involving negotiations between buyers and sellers of products and services that are ultimately used by insured patients is how a merger affects the bargaining leverage of each side in those negotiations. *See, e.g.*, *Penn State Hershey*, 838 F.3d at 342; *Advocate*, 841 F.3d at 471.

MPK prescription and insurance coverage, without losing money, it will. (CCFF ¶¶ 524-529, 531-537). Dr. Argue's effort to reverse-engineer a broad market definition by focusing on a single characteristic of amputees—their Medicare categorization—is a strawman[11] designed to confuse the only relevant economic question: how the Merger will affect the bargaining leverage of MPK manufacturers and clinics that buy MPKs to meet the medical needs of their patients. The evidence is clear that mechanical knees play no role in those negotiations, do not constrain the prices that a hypothetical monopolist could charge for MPKs, and therefore are properly excluded from the relevant market.

B. The Relevant Geographic Market is the United States

The relevant geographic market is the area where the "effect of the merger on competition will be direct and immediate." *Advocate*, 841 F.3d at 476 (citing *United States v. Phila. Nat'l Bank*, 374 U.S. 321, 357 (1963) (internal quotations omitted)); *see also Polypore*, 149 F.T.C. at 835 (Chappell, A.L.J.). The United States is where "the defendants compete in marketing their products or services," *H&R Block*, 833 F. Supp. 2d at 50 n.7 (quoting *CCC Holdings*, 605 F. Supp. 2d at 37). The Supreme Court explained that the relevant geographic market must "correspond to the commercial realities of the industry," as determined through a "pragmatic, factual approach." *Brown Shoe*, 370 U.S. at 336 (internal quotations omitted). Courts consistently define the relevant geographic market by assessing the alternative sources of the relevant product or service to which consumers could practicably turn. *See, e.g.*, *Phila. Nat'l*

[11] Dr. Argue attempts to use evidence showing there are reasons that some K3 or K4 amputees wear a mechanical knee because they do not have access to an MPK or have a personal preference for a mechanical, to suggest that all K3/K4 patients might choose a mechanical knee over an MPK if the price of their preferred MPK went up to a clinic. Because the issue in relevant market definition is whether customers who purchase MPKs would substitute away from them to mechanical knees in response to a SSNIP, whether a group of K3/K4 patients exists that would not choose an MPK in the first place--for reasons completely unrelated to the price of MPKs charged to clinics—is irrelevant to the market definition exercise set forth in the *Merger Guidelines* and case law. Patients that would not have been fit with an MPK before the Merger or after a hypothetical MPK price increase are not in the relevant market and play no role in defining it.

Bank, 374 U.S. at 359; *FTC v. Butterworth Health Corp.*, 946 F. Supp. 1285, 1291 (W.D. Mich. 1996); *Polypore*, 150 F.T.C. at *16; *see also Merger Guidelines* § 4.2. A common tool used to assess the commercial reality of a relevant geographic market is the hypothetical monopolist test. *See Penn State Hershey*, 838 F.3d at 338. "Under the Horizontal Merger Guidelines, a relevant geographic market is the smallest region in which a hypothetical monopolist that was the only seller of the relevant product located within that region could profitably implement a 'small but significant and non-transitory' increase in price." *Polypore*, 150 F.T.C. at *16 (citing *Merger Guidelines* § 4.2).

1. Respondent Agrees that the United States is the Relevant Geographic Market

Throughout these proceedings, Respondent has repeatedly agreed that the United States constitutes the relevant geographic market in this case. When asked by the Court during opening statements, Counsel for Respondent agreed that there is no dispute that the relevant geographic market is the United States. (CCFF ¶ 829). Moreover, Respondent's economic expert, Dr. David A. Argue, wrote in his report, and reiterated at trial, that he does "not dispute that the United States is a properly defined geographic market." (CCFF ¶ 830).

2. Commercial Realities Show that the United States is the Relevant Geographic Market

The commercial realties of the U.S. MPK industry, as reflected in documents and testimony of Respondent, customers, and competitors, show that the sale of MPKs to clinics located in the United States is a distinct geographic market. The United States has unique regulatory and reimbursement realities that distinguish it from other areas in the world where MPKs are sold. For example, in the United States, MPKs are classified as Class I medical devices, according to the Food and Drug Administration, and therefore must be manufactured "in accordance with strict product design, verification, validation, and documentation guidelines."

(CCFF ¶ 835). Additionally, in the United States, unlike other countries, the Centers for Medicare and Medicaid Services dictates the reimbursement amounts for MPKs. (CCFF ¶ 836). Otto Bock's Senior Prosthetics Marketing Manager acknowledged that the United States constitutes a distinct market for the sale of MPKs when she explained that Otto Bock considers the U.S. market to have characteristics that are "very unique and different from other places in the world." (CCFF ¶ 834).

MPK firms that only operate outside of the United States are not viable options for U.S. prosthetic clinics. Customers rely on MPK manufacturers' sales and clinical employees to fit, program, and maintain their patients' MPKs, and consider it essential that an MPK supplier be able to provide those services on site in U.S. clinics. (CCFF ¶¶ 840-41). {[redacted]} (CCFF ¶ 842). As a result, the largest MPK manufacturers—Otto Bock, Freedom, Össur, and Endolite—have extensive U.S. sales and clinical support forces. (CCFF ¶ 1679, 1682-84). Real world MPK sales data shows that these four MPK suppliers account for 98.6 percent of all MPKs sold to U.S. clinics, and even the two small fringe sellers of MPKs, Nabtesco and DAW, sell MPKs using sales representatives that visit U.S. clinic customers. (CCFF ¶ 964, Tables 6-7). According to Freedom's Chairman and former CEO, Maynard Carkhuff, field sales personnel are critical to maintaining MPK sales, because "if we are out of sight, we're out of mind." (CCFF ¶ 844). In contrast, a foreign MPK manufacturer, with little or no sales force presence in the United States, could not meet the needs of U.S. clinic customers. (CCFF ¶ 862).

In the ordinary course of business, Otto Bock and Freedom regularly distinguish the "U.S." MPK market from the sale of MPKs in the rest of the world. (CCFF ¶¶ 718, 720-21, 851-55). In Respondent's strategic planning documents and routine business discussions, Otto Bock and Freedom regularly evaluate their MPK businesses and make strategic decisions for the United States separate and apart from the rest of the world. (CCFF ¶¶ 718, 720-21, 851-55). {[redacted]} (CCFF ¶ 855). Perhaps most powerfully, at trial, no customer even mentioned the possibility of switching to an MPK not currently sold in the U.S. through a U.S. sales force. (CCFF ¶ 850).

3. The Hypothetical Monopolist Test Confirms that the United States is the Relevant Geographic Market

Applying the hypothetical monopolist test in this case, the relevant question is whether a hypothetical monopolist of all MPKs currently sold in the United States could profitably impose a SSNIP on U.S. clinics. The answer is clearly yes. Clinics in the United States indicate that they could not, and would not, turn to firms without a substantial U.S. presence for MPKs in the face of a price increase. (CCFF ¶ 862. Because a hypothetical monopolist of MPKs currently sold in the United States could profitably raise prices to U.S. customers (without losing substantial sales to firms with no significant U.S. presence), the United States is a relevant geographic market. As such, Dr. Scott Morton concludes, "the options of clinics in the United States are limited to the microprocessor knee manufacturers that currently have a presence in the United States." (CCFF ¶ 859). Respondent's expert, Dr. Argue, agrees, having testified that,

"customers are not going to be going to suppliers outside of the [United States] to purchase knees or feet." (CCFF ¶ 860).

C. High Market Concentration and Market Shares Establish an Extremely Strong Presumption that the Merger is Illegal

The Merger presumptively violates Section 7 of the Clayton Act and Section 5 of the FTC Act because it significantly increased concentration in the already highly concentrated U.S. MPK market. (CCFF ¶¶ 953-90 . A merger is presumed to violate the Clayton Act and FTC Act if it produces a firm controlling an "undue concentration in the relevant market." *ProMedica*, 2012 WL 1155392, at *12 (citing *Phila. Nat'l Bank*, 374 U.S. at 363; *Baker Hughes*, 908 F.2d at 982-83). "Sufficiently large HHI[12] figures establish [a] prima facie case that a merger is anti-competitive." *Heinz*, 246 F.3d at 716; *see also Polypore*, 150 F.T.C. at *23. Under the *Merger Guidelines*, mergers "that involve an increase in the HHI of more than 200 points" in a highly concentrated market (i.e., with an HHI over 2500) are presumptively anticompetitive. *Merger Guidelines* § 5.3; *see Heinz*, 246 F.3d at 716 (an increase in the HHI of 510 in a market with a pre-merger HHI of 4,775 created a presumption "by a wide margin").

Here, the U.S. MPK market had a pre-Merger HHI of **{** [redacted] **}** and the Merger increased concentration by **{** [redacted] **}** points, resulting in a post-Merger HHI of **{** [redacted] **}** which far exceed the established thresholds to establish a strong presumption that the Merger is likely to enhance market power. (CCFF ¶ 964, Table 6). At the time of the Merger, Otto Bock's market share, by revenue, exceeded **{** [redacted] **}** percent**,** and Freedom had an approximate **{** [redacted] **}** percent share**,** giving the combined firm more than an **{** [redacted] **}** percent share of the U.S. MPK market.[13] (CCFF ¶ 964, Table

[12] The Herfindahl-Hirschman Index (the "HHI") is "[t]he typical measure for determining market concentration." *ProMedica*, 2012 WL 1155392, at *12 (citing *CCC Holdings*, 605 F. Supp. 2d at 37); *see also Polypore*, 150 F.T.C. at *23 (citing *Heinz*, 246 F.3d at 716). The HHI is the sum of the squares of the market shares. In other words, in a market with four competitors, each of whom has 25% market share, the HHI would be 2500 ($25^2 + 25^2 + 25^2 + 25^2$).

[13] Complaint Counsel's economic expert, Dr. Scott Morton, calculated market shares in both dollars and unit sales

6). As the table below shows, post-Merger, Respondent is now more than five times the size of Össur, the next-largest MPK supplier, and Otto Bock and Össur together account for more than 95 percent of all U.S. MPK sales. (CCFF ¶ 964, Table 6. As the table below shows, post-Merger, Respondent is now more than five times the size of Össur, the next-largest MPK supplier, and Otto Bock and Össur together account for more than **{ }** percent of all U.S. MPK sales. **{**

}

The market shares calculated by Complaint Counsel's economic expert, Dr. Scott Morton are highly consistent with Respondent's ordinary course market share estimates.[15] (CCFF ¶¶

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for all six providers of MPKs in the United States—Otto Bock, Freedom, Össur, Endolite, Nabtesco, and DAW—using real world sales data provided by each of these companies. (CCFF ¶¶ 953, 955). Dr. Scott Morton concluded that it is more appropriate to calculate market shares by revenue (as opposed to units sold) because MPKs are not homogenous goods—that is, they have different features and price points. (CCFF ¶ 960); *see also* (CCFF ¶¶ 961-962). Nevertheless, Dr. Scott Morton concluded that the U.S. MPK market is highly concentrated and the Merger results in a strong presumption of competitive harm regardless of whether market shares are calculated in units sold or dollar revenue. (CCFF ¶ 963); (CCFF ¶ 964, Table 7) (if market shares are calculated on the basis of MPK units sold, the Merger increases concentration by **{ }** points from a pre-Merger HHI of **{ }** to a post-Merger HHI of **{ }**).

[14] Dr. Scott Morton also calculated alternative market shares and HHIs for a "narrower market" excluding high-end and low-end MPKs. (CCFF ¶ 964). This "narrower market" includes U.S. sales of only Otto Bock's C-Leg, Freedom's Plié, Össur's Rheo (not including sales of its Rheo XC), Endolite's Orion, each of DAW's MPKs, and Nabtesco's Allux. (CCFF ¶ 966). Dr. Scott Morton concluded that the pre-Merger HHIs show that this narrower MPK market is highly concentrated and that the change in HHIs post-Merger establish a strong presumption that the Merger will likely enhance the merged firm's market power. (CCFF ¶ 966, Table A1) (showing that in Dr. Scott Morton's narrower MPK market, the Merger increases concentration by **{ }** points from a pre-Merger HHI of **{ }** to a post-Merger HHI of **{ }**).

967-80). For example, pre-Merger, in July 2017, Otto Bock executives prepared a memo for Otto Bock's owner, Hans Georg Näder, estimating Otto Bock's and Freedom's shares of the U.S. MPK market to be **{** **}** respectively. (CCFF ¶ 971); *see also*, (CCFF ¶ 971) **{** **}** (CCFF ¶ 972) (an August 2017 due diligence summary presented by Otto Bock executives included similar shares for the U.S. MPK market). **{** **}** (CCFF ¶ 974). At trial, Otto Bock's Senior Prosthetics Marketing Manager, Cali Solorio, testified that—based on estimates it generated in November 2017—Otto Bock had a **{** **}** percent share of MPKs sold in the United States, Freedom had a **{** **}** percent share, Össur had a **{** **}** percent share, and Endolite had a **{** **}** percent share. (CCFF ¶ 975) **{** **}**

Market share analyses of third parties are strikingly similar. (CCFF ¶¶ 981-84). At trial, Vinit Asar, Hanger's CEO, testified that the **{** **}**

[15] The ordinary course U.S. MPK market share estimates that Respondent generated were consistent over time and used for a number of different business purposes. (CCFF ¶¶ 967-80); *see, e.g.*, (CCFF ¶¶ 969, 976) (in early 2015, at the time of the C-Leg 4 launch, Otto Bock estimated that it had a **{** **}** share of the MPK market, that Freedom had an **{** **}** share, that Össur had a **{** **}** share, and Endolite had a **{** **}** share); (CCFF ¶ 970) (Otto Bock's "2016 Marketing Plan" for "Lower Limb Mechatronics" indicated that Otto Bock had an **{** **}** market MPK share, Freedom had a **{** **}** MPK market share, Össur had an **{** **}** MPK market share, and Endolite had a **{** **}** MPK market share); (CCFF ¶ 973) (during the development of the Quattro, Freedom estimated that Otto Bock's C-Leg had a **{** **}** market share, Freedom's Plié had a **{** **}** market share, Össur's Rheo had a **{** **}** market share, and Endolite's Orion had a **{** **}** market share).

[redacted] (CCFF ¶ 983). The only insurance company witness to testify at trial told a consistent story from a claims perspective. Jack Sanders, Senior Clinical Program Consultant for United Healthcare, testified that—based on his review of actual MPK claims—clinics [redacted] (CCFF ¶ 981).

Finally, Respondent's own economic expert, Dr. David Argue, conceded that the Merger triggers the presumption of anticompetitive harm. (CCFF ¶ 987). Defining the market to include MPKs (except high-end and integrated types), as well as K3/K4 non-MPKs sold in the United States, Dr. Argue contends that the Merger results in a post-Merger HHI of 4,359 and an increase in the HHI of 599. (CCFF ¶ 986). Thus, even though Dr. Argue incorrectly includes sales of mechanical knees in his market definition, *see supra* Part II.A., and improperly calculates market shares based on units sold (rather than revenue), (CCFF ¶ 989), his analysis also shows that the Merger is presumptively illegal by a wide margin. (CCFF ¶¶ 986-87).[16]

III. The Merger Substantially Reduced Competition in the U.S. MPK Market

Complaint Counsel's extremely strong *prima facie* case that the Merger was anticompetitive is buttressed by an abundance of direct evidence in the record proving that the Merger will cause substantial unilateral anticompetitive effects. Documents, data, and testimony from Respondent, customers, and competitors, show that Otto Bock and Freedom

[16] Dr. Scott Morton calculated market shares based on *revenue* for Dr. Argue's proposed market and concluded that the pre-Merger HHI [redacted] and change in HHI [redacted] were similar to the pre-Merger HHI and change in HHI for the relevant market that she defined. (CCFF ¶ 990).

competed vigorously for U.S. MPK sales prior to the Merger, and that this direct and intense competition resulted in significantly lower prices and higher-quality products and services for clinics and amputees. Mergers that eliminate significant head-to-head competition are likely to result in anticompetitive unilateral effects. *See, e.g.*, *ProMedica*, 749 F.3d at 569 ("The extent of direct competition between the products sold by the merging parties is central to the evaluation of unilateral effects."); *Staples 1997*, 970 F. Supp. at 1083 (finding unilateral anticompetitive effects when the transaction "would eliminate significant head-to-head competition" between the merging parties); *Swedish Match*, 131 F. Supp. 2d at 169 ("[A] unilateral price increase . . . is likely after the acquisition because it will eliminate one of Swedish Match's primary direct competitors.").

Complaint Counsel has demonstrated through the trial record that, at the time of the Merger, competition between Freedom and Otto Bock was on the brink of becoming even more intense with the launch of the Quattro, the next-generation MPK that Freedom specifically designed to be the "C-Leg 4 Killer." (CCFF ¶¶ 40, 1232, 1234). Freedom knew that it could grow its share of the U.S. MPK market substantially by training its sights on C-Leg 4, since the C-Leg 4 is, by far, the best-selling MPK in the United States. Otto Bock, which was aware of the looming threat posed by the upcoming launch of the Quattro before the Merger (CCFF ¶ 1330), used the due diligence process to learn details about the product and Freedom's planned strategy to attack the C-Leg 4, and concluded that the Quattro was a "serious threat" to its C-Leg franchise. (CCFF ¶ 1355). Respondent's executives repeatedly extolled the defensive value of the Merger and specifically the benefit of having control over the Quattro to prevent Freedom or another competitor from challenging the C-Leg franchise. (CCFF ¶¶ 1343, 1357). To thwart the

competitive threat of the Quattro, Otto Bock acquired Freedom with an eye toward repositioning Quattro **{** **}** (CCFF ¶ 143).

This is the rare case in which the Court does not need to deduce, from high market shares and Respondent's incentives, whether the merged firm will raise prices, terminate development projects for competing products and/or limit consumer choice following the Merger. Here, having taken control of Freedom, Respondent actually developed its strategy to reposition the Quattro and discontinue or raise the price of the Plié 3. Respondent's ordinary course documents and testimony from several Respondent executives show that the strategy to increase the price of Freedom's Plié 3 and reposition the Quattro was developed at the highest levels of the merged firm. (CCFF ¶¶ 1397, 1410). It was clear that Otto Bock considered Freedom's MPK market share to be **{** **}** (CCFF ¶ 1367) and after the Merger, Respondent got to work leveraging its ownership of Freedom by establishing plans to increase the price of the Plie 3 and extinguishing the competitive threat that Quattro had posed. (CCFF ¶¶ 1392-1411). On November 7 and 8, 2017, more than a month-and-a-half after the Merger, top executives from Otto Bock and the former-Freedom gathered in Irvine, California, to discuss the go-forward strategy. On the agenda: **{** **}** that included **{** **}** (CCFF ¶¶ 141, 1394). The basis of the recommended course of action was Respondent executives' analysis that Otto Bock would capture no less than **{** **}** percent, and as much as **{** **}** percent, of all Plié 3 sales lost as a result of a price increase or discontinuation of Plie altogether. (CCFF ¶ 1363).

As the *Merger Guidelines* and case law make clear, Section 7 exists precisely to prevent firms from doing what Otto Bock's post-Merger plans detail they would do following the

Merger. *See Merger Guidelines* § 6.1; *Swedish Match*, 131 F. Supp. 2d at 169. In fact, the *Merger Guidelines* use the same analytical framework that Respondent used in evaluating whether it should implement a post-Merger price increase. *Merger Guidelines* § 6.1 (stating "[d]iversion ratios between products sold by one merging firm and products sold by the other merging firm can be very informative for assessing unilateral price effects, with higher diversion ratios indicating a greater likelihood of such effects."). Like the *Merger Guidelines*, Otto Bock assessed the extent to which Plie 3 sales would be diverted to Otto Bock in the event of a price increase or product discontinuation. Respondent concluded that the lion's share of sales lost would be recaptured in the form of increased sales of its C-Leg 4, so the price increase would be profitable. (CCFF ¶¶ 1362-64). This is the same analysis that the *Merger Guidelines* use to determine whether a transaction raises competitive concerns, and is the same analysis that Complaint Counsel and its expert applied to demonstrate that Otto Bock has both the incentive and ability to raise prices for MPKs sold in the United States. *See H&R Block, Inc.*, 833 F. Supp. 2d at 86 (finding harm likely where estimated diversions ranged from 12 to 14 percent); *Merger Guidelines* § 6.2 ("A merger between two competing sellers prevents buyers from playing those sellers off against each other in negotiations. This alone can significantly enhance the ability and incentive of the merged entity to obtain a result more favorable to it, and less favorable to the buyer, than the merging firms would have offered separately absent the merger.").

Absent this litigation, Otto Bock's anticompetitive plans would undoubtedly have led to increased prices by this time for U.S. prosthetic clinics, as well as less attractive and/or fewer MPK choices for amputees. Even with this litigation, competition between the Plié 3 and C-Leg 4 has lessened substantially because the Merger has eliminated the incentives for Otto Bock and Freedom to compete and Otto Bock has made significant, anticompetitive changes to Freedom's

business, including halting a significant upgrade of the Plié {[redacted]} (CCFF ¶¶ 129-31, 894). These effects will persist and become even more significant if this Court does not order and effective remedy to this anticompetitive Merger.

A. The Merger Eliminated Aggressive Head-to-Head MPK Competition Otto Bock and Freedom Engaged in to the Benefit of Clinics and Patients

Otto Bock and Freedom have a long history of vigorous head-to-head competition with each other. Their actions over just the last several years, including the introduction of the Plié 3 by Freedom in 2014, the subsequent launch of Otto Bock's C-Leg 4 in 2015, and each company's respective competitive responses to those two launches show how customers have benefited from this intense rivalry.

1. Otto Bock's MPK Market Dominance Prior to the Launch of the Plié 3

Otto Bock launched the first MPK in the United States, the original C-Leg, in 1999. (CCFF ¶¶ 864, 1008). Otto Bock has remained the MPK market leader in the United States ever since, and maintained a market share of over {[redacted]} percent for nearly a decade. (CCFF ¶ 1009). Freedom entered the market in 2007 with the Plié, and followed with the Plié 2 three years later, in 2010. (CCFF ¶ 1010). Growing into a formidable competitor to Otto Bock in the U.S. MPK market took Freedom time. It slowly gained market share from the C-Leg, but even after the launch of the Plié 2, Otto Bock estimated that it still commanded over {[redacted]} percent of the U.S. MPK market. (CCFF ¶ 1010).

2. Freedom's Plié 3 Launch in 2014

Freedom launched its third-generation MPK, the Plié 3, in September 2014. (CCFF ¶ 1011). Freedom sought to differentiate the Plié 3 from the C-Leg 3, Otto Bock's then-current MPK product, so it introduced several innovative features in the Plié 3, including customized stumble recovery, variable speeds, full submersibility, interchangeable batteries, remote access,

and real-time data display. (CCFF ¶ 1017). **{** [redacted] **}** (CCFF ¶¶ 1014, 1023). According to Maynard Carkhuff, Freedom's CEO when it launched the Plié 3 and now Chairman, the Plié 3 was the new "industry standard" and **{** [redacted] **}** (CCFF ¶¶ 1012, 1021).

Freedom did not settle for just having the most innovative MPK on the market in the Plié 3. To maximize its market impact, **{** [redacted] **}** (CCFF ¶ 1024). By offering innovative MPK features at market-leading prices, Freedom experienced a significant jump in its MPK sales and share of the MPK market in the United States. (CCFF ¶ 1025). That growth came at the expense of Otto Bock's MPKs, and Otto Bock's U.S. market share began to slide after the launch of the Plié 3. (CCFF ¶ 1026). Otto Bock's executives observed that Freedom made "inroads" with the Plié 3, causing Freedom to "gain market share" at the same time Otto Bock was "steadily losing market share." (CCFF ¶ 1026).

3. Otto Bock's Competitive Response to the Plié 3 in 2014 and 2015

Otto Bock did not stand pat in the face of the technological advancements of Freedom's Plié 3 and its aggressive pricing and promotion strategy. Dr. Helmut Pfuhl, an Otto Bock GmbH executive vice president, wrote to colleagues that "pricing keeps me up at night more than anything else!" and underscored that Otto Bock was losing sales because Freedom was pricing the Plié 3 below the C-Leg 3. (CCFF ¶ 1030). Another top executive, Otto Bock's Executive Medical Director for North America, Andreas Kannenberg, testified that, "Freedom was driving a very aggressive marketing and promotional campaign with pretty high discounts and

giveaways of additional products." (CCFF ¶ 1027). Facing vigorous competition from Freedom, Otto Bock **{** [redacted] **}** while at the same time preparing to introduce its own next-generation MPK, the C-Leg 4. (CCFF ¶¶ 1028, 1034).

a) Otto Bock's C-Leg 3 Pricing and Promotional Response

Otto Bock's competitive countermeasures included {[redacted]**}** while also developing marketing campaigns that specifically targeted the Plié 3 and attempted to dissuade clinicians from fitting the Plié 3 on their patients. (CCFF ¶¶ 1028, 1033). Otto Bock targeted specific Plié 3 customers for "increasingly aggressive pricing on their MPKs." (CCFF ¶ 1032). For example, **{**[redacted]**}** (CCFF ¶ 1031) *see also* (CCFF ¶ 1029) (showing that after the launch of the Plié 3 Otto Bock provided discounts of $2,500 to each of 21 new C-Leg 3 customers, causing Otto Bock's Brad Ruhl, then the President of Prosthetics Business Unit for North America, to exclaim "Feels like momentum BABY!!"). Otto Bock also armed its sales and marketing staff with "arguments to convince customers to not walk away from the C-Leg and continue to buy C-Legs and fit C-Legs on their patients instead of Plies." (CCFF ¶ 1033).

b) Otto Bock's Launch of the C-Leg 4 in 2015

Less than a year after Freedom launched the Plié 3, Otto Bock introduced its own next-generation MPK, the C-Leg 4 in April 2015. (CCFF ¶ 1034). Otto Bock's C-Leg 4 included features aimed at some of the most popular aspects of the Plié 3. (CCFF ¶ 1047).

(1) Otto Bock's C-Leg 4 Launch Plan

Prior to the launch of the C-Leg 4, a cross-functional team comprised of Otto Bock sales, marketing, clinical, and service employees created launch materials that were circulated among top U.S. and global Otto Bock executives, including Brad Ruhl, then President of Otto Bock Healthcare North America, who led the C-Leg 4 launch in the United States. (CCFF ¶¶ 1035-36). The launch materials included product specifications, competitive analyses, marketing materials, and pricing analyses for the C-Leg 4. (CCFF ¶ 1041). The launch plans also touted innovative new features of the C-Leg 4, including a lower system height, new carbon frame construction, integration of all sensors, Bluetooth compatibility, knee-bending angle of 130 degrees, and weatherproofing. (CCFF ¶ 1038). Otto Bock's Managing Director for North America wrote that the {[redacted]} (CCFF ¶ 1046) Otto Bock's launch materials contrasted the C-Leg 4's features against the Plié 3's features, noting several advances over the Plié 3 including a greater knee flexion angle, longer battery life, Bluetooth compatibility, and protective cover. (CCFF ¶ 1049).

Otto Bock's C-Leg 4 launch plans also included Otto Bock's estimates of shares in the "MPK" market, estimating Otto Bock's share to be 78 percent, and assigning an 11 percent share to Freedom, the firm that it believed was the next-largest competitor. (CCFF ¶ 1039). An explicit goal in the C-Leg 4 launch was to {[redacted]} (CCFF ¶ 1043). Scott Schneider, Otto Bock's Chief Future Development Officer, testified that Otto Bock {[redacted]} (CCFF ¶ 1044).

In preparation for its release, the launch team devoted considerable effort to analyzing the optimal price point for the C-Leg 4. **{** [redacted] **}** (CCFF ¶ 1052). To help its sales people with the launch effort, Otto Bock also developed a "C-Leg 4 Battle Card" to show a point-by-point comparison between the features of the C-Leg 4 and those of the Plié 3, Rheo 3, and Orion 2. (CCFF ¶¶ 1054-55).

Freedom executives recognized that Otto Bock was targeting the Plié 3 with its launch of the C-Leg 4. According to Maynard Carkhuff, Freedom's CEO at the time of the C-Leg 4 launch, the C-Leg 4 **{** [redacted] **}** (CCFF ¶ 1048). Indeed, the launch of the C-Leg 4 increased Otto Bock's MPK sales, and customer **{** [redacted] **}** (CCFF ¶ 1072).

(2) Impact of the C-Leg 4 on Freedom's Plié Sales

The C-Leg 4 launch dealt an immediate and significant blow to Freedom's MPK business. Rob Cripe, Freedom's Executive Vice President for North American Commercial Operations and Global Marketing, wrote to Freedom's then-CEO that, "[w]ith the C-leg, we are up against a new product and everyone wants to try it – you know the drill." (CCFF ¶ 1061). The launch of Otto Bock's C-Leg 4 caused a significant decrease in Freedom's MPK sales. (CCFF ¶¶ 1056-57). **{** [redacted] **}** (CCFF ¶ 1059). For example, in August 2015, just months after the C-Leg 4 launch, Freedom's CFO, Lee Kim, reported to Freedom's board of directors that **{** [redacted] **}** (CCFF ¶ 1058).

Freedom executives continued to note the impact of the C-Leg 4 on Freedom's business in each of its monthly financial reports to the board of directors in October and November of 2015. (CCFF ¶¶ 1060, 1132). Freedom's top executives viewed the impact of the C-Leg 4 launch as such an important development that they felt compelled to include it in their monthly compliance report to Freedom's lenders, where they noted that, **{** [redacted] **}** (CCFF ¶¶ 1059, 1062-63). According to internal documents from **{** [redacted] **}**

In the spring of 2016, Maynard Carkhuff, Freedom's former CEO and current Chairman, provided the board of directors with a "Diagnostics" assessment of Freedom's revenue decline, (CCFF ¶ 1064), which included a graph that charted Freedom's sales in various customer channels throughout the world, including the United States. The chart showed how Freedom's total sales and revenues ramped up immediately following the release of the Plié 3 and continued steadily until the launch of the C-Leg 4, when its sales took a precipitous decline. (CCFF ¶ 1064). In an email to the board of directors accompanying this diagnostic assessment, Mr. Carkhuff trumpeted the growth that Freedom had achieved up until June 2015, when Otto Bock introduced the C-leg 4 and closed the technology gap with the Plié MPK. (CCFF ¶ 1068). The impact of the C-Leg 4 on Plié sales was observable even at the customer level. (CCFF ¶¶ 1070, 1073). For example, one member of Freedom's board of directors noted that "the impact of OB's C-leg launch [] correlates exactly with the decline in our Hangar [sic] knee business."

(CCFF ¶ 1073). **{** [redacted] **}** (CCFF ¶ 1071).

4. Freedom's Response to the C-Leg 4 Launch from 2015 into 2017

Facing an invigorated competitive offering from Otto Bock, Freedom quickly moved to shore up sales of its own product with new sales and marketing tactics and promotions, which effectively countered Otto Bock's "competitive attack." (CCFF ¶ 1073).

a) Creation of Freedom's Ideal Combo

Freedom high-quality prosthetic foot portfolio was one of its distinctive competitive advantages over Otto Bock, and one of Freedom's most significant promotional initiatives to counter Otto Bock was to capitalize on the strong reputation its foot products enjoyed in the market to stimulate Plié 3 sales by bundling its feet and MPK products. (CCFF ¶ 1079). Dubbed the "Ideal Combo," Freedom introduced these promotions in the summer of 2015. (CCFF ¶ 1080). One version of the Ideal Combo involved offering a steep discount, often as high as $1,000, off Freedom's popular Kinterra prosthetic ankle system with the purchase of the Plié 3. (CCFF ¶ 1085). In addition to large discounts off the Kinterra, Freedom also offered as part of the Ideal Combo any Freedom graphite prosthetic foot free with the purchase of a Plié 3. (CCFF ¶ 1086). In practice, the Ideal Combo enabled Freedom to leverage its leading prosthetic foot portfolio to drive sales of its high-margin Plié 3 and has become a hallmark of Freedom's MPK promotional strategy. **{** [redacted] **}** (CCFF ¶ 1080). The effectiveness of Freedom's Ideal Combo promotion is apparent from the trial testimony of several Respondent executives and even Respondent's own expert, Dr. David Argue, who **{** [redacted]

[redacted] } (CCFF ¶¶ 1092, 1097).

{ [redacted] } (CCFF ¶ 1093). These lower costs produced higher margins for clinics, which in turn, flowed back to the patients that use MPKs in the form of increased investment by the clinics in their facilities and to fund various patient support services that are not directly reimbursed by payers. (CCFF ¶¶ 1094-96).

b) Reduced Plié 3 Pricing and Aggressive Marketing Targeting the C-Leg 4

In addition to the launch of the Ideal Combo, Freedom enacted new sales and marketing tactics to combat the competitive advancements of the C-Leg 4. Shortly after the launch of the C-Leg 4, Freedom rallied its sales team with a simple, but clear message: "The presence of new competition means we/you have made an impact – now go defend it!" (CCFF ¶ 1098). Freedom equipped its sales team with new marketing materials specifically highlighting the advantages of the Plié 3 over the C-Leg 4, positioning the Plié 3 as "STRONGER, SMARTER, SUBMERSIBLE." (CCFF ¶ 1102).

{ [redacted] } (CCFF ¶ 1110). According to Respondent's expert, Dr. David Argue, { [redacted] } (CCFF ¶ 1114).

c) Impact of Freedom's Competitive Response to the C-Leg 4 Launch

{ } (CCFF ¶ 1130). Freedom's competitive response was so successful that Freedom's CFO, Lee Kim, informed Freedom's creditors in November 2015 that "the marketing initiatives launched recently to recapture knee trials are having success" and noted that "Plie MPC knee and related product sales increased 32% compared to the prior year." (CCFF ¶ 1131). Mr. Kim also notified Freedom's board of directors in November 2015 that, "the sales team have been given new marketing programs to counter the impact of the new C-leg 4 on customer trials and it appears these programs are having a positive impact." (CCFF ¶ 1132).

Otto Bock executives took note of Freedom's competitive responses to the launch of the C-Leg 4, recognizing that "[p]ressure from the C-Leg 4 has driven lower prices and bundle promotions with feet" from Freedom. (CCFF ¶ 1133). According to Otto Bock's U.S. Market Manager, Cali Solorio, compared to other MPK manufacturers, { } (CCFF ¶ 1133).

Feeling the pressure of Freedom's aggressive promotions, Otto Bock's marketing group provided its sales team with guidance on "Countering Freedom's latest promo." (CCFF ¶ 1135). Otto Bock also ran various sales promotions, including a $2,500 discount on the C-Leg 4 for new MPK customers. (CCFF ¶ 1135). But, as Ms. Solorio admitted in her deposition, and reiterated at trial, { } (CCFF ¶ 1134). Otto

Bock and Freedom continued to compete intensely with each other right up until the time of the Merger in September 2017. Freedom continued to offer discounts to customers throughout 2017, {[redacted]} (CCFF ¶ 1136).

5. Customers Benefitted from Head-to-Head Competition between Otto Bock and Freedom through Lower Prices

The record is replete with testimony from clinic customers that they receive tangible price, quality, and innovation benefits from the sustained, head-to-head competition between Otto Bock and Freedom. For example:

- **Center for Orthotics and Prosthetics**: Keith Senn, President of Kentucky/Indiana Operations, testified that he increased his purchases of Freedom's Plié due to "[t]he competitive pricing that we received from them." (CCFF ¶ 1150). {[redacted]} (CCFF ¶ 1152). As a result, he saw Otto Bock offer "increasingly more aggressive pricing on their MPKs." (CCFF ¶ 1152). Mr. Senn explained that COPC has been able to use the cost savings to benefit patients by hiring more staff and "hiring residents with facilities, with programs that we put in support of the patient care, such as compliance." (CCFF ¶¶ 579, 1151).

- **Hanger**: Vinit Asar, Hanger's CEO, testified that, {[redacted]} (CCFF ¶¶ 574, 1154). Mr. Asar further testified that {[redacted]} (CCFF ¶¶ 1171, 1434). To illustrate this point, Mr. Asar testified, "I know when the C-Leg 3 came out, Freedom was working on their Plie, and so you'll always see, every time a new generation from one manufacturer comes out the other manufacturer is working on something to leapfrog it." (CCFF ¶ 1172).

- **Ability Prosthetics & Orthotics**: Jeff Brandt, Ability's CEO, testified that he used to pay {[redacted]} for the C-Leg, but the "price has come down significantly" due to "competition with Freedom's Plie." (CCFF ¶¶ 1156-57). He further testified that "[I]t's obvious from where I sit that they are – that they are, you know, very traditionally one-upping each other and trying to do – pack more into a knee for the same price or less." (CCFF ¶ 1157).

- **Jonesboro Prosthetics & Orthotics:** Robert Yates, Jonesboro's CEO, testified that his clinics have benefited from Otto Bock and Freedom competition through "relatively competitive pricing structures from both manufacturers," "demo units for use in our offices," "educational support, robust customer service," and "education/marketing opportunities to the physical therapy community from both Otto Bock and Freedom." (CCFF ¶ 1158).

- **Prosthetic & Orthotic Associates**: Mark Ford, President and Managing Partner of Prosthetic & Orthotic Associates, testified that "[b]ecause Freedom and Otto Bock had built their MPK designs on similar ideas and similar platforms, there was an inherent stronger competition between those two companies to essentially one-up each other to keep the attention of clinicians as to which product did they prefer. As they added new benefits, that created interest in their new versions." (CCFF ¶ 1167).

- **Mid-Missouri Orthotics & Prosthetics**: Tracy Ell, Owner and Chief Prosthetist of Mid-Missouri Orthotics & Prosthetics, testified that his clinic has benefited from competition "in two manners[:] . . . one being the potential to reduce a service purchase price as well as facilitate the continued evolution of technology in microprocessor control knee field, that then benefits my business as well as the patients." (CCFF ¶ 1159).

- **Wolfchase Limb & Brace**: {[redacted]}

With the Merger, customers are understandably concerned about losing the substantial benefits they reaped from the intense, head-to-head competition between Otto Bock and

Freedom. For example, Mark Ford of Prosthetic & Orthotic Associates testified that he is concerned "that the price of MPKs can go up over time" and that POA would lose leverage in negotiations against Otto Bock for MPKs. (CCFF ¶ 1161). Likewise, {[redacted]} (CCFF ¶¶ 1162, 1174, 1430, 1435).

B. The Merger Eliminated Competition Set to Intensify Between Freedom's and Otto Bock's Next-Generation MPKs

Not only did the Merger eliminate the vigorous existing head-to-head competition between Freedom and Otto Bock, it snuffed out what promised to be a major competitive battle between the two companies when they launched their next-generation MPKs, Freedom's Quattro and Otto Bock's C-Leg 5.

1. The Merger Eliminated Competition from Freedom's Quattro Poised to Launch and Target Otto Bock's C-Leg 4 in the Near Future

At the time of the Merger, {[redacted]} (CCFF ¶¶ 1176-77), and at the time of the Merger, {[redacted]} (CCFF ¶¶ 1207-09). Freedom executives and engineers nicknamed Quattro the "C-Leg 4 killer," {[redacted]} (CCFF ¶¶ 1230, 1232-36, 1380-83). As Freedom's Quattro Project Leader, Dr. Prince, testified, {[redacted]} (CCFF ¶¶ 1238-39, 1241-42, 1248-49). Absent the Merger, Quattro would have significantly intensified competition

in the near future, providing consumers the choice of a new, high-quality MPK, and likely causing a price war as Freedom and Otto Bock battled to steal and protect share. Absent a remedy, the Merger will prevent this intensification of competition from ever occurring.

{ } *see also* (CCFF ¶¶ 1299-1302). Mr. Carkhuff, Freedom's Chairman, testified at trial that only two months before Otto Bock acquired it, { } (CCFF ¶ 1237). Evidence gathered by the development team after the Merger confirmed that Quattro was, in fact, going to be a better MPK than C-Leg 4 in several ways. { }

Not only is Quattro likely to be higher quality than C-Leg 4, {[redacted]} (CCFF ¶ 1269). Her testimony is consistent with several ordinary course PAC Review presentations showing {[redacted]} (CCFF ¶¶ 1271-72, 1274-75). Freedom's CEO, David Smith, {[redacted]} and Freedom's investment banker expressed to several of Freedom's board members that Quattro "was going to be a blockbuster." (CCFF ¶¶ 1283, 1285). {[redacted]} (CCFF ¶ 1274) (May 2017 interim PAC Phase C presentation {[redacted]} and even higher revenue projections); {[redacted]} (CCFF ¶¶

1272, 1275). At trial, Dr. Prince testified **{** **}** (CCFF ¶ 1261).

It is no wonder that, before and after the Merger, **{** **}** **{** **}** Freedom knew that when Otto Bock learned more about Quattro and the intense competition it would create, there was no way it could walk away from buying Freedom. As Jon Hammack from Moelis wrote to David Smith, Freedom's CEO, "They've now seen how attractive our pipeline is. They know Quattro is a game changer. They know what it means if Ossur ends up with this." (CCFF ¶ 1313). And Freedom was right: Otto Bock chose to buy its competitor to avoid having to face Quattro's challenge to its market-leading MPK franchise.

During the hearing, Respondent counsel strained in an attempt to show that Quattro's future is uncertain, but the record is clear that, despite a short delay, Freedom's next-generation MPK is **{** **}** and has the ability to be the "C-Leg Killer" Freedom told Otto Bock it would be, if Respondent does not reposition it first. At the time of the Merger, and even well after the Merger and the onset of this litigation, **{**

[redacted]

} (CCFF ¶¶ 1452-53). On March 13, 2018, post-Complaint, Dr. Prince testified that **{** [redacted]

[redacted] **}** The record is clear, however, that Respondent has **{**[redacted]**}** On August 16, 2018, Dr. Prince testified that he believed Freedom **{**[redacted]**}** (CCFF ¶ 1223), and with those issues resolved, Freedom expected to **{**[redacted]**}** (CCFF ¶¶ 1224-25).

With evidence from Respondent's own development team indicating Quattro will be a potent competitive force and **{**[redacted]**}** Respondent counsel's argument that the Merger's elimination of direct competition between Quattro and C-Leg must be considered speculative is nonsensical. **{**[redacted]

[redacted]

2. The Merger Will Prevent Otto Bock's C-Leg 5 From Ever Competing against the Quattro

At the same time Freedom was developing Quattro, Otto Bock was in the process of developing its next-generation C-Leg: the C-Leg 5. (CCFF ¶ 1320). Otto Bock's CEO at the time of the Merger, Matthew Swiggum, testified that, [redacted] (CCFF ¶ 1323). Freedom anticipated the impending release of a next-generation C-Leg. [redacted] (CCFF ¶ 1324). The launch of Otto Bock's C-Leg 5 would undoubtedly have led to another round of intense competition with Freedom and its own next-generation MPK.

C. Eliminating its Close Competitor was One of Otto Bock's Core Merger Rationales

"Documents created by the merging parties in the ordinary course of business are often highly probative of both industry conditions and the likely competitive effects of a merger." *Polypore*, 150 F.T.C. at *9 (citing *Merger Guidelines* § 2.2.1). In this case, ordinary course documents and meetings between top-level Otto Bock and Freedom executives, as well as Otto

Bock's own internal due diligence analyses, reveal that Otto Bock viewed the acquisition of Freedom as a way to eliminate a close competitor and increase its already dominant position in the MPK market.

1. Pre-Due Diligence Discussions between Otto Bock and Freedom Described Quattro as the "C-Leg 4 Killer"

In the months leading up to the Merger, top Freedom executives met with high-ranking Otto Bock executives multiple times to discuss the possibility of pursuing an acquisition of Freedom by Otto Bock. **{** [redacted] **}** Mr. Carkhuff and Mr. Smith held another in-person meeting with Professor Näder at The Mark hotel in New York City. (CCFF ¶ 1327). **{** [redacted] **}** (CCFF ¶¶ 1329, 2077). Mr. Carkhuff also presented **{** [redacted] **}** (CCFF ¶ 1330). Notably, Mr. Carkhuff told Professor Näder that Freedom internally referred to the Quattro as the "C-Leg 4 killer," **{** [redacted]

[redacted] (CCFF ¶ 1332).

In March 2017, Mr. Smith and Mr. Carkhuff met again with Professor Näder in Berlin, this time along with a member of Freedom's board of directors, Rolf Classon, and Otto Bock's director of strategy and M&A, Alexander Guck. (CCFF ¶ 1333). [redacted] (CCFF ¶ 1941).

2. Due Diligence by Otto Bock Confirmed that Otto Bock Perceived the Quattro to be a Significant Threat to Its C-Leg 4 Business

During due diligence, Otto Bock closely analyzed Freedom's Quattro project, including testing the Quattro in-person for several hours, [redacted] (CCFF ¶¶ 1355, 1357, 1361).

In August 2017, high-ranking Otto Bock and Freedom executives met in Irvine, California as part of the due diligence process where they had a detailed discussion [redacted]

[redacted] (CCFF ¶ 1342). Mathew Swiggum, Otto Bock's CEO at the time, wrote to other Otto Bock executives in early August 2017 that the Quattro [redacted] Based on this additional due diligence, Otto Bock concluded that [redacted] (CCFF ¶ 1355). At this time, Otto Bock determined that [redacted] (CCFF ¶ 1361). Otto Bock executives in Germany, including Dr. Helmut Pfuhl and Falk Berster, [redacted] (CCFF ¶ 1370).

Days before acquiring Freedom, Scott Schneider, Otto Bock's Vice President of Government, Medical Affairs, and Future Development, and several other Otto Bock executives [redacted]

[redacted] (CCFF ¶¶ 1377-78).

Shortly after [redacted] only days before the Merger was consummated, Mr. Schneider circulated his conclusions to several high-level Otto Bock executives—including Matthew Swiggum, Alexander Guck, Linus Cremer, Helmut Pfuhl, and Soenke Roessing—identifying in a chart the pros and cons of the Quattro, as well as the "risks if we do not control Quattro." (CCFF ¶¶ 1379, 1381). Under the "pros" column of the chart, Mr. Schneider stated that the Quattro "[a]ppears 'on par' with C-Leg 4 and a contender," has "[v]ery low noise," and has "[u]ser and CPO apps on Android and iOs." (CCFF ¶ 1382). Mr. Schneider highlighted that risks of Otto Bock not controlling the Quattro were that "[w]e will have to put more Genium functions in the C-Leg," "Ossur could have something that will compete better with C-Leg 4," and "[a]nyone who takes this product will cut in to C-Leg 4 market share." (CCFF ¶ 1382). [redacted] (CCFF ¶ 1383).

3. Another Merger Rationale was Eliminating Competition from Freedom's Plié 3 and Increasing Otto Bock's MPK Market Share

In due diligence, Otto Bock analyzed the benefit of acquiring C-Leg's close rival, the Plié 3, concluding that, **{** [redacted] **}** (CCFF ¶ 1367). In ordinary course documents, Otto Bock recognized that Freedom aggressively marketed and priced the Plié 3, **{** [redacted] **}** (CCFF ¶ 1368). Not surprisingly, Otto Bock executives discussed **{** [redacted] **}** (CCFF ¶ 1360), because executives expressed concern that continuing to sell the Plié post-Merger would take sales away from the C-Leg. (CCFF ¶ 1360).

Alternatively, Otto Bock executives developed plans to raise the price of the Plié 3. Matthew Swiggum, Otto Bock's then CEO, emailed his Vice President of Sales in August 2017 and indicated that Otto Bock should consider **{** [redacted] **}** (CCFF ¶ 1353). In his deposition, Mr. Swiggum confirmed that he was [redacted] **}** (CCFF ¶ 1353). Otto Bock executives repeatedly referred to plans to **{** [redacted] **}** (CCFF ¶ 1350).

Otto Bock analyzed exactly how much Plié 3 business it would recapture with increased C-Leg 4 sales if it discontinued or raised the price of the Plié. One analysis created by Alexander Guck and his team, and shared with several high-ranking executives, determined that Otto Bock would recapture at least **{** **}** and as much as **{** **}** of all lost Plié 3 sales with increased sales of Otto Bock MPKs. (CCFF ¶¶ 1354, 1363). Mr. Guck and his team also analyzed Otto Bock's and Freedom's pre-Merger shares in the U.S. "Mechatronic knees" market and estimated the combined firm's expected share based on Otto Bock's ability to recapture Plié sales if the product were discontinued. (CCFF ¶ 1362). **{** **}**

D. Post-Merger Evidence Confirms the Likelihood of Unilateral Effects

Unilateral effects analysis typically requires a forward-looking assessment based on the extent of pre-merger direct competition between the merging parties' products and the incentives and ability of Respondent to inflict competitive harm. Although the evidence described above amply demonstrates the likelihood of anticompetitive effects, the Court need not look any further than Respondent's own post-Merger plans for the Plié 3 and Quattro to conclude this Merger will result in substantial unilateral anticompetitive effects.

More than a month and a half after Otto Bock acquired Freedom, and shortly before the Complaint in this case was filed, the highest-ranking officials from Otto Bock and Freedom gathered in Freedom's hometown of Irvine, California for the **{** [redacted] **}** on November 7 and 8, 2017 (hereinafter, the "November 2017 Meeting"). (CCFF ¶ 1384). One of the primary purposes of the November 2017 Meeting was to discuss implementing a strategy that would fully exploit the elimination of competition between the former rivals. (CCFF ¶¶ 1392-1396). Attendees and presenters from Otto Bock were Dr. Helmut Pfuhl, Head of Otto Bock's Prosthetics Business Unit; Matthew Swiggum, CEO of Otto Bock; Scott Schneider, Vice President of Government, Medical Affairs, and Future Development; Soenke Roessing, Chief Strategy and Human Resources Officer; and several other high-ranking Otto Bock executives. (CCFF ¶ 1385). The executives from Freedom included Maynard Carkhuff, Chairman; David Reissfelder, the new CEO recently appointed by Otto Bock; Jeremy Matthews, Vice President of Domestic Sales; Eric Ferris, Vice President of Marketing and Product Development; and John Robertson, Senior Vice President R&D and Mechatronics Manufacturing. (CCFF ¶ 1386).

1. Otto Bock's Plan for the Plié 3

When the November 2017 Meeting kicked off, Dr. Pfuhl delivered a presentation titled {[redacted]} to an audience that included Mr. Swiggum, Mr. Schneider, Dr. Roessing, Mr. Carkhuff, Mr. Reissfelder, Mr. Ferris, Mr. Matthews, and Dr. Robertson. (CCFF ¶¶ 1385-86, 1389). During his presentation, Dr. Pfuhl explained the details of Otto Bock management's recommendation for the Plié 3 go-forward strategy, which unambiguously demonstrates how the Merger provided Respondent both the incentive and ability to impose an anticompetitive unilateral price increase in the U.S. MPK market. (CCFF ¶ 1394). According to Dr. Pfuhl, prior to the Merger, Freedom marketed the Plié 3 "[i]n a very concentrated way" against Otto Bock's C-Leg 4. (CCFF ¶ 1392). {[redacted]} (CCFF ¶ 1473). Thus, management recommended that going forward the Plié 3 and C-Leg 4 {[redacted]} (CCFF ¶¶ 1395, 1404).

Dr. Pfuhl presented a {[redacted]} (CCFF ¶ 1394). Otto Bock's strategy made business sense because Respondent estimated that the C-Leg 4 would recapture at least {[redacted]} percent, and up to {[redacted]} percent, of any lost Plié 3 sales. (CCFF ¶ 1363). {[redacted]}

[redacted] (CCFF ¶ 1403).

Otto Bock's internal plans are consistent with the conclusion of Complaint Counsel's expert, Dr. Scott Morton, who concluded, based on her Gross Upward Pricing Pressure Index analysis, that Respondent has "a strong incentive to increase prices of the Plié 3," which "indicates likely harm to consumers from the Merger." (CCFF ¶ 1415). According to the *Merger Guidelines*, when premerger margins are high, as they are here, (CCFF ¶¶ 781, 784, 777), the percentage of sales Respondent would need to recapture to impose a unilateral price increase "need not approach a majority." *Merger Guidelines* § 6.1. ("A merger may produce significant unilateral effects for a given product even though many more sales are diverted to products sold by non-merging firms than to products previously sold by the merger partner."). Given the high percentage of Plié 3 sales Otto Bock expected to recapture, there is no doubt Respondent's Merger will result in significant unilateral price increases.

2. Otto Bock's Plan for the Quattro

Respondent's incentive and ability to impose competitive harm on consumers in the U.S. MPK market extends to Freedom's pipeline products. During Dr. Pfuhl's presentation at the November 2017 Meeting, he and his colleagues discussed the future of the Quattro and concluded [redacted]

[redacted] } (CCFF ¶ 1411).

3. Customers Have Voiced Concern that the Transaction Will Deprive Them of the Benefits of Competition between Freedom and Otto Bock

Although not privy to Otto Bock's internal plans, prosthetic clinic customers have figured out for themselves that Otto Bock and Freedom no longer have an incentive to compete and have voiced concerns that the transaction will deprive them of the benefits that the fierce competition between the merged firms had provided in the past. Vinit Asar, CEO of Otto Bock's and Freedom's largest customer, Hanger, testified that the Merger is "worrisome" because competition from Freedom had "made sure the other three [MPK manufacturers] were being competitive." (CCFF ¶ 1422). Mr. Asar further testified that {[redacted]

[redacted] **}** (CCFF ¶ 1419).

Other customers have expressed similar concerns about the price of MPKs post-Merger. (CCFF ¶ 1421). Jeffrey Brandt of Ability Prosthetics & Orthotics testified that he is concerned "prices will start going back up." (CCFF ¶ 1428). Robert Yates of Jonesboro Prosthetic & Orthotic Laboratory testified that Otto Bock "certainly" could begin charging more for the Plié following the acquisition. (CCFF ¶ 1426). Keith Senn from Center for Orthotic and Prosthetic Care is also "concerned about cost" given that "there's a significant difference between the cost of a Pli3 [sic] and a C-Leg 4." (CCFF ¶ 1429). **{** [redacted] **}** (CCFF ¶ 1434). Additionally, Mark Ford of Prosthetic Orthotic & Associates highlighted the impact that could befall amputees themselves, testifying that, "patients aren't going to benefit as much from new developments, new innovations and new support" after the Merger. (CCFF ¶ 1444). Freedom's CEO appointed by Otto Bock, David Reissfelder, acknowledged this customer concern in an internal email, writing that, **{** [redacted] **}** (CCFF ¶ 1418).

E. The Merger Has Already Harmed Competition

The Merger has already harmed competition. The record is clear that the Merger has delayed the launch of new and innovative Freedom MPKs and reduced competition between Otto Bock and Freedom in the time since it was consummated, to the detriment of consumers.

1. Otto Bock Cancelled the Launch of Freedom's {[redacted]} and the Merger Delayed the Launch of Freedom's Quattro

At the time of the Merger, Freedom planned to launch an upgrade to the Plié 3 to extend the life of the Plié while it was finishing development of the Quattro. (CCFF ¶¶ 1456-58). **{**[redacted]**}** would have provided customers a new higher-quality MPK by **{**[redacted]**}** (CCFF ¶¶ 1456-57, 1463). **{**[redacted]**}** (CCFF ¶ 1461). As late as August 2017, David Smith, Freedom's CEO, sent to a Freedom shareholder a presentation showing that the **{**[redacted]**}** remained on schedule for an **{**[redacted]**}** (CCFF ¶ 1463-64). **{**[redacted]**}** (CCFF ¶ 1468). Elimination of competition from the **{**[redacted]**}** is a direct anticompetitive consequence of the Merger.

In addition, according to John Robertson, Freedom's SVP of Research and Development, **{**[redacted]**}** (CCFF ¶ 1453). Freedom's Quattro project team leader testified at trial

that, while Quattro development has continued post-Merger, the Merger has "definitely slowed down the entire [Quattro] project." (CCFF ¶ 1452). **{** [redacted] **}** (CCFF ¶¶ 1449, 1454). Although it is conceivable that some delay in the Quattro launch date could be attributable to ordinary technical issues that arose during the development process, it is clear that Freedom believes that the Merger and Otto Bock's persistence with this litigation to keep the company it illegally acquired has directly harmed consumers. That harm has already occurred and cannot be undone.

2. Post-Merger, Otto Bock and Freedom No Longer Compete Against Each Other as Aggressively as Before the Merger to the Detriment of Consumers

The testimony and actions of Respondent's own witnesses show that the Merger drastically altered the incentives of Otto Bock and Freedom to compete against each other, to the great detriment of consumers. (CCFF ¶¶ 1473, 1475-77). In post-Merger discussions with former Freedom sales executives, **{** [redacted] **}** (CCFF ¶ 1475). If Freedom sales representatives forgot this directive, Otto Bock executives set them straight. For example, in November 2017, **{** [redacted] **}** (CCFF ¶ 1476). According to David Reissfelder, Freedom's CEO installed by Otto Bock, Matthew Swiggum and another high-ranking Otto Bock executive expressed concern to Freedom executives about perceived aggressive promotions and discounting on the Plié 3. (CCFF ¶ 1477). The message was clear: do not compete aggressively against Otto Bock anymore. Mr. Reissfelder testified that these Otto Bock executives explained to Freedom that aggressive Plié

promotions and discounting "wasn't something they would allow the OttoBock sales team to do, and therefore they recommended or they wanted us to stop doing it." (CCFF ¶ 1477). Customers experienced the negative consequences of these changes in incentives. (CCFF ¶¶ 1478-79). Mr. Endrikat of Empire explained that his Freedom sales representative used to sell the Plié 3 by "selling against the C-Leg 4 mostly," but post-Merger, the former-Freedom sales representative informed Mr. Endrikat that "I'm now competing against my partner[.]" (CCFF ¶ 1478). According to Mr. Endrikat, his Freedom sales representative no longer "talk[ed] bad about" Otto Bock. (CCFF ¶ 1478). This reduction in the intensity of competition between Otto Bock and Freedom since the Merger has undoubtedly led to less favorable outcomes for customers.

IV. Respondent Did Not Rebut the Strong Presumption that the Merger is Illegal

Having clearly established a strong *prima facie* case, and presented additional direct evidence of anticompetitive effects, Complaint Counsel has shown the Merger's illegality under Section 7. Because of the strength of Complaint Counsel's showing, Respondent bears a heavy burden to rebut the presumption of competitive harm. *See, e.g.*, *ProMedica*, 2012 WL 1155392, at *12. "'The more compelling the prima facie case'—including other evidence presented by Complaint Counsel that reinforces the structural presumption—'the more evidence defendant must present to rebut it successfully.'" *Id.* at *25 (quoting *Baker Hughes*, 908 F.2d at 991); *see also Chi. Bridge*, 534 F.3d at 426; *Staples 2016*, 190 F. Supp. 3d at 115. Respondent has failed to meet its heavy burden. The trial record shows that remaining MPK sellers will not prevent the Merger's anticompetitive effects and that entry will not be timely, likely, or sufficient to prevent harm to consumers. Moreover, Respondent has not proven any cognizable efficiencies, nor has it established that Freedom was a "failing" or even a "flailing" firm at the time of the Merger.

Finally, Respondent failed to prove that **{** [redacted] **}** to sell a limited set of Freedom assets would restore competition lost from the Merger.

A. Remaining MPK Sellers Will Not Prevent the Merger's Anticompetitive Effects

Respondent carries the burden to show that "ease of expansion is sufficient 'to fill the competitive void that will result if [it is] permitted to purchase' [its] acquisition target." *H&R Block*, 833 F. Supp. 2d at 73 (quoting *Swedish Match*, 131 F. Supp. 2d at 169); *see also Sysco*, 113 F. Supp. 3d at 80. Expansion of existing competitors must be "timely, likely, and sufficient in its magnitude, character, and scope to deter or counteract the competitive effects of concern." *H&R Block*, 833 F. Supp. 2d at 73 (internal quotations omitted); *see also CCC Holdings*, 605 F. Supp. 2d at 47. To carry its burden, Respondent must do more than show that expansion would replace "*some* of the competition" lost to the Merger. *Swedish Match*, 131 F. Supp. 2d at 170 (emphasis added). Here, Respondent has failed to meet its burden to show that remaining MPK suppliers would prevent the competitive harm resulting from the loss of Freedom as an independent competitor.

In acquiring Freedom, Otto Bock eliminated one of its closest and most significant competitors in the U.S. MPK market. (CCFF ¶¶ 1008-1174). With the Merger, Össur is the most significant MPK manufacturer remaining, (CCFF ¶ 964), but its products are functionally different from the C-Leg and Plié, as well as Freedom's next-generation Quattro, and many customers perceive Össur's Rheo to have significant safety and reliability issues. (CCFF ¶¶ 1480-1527). Endolite, the fourth-largest MPK supplier in the United States, currently sells far fewer MPKs than Freedom did before the Merger. (CCFF ¶ 964). Endolite is unlikely to expand sufficiently to replace the lost competition because it still suffers from a legacy of poor quality

and service, U.S. prosthetic clinics prefer the MPKs sold by Otto Bock and Freedom, and it does not price as aggressively as Freedom. (CCFF ¶¶ 1528-47). The two remaining firms that currently sell MPKs—Nabtesco and DAW—have a negligible presence in the U.S. market despite having operated here for many years, (CCFF ¶ 964), and neither is likely to make the quantum leap that would be required to replace Freedom's competitive influence on the market, (CCFF ¶¶ 1548-1604, 1605-26); *see In re Chi. Bridge & Iron Co.*, No. 9300, 138 F.T.C. 1024, at *1071 (F.T.C. Dec. 22, 2004) ("the mere fact that … fringe firms have an intent to compete does not necessarily mean that those firms are significant competitors capable of replacing lost competition"). Taken individually or collectively, the remaining suppliers would not constrain Respondent's post-Merger plans to increase MPK prices to U.S. prosthetic clinics, nor could they rectify the harm to consumers from Otto Bock's plans to reposition the Quattro.

With the acquisition of Freedom, Össur is the only MPK supplier that would possess a market share greater than { } percent. (CCFF ¶ 964). But Össur is unlikely to grow beyond its current { } percent share of the market because, for many clinicians and patients, Össur's Rheo 3 is an unattractive alternative to the C-Leg 4 and Plié 3. (CCFF ¶ 1487) { [redacted] } (CCFF ¶ 1491) (Michael Bright, owner of North Bay, testified that most patients who chose an MPK other than the Rheo after a trial fitting did so because "most just preferred the feel and function of either the Freedom Plie or the Otto Bock C-Leg"); *see also* (CCFF ¶¶ 1501, 1514-15).

As Össur's Executive Vice President of R&D, Kim De Roy, testified at trial, Össur's MPKs use a functionally different technology than the C-Leg 4 or Plié 3, which are much more

similar to each other than to the Rheo 3. (CCFF ¶¶ 1480-82) (describing "magnetorheologic technology"); (CCFF ¶¶ 1483-85) (market participant testimony on how the Rheo's technology and functionality differ from the C-Leg 4 and Plié 3). Moreover, many customers have safety and reliability concerns about Össur's MPK technology. (CCFF ¶¶ 1493-1516). As Manar Ammouri, Freedom's Senior Product Manager, explained, when the Rheo "goes into dead battery mode, the knee goes into free swing, which means it's loose, it's not stable." (CCFF ¶ 1495).[17] For this reason, Keith Senn, COPC's President of Kentucky/Indiana Operations, testified that his company "steer[s]" patients away from the Rheo and to the Plié and C-Leg because the Rheo "increas[es] your risk of falls which is the whole purpose of the MPK." (CCFF ¶ 1505); *see also* (CCFF ¶ 1502) (Owner and Clinical Director of Scott Sabolich Prosthetics and Research testified at trial that in February 2015 "one of [his clinic's] patients [fell] on a Rheo Knee, and it broke literally in half"); (CCFF ¶¶ 1501, 1504) (additional third-party testimony on safety concerns with the Rheo**).** **{** **}** (CCFF ¶ 1492); *see also* (CCFF ¶ 1499); (CCFF ¶ 1500) (Freedom's Senior Product Manager testified that customers have told her that the Rheo is "heavier" than other MPKs, adding that "[t]he heavier the product," the fewer "patients you can put it on").

{ **}** (CCFF ¶¶ 1519-20, 1524). Stephen Prince, Freedom's Quattro Project Leader, **{**

[17] The Rheo has a mechanical lock that the patient must manually engage if the knee's battery dies, so the C-Leg and the Plié are considered more reliable. (CCFF ¶ 1494) (Otto Bock's Vice President of Government, Medical Affairs, and Future Development testified that the Rheo "go[es] into a free swing when the battery was dead," while Otto Bock's MPKs "have the safety of locking up" if the battery dies or malfunctions); (CCFF ¶ 1496) (Freedom's Senior Product Manager testified that, unlike the Rheo, the Plié does not require "engag[ing] a manual lock" when the battery dies); (CCFF ¶ 1493) **{**

[redacted] (CCFF ¶ 1519). Moreover, Otto Bock concluded [redacted] After testing the Quattro extensively, Otto Bock executives determined that one of the "RISKS IF WE DO NOT CONTROL QUATTRO" was that "Ossur could have something that will compete better with C-Leg 4 because the stance phase functions will be much better than Rheo can acheive [sic]." (CCFF ¶ 1517). [redacted] (CCFF ¶ 1518). With a [redacted] product [redacted] Össur could not possibly replace the competition lost by eliminating the Quattro as an independent competitor to the C-Leg 4.

With less than [redacted] of the U.S. MPK market and [redacted] Endolite is even less likely to replace the competition lost from the Merger. (CCFF ¶ 964); (CCFF ¶ 1531) [redacted] (CCFF ¶¶ 1533-36). Although it has been selling MPKs in the United States for more than twenty years, Endolite's market share remains less than [redacted] (CCFF ¶ 964). A principal reason for its inability to grow into a stronger MPK competitor is that, in the words of Endolite's Executive Chairman, Stephen Blatchford, Endolite [redacted] (CCFF ¶ 1536); *see also* (CCFF ¶¶ 1533-35). In addition, [redacted]

[redacted] Although Endolite's MPK sales have improved slightly since the launch of the Orion 3 in September 2016, many prosthetic clinics remain wary of its product and its service.[18] (CCFF ¶ 1539) (Keith Senn, COPC's President of Kentucky/Indiana Operations, testified at trial that its practitioners "feel that the quality of the Plie 3 or back up to the C-Leg 4 is greater than the Endolite knee"); (CCFF ¶ 1540) (Mark Ford, the President and CEO of POA, testified at trial that it is "more challenging" to get timely support from Endolite because they "don't have as much support staff … don't have as large a sales force, [and] they have far fewer clinicians").

Only two other firms currently sell MPKs in the United States, and both have a negligible presence in the market. (CCFF ¶ 964). The first, Nabtesco, sells three MPKs in the United States, (CCFF ¶ 1563), but its "best-seller," [redacted] (CCFF ¶¶ 1564-66). Consistent with its *de minimis* sales, many customers testified that they were unfamiliar with Nabtesco's MPKs. (CCFF ¶¶ 1593-98). [redacted] (CCFF ¶ 1591). Among customers who had heard of Nabtesco's MPKs, several testified that they would not fit one on a patient because of concerns about reliability or service. (CCFF ¶¶ 1599-1602); (CCFF ¶ 1592) (Owner and Clinical Director of Scott Sabolich Prosthetics and Research testifying at trial that his clinic has not fit an Allux, which he described as a "very janky knee"). [redacted] (CCFF ¶¶ 1572-73, 1604); *see also* (CCFF ¶ 1585) (Lloyd Presswood, Freedom's Director of Field Sales and Clinical Training, describing the Allux as a "piece of crap

[18] [redacted]

knee"). Tellingly, Brad Mattear, Vice President of Orthotics at Proteor Inc., the exclusive distributor of Nabtesco's MPKs in the United States, described Proteor Inc. {[redacted]} (CCFF ¶¶ 1554, 1588).[19]

Like Nabtesco, DAW has minimal MPK sales in the United States.[20] (CCFF ¶ 964); *see also* (CCFF ¶ 1610) {[redacted]} Many customers have never fit a DAW MPK. (CCFF ¶ 1615). In fact, none of the customers who testified either at trial or in a deposition in this case currently buy MPKs from DAW. (CCFF ¶¶ 1614, 1616). Those customers familiar with DAW testified that they would not fit a DAW MPK on a patient because of concerns about the reliability of its MPKs or negative experiences they had with the company's sales or customer service staff. (CCFF ¶¶ 1620-23). Simply put, there is nothing in the record that even remotely suggests DAW would play any role in replacing the competition lost through the elimination of Freedom as an independent competitor.

B. New Entry Will Not be Timely, Likely, or Sufficient to Prevent the Merger's Anticompetitive Effects

New entry will not avert the anticompetitive consequences of the Merger. Respondent carries "the burden of showing that the entry or expansion of competitors will be 'timely, likely and sufficient in its magnitude, character, and scope to deter or counteract the competitive effects of concern.'" *Staples 2016*, 190 F. Supp. 3d at 133 (internal citation omitted); *see also Sysco*, 113 F. Supp. 3d at 80; *Merger Guidelines* § 9. Respondent must show that entry is likely—meaning both technically possible and economically sensible—and that it will replace the competition that existed prior to the Merger. *See Cardinal Health*, 12 F. Supp. 2d at 56-57; *Chi.*

[19] At trial, Mr. Mattear further testified that the Allux {[redacted]} (CCFF ¶¶ 1575, 1579, 1582). Furthermore, Mr. Matter admitted that Proteor executives represented to the FTC in September 2018 that, if Proteor acquired the Plié 3, it would compete in a different segment than the Allux. (CCFF ¶ 1577).

[20] DAW only distributes the MPKs it sells. A company named Teh Lin, located in Taipei, Taiwan, manufactures the MPKs that DAW distributes in the United States. (CCFF ¶ 1606).

Bridge, 138 F.T.C. at *1071 (noting that new entrants might not replace lost competition). "For entry to constrain the likely harm from a merger that enhances market power, the scale must be large enough to constrain prices post-acquisition." *Polypore*, 150 F.T.C. at *29 (internal citation omitted). The higher the barriers to entry, the less likely it is that the "timely, likely, and sufficient" test can be met. *United States v. Visa U.S.A., Inc.*, 163 F. Supp. 2d 322, 342 (S.D.N.Y. 2001). "Respondent's burden is to produce evidence sufficient to show that the likelihood of entry 'reaches a threshold ranging from reasonable probability to certainty.'" *Polypore*, 150 F.T.C. at *29 (quoting *Chi. Bridge*, 534 F.3d at 430 n.10). Respondent did not meet its burden here.

1. Launch of a New MPK Would Not Be Timely

Developing a new MPK takes several years, even for the few experienced industry participants that have successfully developed and commercialized an MPK in the past. {[redacted]} (CCFF ¶ 1627). Otto Bock's Head of Business Unit, Prosthetics Lower Limb Mechatronic Systems, explained that "alterations on [an MPK] can take up to two years, sometimes even three to four," but acknowledged that "[o]ne could even say that the C-Leg 4 has been developed since 1997" when Otto Bock introduced the original C-Leg. (CCFF ¶ 1628). Similarly, Freedom took about three years to develop its first MPK, the Plié 1, and a further three years to develop the second generation Plié 2. (CCFF ¶ 1631). Freedom began the development of its next-generation MPK, the Quattro, in the third quarter of 2015, roughly three years ago. (CCFF ¶ 1633).

{[redacted]}

[redacted] **}** (CCFF ¶ 1641). A new entrant into the MPK market, however, would have no such prior knowledge to leverage.

Any attempt at *de novo* entry into the U.S. MPK market would not be timely. Today, only two entities—BionicM and ST&G—are working to develop a new MPK and neither project is expected to launch for at least another five years. (CCFF ¶ 1643). BionicM—a student-research team at the University of Tokyo—began a research project to develop an MPK in approximately 2016, which it dubbed the "SuKnee." (CCFF ¶ 1644). As of March 2018, BionicM had not finished developing a prototype. (CCFF ¶ 1645). The project leader of BionicM, Xiaojun Sun, does not expect to commercialize a SuKnee for several years, stating that the "process required to begin selling the SuKnee in the United States would take a long time,

maybe even more than a decade." (CCFF ¶ 1646). The only other company currently working on a new MPK project is ST&G, an upper and lower limb prosthetics company that sells mechanical knees and prosthetic feet, but not MPKs. (CCFF ¶ 1647). The President of ST&G, Glenn Choi, testified at his deposition that the company began its MPK development project in approximately 2016, but as of March 2018, ST&G had not created a functioning prototype. (CCFF ¶¶ 1648-49). According to Mr. Choi, it would take "[a]t best, five years" before ST&G could begin selling an MPK in the United States, because the company still has many steps to complete, including building and testing a prototype, developing a commercial-scale production, conducting field tests, and performing a "soft launch" outside of the United States. (CCFF ¶¶ 1650-52).

Respondent has not presented evidence that any other company has plans to enter the U.S. MPK market. In fact, at trial, several other industry participants testified that they have no current plans to develop an MPK. (CCFF ¶ 1729) {[redacted]} (CCFF ¶ 1730) {[redacted]} (CCFF ¶ 1732) {[redacted]} Additional prosthetic companies provided similar testimony at their depositions. (CCFF ¶ 1728) (Trulife); (CCFF ¶ 1731) {[redacted]} Thus, it is hardly surprising that Respondent's own expert, Dr. David Argue, could not identify any entrants likely to enter the U.S. MPK market in a timely fashion. (CCFF ¶ 1654).

2. Launch of a New MPK is Not Likely

a) Barriers to Entry

Significant barriers to developing a new MPK would prevent any new entry post-Merger. The foremost challenge of developing a competitive MPK is navigating the thicket of patents held by market incumbents Otto Bock, Freedom, Össur, and Endolite. (CCFF ¶ 1657). {[redacted]}

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]**}**

If, theoretically, a company were to successfully navigate this patent minefield and bring a new MPK to the U.S. market, it would then have to develop a reputation and earn the trust and business of prosthetic clinics to compete successfully. Reputation is important to prosthetists when choosing an MPK; they are reluctant to fit patients with an unproven product given the risk of inferior clinical outcomes. (CCFF ¶ 1672); (CCFF ¶ 1673) (a certified prosthetist and clinic co-owner testifying that he would like to see an MPK "on the market for a period of time … without having problems" before he would recommend it to patients); *see also* (CCFF ¶ 1664) (Otto Bock's Chief Future Development Officer and President of Medical Care testifying that, "[b]rand and reputation is a very large consideration in the purchase of a prosthetic device").

After a firm launches a new MPK, it often takes several years for the product to earn a favorable reputation in the marketplace and achieve significant sales. (CCFF ¶¶ 1671, 1674). Freedom's Chairman, Maynard Carkhuff, testified that it took about three years after the launch of the original Plié in 2007 for the company "to really gain credibility" and compete effectively in the market. (CCFF ¶ 1671). Similarly, ST&G estimates that, if it ever successfully launches an MPK, it will need to spend an additional three years post-launch to develop meaningful brand recognition in the United States. (CCFF ¶ 1674). **{**[redacted]

[redacted]

[redacted]

[redacted] (CCFF ¶ 1638); *see also* (CCFF ¶ 1630) (according to Otto Bock's Head of Business Unit, Prosthetics Lower Limb Mechatronic Systems, in addition to the time it takes to develop an MPK, an MPK manufacturer would also need to develop a sales force and qualify for reimbursement, among other requirements). [redacted] (CCFF ¶ 1637). Indeed, numerous industry participants have testified that a direct sales force is important to the effective sale of MPKs in the United States. (CCFF ¶ 1676. In particular, a direct sales force allows an MPK manufacturer to build and maintain relationships with its customers, which in turn drives MPK sales. (CCFF ¶¶ 1687, 1690-92). An MPK manufacturer's sales representatives and clinical staff provide technical support and troubleshooting services,[21] assist with fittings and reimbursement, and educate customers on the latest technological developments in MPKs through demos and other means. (CCFF ¶¶ 1689-1714). For these

[21] MPKs are highly technical products, so an MPK manufacturer's direct sales force must be knowledgeable about those products. (CCFF ¶¶ 1694-95). Direct sales representatives typically have better knowledge of MPKs than distributors, which has led some manufacturers to rely more on their direct sales representatives than distributors. (CCFF ¶¶ 1681, 1696); *see also* (CCFF ¶ 1696) (Endolite's Executive Chairman, Stephen Blatchford, testifying at trial why Endolite switched to using its own sales force about ten years ago and how, as a result, Endolite's sales tripled and its customer relationships improved). Otto Bock, for example, sells 100 percent of its MPKs directly. (CCFF ¶ 1681).

reasons, each of the four-largest MPK manufacturers employs a direct sales force in the United States. (CCFF ¶ 1681-82) (Otto Bock); (CCFF ¶ 1680) (Freedom); (CCFF ¶ 1684) (Össur); (CCFF ¶ 1683) (Endolite). As Vinit Asar, President and CEO of Hanger, the largest prosthetic clinic in the country, testified at his deposition, "[i]t would be very difficult to work with" an MPK manufacturer who does not have a direct sales force. (CCFF ¶ 1686**).** **{** [redacted] **}** (CCFF ¶ 1686); *see also* (CCFF ¶ 1706) (if MPK manufacturers did not have a direct sales force, it would lead to fewer MPK sales).

b) Failed Entry Attempts by Prosthetic Companies Highlight the Difficulty of Developing an MPK

The difficulty of entering the MPK market is illustrated by the failed entry attempts of prosthetic companies. **{** [redacted] **}**

3. Launch of a New MPK Would Not Be Sufficient to Prevent Harm from the Merger

To prevent the harm caused by eliminating Freedom as an independent competitor, an entrant's "scale must be large enough to constrain prices post-acquisition." *Polypore*, 150 F.T.C. at *29 (internal citation omitted). {[redacted]} (CCFF ¶¶ 964 Table 6, 1405-11). Even if a new entrant overcame the enormous barriers to entering the U.S. MPK market, simply launching a product would not counteract the anticompetitive effects of the Merger. To prevent harm from the Merger, a new entrant would need to achieve the size and competitive vigor that Freedom would have achieved absent the Merger. *See Chi. Bridge*, 138 F.T.C. at *1070-72; *Merger Guidelines* § 9 (entry must be sufficient to "replicate at least the size and strength of one of the merging firms"). As the experience of Nabtesco and DAW show, simply making an MPK available for sale in the United States does not guarantee that customers will find it attractive. After several years of selling their MPKs in the United States, neither company has garnered {[redacted]} share of U.S. MPK revenues. (CCFF ¶ 964). Even Endolite, which has been selling MPKs in the United States for more than twenty years, has less than a {[redacted]} percent share of the market. (CCFF ¶ 964). There is simply no evidence in the record that any firm will enter the market and grow to a size that would effectively restore competition lost by the Merger in a timely fashion.

C. Respondent's Asserted Efficiencies Do Not Rebut the Strong Presumption of Competitive Harm

No court has permitted an otherwise unlawful transaction to proceed based on claimed efficiencies. *See, e.g.*, *FTC v. Wilh. Wilhelmsen Holding ASA*, No. 18-cv-00414-TSC, 2018 WL 4705816, at *23 (D.D.C. Oct. 1, 2018) (citing *CCC Holdings*, 605 F. Supp. at 72); *Sysco*, 113 F.

Supp. 3d at 82 ("The court is not aware of any case, and Defendants have cited none, where the merging parties have successfully rebutted the government's *prima facie* case on the strength of the efficiencies."). This case does not merit exception, as Respondent has failed to demonstrate any cognizable efficiencies.

While courts consider efficiencies claims to rebut evidence of an anticompetitive merger, they apply strict standards in their review. *Heinz*, 246 F.3d at 720-21; *H&R Block*, 833 F. Supp. 2d at 89; *Merger Guidelines* § 10. In assessing efficiencies claims, "the court must undertake a rigorous analysis of the kinds of efficiencies being urged by the parties in order to ensure that those 'efficiencies' represent more than mere speculation and promises about post-merger behavior." *Heinz*, 246 F.3d at 721; *see also Wilhelmsen*, 2018 WL 4705816, at *23; *CCC Holdings*, 605 F. Supp. 2d at 72-73. Accordingly, Respondent bears the heavy burden to show that its efficiencies claims are cognizable, meaning that they are "merger-specific efficiencies that have been verified and do not arise from anticompetitive reductions in output or service." *Merger Guidelines* § 10; *see also Heinz*, 246 F.3d at 720; *Staples 2016*, 190 F. Supp. 3d at 137-38 n.15; *Sysco*, 113 F. Supp. at 82. Respondent must also demonstrate that the efficiencies "ultimately would benefit competition and, hence, consumers." *FTC v. Univ. Health, Inc.*, 938 F.2d 1206, 1223 (11th Cir. 1991). Moreover, when the relevant market is highly concentrated, as it is here, courts have expressly required "proof of extraordinary efficiencies." *Heinz*, 246 F.3d at 720; *Sysco*, 113 F. Supp. at 81-82; *CCC Holdings*, 605 F. Supp. 2d at 72.

Relying on "early stage" synergy estimates that the leader of Otto Bock's post-Merger integration efforts described as "incomplete," Respondent's efficiencies expert, James Peterson, has identified three categories of potentially cognizable efficiencies: gross margin improvement, EU consolidation, and quality and regulatory affairs. (CCFF ¶¶ 1735-40, 1748). But Mr.

Peterson has failed to demonstrate that any of these purported efficiencies are verifiable or merger-specific. (CCFF ¶¶ 1767-81, 1783-89). In fact, at trial, Mr. Peterson admitted that it was {[redacted]}[22] (CCFF ¶ 1762). Moreover, there is no evidence that any of Respondent's claimed efficiencies would be passed on to U.S. consumers. (CCFF ¶¶ 1798-1805). Simply put, Respondent has not come close to carrying its burden to show that the Merger is likely to produce "extraordinary efficiencies" sufficient to outweigh its anticompetitive effects. *Heinz*, 246 F.3d at 720; *Sysco*, 113 F. Supp. at 81-82; *CCC Holdings*, 605 F. Supp. 2d at 72.

1. Respondent's Claimed Efficiencies are Not Cognizable

a) Respondent's Claimed Efficiencies are Not Verifiable

Courts have held that efficiencies claims are cognizable only if "it is possible to 'verify by reasonable means the likelihood and magnitude of each asserted efficiency[.]" *H&R Block*, 833 F. Supp. 2d at 89 (quoting *Merger Guidelines* § 10); *see also Sysco*, 114 F. Supp. 3d at 82. Because "[e]fficiencies are inherently difficult to verify and quantify' . . . 'it is incumbent upon the merging firms to substantiate efficiency claims.'" *H&R Block*, 833 F. Supp. 2d at 89 (quoting *Merger Guidelines* § 10); *see also Wilhelmsen*, 2018 WL 4705816, at *23. To satisfy this requirement, Respondent's "estimate of the predicted saving must be reasonably verifiable by an independent party." *H&R Block*, 833 F. Supp. 2d at 89; *see also Tronox*, 2018 WL 4353660, at *20; *Sysco*, 114 F. Supp. 3d at 82.

[22] {[redacted]} (CCFF ¶ 1763). Nonetheless, Mr. Peterson estimated that the Merger could result in {[redacted]} (CCFF ¶¶ 1741-42).

Respondent's efficiencies claims suffer from a fatal flaw: they are based entirely on preliminary integration planning and synergies estimates that Otto Bock and its consultant, A.T. Kearney, never completed. (CCFF ¶¶ 1748-64). Although an integration team comprised of personnel from Otto Bock, Freedom, and A.T. Kearney began efforts to estimate potential synergies from the Merger, all work on integration planning and synergies estimation stopped in {[redacted]}[23] (CCFF ¶¶ 1737, 1748, 1756). Dr. Juerg Baggenstoss, the A.T. Kearney consultant who led the integration team, testified that when integration efforts ceased in mid-{[redacted]} the work to identify synergies opportunities was "all early stage" and "incomplete." (CCFF ¶¶ 1738, 1748); *see also* (CCFF ¶ 1760) (Scott Schneider, Otto Bock's Vice President of Government, Medical Affairs, and Future Development testifying that "I don't believe we have a set number [of cost savings] that we'd be able to tell you"); (CCFF ¶ 1758) (David Reissfelder, Freedom's CEO, testifying that, "in the U.S., I don't believe there were any decisions really made at any point about, you know, honestly, any aspect of the integration"). To track progress on its work on synergies, the integration team used five "Hardness Levels." (CCFF ¶ 1749).[24] When asked at his deposition which identified synergies opportunities had progressed to "Hardness Level 2" (setting a synergy target), Dr. Baggenstoss replied, "None of them." (CCFF ¶ 1751).

At trial, Complaint Counsel's expert, Ms. Christine Hammer, testified that Otto Bock's failure to set definitive synergies targets shows that its claimed efficiencies are preliminary and speculative. (CCFF ¶ 1754). Because Respondent's expert, Mr. Peterson, relied on these

[23] The integration team's work {[redacted]} on estimating potential synergies from the Merger is reflected in a financial model created by Dr. Baggenstoss and other members of the integration team. (CCFF ¶ 1736-1738, 1756 (citing PX03185)).

[24] The five stages of this synergies tracking system are Hardness Level 1 (identifying the opportunity), Hardness Level 2 ("savings targeted"), Hardness Level 3 ("savings validated"), Hardness Level 4 ("savings effective"), and Hardness Level 5 ("savings realized"). (CCFF ¶ 1749).

inchoate synergies estimates, his opinion that the Merger is likely to result in cognizable efficiencies is not credible. (CCFF ¶ 1780-81).

Moreover, Mr. Peterson did not independently verify Respondent's early-stage synergies estimates. The financial model's synergies estimates were based on numerous assumptions, but Mr. Peterson failed to test any of them in formulating his opinion. (CCFF ¶¶ 1766-71); (CCFF ¶ 1172) (Mr. Peterson {[redacted]} *see also* FED. TRADE COMM'N AND U.S. DEP'T OF JUSTICE, COMMENTARY ON THE HORIZONTAL MERGER GUIDELINES 52 (2006) (stating that verification of efficiencies claims usually includes "an assessment of the parties' analytical methods, including … an evaluation of the reasonableness of assumptions in the analysis, and scrutiny into how well the parties' conclusions stand up to modifications in any assumptions") (attached as Attachment C). {[redacted]}

As Complaint Counsel's expert, Ms. Hammer, explained at trial, applying {[redacted]} is not a valid method of verifying efficiencies and fails to meet the requirements of the *Merger Guidelines*. (CCFF ¶ 1775). {[redacted]} not only fails to assess the impact of the financial model's assumptions, but also fails to provide "a reasonably derived estimate of the future efficiency." (CCFF ¶¶ 1775-76). Moreover, Mr. Peterson's claim that Otto Bock and A.T. Kearny {[redacted]}

[redacted]**}**—even if it were true—cannot compensate for his failure to independently verify those estimates. (CCFF ¶ 1770); *H&R Block*, 833 F. Supp. 2d at 91 (rejecting efficiencies claim based on "estimation and judgment of experienced executives" because of "the lack of a verifiable method of factual analysis"). Because he did not independently verify Otto Bock's efficiency claims,[25] Mr. Peterson's analysis does nothing to bolster the preliminary and incomplete efficiency estimates. Respondent therefore has failed to meet its burden to substantiate those claims. (CCFF ¶ 1781).

b) Respondent's Claimed Efficiencies are Not Merger Specific

Respondent's efficiencies defense also fails because its purported efficiencies are not merger specific. *See Sysco*, 113 F. Supp. 3d at 84 (holding that, despite the "rigor and scale of the analysis," defendants' efficiencies claims are inadequate because they are not merger specific); *Cardinal Health*, 12 F. Supp. 2d at 62 ("In light of the anti-competitive concerns that mergers raise, efficiencies, no matter how great, should not be considered if they could also be accomplished without a merger."); *Merger Guidelines* § 10. As several courts have explained, "a 'cognizable' efficiency claim must represent a type of cost saving that could not be achieved without the merger." *H&R Block*, 833 F. Supp. 2d at 89; *see also Sysco*, 113 F. Supp. 3d at 82. If a company could achieve its purported cost savings either alone or via a less anticompetitive alternative, such as a licensing agreement or less anticompetitive transaction, then its claimed efficiencies are not merger specific. *See H&R Block*, 833 F. Supp. 2d at 90; *Cardinal Health*, 12 F. Supp. 2d 34 at 62; *Merger Guidelines* § 10, n.13.

Because "[d]efendants bear the burden of demonstrating that their claimed efficiencies are merger specific," *Sysco*, 113 F. Supp. 3d at 82 (citing *H&R Block*, 833 F. Supp. 2d at 89), it

[25] Respondent's other expert, Dr. David Argue, did not do any independent assessment to verify the cost savings that Mr. Peterson calculated in his report. (CCFF ¶ 1782).

is instructive to look to Respondent's own assertions when evaluating merger specificity. Respondent's expert, Mr. Peterson, admits that certain potential efficiencies identified by Otto Bock in the financial model are non-merger specific{ } (CCFF ¶ 1746). That leaves only three categories of supposed merger-specific efficiencies—{ }[27] (CCFF ¶ 1740). In his attempt to demonstrate merger specificity, Mr. Peterson states that, { } (CCFF ¶ 1784). { } (CCFF ¶ 1796). Finally, { } (CCFF ¶ 1786). All of these explanations fall far short of showing the merger specificity of Respondent's efficiencies claims.

Mr. Peterson failed to even consider alternative arrangements that cut against the alleged merger specificity of these purported efficiencies. (CCFF ¶¶ 1785, 1787-88, 1795, 1797). First, Mr. Peterson failed to evaluate whether any of Respondent's claimed efficiencies could be

[26] Efficiencies outside of the relevant market cannot be used to justify anticompetitive effects within the relevant market. *See Philadelphia Nat'l Bank*, 374 U.S. at 370 (explaining that "anticompetitive effects in one market" could not be justified by "procompetitive consequences in another"). Here, there is no dispute that the relevant geographic market is the United States. (CCFF ¶¶ 829-31). But there is no evidence in Mr. Peterson's report or elsewhere in the record that { } would counteract harm for customers within the United States. (CCFF ¶ 1800) { } Thus, even if merger specific, this purported efficiency is irrelevant to Respondent's defense.

[27] Mr. Peterson admitted at trial that { } are actually **a** { } (CCFF ¶ 1745). Accordingly, they should not be considered a cognizable efficiency to offset the anticompetitive effects of the Merger.

achieved from a less anticompetitive transaction, such as an alternative acquisition or a licensing arrangement. (CCFF ¶¶ 1795, 1797). When asked at trial if he considered whether Otto Bock could have achieved a portion of the claimed **{** **}** through any other type of arrangement, Mr. Peterson replied, **{** **}** (CCFF ¶ 1795). Instead of evaluating alternative arrangements, Mr. Peterson makes only vague assertions that the claimed efficiencies are **{** **}** (CCFF ¶¶ 1784, 1796). Second, Mr. Peterson did not address whether Otto Bock could have achieved its claimed efficiencies through independent cost-savings initiatives or through implementing non-proprietary best practices. (CCFF ¶¶ 1785, 1787-89). Mr. Peterson admits, however, that the claimed **{** **}** making it clear that Freedom could achieve some, if not all, of these improvements independently, without the Merger. (CCFF ¶ 1786). Because Mr. Peterson failed to take into consideration whether Otto Bock could achieve any, if not all, of these supposed efficiencies absent the Merger, Respondent fails to meet its burden to establish merger specificity.[28]

2. There is No Evidence that Respondent's Claimed Efficiencies Would Be Passed on to Customers

Even if Respondent's claimed efficiencies were verifiable and merger-specific, its defense fails because there is no evidence that the purported cost savings are likely to be passed on to customers. *See, e.g.*, *Penn State Hershey*, 838 F.3d at 350-51; *Univ. Health*, 938 F.2d at 1223; *see also CCC Holdings*, 605 F. Supp. 2d at 74 ("Even assuming *arguendo* that the Defendants will achieve significant cost savings in a timely manner, there is no evidence to suggest that a sufficient percentage of those savings will accrue to the benefit of the consumers

[28] Respondent's other expert, Dr. David Argue, did not do any independent assessment to determine whether the cost savings Mr. Peterson cites in his report are merger specific. (CCFF ¶ 1790).

to offset the potential for increased prices."). As the Commentary to the *Merger Guidelines* explains, price reductions to customers "are expected when efficiencies reduce the merged firm's marginal costs," but "reductions in fixed costs . . . typically are not expected to lead to immediate price effects and hence to benefit consumers in the short term." FED. TRADE COMM'N AND U.S. DEP'T OF JUSTICE, COMMENTARY ON THE HORIZONTAL MERGER 57 (2006). At trial, Respondent's expert, Mr. Peterson, admitted that **{** [redacted] **}** (CCFF ¶ 1798) (Mr. Peterson testifying that **{** [redacted] **}** *see also* (CCFF ¶ 1799) (Mr. Peterson admitted at his deposition that **{** [redacted] **}** Furthermore, there is no evidence in Mr. Peterson's report or elsewhere in the record as to which portion of the claimed efficiencies relate to fixed versus marginal costs, and thus there is no evidence as to whether customers will receive any price reductions from the Merger. (CCFF ¶¶ 1803-04). Respondent's economic expert, Dr. Argue, also admitted he did not analyze whether any of the claimed efficiencies identified by Mr. Peterson would be passed through to customers. (CCFF ¶¶ 1801-02).

Finally, efficiency claims are only cognizable if they "do not arise from anticompetitive reductions in output or service." *Merger Guidelines* §10; *see also Penn State Hershey*, 838 F.3d at 348-49; *Heinz*, 246 F.3d at 722; *Univ. Health*, 938 F.2d at 1223. Although Respondent tries to cast its purported plans **{** [redacted] **}** as a cognizable efficiency, *see* Resp. Pretrial Br. at 61-62, **{** [redacted] **}** (CCFF ¶¶ 1397-1403). Thus, Respondent's **{** [redacted] **}** cannot constitute a cognizable

efficiency, as they would result in an anticompetitive reduction of output, the natural consequence of {[redacted]} *See Penn State Hershey*, 838 F.3d at 348-49; *Heinz*, 246 F.3d at 722; *Univ. Health*, 938 F.2d at 1223.

D. Respondent Has Failed to Meet its Burden to Show that Freedom is a Failing Firm

Respondent has not met the strict standards of the failing firm defense. *See, e.g.*, *Mich. Citizens for an Indep. Press v. Thornburgh*, 868 F.2d 1285, 1288 (D.C. Cir. 1989) (explaining that the Supreme Court has "narrowly confined the scope of the doctrine") (citing *Citizen Publ'g Co. v. United States*, 394 U.S. 131, 137-38 (1969)); *FTC v. Warner Commc'ns*, 742 F.2d 1156, 1164 (9th Cir. 1984) (noting that the defense has "strict limits"); *United States v. Energy Sols., Inc.*, 265 F. Supp. 3d 415, 444 (D. Del. 2017) (observing that "[b]ecause the doctrine is 'narrow in scope,' it 'rarely succeeds'" (internal citations omitted)). To qualify, "[a] company invoking the defense has the burden of showing that its 'resources [were] so depleted and the prospect of rehabilitation so remote that it faced the grave probability of a business failure' . . . and further that it tried and failed to merge with a company other than the acquiring one." *Gen. Dynamics*, 415 U.S. at 507 (quoting *Int'l Shoe Co. v. FTC*, 280 U.S. 291, 302 (1930); citing *Citizen Publ'g*, 394 U.S. at 138); *see also Energy Sols.*, 265 F. Supp. 3d at 444. The *Merger Guidelines* provide further detail on these criteria, requiring those asserting the defense to prove that "(1) the allegedly failing firm would be unable to meet its financial obligations in the near future; (2) it would not be able to reorganize successfully under Chapter 11 of the Bankruptcy Act; and (3) it has made unsuccessful good-faith efforts to elicit reasonable alternative offers that would keep its tangible and intangible assets in the relevant market and pose a less severe danger to competition than does the proposed merger." *Merger Guidelines* § 11. Here, Respondent has not met any of these criteria, much less all of them.

1. Freedom Was Able to Meet Its Near-Term Financial Obligations

At the time of the Merger, Freedom was not at risk of "imminent failure." *ProMedica*, 2011 WL 1219281, at *42; *Merger Guidelines* § 11. {[redacted]} (CCFF ¶¶ 1946-2012). For these reasons, Complaint Counsel's expert, Ms. Christine Hammer, concluded that, at the time of the Merger, Freedom would have been able to meet its financial obligations in the near future. (CCFF ¶ 1945). Respondent introduced no evidence at trial proving otherwise.

a) Freedom's Financial Condition Prior to the Merger

{[redacted]} (CCFF ¶¶ 1819, 1821). Externally, Otto Bock had released the C-Leg 4, which cut

into Freedom's MPK sales. (CCFF ¶ 1820); **{** [redacted] **}** (CCFF ¶ 1824).

Mr. Smith became Freedom's new CEO in April 2016 and promptly took several steps to improve Freedom's business. (CCFF ¶¶ 1824-26). **{** [redacted] **}** (CCFF ¶¶ 1840-41). Complaint Counsel's expert, Ms. Hammer, determined that "the 2017 Strategic Plan provided a sound roadmap for Freedom to address its declining revenues and profits, which had caused the liquidity constraints that it faced." (CCFF ¶ 1842). Ms. Hammer concluded that, "Freedom appears to be a company that had temporarily experienced financial difficulties but had successfully implemented the changes required for it to succeed in the future." (CCFF ¶ 1842).

The strategic plan produced immediate and sustained results. As Lee Kim, Freedom's CFO, testified at trial, in December 2016, Freedom's revenues and profits exceeded the goals of its financial plan. (CCFF ¶ 1848); *see also* (CCFF ¶ 1847) {[redacted]} (CCFF ¶¶ 1852-53) (January 2017)); (CCFF ¶¶ 1855, 1857) (February 2017)); (CCFF ¶¶ 1865) (March 2017)); (CCFF ¶¶ 1877-78, 1883) (May 2017)); (CCFF ¶¶ 1884-86) (June 2017)); (CCFF ¶¶ 1892-93) (July 2017)); (CCFF ¶¶ 1896-97, 1900) (August 2017)). {[redacted]} (CCFF ¶¶ 1856, 1861, 1864, 1881-83, 1887-89, 1894-95, 1898-1902). Based on Freedom's financial results from late 2016 through the first eight months of 2017, Complaint Counsel's expert, Ms. Hammer, concluded that, "Freedom's financial position had significantly improved by the time Otto Bock acquired it in September 2017. (CCFF ¶ 1908).

[29] At trial, Respondent's expert, Mr. Peterson, suggested that {[redacted]} (CCFF ¶ 3162). Mr. Peterson's opinion, however, directly conflicts with the testimony of Mr. Smith, Freedom's CEO at the time of the Merger, who denied that Freedom {[redacted]} (CCFF ¶ 3163).

[30] {[redacted]} (CCFF ¶ 1862); *see also* (CCFF ¶ 1858) {[redacted]}

b) Clean Audit of Freedom's 2016 Financial Statements is Inconsistent with an Inability to Meet Near-Term Financial Obligations

Freedom's audited financial statements for calendar year 2016 belie Respondent's claim that the company would have been unable to meet its financial obligations in the near future. At trial, Freedom's CFO, Lee Kim, explained that it was the company's regular practice to hire an independent auditor to audit Freedom's annual financial statements. (CCFF ¶¶ 1946-47). Upon completing the annual audit, the independent auditor would prepare a report on the company's financial statements, including an opinion on whether Freedom's financial statements present fairly the financial position of the company in accordance with Generally Accepted Accounting Principles ("GAAP"). (CCFF ¶¶ 1948-49). As Mr. Kim testified at trial, he was responsible for managing the audit process, interacting with Freedom's independent auditor, and providing the auditor with information free from material misstatements. (CCFF ¶¶ 1955-59, 1963-64).

{ [redacted] } (CCFF ¶¶ 1954, 1960, 1962, 1974, 1989, 2003-04).

{ [redacted]

[redacted] (CCFF ¶¶ 1973, 1997-2001).

The Court should reject Respondent's cynical attempt to discredit Freedom's clean audit by calling into question both the veracity and competence of Mr. Kim—its own witness.[31] At trial, Mr. Kim, who is a licensed CPA, testified that he strived to be truthful in his communications with Squire. (CCFF ¶¶ 1953, 1964). He also testified that when he [redacted]

[31] [redacted] (CCFF ¶¶ 2005-06). No witnesses from Squire testified at trial or in deposition in this case. (CCFF ¶¶ 2007-08).

[redacted]} (CCFF ¶¶ 1991-92). Any suggestion by Respondent that Mr. Smith was unaware that Freedom received a clean audit on its 2016 financial statements—or that it is inappropriate that Freedom received a clean audit—is not credible.

c) Freedom's Actions Were Inconsistent with an Inability to Meet Near-Term Financial Obligations

Prior to the Merger, Freedom did not behave like a company at risk of imminent failure. {[redacted]} Consistent with its strategic plan, {[redacted]} (CCFF ¶ 2020-21). As Complaint Counsel's expert, Ms. Hammer, noted, "Freedom's continued investment in its product development pipeline and plans for business expansion are not consistent with a company that is close to imminent failure or in decline." (CCFF ¶ 2026).

Freedom exhibited other behavior inconsistent with Respondent's argument that Freedom would have been unable to meet its financial obligations in the near future. (CCFF ¶¶ 2013, 2018, 2022, 2023-24). {[redacted]

[redacted] (CCFF ¶ 2022). Likewise, prior to the Merger, Freedom's board [redacted] (CCFF ¶ 2024). Finally, as Freedom's CFO, Lee Kim, testified at trial, [redacted] (CCFF ¶¶ 2023, 2014).

d) Respondent Has Not Shown that, Absent the Merger, Freedom's Creditors Would Likely Have Forced Freedom Into Bankruptcy or Liquidation

[redacted]

(CCFF ¶ 2203), Respondent has produced no direct evidence to support its assertion that, absent the Merger, the two banks it owed money would have foreclosed on the company's debt, (CCFF ¶¶ 2037-39, 2041-43). Respondent did not call any witness from Madison Capital or BMO to testify at trial, and did not depose anyone from either bank during discovery. (CCFF ¶¶ 2037-39, 2041-43). Moreover, Respondent does not rely on a single Madison Capital or BMO document to substantiate its claim that the banks would have "taken" Freedom had Otto Bock not acquired the company in September 2017. Respondent has therefore failed to carry its burden to show that Freedom faced "the grave probability of a business failure" because of its outstanding debt. *Gen. Dynamics*, 415 U.S. at 507 (internal quotations omitted); *see also Energy Sols.*, 265 F. Supp. 3d at 444.

In fact, evidence indicates that it is highly unlikely that Freedom would have been unable to extend its existing credit arrangement with the banks or secure additional funding to satisfy

the loan. {[redacted]} (CCFF ¶ 2056). Though these alternative arrangements may not have been as favorable to Freedom's equity investors as the sale to Otto Bock, as Complaint Counsel's expert, Ms. Hammer, explained, they "would likely have been pursued" in lieu of bankruptcy or liquidation. (CCFF ¶ 2060).

2. Freedom Did Not Seriously Consider Chapter 11 Reorganization

Respondent has not shown that Freedom "would not be able to reorganize successfully under Chapter 11 of the Bankruptcy Act." *Merger Guidelines* § 11; *see also Citizen Publ'g*, 394 U.S. at 138 (for the failing firm defense to apply, a defendant must show that the prospects for reorganization under the bankruptcy laws are "dim or nonexistent"). Freedom did not initiate Chapter 11 bankruptcy proceedings, and there is no evidence to suggest that it ever seriously explored the possibility of doing so. (CCFF ¶ 2061); *see also* (CCFF ¶ 2063) (Freedom's then-CEO, David Smith, testifying that Freedom {[redacted]} According to Thomas Chung, who is a Vice-President at HEP, Freedom's

majority equity owner, **{** [redacted] **}** (CCFF ¶ 2062).

But there is no reason to believe that Freedom could not have reorganized under Chapter 11 if necessary. (CCFF ¶¶ 2064-71). According to Complaint Counsel's expert, Ms. Hammer, {[redacted]} (CCFF ¶ 2069). Because Freedom's "reorganization efforts were proving to be successful outside of Chapter 11," Ms. Hammer concluded "there is no reason to believe . . . that Freedom could not have reorganized successfully in Chapter 11 or implemented a successful reorganization plan." (CCFF ¶ 2064).[32]

3. Freedom Did Not Make Good Faith Efforts to Elicit Reasonable Alternative Offers

Respondent cannot carry its burden unless it also shows that Freedom made unsuccessful "good-faith efforts to elicit reasonable alternative offers . . . that would both keep it in the market and pose a less severe danger to competition." *Energy Sols.*, 265 F. Supp. 3d at 445 (quoting *Dr. Pepper/Seven–Up Co. v. FTC*, 991 F.2d 859, 865 (D.C. Cir. 1993)); *see also Merger Guidelines* § 11. As the Supreme Court held, "[t]he failing company doctrine plainly cannot be applied in a merger … unless it is established that the company that acquires the failing company . . . is the only available purchaser." *Citizen Publ'g*, 394 U.S. at 138; *see also Energy Sols.*, 265 F. Supp.

[32] Although Respondent's expert, Mr. Peterson, [redacted] **}** (CCFF ¶ 2070). Moreover, as Complaint Counsel's expert, Ms. Hammer, states in her rebuttal report, not only would Freedom's cash situation not be unusual in the Chapter 11 context, but cash is often made available to companies in Chapter 11 through debtor-in-possession or "DIP" financing. (CCFF ¶ 2071).

3d at 445; *FTC v. Harbour Grp. Invs., L.P.*, No. 90-2525, 1990 WL 198819, at *3 (D.D.C. Nov. 19, 1990). Here, the trial record is clear that Freedom's sales process focused on Otto Bock and excluded several prosthetics companies, thereby precluding likely reasonable alternative offers. (CCFF ¶¶ 2075-2120). These deficiencies in Freedom's sales process are not simply an abstract concern—the evidence shows that Freedom failed to approach several prosthetics companies that had an interest in purchasing Freedom. (CCFF ¶¶ 2121-63). Finally, it is undisputed that Freedom rejected a $55 million offer from Össur. (CCFF ¶¶ 2166-93). Because Respondent offered no evidence that Freedom's liquidation value at the time of the Merger was above {[redacted]}—all evidence in the trial record indicates otherwise—and Respondent did not prove that an Össur acquisition of Freedom would pose a more severe danger to competition, Respondent has failed to meet the strict standards of the failing firm defense. (CCFF ¶¶ 2194-2240).

a) Freedom's Sales Process Focused on Otto Bock to the Exclusion of Other Options

From the outset of the sales process, which began in 2016, Freedom's shareholders much preferred a sale of Freedom rather than diluting their equity by bringing on new investors. (CCFF ¶ 2084) {[redacted]} Accordingly, Freedom's CEO, David Smith, started exploring the possibility of selling the company. {[redacted]}

[redacted]

(CCFF ¶¶ 2077-79). Discussions continued over the next seven months, with Freedom singularly focused on completing a deal with Otto Bock. (CCFF ¶¶ 2085-86, 2093-97); *see also* (CCFF ¶¶ 2091-92) [redacted] (CCFF ¶ 2099) (Complaint Counsel's expert, Ms. Hammer, concluded that nothing in the record shows "that Freedom pursued similar discussions with any potential acquirer other than Otto Bock before April 2017"). [redacted]

Even after Freedom retained Moelis, and started outreach to potential alternative buyers, the company failed to fully explore refinancing options. (CCFF ¶¶ 2100-18). [redacted]

[33] Jon Hammack, Managing Director at Moelis, testified that at no time in October 2016 was Moelis asked by Freedom to identify potential acquirers for the business; to conduct any outreach to potential acquirers for the business; or to reach out to any possible refinancing partners. (CCFF ¶¶ 2087-89).

[redacted] (CCFF ¶ 2105). Soon thereafter, Otto Bock and Össur submitted non-binding letters of interest in acquiring Freedom. (CCFF ¶ 2108). Mr. Gück testified that Otto Bock began its due diligence on Freedom only *after* Moelis informed Otto Bock that Freedom would be sold—rather than refinanced—and formally solicited initial bids in June 2017. (CCFF ¶ 67). Ultimately, Otto Bock outbid Össur, acquiring Freedom on September 22, 2017. (CCFF ¶¶ 2108-15). Freedom's behavior from October 2016 up until the Merger led Complaint Counsel's expert, Ms. Hammer, to conclude that, "by focusing primarily on a strategic sale, Freedom precluded the opportunity to refinance its existing credit facility with debt and/or equity." (CCFF ¶ 2116).

b) Freedom's Sales Process Precluded Likely Additional Reasonable Alternative Offers

The trial record makes clear that if Freedom had looked for strategic buyers in its own industry, it would have found a wealth of interest in acquiring the company.[34] (CCFF ¶¶ 2119-63). But Freedom was not interested in soliciting "reasonable alternative offers" to Otto Bock's bid; its goal was to maximize the purchase price, an appropriate strategy as long as the highest bidder does not raise grave antitrust issues. (CCFF ¶ 2120) (Freedom's CEO at the time, David Smith, testified that he was [redacted] *see Merger Guidelines* § 11 n.16 (defining a "reasonable alternative offer" as "[a]ny offer to purchase the assets of the failing firm for a price above the liquidation value of those assets"); *Energy Sols.*, 265 F. Supp. 3d at 446 (observing that the owner of the acquired firm "was clearly focused on obtaining what it perceived to be [the acquired firm's] fair value,

[34] During the sale process, Freedom and Moelis contacted only three companies in the prosthetics industry to gauge whether they would be interested in purchasing Freedom: Otto Bock, Össur, and Permobil—a wheelchair company. (CCFF ¶¶ 2101-2107).

not an offer above the liquidation value, which is likely to be less"). At trial, Jon Hammack, Managing Director at Moelis—and the person leading Freedom's sale process—admitted that he did not reach out to companies that, in his view, {[redacted]} for Freedom. (CCFF ¶ 2119). While Mr. Hammack's decision may have been reasonable in the context of a typical sales process where antitrust concerns are not present and maximizing the purchase price is the only goal, it undercuts Respondent's claim that Freedom made good-faith efforts to elicit reasonable alternative offers, as the law requires. *See Harbour Grp.*, 1990 WL 198819, at *4 (stating that the "Supreme Court has implied that, at least in some cases, approaching smaller companies in a given industry might be exactly what is required of a company seeking the protection of the failing company defense") (discussing *United States v. Greater Buffalo Press, Inc.*, 402 U.S. 549 (1971)).

Here, several smaller prosthetics companies—some of which Respondent now proffers as {[redacted]}—testified that they were not contacted during Freedom's sales process, but had interest in acquiring Freedom.[35] (CCFF ¶¶ 2160-61) {[redacted]}

[35] Respondent cannot meet its burden to prove that its search for alternative offers was sufficient by simply alleging that any offer these other companies would have made would not have been "reasonable." In the failing company context, a "reasonable alternative offer" is one that exceeds liquidation value, *Merger Guidelines* § 11 n.16, but Respondent presented no evidence of the liquidation value of Freedom nor an estimate of what a bid from any of these firms might be.

[redacted]

Even if its sales process had been otherwise sufficient, Freedom cannot overcome the fact that it completely disregarded the expression of interest [redacted] in its rush to come to an agreement with Otto Bock. (CCFF ¶¶ 2122-34). [redacted]

c) Freedom Received a Reasonable Alternative Offer from Össur

The fact that Freedom rejected Össur's [redacted] bid to acquire Freedom is fatal to Respondent's failing company defense. (CCFF ¶ 2110). With an actual offer from Össur, the only way Respondent could successfully invoke the failing company defense would be to prove either Össur's offer was not a "reasonable alternative offer" or that an Össur acquisition of Freedom would pose a more severe danger to competition than the Merger. *See Energy Sols.*, 265 F. Supp. 3d at 445; *Merger Guidelines* § 11. Respondent did not prove either.

(1) Respondent Did Not Show that the Liquidation Value of Freedom's Assets Exceeded Össur's Offer

Under the Merger Guidelines, a "reasonable alternative offer" is "[a]ny offer to purchase the assets of the failing firm for a price above the liquidation value of those assets." *Merger Guidelines* § 11 n.16; *see also Energy Sols.*, 265 F. Supp. 3d at 446. Here, Respondent failed to prove that, at the time of the Merger, the liquidation value of Freedom's assets was *greater* than Össur's {[redacted]} offer.

Nothing in the record shows that the liquidation value of Freedom's assets at the time of the Merger was greater than {[redacted]}; in fact, available evidence indicates otherwise. {[redacted]} (CCFF ¶ 2196) (David Smith); (CCFF ¶ 2194) (Maynard Carkhuff); (CCFF ¶ 2195) (Lee Kim); *see also* (CCFF ¶¶ 2198-99) {[redacted]} Moreover, neither of Respondent's experts calculated Freedom's liquidation value in their work on this case. (CCFF ¶¶ 2200-02). On the other hand, the best estimates of Freedom's liquidation value suggest that it was much lower than Össur's {[redacted]} bid. (CCFF ¶¶ 2203-11). {[redacted]} Complaint Counsel's expert, Ms. Hammer, also concluded that Freedom's liquidation value was likely much less than {[redacted]}. (CCFF ¶¶ 2212-19). Although Ms. Hammer did not offer an opinion on Freedom's

[36] {[redacted]} put the liquidation value of Freedom's assets below what Freedom owed its banks and thus well below {[redacted]} (CCFF ¶ 2210).

exact liquidation value, she concluded that the upper bound of the liquidation value of Freedom's assets was {[redacted]}, but that they would likely yield much less at a liquidation sale. (CCFF ¶¶ 2213-15).

Unable to establish that Össur's {[redacted]} bid was below Freedom's liquidation value, Respondent instead asserts that Össur offer was "not sincere." Resp. Pretrial Br. at 71. The trial record refutes this desperate argument. First, Össur offered {[redacted]}—a substantial sum —to buy Freedom. (CCFF ¶ 2176). {[redacted]} (CCFF ¶¶ 2180, 2183-84). Second, nothing in the trial record suggests that Össur lacked an ability or desire to close a deal quickly; in fact, the evidence indicates otherwise. (CCFF ¶ 2181) {[redacted]} Finally, Össur's decision to keep its offer at {[redacted]} in the final round of bidding reflects the company's independent business judgment, not its insincerity. As Össur's Executive Vice President of Research Development, Kim De Roy, explained, {[redacted]} (CCFF ¶¶ 2171-2172).

[37] [redacted] (CCFF ¶ 2171).

Össur's {[redacted]} bid for Freedom was based on its independent valuation of the company, and was not insincere simply because it came in less than Otto Bock's. (CCFF ¶ 2185) {[redacted]}[38]

(2) Respondent Did Not Show that an Össur Acquisition of Freedom Would Raise the Same or More Significant Antitrust Issues than the Merger

Respondent also failed to prove that an Össur acquisition of Freedom would pose the same or a more severe danger to competition as the Merger. *See Energy Sols.*, 265 F. Supp. 3d at 445; *Merger Guidelines* § 11. On this issue, Respondent relies almost exclusively on the report and testimony of its expert, Dr. David Argue. At trial, however, Dr. Argue, admitted that {[redacted]}[39] Moreover, Dr. Argue's market shares and concentration estimates for his proposed K3/K4 foot market are unreliable; at trial, he admitted {[redacted]} (CCFF ¶¶ 2228-34). Finally, Dr. Argue's analysis ignores evidence in the trial record that the U.S. prosthetic foot market is highly competitive. (CCFF ¶ 2237) {[redacted]} (CCFF ¶ 2238) (Össur's Executive Vice President of Research

[38] Respondent also points to Össur's refusal to sign a non-solicitation agreement as evidence of its insincerity. Resp. Pretrial Br. at 71. Freedom was hardly concerned with Össur's decision, however, as it did not withhold any people from Össur during the due diligence process. (CCFF ¶ 3160). In fact, Jon Hammack, Managing Director at Moelis, could not "recall there being significant differences" in the information that Otto Bock and Össur received during the due diligence process. (CCFF ¶ 3160).

[39] (CCFF ¶¶ 2220-26) {[redacted]}

Development testified that there are between seven and nine foot producers); (CCFF ¶ 2235) (Owner and Chief Prosthetist of Mid-Missouri Orthotics & Prosthetics testified that there is "an extensive number" of prosthetic foot manufacturers from which you can choose to purchase the foot portion of the prosthesis).

E. Respondent Failed to Demonstrate that Freedom is a "Flailing Firm"

Like its failing firm defense, Respondent's "flailing firm" defense is unavailing. Courts have held that "[f]inancial weakness . . . is probably the weakest ground of all for justifying a merger" and "certainly cannot be the primary justification." *Kaiser Aluminum & Chem. Corp. v. FTC*, 652 F.2d 1324, 1339, 1341 (7th Cir. 1981); *see also Univ. Health*, 938 F.2d at 1221; *Warner Commc'ns*, 742 F.2d at 1164; *ProMedica*, 2012 WL 1155392, at *25. For this reason, "courts have imposed an extremely heavy burden on defendants seeking to rebut the structural presumption on this ground." *ProMedica*, 2012 WL 1155392, at *25. To satisfy this burden, Respondent must "'make[] a *substantial showing* that [Freedom's] weakness, which cannot be resolved by any competitive means, would cause [Freedom's] market share to reduce to a level that would undermine the government's prima facie case.'" *Id.* (quoting *Univ. Health*, 938 F.2d at 1221) (emphasis added). Respondent has failed to do so here.

As with the failing firm defense, a principal flaw in Respondent's flailing firm defense is the significant interest from other companies in acquiring Freedom that existed prior to the Merger. (CCFF ¶ 2124) **{[redacted]}**; (CCFF ¶ 2146) **{[redacted]}**; (CCFF ¶ 2154) **{[redacted]}**; (CCFF ¶ 2160) **{[redacted]}**; (CCFF ¶ 2176) **{[redacted]}**. Many of these firms remain interested in acquiring all of Freedom today. (CCFF ¶¶ 2132-33) **{[redacted]};** (CCFF ¶ 2163) **{[redacted]}**; (CCFF ¶ 107) **{[redacted]}**; *see also* (CCFF ¶ 2140) **{[redacted]}**. This interest is fatal to Respondent's flailing firm defense as well because, even if

Respondent could show that Freedom was financially weak, it cannot show that such weakness "'cannot be resolved through . . . acquisition by [someone] other than a leading competitor.'" *ProMedica*, 2012 WL 1155392, at *26 (quoting *Univ. Health*, 938 F.2d at 1221).[40]

{ [redacted] } *See id.* at *25 (stating that financial difficulties "are relevant only where they indicate that market shares would decline in the future and by enough to bring the merger below the threshold of presumptive illegality") (internal quotations omitted). { [redacted]

[40] Respondent argues—incorrectly—that Freedom's bank debt made it a "flailing firm." *See* Resp. Pretrial Br. at 56. Although Freedom owed its banks approximately $27 million at the time of the Merger, this "weakness" would have been resolved through its acquisition by another company. *See ProMedica*, 2012 WL 1155392, at *26. When Otto Bock acquired Freedom on September 22, 2017, { [redacted] } (CCFF ¶ 113). Had another company—such as Ossur—acquired Freedom, its debt would have been paid off in a similar fashion.

[redacted] (CCFF ¶ 1407). Thus, Freedom's current market share likely understates, rather than overstates, its future competitiveness in the U.S. MPK market.[41]

F. Respondent's Other Arguments Fail to Rebut the Strong Presumption that the Merger is Illegal

In an attempt to rebut Complaint Counsel's strong *prima facie* case, Respondent has also claimed that (1) the Plié 3 is not a "true" MPK and therefore does not compete closely with Otto Bock's C-Leg 4 (*see* Resp. Pretrial Br. at 35-37); (2) the way insurers reimburse U.S. prosthetic clinics for MPKs will somehow preclude Otto Bock from raising prices post-Merger (*see* Resp. Pretrial Br. at 34; Resp. Opening Statement, Tr. 119); and (3) Hanger is a "power buyer" capable of compelling the merged firm to price its MPKs competitively (*see* Resp. Pretrial Br. at 56-61). None of these arguments has merit.

1. Respondent's Claim that Freedom's Plié 3 is not a "True" MPK is Refuted by the Trial Record

Respondent alleges, despite overwhelming evidence to the contrary, that Freedom's Plié 3 is not a "true" MPK. *See* Resp. Pretrial Br. at 35-37. In an attempt to undermine its competitor back in 2015, Otto Bock raised the same, tired claims that the Plié 3 is a not a microprocessor-controlled swing and stance knee and lacks PDAC approval, but Freedom successfully rebutted

[41] Respondent has not introduced any reliable evidence that projects a decline in Freedom's market share, much less the drastic decline necessary to rebut the strong presumption of anticompetitive harm that Complaint Counsel has established. *See, e.g.*, *ProMedica*, 2012 WL 1155392, at *25-26. Instead, Respondent simply asserts that Freedom's aggressive pricing strategy was not sustainable. *See* Resp. Pretrial Br. at 53-55. At trial, however, David Smith, Freedom's then-CEO, expressly denied that [redacted] (CCFF ¶ 1310).

these claims in the marketplace. (CCFF ¶ 994). For example, in Freedom's publicly available "Fact Sheet," it addressed "Ottobock Claims vs. Reality," clearly explaining that, "Both Plié 3 and C-Leg 4 have swing and stance control" and, in fact, "Plié 3 samples data at rate of 1000Hz which is 10x faster than C-Leg 4. The speed of Plié 3 processor makes it Real Time." (CCFF ¶ 994). Freedom also wrote in the Fact Sheet that, "PDAC is not required for reimbursement." (CCFF ¶ 994). Indeed, it was and is not, and Freedom has sold thousands of Plié 3 MPKs to customers since posting its Fact Sheet in 2015, all of which had the opportunity to buy a C-Leg 4, but chose a Plié 3 instead. (CCFF ¶¶ 966, Table A2).

Several Freedom witnesses testified that the Plié 3 is an MPK, (CCFF ¶ 3073), with functionality that competes directly against Otto Bock's C-Leg 4, (CCFF ¶¶ 1016, 1056, 1083). Other MPK manufacturers also view the Plié 3 as an MPK that competes directly with the C-Leg and their own MPKs. (CCFF ¶ 754, 758). And clinics confirm that the Plié 3 is an MPK that competes directly with the C-Leg and other MPKs. (CCFF ¶¶ 1147-1162). Moreover, Otto Bock's documents consistently identify the Plié, along with other swing and stance MPKs, as the C-Leg's primary competitors. (CCFF ¶ 3088). Finally, insurers reimburse the Plié as a swing and stance MPK under L-Code 5856. (CCFF ¶¶ 3072, 3080) (United Healthcare reimburses clinics the same amount for the C-Leg 4 and Plié 3); *see also* (CCFF ¶¶ 3067-3070, 3074-3078, 3082) (clinics receive the same reimbursement for the Plié as they do for the C-Leg).[42] Thus, Respondent's claims about the functionality of Plié 3 are not only refuted by the trial record, but also irrelevant because Freedom has competed effectively in the U.S. MPK market with its product for years.

[42] {[redacted] (CCFF ¶ 3079).

2. Respondent Fails to Show that Insurer Reimbursement Rates Will Prevent Post-Merger MPK Price Increases

Respondent's claim that "the presence of government payors and private insurers prevent supracompetitive pricing" of MPKs is incorrect. Resp. Pretrial Br. at 57. Though Medicare and other third-party payers reimburse prosthetic clinics the same fixed dollar amount for all MPKs, including the Plié 3 and C-Leg 4, (CCFF ¶¶ 382-83, 748-49, 3039-3040), these fixed rates have not—and will not—preclude post-Merger price increases. (CCFF ¶¶ 3054, 3059).

Respondent's argument ignores several key facts. First, clinics are reimbursed for, and earn their profit margin on, the complete lower limb prosthetic, not simply the MPK. (CCFF ¶¶ 3041-47); (CCFF ¶ 3041) {[redacted]} Thus, even if an MPK price increase squeezed a clinic's margin on that component, margin earned by the clinic on other components could still make fitting a prosthesis with an MPK profitable. (CCFF ¶¶ 2959-2961). {[redacted]} (CCFF ¶¶ 2959-2961). Second, MPK manufacturers compete with each other by offering discounts and rebates, and the actual prices charged by different manufacturers vary significantly. (CCFF ¶¶ 3050-53).

As a result, the margin clinics earn on an MPK varies depending on the brand of MPK they purchase. (CCFF ¶ 3052) (customers tend to have a greater profit margin on the Plié 3 than the C-Leg 4, but still fit the C-Leg 4 profitably); (CCFF ¶ 3053) {[redacted]

[redacted] (CCFF ¶ 3038) (Össur's Executive Vice President of R&D testified that, "there's fair margins" for prosthetists at the current reimbursement levels). There is no doubt that clinics could still fit prostheses with the Plié 3 profitably if Respondent raised the price of the Plié 3 by 10 percent, because even after such an increase the Plié 3 typically would still cost less than Otto Bock's C-Leg 4 does today.[43]

The fixed reimbursement system has not precluded MPK price increases in the past and it would not prevent price increases after the Merger. (CCFF ¶ 3059) [redacted] (CCFF ¶ 3054) (Össur's Executive Vice President of R&D testified that there is "room" for Össur to raise the price of its MPK with current reimbursement rates). [redacted] (CCFF ¶

[43] [redacted]

3056). Accordingly, the trial record refutes Respondent's claim that the reimbursement system for MPKs would prevent a price increase post-Merger.

3. Respondent Fails to Show that Hanger is a "Power Buyer" that Will Prevent Post-Merger MPK Price Increases

Respondent's claim that Hanger "can compel Otto Bock/Freedom to price its MPKs competitively" is analytically incorrect and contradicted by the trial record. Resp. Pretrial Br. at 61. As the *Merger Guidelines* explain, "[e]ven buyers that can negotiate favorable terms may be harmed by an increase in market power." *Merger Guidelines* § 8. As the Third Circuit held in *Penn State Hershey*, customers' leverage remains unaffected by a merger; only the merging firms' leverage change, and the relevant question is "whether the merger will cause such a significant increase in the [merging firms'] bargaining leverage that they will be able to profitably impose" a price increase. 838 F.3d at 346. "Normally, a merger that eliminates a supplier whose presence contributed significantly to a buyer's negotiating leverage will harm that buyer." *Merger Guidelines* § 8.

Respondent has not proven that Hanger's ability to play Otto Bock and an independent Freedom off each other did not contribute significantly to its ability to negotiate lower prices pre-Merger. In fact, the record clearly indicates otherwise.[44] For example, Mr. Carkhuff, Freedom's Chairman, testified that Hanger's ability to threaten to move Plié volume to C-Leg allowed it to

[44] {[redacted]}

negotiate lower prices from Freedom. (CCFF ¶ 3090) ("Q. And so in negotiations with Freedom, Hanger may be able to negotiate a lower price based on that bargaining leverage, right? A. Yes. Q. And the ability of Hanger to negotiate lower prices turns in part on whether it could credibly threaten to switch to another microprocessor knee some portion of its sales to say, like, C-Leg 4, right? A. Yes. Q. And so if that threat is credible, they may use that to negotiate lower prices from Freedom for the Plié 3, right? A. Right."). {[redacted]} (CCFF ¶¶ 1154-55). Thus, the record shows that the loss of an independent Freedom will reduce Hanger's negotiating leverage with the merged firm, likely resulting in higher prices. (CCFF ¶ 3103) {[redacted]}

Even if Hanger could somehow avoid price increases as a result of its size, "there is no reason to believe that other [] customers would fare as well." *Polypore*, 150 F.T.C. at *32; *Merger Guidelines* § 8 (explaining that "even if some powerful buyers could protect themselves, the Agencies also consider whether market power can be exercised against other buyers"); *see* (CCFF ¶ 3109-3110) {[redacted]}

Where prices are individually negotiated, as is the case here, (CCFF ¶¶ 568-580), "smaller buyers would not be protected by [any] resistance offered by larger, more powerful customers." *Polypore*, 150 F.T.C. at *32; *see also Bass Bros.*, 1984 WL 355, at *16 (large buyers could not protect remainder of purchasers).

G. Respondent's Divestiture {[redacted]} Fail to Cure its Anticompetitive Merger

1. Materiality of Evidence Related to Respondent's Proposed {[redacted]}

In its "Order on Post-Trial Briefs" issued on October 10, 2018, the Court directed both parties to "address how evidence related to divestiture presented in this case is material to the decision, including but not limited to the likelihood of anticompetitive effects from the merger and/or as to any remedy." Order on Post-Trial Briefs, *In the Matter of Otto Bock HealthCare North America, Inc.*, Docket No. 9378 (Oct. 10, 2018) at 2-3. Evidence related to divestiture is not material to the determination that Respondent consummated the Merger in violation of Section 7. When consummated, the effect of the transaction was "substantially to lessen competition." 15 U.S.C. § 18 (2012). Evidence related to divestiture is only material to the remedy that the Commission may order for that violation of Section 7 or to assessing the likelihood and significance of continuing anticompetitive effects after any divestiture occurs.

Whether Respondent presents a "planned divestiture" as a proposed remedy, or in rebuttal to address the likelihood of continuing anticompetitive effects, Respondent bears the burden of showing that (1) "the divestiture . . . replace[s] the competitive intensity lost as a result of the merger;" and (2) its proposal is "sufficiently non-speculative for the court to evaluate its effects on future competition." *Aetna*, 240 F. Supp. 3d at 60 (internal quotations omitted); *see Staples 2016*, 190 F. Supp. 3d at 137 n.5. In evaluating post-divestiture competitive effects, the

more "compelling the [government's] prima facie case, the more evidence the defendant must present to rebut it successfully." *Baker Hughes*, 908 F.2d at 991.

2. Future Divestiture Cannot Undo the Merger's Consummation in Violation of Section 7 or the Additional Harm That Has Already Occurred

Respondent's "planned divestitures" cannot affect the determination of whether the acquisition of Freedom violated Section 7 on the day Respondent consummated it. When Respondent closed its acquisition on September 22, 2017, concentration increased dramatically and an important rival in the U.S. MPK market was eliminated. Otto Bock's incentives—both with regard to the conduct of its own business and that of Freedom—changed significantly. The "planned divestiture" that Respondent averred in its Answer "addresses any conceivable anticompetitive effect" of the Merger has not occurred. As the Commission observed when it rejected this averral as an affirmative defense, "planned divestiture," by its terms, "cannot eliminate the potential for demonstrating likely anticompetitive effects" before it takes place. Opinion and Order of the Commission, *Otto Bock HealthCare North America*, Docket No. 9378 (April 18, 2018) ("Commission Order") at 4.

To bridge this shortcoming, Respondent has relied on its private decision to "put integration plans on hold" sometime after the Merger and its subsequent agreement to hold the business separate to avoid defending a federal court action for injunctive relief. *See* Respondent's Opp'n to Complaint Counsel's Motion to Strike, *Otto Bock HealthCare North America*, Docket No. 9378 (Feb. 23, 2018) at 6. Respondent also claims that it has not implemented the price increases that it had planned for Freedom's MPK products. Even if true, the decision to forestall anticompetitive behavior would not legalize a transaction, since the focus in a Section 7 case "is in probabilities, not in what later transpired." *FTC v. Consolidated Foods Corp*., 380 U.S. 592, 598 (1965). As the Supreme Court cautioned, "[i]f a demonstration that no

anticompetitive effects had occurred at the time of trial or of judgment constituted a permissible defense to a § 7 divestiture suit, violators could stave off such actions merely by refraining from aggressive or anticompetitive behavior when such a suit was threatened or pending." *Gen. Dynamics*, 415 U.S. at 504-05. Thus, even if Respondent has refrained from price increases in the wake of the Merger, it would not preclude a determination that Respondent violated Section 7 when it acquired Freedom. Commission Order at 4 n.3.

As the Commission has already found, "Nothing in Otto Bock's Seventh Affirmative Defense . . . addresses the alleged change in incentives attributable to the consummated merger or the competitive harm that the Complaint alleges followed therefrom." Commission Order at 4. The Merger had a significant and immediate impact on Freedom's incentives and operations. Unlike the independent Freedom, Respondent summarily dismissed Freedom's CEO, who had engineered its turnaround, and numerous other employees have left in the wake of the acquisition. (CCFF ¶¶ 124, 127). Unlike the independent Freedom, Freedom under Respondent's control now uses Otto Bock as its international distributor. (CCFF ¶ 150). And, unlike the independent Freedom, Freedom under Respondent's control had no reason to compete aggressively against Otto Bock. {[redacted]} (CCFF ¶ 1473). David Reissfelder, the CEO Respondent installed to run Freedom, confirmed that top Otto Bock officials were concerned about aggressive promotions and discounting on the Plié 3, which they do not "allow the OttoBock sales team to do, and therefore they recommended or they wanted us to stop doing it." (CCFF ¶ 1477). {[redacted]}

[redacted] (CCFF ¶¶ 1446-68). A divestiture someday, even if effective, would not change the anticompetitive nature of a transaction that closed more than a year ago in violation of Section 7, nor can it undo the harm that has already occurred.

3. Respondent Fails to Show that Its Proposed {[redacted]} Would Prevent Anticompetitive Effects and Fully Restore Competition

Restoring competition is the "key to the whole question of an antitrust remedy." *United States v. E. I. du Pont de Nemours & Co.*, 366 U.S. 316, 326 (1961) (hereinafter "*du Pont 1961*"). In most cases, relief is only fashioned after a determination that the transaction violated Section 7. Occasionally, however, parties attempt to devise a "fix-it-first" remedy to enhance their litigation position, particularly when the anticompetitive effects of a proposed transaction appear obvious. In the unconsummated merger context, some courts have been willing to treat such remedial divestitures and the primary transaction as one for the purposes of assessing whether the merger would have an anticompetitive effect. *See, e.g.*, *FTC v. Libbey, Inc.*, 211 F. Supp. 2d 34, 46 (D.D.C. 2002). In consummated mergers, however, it is not feasible to modify the offending transaction because it has already occurred. Instead, the legality of the transaction can be assessed without regard to any proposed divestiture, but a planned divestiture can "impact . . . the existence or magnitude of likely post-divestiture competitive harms." Commission Order at 6.

In all Section 7 cases, "relief . . . must be 'effective to redress the violations.'" *Ford Motor Co. v. United States*, 405 U.S. 562, 573 (1972) (quoting *du Pont 1961*, 366 U.S. at 326). Where a violation has been established, as guidance issued by the Justice Department's Antitrust Division states, "the Division only considers remedies that resolve the competitive problem and effectively preserve competition." U.S. DEP'T OF JUSTICE, ANTITRUST DIVISION POLICY GUIDE

TO MERGER REMEDIES 3 (2011) (withdrawn Sept. 25, 2018) ("2011 DOJ Remedies Guide").[45] That same standard applies when a respondent seeks to rebut the *prima facie* case with evidence of a planned divestiture: "*In rebuttal*, a defendant may introduce evidence that a proposed divestiture . . . 'effectively preserve[s] competition in the relevant market.'" *Aetna*, 240 F. Supp. 3d at 60 (quoting 2011 DOJ Remedies Guide at 1) (emphasis added); *see also* U.S. DEP'T OF JUSTICE, ANTITRUST DIVISION POLICY GUIDE TO MERGER REMEDIES 4 (2004) (attached as Attachment D). Whether as a remedy for a violation or in rebuttal, Respondent bears the burden of showing that the remedy negates the anticompetitive effects of the transaction. *Aetna*, 240 F. Supp. 3d at 60; *Staples 2016*, 190 F. Supp. 3d at 137 n.5. For divestitures raised in rebuttal, the more "compelling the [government's] prima facie case, the more evidence the defendant must present to rebut it successfully." *Baker Hughes*, 908 F.2d at 991. Here, Respondent has not met its burden to show that its contingent and uncertain divestiture **{** **}** which lack essential assets, intellectual property rights, and other terms, will counteract the anticompetitive effects of the Merger and restore competition in the U.S. MPK market.

4. Respondent's { } Incomplete and Inadequate Divestiture

Respondent failed to deliver on its promise that its "planned divestiture" would "address any conceivable anticompetitive effect" of its acquisition of Freedom on the U.S. MPK market. (CCFF ¶¶ 2241). **{**

[45] The 2011 DOJ Remedies Guide was withdrawn on September 25, 2018. The 2004 Policy Guide to Merger Remedies was reinstated, which includes similar language. *See* U.S. DEP'T OF JUSTICE, ANTITRUST DIVISION POLICY GUIDE TO MERGER REMEDIES 4 (2004) (stating that "[t]he Division will insist upon relief sufficient to restore competitive conditions the merger would remove," and that "[r]estoring competition requires replacing the competitive intensity lost as a result of the merger rather than focusing narrowly on returning to premerger HHI levels" because "assessing the competitive strength of a firm purchasing divested assets requires more analysis than simply attributing to this purchaser past sales associated with those assets").

[redacted]

}

a) [redacted]

}

{[redacted]

[redacted]

[redacted]

}

b) [redacted]

{[redacted]

[redacted]

c) [redacted]

[redacted] There is no reason to expect that Respondent can be counted on to address these open issues in a way that will ensure competition is restored fully, since Respondent has "no incentive to provide any assistance beyond the bare minimum…, lest they create too powerful a competitor." *Aetna*, 240 F. Supp. 3d at 71.

[redacted]

[redacted]

[redacted] **}** (CCFF ¶ 2706). With all of these open issues, Respondent's proposed divestiture to **{** [redacted] **}** does not meet the basic requirement that a divestiture proposal be "sufficiently non-

speculative for the court to evaluate its effects on future competition." *Aetna*, 240 F. Supp. 3d at 60; *see also* Transcript of Prehearing Conference at 29:10-22, *FTC v. Ardagh Group*, 13-CV-1021 (D.D.C. Sept. 24, 2013) (refusing to consider evidence of a planned divestiture because "the negotiations are [not] far enough along") (attached as Attachment E).

{ } *Otto Bock HealthCare North America*, Docket No. 9378, Order Granting Respondent's Motion for Leave to Amend Exhibit List and to Admit Certain Exhibits (Sept. 12, 2018) at 4.

{ }

[46] {

5. Significant Risks Exist that Respondent's Divestiture {[redacted]} Will Not Fully Restore Competition

A remedy must replace the "competitive intensity lost as a result of the merger." *Aetna*, 240 F. Supp. 3d at 60 (quoting *Sysco*, 113 F. Supp. 3d at 72). The "natural remedy" for a Section 7 violation is to undo the acquisition by divesting the existing business entity. *du Pont 1961*, 366 U.S. at 329; *see Ford Motor Co.*, 405 U.S. at 573 (stating that "[c]omplete divestiture is particularly appropriate where . . . acquisitions violate the antitrust laws"); *RSR Corp. v. FTC*, 602 F.2d 1317, 1326 n.5 (9th Cir. 1979) (stating that "complete divestiture of all pre-merger assets is the usual remedy for a Section 7 violation"). An existing business entity already has "the 'personnel, customer lists, information systems, intangible assets and management infrastructure' necessary to competition." *Aetna*, 240 F. Supp. 3d at 60. Divestitures of selected assets, in contrast, "even with upfront buyers, succeed[] less often and raise[] more concerns than divestitures of ongoing businesses."[47] The FTC Remedy Study, which analyzed all of the Commission's merger orders from 2006 to 2012, explained that "all remedies involving divestitures of assets comprising ongoing businesses succeeded," whereas "buyers of less than an ongoing business . . . 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." FTC Remedy Study at 5.

{[redacted]}

[47] The FTC's Merger Remedies 2006-2012 (January 2017) at 32, *available at* https://www.ftc.gov/system/files/documents/reports/ftcs-merger-remedies-2006-2012-report-bureauscompetition-economics/p143100_ftc_merger_remedies_2006-2012.pdf (hereinafter "FTC Remedy Study") (attached as Attachment F).

[redacted]}

a) Respondent Does Not Plan to Divest an Ongoing Business

{[redacted]

48 {[redacted]} As the Commission observed, the risk that a proposed divestiture negotiated by Respondent is inadequate is significant because "a seller has the incentive to create a weak competitor with its divestiture package, [and] buyers may lack the necessary information to assess properly the asset package." *Chi. Bridge*, 138 F.T.C. at *1162. As a result, "some buyers may agree to certain undesirable provisions that later undermine the buyer's effectiveness in the market." Fed'l Trade Comm'n, NEGOTIATING MERGER REMEDIES: STATEMENT OF THE BUREAU OF COMPETITION OF THE FEDERAL TRADE COMMISSION (JAN. 2012) at 14 (hereinafter "Negotiating Merger Remedies") (attached as Attachment G). Additionally, any risk can be factored into the purchase price. [redacted]} (CCFF ¶ 2727).

[redacted]}

b) Respondent's Exclusion of Assets Freedom Uses to Compete in the U.S. MPK Market Increases the Risk of Failure

The Commission has held that "complete divestiture is generally the most appropriate way to restore competition lost through an unlawful acquisition." *Polypore*, 150 F.T.C. at *33 (citing *du Pont 1961*, 366 U.S. at 329; *Chi. Bridge*, 534 F.3d at 441); *see* Fed'l Trade Comm'n, The Evolving Approach to Merger Remedies, 2000 WL 739461, at *18 (May 1, 2000) (stating that "divestiture of an ongoing business is strongly preferred over more limited forms of divestiture") (attached as Attachment H). The divestiture of anything less than an ongoing business presents enhanced risk. *See* FTC Remedy Study at 11, 32-33 (showing that a divestiture of less than an ongoing business poses enhanced risk and that both acquirer and respondent must be prepared to demonstrate why a more limited asset package is likely to maintain or restore competition). The importance of divesting an ongoing business is so great

that a divestiture must include complementary assets used outside of the relevant market at issue if they are "necessary to restore competition within the relevant market." *Polypore*, 150 F.T.C. at *33; *Chi. Bridge* 138 F.T.C. at *1163-64 (ordering a divestiture of water tank business to support the cryogenic tanks business of concern to ensure viability); FTC Remedy Study at 32 ("[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[.]"). {[redacted]}

(1) Respondent's Exclusion of {[redacted]} Increases the Risk that Divestiture Would Not Fully Restore Competition

{[redacted]}

[redacted]

[redacted]

(2) Respondent's Exclusion of {[redacted]} Increases Risks of Divestiture Failure

{[redacted]} have been a key element to Freedom's success in the U.S. MPK market. {[redacted]} (CCFF ¶¶ 2551-52). {[redacted]} (CCFF ¶ 2556). {[redacted]} (CCFF ¶ 2557). The "Ideal Combo" provides a free or heavily discounted prosthetic foot to clinics with the purchase of Freedom's Plié 3. (CCFF ¶¶ 1084, 2553). {[redacted]} (CCFF ¶¶ 2555, 2558).

[49] {[redacted]}

[redacted]

[redacted]

[redacted] (CCFF ¶¶ 2440-47). Consequently, it will never be able to continue Freedom's aggressive and effective marketing strategies to win sales against the C-Leg 4 and other MPKs. [redacted]

[redacted]**}** (CCFF ¶ 2596). Respondent has not shown that its own former top executive is wrong and has not met its burden to show **{**[redacted]**}**

{[redacted]

[redacted]

[redacted]

(3) Respondent's Exclusion of MPK-Related Intellectual Property Increases Risks of Divestiture Failure

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]**}**

c) Post-Divestiture Entanglements with Respondent Increase the Risks that the {[redacted]} Would Fail to Restore Competition

"[C]urative divestitures" must produce an "*independent* competitor." *CCC Holdings*, 605 F. Supp. 2d at 59 (citing *White Consol. Indus. v. Whirlpool Corp.*, 781 F.2d 1224, 1228 (6th Cir. 1986) (emphasis in original)). It is therefore problematic that the proposed **{[redacted]}** require the assistance of Respondent at all as part of their divestitures. (CCFF ¶¶ 2286, 2309, 2329, 2352). **{**[redacted]

[redacted]

[redacted]

[redacted]**}** (CCFF ¶¶ 2309-11, 2404-06). If Respondent does not provide these services, or does so poorly, it could undermine the divestiture. Such assistance agreements are "a problem" because they "increase a buyer's vulnerability to the seller's behavior." *Sysco*, 113 F. Supp. 3d at 77. As in *Aetna*, the Court should not "rely too heavily" on any agreement that leaves a divestiture buyer "susceptible to the seller's actions—which are not aligned with ensuring that the buyer is an effective competitor." 240 F. Supp. 3d at 60, 71. A sale of all of Freedom would minimize post-divestiture entanglements.

For buyers to turn the discrete assets Respondent proposes to sell into a viable business would require heavy reliance on Respondent. **{**[redacted]

[redacted]

[redacted]

[redacted] (CCFF ¶ 2436). Given the expected level of services created by the limited nature of Respondent's divestiture proposal, [redacted] "rel[ies] too heavily" on Respondent to assist in its competitiveness post-divestiture. *Aetna*, 240 F. Supp. 3d at 71. [redacted] there is no reason to expect Respondent to voluntarily perform such services in a way that ensures [redacted] success, since Respondent has "no incentive to provide any assistance beyond the bare minimum, lest they create too powerful a competitor." *Aetna*, 240 F. Supp. 3d at 71.

6. Respondent's Failure to Provide Fulsome Due Diligence [redacted] Increases Risks of Divestiture Failure

A principal issue in any divestiture is the information asymmetry between the buyer and seller. In the Commission's experience, "buyers sometimes—too often, in fact—have a serious

informational disadvantage. They may not fully know what assets they need to succeed in the business, or whether the assets offered by respondents are up to the task." Fed'l Trade Comm'n, The Evolving Approach to Merger Remedies, 2000 WL 739461, at *6 (May 1, 2000). Respondent can exploit its advantage to limit the scope of the divestiture and diminish the competitiveness of the buyer. *See Chi. Bridge*, 138 F.T.C. at *1162. Here, there is reason to believe that Respondent's proposed divestiture {[redacted]} from a significant informational disadvantage. Respondent limited due diligence to the cherry-picked assets it was offering, and {[redacted]} have only been able to speak to a handful of high-level Freedom employees. {[redacted]} The risk is exponentially greater when a buyer must be sure it gets exactly the right discrete assets pulled out of an ongoing business. FTC Remedy Study at 21-24.

{[redacted]} (CCFF ¶¶ 2440-62). Thus, {[redacted]} has been able to "fully know what assets they need to succeed in the business." Fed'l Trade Comm'n, The Evolving Approach to Merger Remedies, 2000 WL 739461, at *6 (May 1, 2000). {[redacted]}

[redacted]

[redacted]}

The only other witness called by Respondent at trial that could shed light on the due diligence conducted by divestiture {[redacted]

[redacted]

[redacted]

[redacted]**}**

7. Respondent's Failure to Divest an Ongoing Business Increases Risks that {[redacted]} Will Not Have Personnel Needed to Compete Effectively

A principal reason that divestiture of an ongoing business is the presumptive remedy for an anticompetitive merger is that the business already has "the personnel . . . necessary to competition." *Aetna*, 240 F. Supp. 3d at 60. A key component of successful divestitures is sufficient "access to employees who understood the relevant products." FTC Remedy Study at 25. Where the asset package is too limited, however, and "employees . . . did not transfer with the selected assets," the divestitures "did not maintain competition." *Id.* at 23-24. An ongoing business, however, has the personnel necessary for competition. *Aetna*, 240 F. Supp. 3d at 60. As with information about specific assets and aspects of Freedom's business, Respondent has not shown that it has provided **{**[redacted]**}** with access to key Freedom employees.

{[redacted]

[redacted]

} (CCFF ¶¶ 2729-30, 2732-34, 2781-88, 2829, 2834), Respondent has failed to show that its **{** [redacted] **}** the opportunity to hire these key employees. **{** [redacted] **}**

a) Key Quattro Employees Are Not Included in {[redacted]} Divestiture Proposal

{[redacted]

[redacted]

[redacted]

b) Several Key Plié Employees Are Not Included in {[redacted]} Divestiture Proposal

Freedom has several key employees manufacturing and fixing the Plié. {[redacted]} (CCFF ¶¶ 2778-80). Freedom has identified several employees that are critical to the Plié manufacturing process. {[redacted]}

[redacted]}

c) Several Key Sales and Clinical Employees Are Not Included in {[redacted]} Divestiture Proposal

{[redacted]

[redacted]

[redacted]

8. {[redacted]} Recognize that Respondent's {[redacted]} of Limited Assets Create Significant Risks of Failure

{[redacted]} recognize that the scheme Respondent has proposed is risky. **{**[redacted]

[redacted] were to acquire the entire company, they would not have to contend with identifying and recruiting the personnel needed to maintain the competitiveness of Freedom's MPK business.[50]

9. Respondent's [redacted] Increasing Risks of Divestiture Failure

Even though it has no experience in the MPK business and has had limited due diligence on that of Freedom, [redacted] (CCFF ¶ 2880). Distribution may be perfectly appropriate for commodity products like liners, but the consensus among participants in the MPK business is that a direct sales force is critical to driving sales of MPKs in the United States. (CCFF ¶¶ 2883, 2885-96). [redacted] (CCFF ¶¶ 2878, 2884). According to both Otto Bock and Freedom executives, giving up this hands-on assistance from a direct sales force would lead to fewer MPK sales. (CCFF ¶¶ 2893-95). [redacted]

[50] The same would be true if a divestiture buyer acquired all of Freedom but determined, after full due diligence on all of Freedom, [redacted] that it could restore competition without owning certain discrete Freedom foot assets. In that scenario, as contemplated in Complaint Counsel's Proposed Order, a buyer could buy all of Freedom but agree to sell discrete foot assets back to Respondent upon obtaining approval of the Commission.

[redacted]

During the trial, Respondent's {[redacted]} (CCFF ¶¶ 2633-34, 2920, 2922). And there is literally no evidence whatsoever about {[redacted]} (CCFF ¶¶ 2340, 2356).

[51] {[redacted]}

10. Respondent Has Failed to Show that {[redacted]

The purpose of a divestiture "is to restore competition lost through the unlawful acquisition," not to create a new competitive problem. *Polypore*, 150 F.T.C. at *33 (citing *Evanston Northwestern*, Comm'n Op. on Remedy at 3 (Apr. 28, 2008); *Ford Motor Co.*, 405 U.S. at 573). {[redacted]} (CCFF ¶ 2934). Respondent's own economic expert, Dr. Argue, conceded in his report that, {[redacted]} (CCFF ¶ 2927). Even under Dr. Argue's own market shares, the U.S. MPK market is highly concentrated. (CCFF ¶ 987). According to the *Merger Guidelines*, "[m]ergers resulting in highly concentrated markets [HHI above 2,500] that involve an increase in the HHI of between 100 points and 200 points potentially raise significant competitive concerns and often warrant scrutiny." *Merger Guidelines* § 5.3. Respondent did not produce any evidence relating to these potentially "significant competitive concerns," much less scrutinize them. Respondent therefore has not met its burden to show that {[redacted]}

V. Remedy

As a remedy for Otto Bock's illegal acquisition of Freedom, Complaint Counsel seeks an order ("Proposed Order" or "CCPO" attached as Attachment B) requiring the divestiture of

Freedom's ongoing business to restore the competition lost from the Merger. The Proposed Order would require Respondent to sell Freedom to a qualified, Commission-approved buyer, but would allow certain buyers, based on their complementary assets and business plans, to exclude certain Freedom prosthetic foot products if they are not necessary to restore competition.[52] Divestiture of Freedom's ongoing business is the necessary and appropriate remedy to "restore competition to the state in which it existed prior to, and would have continued to exist but for, the illegal merger." *In re B.F. Goodrich Co.*, No. 9159, 110 F.T.C. 207, 1988 WL 1025464, at *95 (F.T.C. Mar. 15, 1988) (quoting *In re RSR Corp.*, 88 F.T.C. 800, 893 (F.T.C. Dec. 2, 1976)).

A. Divestiture of Freedom's Ongoing Business is the Proper Remedy and Will Restore Competition

Both this Court and the Supreme Court have declared complete divestiture as "the usual and proper remedy where a violation of Section 7 has been found." *Polypore*, 149 F.T.C. at 678 (Chappell, A.L.J.) (citing *du Pont 1961*, 366 U.S. at 329; *Ford Motor Co.*, 405 U.S. at 573). According to the Supreme Court, "[t]he very words of § 7 suggest that an undoing of the acquisition is a natural remedy." *du Pont 1961*, 366 U.S. at 329. Divestiture of an entire ongoing business is "simple, relatively easy to administer, and sure. It should always be in the forefront of a court's mind when a violation of § 7 has been found." *du Pont 1961*, 366 U.S. at 331.

[52] The Proposed Order creates two categories of potentially excludable prosthetic feet products. For prosthetic feet that Freedom does not use to drive MPK sales, the Proposed Order would give Respondent the option of keeping them unless the divestiture buyer demonstrates that they are necessary to restore competition. (CCPO ¶ II.A.1). Respondent would be required to divest the prosthetic feet that Freedom regularly bundles with its Plié 3 to drive MPK sales and uses to compete in the U.S. MPK market unless the buyer demonstrates that these products are not necessary to restore competition, taking into consideration any complementary assets that the buyer may have. (CCPO ¶ II.A.1).

Complaint Counsel has established that Otto Bock's acquisition of Freedom has substantially lessened competition in the U.S. MPK market in violation of Section 7. Having borne that considerable burden, "all doubts as to the remedy are to be resolved in its favor." *du Pont 1961*, 366 U.S. at 334. The Commission has broad discretion to select a remedy so long as it bears a "reasonable relation to the unlawful practice found to exist." *Jacob Siegal Co. v. FTC*, 327 U.S. 608, 611-13 (1946). Complaint Counsel seeks the ordinary divestiture of the viable and integrated Freedom business that Respondent acquired. *Cf. In re Chicago Bridge & Iron Co.*, 138 F.T.C. 1024, 1158-1169 (F.T.C. 2004) (requiring the complete divestiture of the acquired business *plus* additional assets to fully restore competition). The ongoing business is necessary to restore competition because Freedom uses much more than just the select assets that Respondent has offered **{[redacted]}** in order to compete in the U.S. MPK market. Freedom's competitiveness derives from employees, products, technology, and tangible and intangible property spanning multiple product lines used to develop, manufacture, market, and sell MPKs. A divestiture of Freedom's ongoing business is, therefore, the only way to create a viable, independent MPK competitor that can replace the competitive intensity that was eliminated by Respondent's illegal Merger.

1. Divestiture of Freedom's Ongoing Business is Straightforward Because Freedom Exists as a Viable, Separate Business

It is not necessary to reconstitute Freedom because it was never integrated into Otto Bock's broader operations. Instead, Otto Bock took only limited steps to combine Freedom's business with its own immediately following the Merger, and on December 19, 2017 formally agreed to a Hold Separate and Asset Maintenance Agreement ("Hold Separate Agreement") to stave off a Commission action for injunctive relief and rescission in federal court. (CCFF ¶ 126). To be sure, Freedom has not been completely unaffected by the acquisition: Otto Bock did make

changes to Freedom's business, and Freedom has lost a number of employees, including its Chairman and CEO, due to the Merger (CCFF ¶¶ 124, 127), and Freedom has not been as vigorous a competitor as it had been as an independent company.[53] Yet with the Hold Separate Agreement, divestiture of Freedom remains a "simple, relatively easy to administer, and sure," remedy despite the consummation of the illegal Merger.

2. Divestiture of Freedom's Ongoing Business is Necessary to Minimize Execution Risks and to Fully Restore Competition

While divestiture is the appropriate and necessary remedy here, it is not enough simply to require divestiture of a handpicked, limited set of assets, as Respondent requests. That limited divestiture would deprive the buyer of critical assets, rights, and personnel necessary to match the competitive vigor of the pre-acquisition Freedom in the MPK market. That is why courts and the Commission have consistently held that "undoing of the acquisition" is the "natural remedy" to cure the anticompetitive harms of an unlawful acquisition. *du Pont 1961*, 366 U.S. at 329; *see Ford Motor Co.*, 405 U.S. at 573 (stating that "[c]omplete divestiture is particularly appropriate where . . . acquisitions violate the antitrust laws"); *RSR Corp.*, 602 F.2d at 1326 n.5 (stating that "complete divestiture of all pre-merger assets is the usual remedy for a Section 7 violation"). As this Court recognized, "complete divestiture is the appropriate remedy to most effectively 'pry open to competition [the] market[s] that [have] been closed by [Respondent's] illegal restraints.'" *Polypore*, 149 F.T.C. at 945 (Chappell, A.L.J.) (quoting *du Pont 1961*, 366 U.S. at 323). That is especially the case where, as here, the products of concern are part of an integrated business that shares assets and employees used to develop, manufacture, and sell MPKs across

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53 [redacted] (CCFF ¶¶ 128-43). Freedom's incentive to compete against Otto Bock has also diminished. [redacted] (CCFF ¶ 1473). With the diminished incentives to compete, Freedom MPK development projects like the Plié 4/Plié 3 Fast Fit and the Quattro, have flagged or been scuttled altogether. (CCFF ¶¶ 1446-68).

its multiple product areas. It is well established that, in such cases, the complementary assets must be divested if "necessary to restore competition within the relevant market." *Polypore*, 150 F.T.C. at *33; *Chi. Bridge*, 138 F.T.C. at 1158, 1163-64; *see also* FTC Remedy Study at 32 ("[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[.]").

Anything less than divestiture of Freedom's ongoing business would risk not restoring the competition that was lost when Respondent acquired Freedom. The Commission studied this very question in reviewing a decade's worth of remedies and found that "all remedies involving divestitures of assets comprising ongoing businesses succeeded, confirming that such divestitures are most likely to maintain or restore competition." FTC Remedy Study at 5. The same was not true for the type of remedy Respondent has proposed: "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." *Id.* at 5. While contingent and incomplete divestiture of selected assets may be what best serves Respondent's interest, and may even be attractive to the buyer at the right price, MPK consumers would be forced to bear the considerable risk that it would fail to fully restore competition.

Freedom's MPK line is no stand-alone, ongoing business. It shares key technology, employees, and assets with other Freedom product lines. {[redacted]}

[redacted] (CCFF ¶¶ 2512-17).

Relying on Respondent to select the assets and personnel that a buyer has access to is always risky because, "a seller has the incentive to create a weak competitor with its divestiture package, [and] buyers may lack the necessary information to assess properly the asset package." *Chi. Bridge*, 138 F.T.C. at 1162. Here, the information asymmetry is exacerbated by the lack of due diligence that Respondent has afforded its [redacted] (CCFF ¶¶ 2440-93). With only limited information, [redacted] cannot know all of the assets and people that are missing from the package being offered by Respondent, so any claim that they believe that they can restore competition is little more than speculation. (CCFF ¶¶ 2378, 2380, 2422). Because

Respondent has been unwilling to provide the requisite information, the order must guarantee buyers will be able to conduct adequate due diligence on Freedom and ensure the sale of all of the assets used in Freedom's ongoing business to compete effectively in the U.S. MPK market.

3. Anticompetitive Harm Will Result without the Divestiture of Freedom's Ongoing Business to a Qualified Buyer

Absent a divestiture of Freedom's ongoing business, Respondent's illegal Merger will continue to harm consumers. **{** [redacted] **}** (CCFF ¶¶ 1024-25, 1028, 1033, 1079) and "one-upping" each other to introduce higher-quality MPKs to the market, (CCFF ¶¶ 1157). This direct competition led to lower prices and improved technology for clinics and amputees, (CCFF ¶¶ 1141-74), **{** [redacted] **}** (CCFF ¶¶ 1346, 1361, 1366, 1370, 1392-1411).

The hold separate has ameliorated some of the effects that the Merger would have produced already had it gone unchecked. Without a proper remedy, Otto Bock may well succeed in doing what the Hold Separate Agreement has thus far restrained: **{** [redacted] **}** (CCFF ¶¶ 1360, 1392-1400, 1405-11).

B. Every Provision of the Proposed Order is Supported by Case Law and Sound Competition Policy

In its Order on Post-Trial Briefs issued on October 10, 2018, the Court directed that Complaint Counsel "shall specifically include briefing in support of . . . the proposed remedy, including each and every provision of the proposed order (other than definitions, boilerplate, or non-substantive provisions)." Order on Post-Trial Briefs, *In the Matter of Otto Bock HealthCare North America, Inc.*, Docket No. 9378 (Oct. 10, 2018) at 2-3. In compliance with this directive, Complaint Counsel has attached as Attachment A an annotated version of its Proposed Order (the "Annotated Proposed Order"), which includes endnotes explaining the purpose of and precedent for each provision in the Proposed Order, as well as explanations of the need for specific provisions based on record evidence in this case.

Consistent with well-established law, Complaint Counsel's Proposed Order directs Respondent to divest Freedom's ongoing business to a Commission-approved buyer no later than ninety days after the Proposed Order becomes final. (CCPO ¶ II.A.1). As explained in the Annotated Proposed Order, virtually every provision in the Proposed Order is based on this Court's Final Orders in *ProMedica Health System, Inc.*, Docket No. 9346, and *Polypore International, Inc.*, Docket No. 9327. As explained in the Annotated Proposed Order, certain provisions are needed because record evidence demonstrates particular deficiencies in Respondent's divestiture proposals. **{** [redacted] **}**

The Proposed Order requires Respondent to divest the ongoing Freedom business to a Commission-approved buyer. It has been designed, however, to allow **{** [redacted]

[redacted]} so long as in doing so, the competitive intensity of Freedom in the MPK market is not compromised. Thus, if after conducting proper and complete due diligence, the buyer concludes that certain Freedom prosthetic foot products are not required to compete effectively in the U.S. MPK market, it may opt not to acquire them. (CCPO ¶¶ I.I, I.J, I.M, I.N, II.A.1). The Proposed Order groups Freedom's prosthetic foot assets into two buckets—"Divestiture Products Group A" and "Divestiture Products Group B." (CCPO ¶¶ I.I, I.J). "Divestiture Products Group A" includes prosthetic feet that evidence shows Freedom does not use in the development or sale of MPKs. (CCFF ¶ 2560). These products could be retained by Respondent unless the divestiture buyer demonstrates that it needs any or all of them to compete effectively in the MPK market. (CCPO ¶ II.A.1). "Divestiture Products Group B" are the prosthetic feet Freedom uses to maximize the competitiveness of its Plié 3 MPK. (CCPO ¶ I.J; CCFF ¶¶ 2555, 2558-59). Under the Proposed Order, these products must be sold to a buyer unless the buyer, after conducting fulsome due diligence and developing a detailed business plan, demonstrates that any of them are not necessary to restoring competition because the buyer already has its own complementary assets. (CCPO ¶ II.A.1).

Under the Proposed Order, the entire business, excluding the products specifically identified in the Divestiture Products Group A and Divestiture Products Group B, must be divested to a qualified, Commission-approved divestiture buyer. {[redacted]

[redacted]

[redacted] **}** the Freedom business to be divested under the Proposed Order contains other MPK-related assets Respondent has excluded from its divestiture proposals. First, the Proposed Order would ensure that the buyer receives Freedom's rights to the Gunnison, Utah and Irvine, California facilities. (CCPO ¶ I.M.1). **{** [redacted] **}** (CCFF ¶¶ 2641-42, 2647-48, 2654-57, 2661-64, 2670-77). Second, the divested Freedom business would include "all Intellectual Property," and Otto Bock would be prohibited from "plac[ing] . . . restrictions on the use" of the intellectual property. (CCPO ¶¶ I.M.7, II.A.7.a). **{** [redacted] **}** (CCFF ¶¶ 2695-96, 2700, 2702, 2706, 2714, 2719, 2723).

A successful remedy requires Freedom's key employees stay with the divested business. FTC Remedy Study at 23. The divestiture of the ongoing business means that employees would have to affirmatively choose to leave, but otherwise would remain employees of Freedom, as owned by its new buyer. The Proposed Order further provides explicitly that the divestiture buyer will have "the opportunity to recruit and employ *all* Freedom Employees." (CCPO ¶¶ II.A.5.c, II.A.9). **{** [redacted]

[redacted] (CCFF ¶¶ 2269, 2281-82, 2308, 2328, 2351).

Furthermore, the Proposed Order recognizes that it is "critically important that the buyer conduct adequate due diligence to avoid surprises" when acquiring the divested business by ensuring that the buyer will have access to all of the information it needs to determine what assets it needs to compete successfully post-divestiture. FTC Remedy Study at 25. The Proposed Order specifically requires Otto Bock to provide the buyer with "all information and documents relating to Freedom Assets and Business customarily provided in a due diligence process[.]" (CCPO ¶ II.A.4). It will not be able to parse out information [redacted] in the dark about how Freedom operates its MPK business, as Respondent has done throughout the divestiture process it engaged in during trial. (CCFF ¶¶ 2463-93). The due diligence process contemplated under the Proposed Order will also ensure that prospective buyers will have "reasonable access to personnel." (CCPO ¶ II.A.4). [redacted] (CCFF ¶¶ 2746-62, 2791-94, 2836-40).

Because the Proposed Order requires a divestiture of the entire Freedom business (save for any assets specifically excluded under the Order), there should be little to no need for the buyer to depend on Respondent for transitional services to ensure that the divestiture is successful. Nevertheless, because it is possible that some support may be required, either to accommodate the exclusion of assets as permitted under the Proposed Order or to reverse any deterioration in the business that has occurred during the period of the Hold Separate Agreement, the Proposed Order requires that "Otto Bock shall provide Transitional Services to the Acquirer sufficient to enable the Acquirer to conduct the Freedom Business in substantially the same manner that the Freedom Business was conducted prior to the Acquisition[.]" (CCPO ¶ II.A.8.a). Any transitional services must be provided "at substantially the same level and quality as such services are provided by Otto Bock in connection with the Hold-Separate Agreements" and shall be provided at cost. (CCPO ¶ II.A.8.b). **{** [redacted] **}** (CCFF ¶¶ 2401, 2435-37).

The Proposed Order also includes several important ancillary provisions designed to protect the divested Freedom business and foster competition. First, the Proposed Order prevents Otto Bock from disclosing any confidential information about Freedom that it received through the Merger. (CCPO ¶ II.A.11). **{** [redacted] **}** (CCFF ¶¶ 128, 135-43). The Proposed Order requires that Otto Bock return any confidential information in its possession and

refrain from using it to the detriment of the business once divested. (CCPO ¶¶ II.A.10-11). Second, the Proposed Order requires Otto Bock to "maintain the viability, marketability, and competitiveness" of the Freedom business pending divestiture. (CCPO ¶ IV.A; *see also* ¶¶ III.A, III.B (preventing Otto Bock from selling Freedom's assets or eliminating Freedom's services); ¶ III.C (preventing Otto Bock from failing to maintain employment of Freedom's employees)). {[redacted]} (CCFF ¶ 124). It now must rely on Respondent for international distribution too. (CCFF ¶ 150) With the protection of the Proposed Order, Otto Bock will be compelled to fully preserve Freedom's operations, so that the divestiture buyer would receive a competitive, ongoing business.

CONCLUSION

For the foregoing reasons, the evidence presented at trial and admitted to the record establishes that Otto Bock's acquisition of Freedom on September 22, 2017 violated Section 7 of the Clayton Act and Section 5 of the FTC Act, as alleged in the Complaint, and justifies entry of the enclosed Proposed Order and any such other relief that the Court deems necessary and proper.

Dated: November 20, 2018

Respectfully Submitted,

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Attachment A

UNITED STATES OF AMERICA
BEFORE THE FEDERAL TRADE COMMISSION
OFFICE OF ADMINISTRATIVE LAW JUDGES

In the Matter of **Otto Bock HealthCare North America, Inc.,** **a corporation**. **Respondent**	**DOCKET NO. 9378**

ORDER

I.

IT IS ORDERED that, as used in the Order, the following definitions apply:

A. "Otto Bock" or "Respondent" means[1] Otto Bock Healthcare North America, Inc., its directors, officers, employees, agents, representatives, successors, and assigns; and its joint ventures, subsidiaries, divisions, groups, and affiliates controlled by Otto Bock Healthcare North America, Inc., and the respective directors, officers, employees, agents, representatives, successors, and assigns of each.

B. "Commission" means[2] the Federal Trade Commission.

C. "Acquirer" means[3] the Person that acquires, with the prior approval of the Commission, the Freedom Assets and Business from Otto Bock pursuant to Paragraph II, or from the Divestiture Trustee pursuant to Paragraph VII of this Order.

D. "Acquisition" means[4] the acquisition of the Freedom Assets and Business by Respondent Otto Bock pursuant to the Agreement and Plan of Merger dated September 22, 2017 and subsequent amendments and schedules.

E. "Acquisition Date" means[5] September 22, 2017, the date on which Otto Bock acquired the Freedom Assets and Business.

F. "Confidential Business Information" means[6] any non-public information relating to the Freedom Assets and Business either prior to or after the Effective Date of Divestiture, including, but not limited to, all customer lists, price lists, distribution or marketing methods, or Intellectual Property relating to Freedom Assets and Business and:

1. Obtained by Otto Bock prior to the Effective Date of Divestiture;[7] or,

2. Obtained by Otto Bock after the Effective Date of Divestiture, in the course of performing Otto Bock's obligations under any Divestiture Agreement.

Provided, however, that Confidential Business Information shall not include:

1. Information that Otto Bock can demonstrate it obtained prior to the Acquisition Date, other than information it obtained during due diligence pursuant to any confidentiality or non-disclosure agreement;
2. Information that is in the public domain when received by Otto Bock;
3. Information that is not in the public domain when received by Otto Bock and thereafter becomes public through no act or failure to act by Otto Bock;
4. Information that Otto Bock develops or obtains independently, without violating any applicable law or this Order; and
5. Information that becomes known to Otto Bock from a third party not in breach of applicable law or a confidentiality obligation with respect to the information.

G. "Direct Cost" means[8] the cost of direct material and direct labor used to provide the relevant assistance or service.

H. "Divestiture Agreement" means[9] any agreement, including all exhibits, attachments, agreements, schedules and amendments thereto, that has been approved by the Commission pursuant to which the Freedom Assets and Business are divested by Otto Bock pursuant to Paragraph II, or by the Divestiture Trustee pursuant to Paragraph VII in this Order.

I. "Divestiture Products Group A" means[10] all Freedom Assets and Business related to the products listed in Appendix A of this Order.

J. "Divestiture Products Group B" means[11] all Freedom Assets and Business related to the products listed in Appendix B of this Order.

K. "Divestiture Trustee" means[12] the Person appointed pursuant to Paragraph VII of this Order to divest the Freedom Assets and Business.

L. "Effective Date of Divestiture" means[13] the date on which the divestiture of the Freedom Assets and Business to an Acquirer pursuant to Paragraph II or Paragraph VII of this Order is completed.

M. "Freedom Assets" means[14] all of Otto Bock's right, title, and interest in and to the Freedom Business and all related assets, tangible or intangible, business, and properties, including any improvements or additions thereto made subsequent to the Acquisition, relating to the operation of the Freedom Business, including, but not limited to:

1. All Real Property of the Freedom Business;[15]
2. All Tangible Personal Property;[16]
3. All Intangible Property;[17]
4. All consumable or disposable inventory;[18]

5. All rights under any contracts and agreements, including, but not limited to, all rights to leases, service agreements, supply agreements and procurement contracts;[19]

6. All rights and title in and to the use of the Freedom Business name and marks on a permanent and exclusive basis;[20]

7. All Intellectual Property;[21]

8. All governmental approvals, consents, licenses, permits, waivers, or other authorizations to the extent transferrable;[22]

9. All rights under warranties and guarantees, express or implied;[23]

10. All items of prepaid expense;[24] and

11. Books, records, files, correspondence, manuals, computer printouts, databases, and other documents relating to the operation of the Freedom Business, electronic and hard copy, located on the premises of Freedom Business Real Property or in the possession of any Otto Bock Employee (or copies thereof where Otto Bock has a legal obligation to maintain the original document), including, but not limited to:[25]

    a. Customer files and records, including customer lists, customer product specifications, customer purchasing histories, customer service and support materials, and customer information;[26]

    b. Research and development data and files;[27]

    c. Financial records;[28]

    d. Personnel files;[29]

    e. Maintenance records;[30]

    f. Advertising, promotional and marketing materials, including website content;[31]

    g. Documents relating to policies and procedures;[32]

    h. Documents relating to quality control;[33]

    i. Documents relating to Payors;[34] and

    j. Documents relating to Suppliers.[35]

Provided, however, Freedom Assets does not include any assets exclusively related to the Otto Bock business (including prosthetic products sold or marketed by Otto Bock) prior to the Acquisition Date, unless such assets were also used by the Freedom Business after the Acquisition Date.[36]

N. "Freedom Business" means[37] all activities relating to the manufacture and sale of prosthetics and other related products and services.

Provided however, the Freedom Business does not include any activities relating to Otto Bock's manufacture and sale of prosthetics and other related products and services prior to the Acquisition Date.[38]

O. "Freedom Assets and Business" means[39] the Freedom Assets and the Freedom Business.

P. "Freedom Employee(s)" means[40] Any Person:

1. Employed by the Freedom Business as of the Acquisition Date;[41] and/or

2. Employed by the Freedom Business at any time from the Acquisition Date through the Effective Date of Divestiture.[42]

Q. "Freedom Key Employee(s)" means[43] any Person listed in Confidential Appendix C Attached to this Order.

R. "Hold-Separate Agreements" means[44] the Letter Agreement and Hold Separate and Asset Maintenance Agreement signed by Otto Bock and Bureau of Competition Staff on December 20, 2017, attached as Confidential Appendix D to this Order, and the Procedures, Terms and Conditions Agreement.

S. "Hold-Separate Manager Agreement" means the Agreement signed by Otto Bock and the Hold Separate Manager on December 22, 2017, attached as Confidential Appendix E to this Order.

T. "Hold-Separate Monitor Agreement" means the Agreement signed by Otto Bock and the Hold Separate Monitor on December 27, 2017, attached as Confidential Appendix F to this Order.

U. "Intangible Property" means[45] intangible property relating to the operation of the Freedom Business including, but not limited to, Intellectual Property, the Freedom name and marks, trademarks, logos, and the modifications or improvements to such intangible property.

V. "Intellectual Property" means,[46] without limitation: (i) all patents, patent applications, inventions, and discoveries that may be patentable; (ii) all know-how, trade secrets, software, technical information, data, registrations, applications for governmental approvals, inventions, processes, best practices (including clinical pathways), formulae, protocols, standards, methods, techniques, designs, quality-control practices and information, research and test procedures and information, and safety, environmental and health practices and information; (iii) all confidential or proprietary information, commercial information, management systems, business processes and practices, patient lists, patient information, patient records and files, patient communications, procurement practices and information, supplier qualification and approval practices and information, training materials, sales and marketing materials, patient support materials, advertising and promotional materials; and (iv) all rights in any jurisdiction to limit the use or disclosure of any of the foregoing, and rights to sue and recover damages or obtain injunctive relief for infringement, dilution, misappropriation, violation, or breach of any of the foregoing.

W. "Licensed Intangible Property" means[47] Intangible Property licensed to Otto Bock or to the Freedom Business from a third party relating to Freedom Assets and Business including, but not limited to, Intellectual Property, software, computer programs, patents, know-how, goodwill, technology, trade secrets, technical information, marketing information, protocols, quality-control information, trademarks, trade names, service marks, logos, and the modification or improvements to such intangible property that are licensed to Otto Bock or to the Freedom Business ("Licensed Intangible Property" does not mean modifications and improvements to intangible property that are not licensed to Otto Bock).

X. "Monitor" means[48] the Person appointed pursuant to Paragraph VI of the Order and with the prior approval of the Commission.

Y. "Monitor Agreement" means[49] the agreement Otto Bock enters into with the Monitor and with the prior approval of the Commission.

Z. "Payor" means[50] any Person that purchases, reimburses for, or otherwise pays for medical goods or services for themselves or for any other person, including, but not limited to: health insurance companies; preferred provider organizations; point-of-service organizations; prepaid hospital, medical, or other health-service plans; health maintenance organizations; government health-benefits programs; employers or other persons providing or administering self-insured health-benefits programs; and patients who purchase medical goods or services for themselves.

AA. "Person" means[51] any natural person, partnership, corporation, association, trust, joint venture, government, government agency, or other business or legal entity.

BB. "Procedures, Terms and Conditions Agreement" means the Procedures, Terms, and Conditions Regarding Access to the Held-Separate Business for FTC Litigation Purposes Pursuant to Hold Separate and Asset Maintenance Agreement dated December 20, 2017, between Bureau of Competition Staff and Otto Bock, signed on January 31, 2018, and attached as Confidential Appendix G to this Order.

CC. "Real Property" means[52] all real property interests (including fee simple interests and real property leasehold interests including all rights, easements and appurtenances, together with all buildings, structures, facilities) that Otto Bock acquired pursuant to the Acquisition and/or that Otto Bock acquired after the Acquisition to the extent the interests relate to the operation of the Freedom Business. Real Property includes, but is not limited to, the assets, which are identified and listed on Appendix H to this Order.

DD. "Supplier" means[53] any Person that has sold to the Freedom Business or Otto Bock any goods or services for use in connection with the operation of the Freedom Business; provided, however, that "Supplier" does not mean an employee of Otto Bock.

EE. "Tangible Personal Property" means[54] all machinery, equipment, spare parts, tools, and tooling (whether customer specific or otherwise); furniture, office equipment, computer hardware and software; supplies and materials; vehicles and rolling stock; and other items of tangible personal property of every kind whether owned or leased, together with any express or implied warranty by the manufacturers, sellers, or lessors of any item or

component part thereof, and all maintenance records and other documents relating thereto.

FF. "Technical Services Agreement" means[55] the provision by Otto Bock at Direct Cost of all advice, consultation, and assistance reasonably necessary for any Acquirer to receive and use, in any manner related to achieving the purposes of this Order, any asset, right, or interest related to the Freedom Business.

GG. "Transitional Services" means[56] the Technical Services Agreement and the Transition Services Agreement.

HH. "Transition Services Agreement" means[57] an agreement requiring Otto Bock to provide at Direct Cost all services reasonably necessary to transfer administrative support services to the Acquirer, including, but not limited to, such services related to payroll, employee benefits, accounts receivable, accounts payable, and other administrative and logistical support.

II.

IT IS FURTHER ORDERED that:[58]

A. Otto Bock shall:

1. No later than ninety (90) days[59] from the date this Order becomes final and effective, divest absolutely and in good faith, and at no minimum price, the Freedom Assets and Business to an Acquirer[60] that receives the prior approval of the Commission and in a manner, including pursuant to a Divestiture Agreement, that receives the prior approval of the Commission;[61]

   Provided, however, that Otto Bock may retain any or all of the Divestiture Products Group A *unless* the Acquirer demonstrates to the Commission's satisfaction:[62] (i) that any such asset is necessary to achieve the purpose of this Order; and (ii) that the Acquirer needs such asset to effectively operate the Freedom Business in a manner consistent with the purpose of this Order, and the Commission approves the divestiture with the divestiture of such asset.[63]

   Provided, however, that Otto Bock must divest any or all of the Divestiture Products Group B *unless* the Acquirer demonstrates to the Commission's satisfaction:[64] (i) that any such asset is not necessary to achieve the purpose of this Order; and (ii) that the Acquirer does not need such asset to effectively operate the Freedom Business in a manner consistent with the purpose of this Order, and the Commission approves the divestiture without the divestiture of such asset.[65]

2. Comply with all terms of the Divestiture Agreement approved by the Commission pursuant to this Order, which agreement shall be deemed incorporated by reference into this Order; and any failure by Otto Bock to comply with any term of the Divestiture Agreement shall constitute a failure to comply with this Order. The Divestiture Agreement shall not reduce, limit or contradict, or be construed to

reduce, limit or contradict, the terms of this Order; *provided, however*, that nothing in this Order shall be construed to reduce any rights or benefits of any Acquirer or to reduce any obligations of Otto Bock under such agreement; *provided further*, that if any term of the Divestiture Agreement varies from the terms of this Order ("Order Term"), then to the extent that Otto Bock cannot fully comply with both terms, the Order Term shall determine Otto Bock's obligations under this Order. Notwithstanding any paragraph, section, or other provision of the Divestiture Agreement, any failure to meet any condition precedent to closing (whether waived or not) or any modification of the Divestiture Agreement, without the prior approval of the Commission, shall constitute a failure to comply with this Order.[66]

3. Prior to the Effective Date of Divestiture, Otto Bock shall not rescind the Hold-Separate Agreements, the Hold-Separate Manager Agreement, the Hold-Separate Monitor Agreement, or the Procedures, Terms, and Conditions Agreement or any term of the above Agreements necessary to comply with any Paragraph of this Order.[67]

4. No later than thirty (30) days from the date this Order becomes final and effective, Otto Bock shall offer to furnish to all prospective Acquirers, subject to customary confidentiality assurances, all information and documents relating to the Freedom Assets and Business customarily provided in a due diligence process except such information or documents subject to the attorney-client privilege or work-product doctrine.[68]

   Provided further that Otto Bock shall permit prospective Acquirers of the Freedom Assets and Business to have reasonable access to personnel[69] and to make inspections of the physical facilities; and access to any and all financial, operational, or other documents and information customarily provided as part of a due diligence process.[70] *Provided, however*, that Otto Bock shall require all prospective Acquirers to sign a confidentiality agreement pursuant to which that prospective Acquirer shall be required to maintain all Confidential Business Information obtained as part of the due diligence process as strictly confidential, including the nondisclosure of that information to all other employees, executives, or other personnel of the potential Acquirer that were not involved in the due diligence process.[71] Otto Bock shall require, as part of a confidentiality agreement, that the potential Acquirer limit access to Confidential Business Information to only those employees necessary to conduct sufficient due diligence.[72]

5. Take all actions and shall effect all arrangements in connection with the divestiture of the Freedom Assets and Business necessary to ensure that the Acquirer can conduct the Freedom Assets and Business in substantially the same manner as operated prior to the Acquisition, including, but not limited to:[73]

   a. Complying with the Hold-Separate Agreements, the Hold-Separate Manager Agreement, the Hold-Separate Monitor Agreement, or the

Procedures, Terms, and Conditions Agreement or any term of the above Agreements,[74]

b. Providing Transitional Services,[75]

c. Providing the opportunity to recruit and employ all Freedom Employees.[76]

6. Convey as of the Effective Date of Divestiture to the Acquirer the right to use any Licensed Intangible Property (to the extent permitted by the third-party licensor), if such right is needed for the operation of the Freedom Business by the Acquirer and if the Acquirer is unable, using commercially-reasonable efforts, to obtain equivalent rights from other third parties on commercially-reasonable terms and conditions.[77]

7. Otto Bock shall:

a. Place no restrictions on the use by the Acquirer of the Freedom Assets and Business, including any Intangible Property;[78]

b. On or before the Effective Date of Divestiture, provide to the Acquirer contact information about customers, Payors, and Suppliers for the Freedom Assets and Business;[79]

c. With respect to contracts with Freedom Business Suppliers, at the Acquirer's option and as of the Effective Date of Divestiture:[80]

i. If such contract can be assigned without third-party approval, assign its rights under the contract to the Acquirer; and

ii. If such contract can be assigned to the Acquirer only with third-party approval, assist and cooperate with the Acquirer in obtaining:

a) Such third-party approval and in assigning the contract to the acquirer; or

b) A new contract.

8. At the request of the Acquirer, for two (2) years from the Effective Date of Divestiture, with the option of the Acquirer to renew for two six (6) month periods with written notification to Commission staff,[81] except as otherwise approved by the Commission, and in a manner (including pursuant to an agreement) that receives the prior approval of the Commission:[82]

a. Otto Bock shall provide Transitional Services to the Acquirer sufficient to enable the Acquirer to conduct the Freedom Business in substantially the same manner that the Freedom Business was conducted prior to the Acquisition and during the Hold-Separate Period.

b. Otto Bock shall provide the Transitional Services required by this Paragraph II.A.8 at substantially the same level and quality as such

services are provided by Otto Bock in connection with the Hold-Separate Agreements.

Provided, however, that Otto Bock shall not (i) require the Acquirer to pay compensation for Transitional Services that exceeds Direct Cost of providing such goods and services,[83] (ii) terminate its obligation to provide Transitional Services because of a material breach by the Acquirer of any agreement to provide such assistance, in the absence of a final order of a court of competent jurisdiction, or (iii) include a term in any agreement to provide Transitional Services that limits the type of damages (such as indirect, special, and consequential damages) that the Acquirer would be entitled to seek and in event of Otto Bock's breach of such agreement.[84]

9. Otto Bock shall allow the Acquirer an opportunity to recruit and employ any Freedom Employee in connection with the divestiture of the Freedom Assets and Business, including as follows:[85]

   a. No later than five (5) days after execution of a divestiture agreement, Otto Bock shall (i) identify each Freedom Employee, (ii) allow the Acquirer an opportunity to interview any Freedom Employee, and (iii) allow the Acquirer to inspect the personnel files and other documentation relating to any Freedom Employee, to the extent permissible under applicable laws.[86]

   b. Otto Bock shall (i) not offer any incentive to any Freedom Employee to decline employment with the Acquirer, (ii) remove any contractual impediments that may deter any Freedom Employee from accepting employment with the Acquirer, including, but not limited to, any non-compete or confidentiality provisions of employment or other contracts with Otto Bock that would affect the ability of the Freedom Employee to be employed by the Acquirer, and (iii) not otherwise interfere with the recruitment of any Freedom Employee by the Acquirer.[87]

   c. Otto Bock shall (i) vest all current and accrued pension benefits as of the date of transition of employment with the Acquirer for any Freedom Employee who accepts an offer of employment from the Acquirer no later than thirty (30) days from the Effective Date of Divestiture and (ii) if the Acquirer has made a written offer of employment to any Key Employee, as identified and listed on Confidential Appendix C to this Order, provide such Key Employee with reasonable financial incentives to accept a position with the Acquirer at the time of the Effective Date of Divestiture, including, but not limited to (and subject to Commission approval), payment of an incentive equal to up to three (3) months of such Key Employee's base salary to be paid only upon such Key Employee's completion of one (1) year of employment with the Acquirer.[88]

   Provided, however, that Otto Bock and the Acquirer will work together in good faith to determine whether any additional Freedom Employee should be identified as a Key Employee and subject to the provisions of this

Paragraph II.A.9.c.

d. For a period ending two (2) years after the Effective Date of Divestiture, Otto Bock shall not, directly or indirectly, solicit, hire, or enter into any arrangement for the services of any Freedom Employee employed by the Acquirer, unless such Freedom Employee's employment has been terminated by the Acquirer; provided, however, this Paragraph II.A.9.d shall not prohibit Otto Bock from: (i) advertising for employees in newspapers, trade publications, or other media not targeted specifically at the Freedom Employees, (ii) hiring employees who apply for employment with Otto Bock, as long as such employees were not solicited by Otto Bock in violation of this Paragraph II.A.9.d, or (iii) offering employment to a Freedom Employee who is employed by the Acquirer in only a part-time capacity, if the employment offered by Otto Bock would not, in any way, interfere with that employee's ability to fulfill his or her employment responsibilities to the Acquirer.[89]

10. Otto Bock shall submit to the Acquirer, at Otto Bock's expense, all Confidential Business Information, and:[90]

a. Deliver such Confidential Business information as follows: (i) in good faith; (ii) as soon as practicable, avoiding any delays in transmission of the respective information; and (iii) in a manner that ensures its completeness and accuracy and that fully preserves its usefulness;

b. Pending complete delivery of all such Confidential Business Information to the Acquirer, provide the Acquirer and Monitor with access to all such Confidential Business Information and employees who possess or are able to locate such information for the purposes of identifying the books, records, and files that contain such Confidential Business Information and facilitating the delivery in a manner consistent with this Order.

11. Except in the course of performing its obligations under this Order, Otto Bock shall:[91]

a. Not provide, disclose, or otherwise make available any Confidential Business Information, including trade secrets or any sensitive or proprietary commercial or financial information relating to the Acquirer or the Freedom Business to any Person other than the Acquirer, and shall not share such information for any reason or purpose;[92]

b. Disclose any Confidential Business Information trade secrets or any sensitive or proprietary commercial or financial information related to the Acquirer or the Freedom Business to any Person other than the Acquirer (i) only in the manner and to the extent necessary to satisfy Otto Bock's obligations under this Order and (ii) only to Persons who agree in writing to maintain the confidentiality of such information;[93] and

c. Enforce the terms of this Paragraph II.A.11 as to any Person and take such

action as is necessary, including training, to cause each such Person to comply with the terms of this Paragraph II.A.11, including any actions Otto Bock would take to protect its own trade secrets or sensitive or propriety commercial or financial information.[94]

Provided, however, that Otto Bock may provide, disclose, use, or otherwise make available any Confidential Business Information relating to any of the Divestiture Products Group A or Divestiture Products Group B retained under Paragraph II.A.1 of this Order to the extent that such Confidential Business Information is solely under the use or control of Otto Bock.[95]

12. Otto Bock shall, no later than five (5) days after the date this Order becomes final and effective:

a. Require that each employee of Otto Bock, including the Hold-Separate Manager and the Hold-Separate Monitor, who has, had, or may have had access to Confidential Business Information relating to the Freedom Assets and Business, and the direct supervisor(s) of any such employee, sign a confidentiality agreement pursuant to which that employee shall be required to maintain all Confidential Business Information related to the Freedom Assets and Business as strictly confidential, including the nondisclosure of that information to all other employees, executives, or other personnel of Otto Bock (other than as necessary to comply with the requirements of this Order), or the use of such Confidential Business Information in any way.[96]

b. Cause all Persons under Otto Bock's control, including all Otto Bock employees, the Hold-Separate Manager, and the Hold-Separate Monitor, having access to Confidential Business Information of or pertaining to the Freedom Assets and Business to submit a signed statement to the Commission's staff that the individual will maintain the confidentiality required by this Order.[97]

c. Provide written notification of the restrictions on the use and disclosure of the Confidential Business Information related to the Freedom Assets and Business by Otto Bock's personnel to all of its employees who (i) may be in possession of such Confidential Business Information or (ii) may have access to such Confidential Business Information. Otto Bock shall give the above-described notification by e-mail with return receipt requested or similar transmission, and keep a file of those receipts for two (2) years after the date this Order becomes final and effective. Otto Bock shall maintain complete records of all such notifications at Otto Bock's registered office within the United States and shall provide an officer's certification to the Commission affirming the implementation of, and compliance with, the acknowledgement program.[98]

B. The purpose of the divestiture of the Freedom Assets and Business is to ensure the continued operation of the Freedom Business by the Acquirer, independent of Otto Bock, and to remedy the lessening of competition resulting from the Acquisition.[99]

III.

IT IS FURTHER ORDERED[100] that from the date this Order becomes final and effective (without regard to the finality of the divestiture requirements herein) until the Effective Date of Divestiture, Otto Bock shall abide by the Hold-Separate Agreements and shall not:[101]

A. Sell or transfer any Freedom Assets;[102]

B. Eliminate, transfer, or consolidate any service offered in connection with the Freedom Business;[103]

C. Fail to maintain the employment of all Freedom Employees[104] or otherwise fail to keep the Freedom Business staffed with sufficient employees; provided, however, that Freedom Employees may be terminated for cause as provided by the Hold-Separate Agreements (in which even Otto Bock shall replace such employees).[105]

IV.

IT IS FURTHER ORDERED that:[106]

A. From the date this Order becomes final and effective (without regard to the finality of the divestiture requirements herein) until the Effective Date of Divestiture, Otto Bock shall take such actions as are necessary to maintain the viability, marketability, and competitiveness of the Freedom Assets and Business,[107] as provided in the Hold-Separate Agreements. Among other things that may be necessary, as provided for in the Hold-Separate Agreements, Otto Bock shall:[108]

1. Maintain the operations of the Freedom Business relating to the Freedom Assets in the Ordinary Course of Business and in accordance with the Hold-Separate Agreements;[109]

2. Use best efforts to maintain and increase revenues of the Freedom Business, and to maintain at budgeted levels for the year 2018 or the current year, whichever are higher, all administrative, technical, and marketing support for the Freedom Business and in accordance with the Hold-Separate Agreements;[110]

3. Use best efforts to maintain the current workforce and to retain the services of employees and agents in connection with the Freedom Business, including payments of bonuses as necessary, and maintain the relations and goodwill with customers.[111]

B. No later than thirty (30) days from the date this Order becomes final and effective (without regard to the finality of the divestiture requirements herein), Otto Bock shall file

a verified written report to the Commission that identifies (i) all assets included in the Freedom Assets, (ii) all assets originally acquired or that replace assets originally acquired as a result of the Acquisition, and (iii) all services, functions, and agreements that Otto Bock discontinued after the Acquisition.[112]

V.

IT IS FURTHER ORDERED[113] that no later than five (5) days from the date this Order becomes final and effective (without regard to the finality of the divestiture requirements herein), Otto Bock shall provide a copy of this Order to each of Otto Bock's officers, employees, or agents having managerial responsibility for any of Otto Bock's obligations under Paragraphs II, III, and IV of this Order.[114]

VI.

IT IS FURTHER ORDERED that:[115]

A. At any time after this Order becomes final and effective (without regard to the finality of the divestiture requirements herein), the Commission may appoint a Person ("Monitor") to monitor Otto Bock's compliance with its obligations under this Order, consult with Commission staff, and report to the Commission regarding Otto Bock's compliance with its obligations under this Order.[116]

B. If a Monitor is appointed pursuant to Paragraph VI.A of this Order, Otto Bock shall consent to the following terms and conditions regarding the powers, duties, authorities, and responsibilities of the Monitor:[117]

1. The Monitor shall have the power and authority to monitor Otto Bock's compliance with the terms of this Order, and shall exercise such power and authority and carry out the duties and responsibilities of the Monitor pursuant to the terms of this Order and in a manner consistent with the purposes of this Order and in consultation with the Commission or its staff.[118]

2. Within ten (10) days after appointment of the Monitor, Otto Bock shall execute an agreement that, subject to the approval of the Commission, confers on the Monitor all the rights and powers necessary to permit the Monitor to monitor Otto Bock's compliance with the terms of this Order in a manner consistent with the purposes of this Order. If requested by Otto Bock, the Monitor shall sign a confidentiality agreement prohibiting the use or disclosure to anyone other than the Commission (or any Person retained by the Monitor pursuant to Paragraph VI.B.5 of this Order), of any competitively-sensitive or proprietary information gained as a result of his or her role as Monitor, for any purpose other than performance of the Monitor's duties under this Order.[119]

3. The Monitor's power and duties under this Paragraph VI shall terminate three (3) business days after the Monitor has completed his or her final report pursuant to Paragraph VI.B.8 of this Order or at such other time as directed by the Commission.[120]

4. Otto Bock shall cooperate with any Monitor appointed by the Commission in the performance of his or her duties, and shall provide the Monitor with full and complete access to Otto Bock's books, records, documents, personnel, facilities, and technical information relating to compliance with this Order, or to any other relevant information, as the Monitor may reasonably request. Otto Bock shall cooperate with any reasonable request of the Monitor. Otto Bock shall take no action to interfere with or impede the Monitor's ability to monitor Otto Bock's compliance with this Order.[121]

5. The Monitor shall serve, without bond or other security, at the expense of Otto Bock, on such reasonable and customary terms and conditions as the Commission may set. The Monitor shall have the authority to employ, at the expense of Otto Bock, such consultants, accountants, attorneys, and other representatives and assistants as are reasonably necessary to carry out the Monitor's duties and responsibilities. The Monitor shall account for all expenses incurred, including fees for his or her services, subject to the approval of the Commission.[122]

6. Otto Bock shall indemnify the Monitor and hold the Monitor harmless against any losses, claims, damages, liabilities, or expenses arising out of, or in connection with, the performance of the Monitor's duties, including all reasonable fees of counsel and other expenses incurred in connection with the preparation for, or defense of, any claim, whether or not resulting in any liability, except to the extent that such losses, claims, damages, liabilities, or expenses result from the Monitor's gross negligence or willful misconduct. For purposes of this Paragraph VI.B.6, the term "Monitor" shall include all Persons retained by the Monitor pursuant to Paragraph VI.B.5 of this Order.[123]

7. If at any time the Commission determines that the Monitor has ceased to act or failed to act diligently, or is unwilling or unable to continue to serve, the Commission may appoint a substitute to serve as Monitor in the same manner as provided by this Order.[124]

8. The Monitor shall report in writing to the Commission (i) every sixty (60) days from the date this Order becomes final and effective (without regard to the finality of the divestiture requirements herein), (ii) no later than thirty (30) days from the date Otto Bock completes its obligations under this Order, and (iii) at any other time as requested by the staff of the Commission, concerning Otto Bock's compliance with this Order.[125]

C. Otto Bock shall submit the following reports to the Monitor: (i) no later than twenty (20) days after the date the Monitor is appointed by the Commission pursuant to Paragraph VI.A of this Order, a copy of the Accounting required by Paragraph IV.B of this Order; and (ii) copies of all compliance reports filed with the Commission.[126]

D. Otto Bock shall provide the Monitor with: (i) prompt notification of significant meetings, including date, time and venue, scheduled after the execution of the Monitor Agreement, relating to the regulatory approvals, marketing, sale and divestiture of the Freedom Assets and Business, and such meetings may be attended by the Monitor or his representative, at the Monitor's option or at the request of the Commission or staff of the Commission; and (ii) the minutes, if any, of the above-referenced meetings as soon as practicable and, in any event, not later than those minutes are available to any employee of Otto Bock.[127]

E. The Commission may, on its own initiative or at the request of the Monitor, issue such additional orders or directions as may be necessary or appropriate to assure compliance with the requirements of this Order.[128]

F. The Monitor appointed pursuant to this Order may be the same Person appointed as Divestiture Trustee pursuant to Paragraph VII of this Order.[129]

VII.

IT IS FURTHER ORDERED that:[130]

A. If Otto Bock has not divested, absolutely and in good faith, the Freedom Assets and Business pursuant to the requirements of Paragraph II of this Order, within the time and manner required by Paragraph II of this Order, the Commission may at any time appoint one or more Persons as Divestiture Trustee to divest the Freedom Assets and Business, at no minimum price, and pursuant to the requirements of Paragraph II of this Order, in a manner that satisfies the requirements of this Order.[131]

B. In the event that the Commission or the Attorney General of the United States brings an action pursuant to § 5(l) of the Federal Trade Commission Act, 15 U.S.C. § 45(l), or any other statute enforced by the Commission, Otto Bock shall consent to the appointment of a Divestiture Trustee in such action. Neither the appointment of a Divestiture Trustee nor a decision not to appoint a Divestiture Trustee under this Paragraph VII shall preclude the Commission or the Attorney General from seeking civil penalties or any other relief available to it, including appointment of a court-appointed Divestiture Trustee, pursuant to § 5(l) of the Federal Trade Commission Act, or any other statute enforced by the Commission, for any failure by Otto Bock to comply with this Order.[132]

C. If a Divestiture Trustee is appointed by the Commission or a court pursuant to this Paragraph VII, Otto Bock shall consent to the following terms and conditions regarding the Divestiture Trustee's powers, duties, authority, and responsibilities:[133]

1. Subject to the prior approval of the Commission, the Divestiture Trustee shall have the exclusive power and authority to effect the divestiture pursuant to the requirements of Paragraph II of this Order and in a manner consistent with the purposes of this Order.[134]

2. Within ten (10) days after appointment of the Divestiture Trustee, Otto Bock shall execute an agreement that, subject to the prior approval of the Commission and, in the case of a court-appointed Divestiture Trustee, of the court, transfers to the Divestiture Trustee all rights and powers necessary to permit the Divestiture Trustee to effect the divestiture and perform the requirements of Paragraph II of this Order for which he or she has been appointed.[135]

3. The Divestiture Trustee shall have twelve (12) months from the date the Commission approves the agreement described in Paragraph VII.C.2 of this Order to accomplish the divestiture, which shall be subject to the prior approval of the Commission. If, however, at the end of the twelve-month period the Divestiture Trustee has submitted a plan of divestiture or believes that divestiture can be achieved within a reasonable time, the divestiture period may be extended by the Commission, or, in the case of a court appointed Divestiture Trustee, by the court.[136]

4. Otto Bock shall provide the Divestiture Trustee with full and complete access to the personnel, books, records, and facilities related to the assets to be divested, or to any other relevant information, as the Divestiture Trustee may request. Otto Bock shall develop such financial or other information as the Divestiture Trustee may reasonably request and shall cooperate with the Divestiture Trustee. Otto Bock shall take no action to interfere with or impede the Divestiture Trustee's accomplishment of the divestiture. Any delays in divestiture caused by Otto Bock shall extend the time for divestiture under this Paragraph in an amount equal to the delay, as determined by the Commission or, for a court-appointed Divestiture Trustee, by the court.[137]

5. The Divestiture Trustee shall use his or her best efforts to negotiate the most favorable price and terms available in each contract that is submitted to the Commission, but shall divest expeditiously at no minimum price. The divestiture shall be made only to an Acquirer that receives the prior approval of the Commission, and the divestiture shall be accomplished only in a manner that receives the prior approval of the Commission; provided, however, if the Divestiture Trustee receives bona fide offers from more than one acquiring entity, and if the Commission determines to approve more than one such acquiring entity, the Divestiture Trustee shall divest to the acquiring entity or entities selected by Otto Bock from among those approved by the Commission; provided, further, that Otto Bock shall select such entity within ten (10) business days of receiving written notification of the Commission's approval.[138]

6. The Divestiture Trustee shall serve, without bond or other security, at the cost and expense of Otto Bock, on such reasonable and customary terms and conditions as the Commission or a court may set. The Divestiture Trustee shall have the authority to employ, at the cost and expense of Otto Bock, such consultants, accountants, attorneys, investment bankers, business brokers, appraisers, and other representatives and assistants as are necessary to carry out the Divestiture Trustee's duties and responsibilities. The Divestiture Trustee shall account for all

monies derived from the divestiture and all expenses incurred. After approval by the Commission of the account of the Divestiture Trustee, including fees for his or her services, all remaining monies shall be paid at the direction of Otto Bock, and the Divestiture Trustee's power shall be terminated. The Divestiture Trustee's compensation may be based in part on a commission arrangement contingent on the Divestiture Trustee's divesting the assets.[139]

7. Otto Bock shall indemnify the Divestiture Trustee and hold the Divestiture Trustee harmless against any losses, claims, damages, liabilities, or expenses arising out of, or in connection with, the performance of the Divestiture Trustee's duties, including all reasonable fees of counsel and other expenses incurred in connection with the preparation for, or defense of any claim, whether or not resulting in any liability, except to the extent that such liabilities, losses, damages, claims, or expenses result from gross negligence or willful misconduct by the Divestiture Trustee. For purposes of this Paragraph VII.C.7, the term "Divestiture Trustee" shall include all Persons retained by the Divestiture Trustee pursuant to Paragraph VII.C.6 of this Order.[140]

8. If the Divestiture Trustee ceases to act or fails to act diligently, the Commission may appoint a substitute Divestiture Trustee in the same manner as provided in this Paragraph VII for appointment of the initial Divestiture Trustee.[141]

9. The Divestiture Trustee shall have no obligation or authority to operate or maintain the assets to be divested.[142]

10. The Divestiture Trustee shall report in writing to the Commission every sixty (60) days concerning the Divestiture Trustee's efforts to accomplish the divestiture.[143]

D. The Commission or, in the case of a court-appointed Divestiture Trustee, the court, may on its own initiative or at the request of the Divestiture Trustee issue such additional orders or directions as may be necessary or appropriate to accomplish the divestiture required by this Order.[144]

E. The Divestiture Trustee appointed pursuant to this Paragraph may be the same Person appointed as the Monitor pursuant to Paragraph VI of this Order.[145]

VIII.

IT IS FURTHER ORDERED that:[146]

A. Otto Bock shall[147]

1. Submit the complete Divestiture Agreement to the Commission at ElectronicFilings@ftc.gov and bccompliance@ftc.gov no later than 30 days after the Divestiture Date.

B. Otto Bock shall submit verified written reports ("compliance reports") in accordance with the following:[148]

1. Otto Bock shall submit:

a. Interim compliance reports (i) no later than thirty (30) days after the Order becomes final and effective (without regard to the finality of the divestiture requirements herein), and every thirty (30) days thereafter until the divestiture of the Freedom Assets and Business is accomplished, and (ii) thereafter, every sixty (60) days (measured from the Effective Date of Divestiture) until the date Otto Bock completes its obligations under this Order; and

b. Additional compliance reports as the Commission or its staff may request.[149]

2. Otto Bock shall include in its compliance reports, among other things required by the Commission, a full description of the efforts being made to comply with the relevant Paragraphs of this Order, the identity of all parties contacted, copies of all written communications to and from such parties, internal documents and communications, and all reports and recommendations concerning the divestiture, the date of divestiture, and a statement that the divestiture has been accomplished in the manner approved by the Commission.[150] Each compliance report shall contain sufficient information and documentation to enable the Commission to determine independently whether Otto Bock is in compliance with each Paragraph of the Order. Conclusory statements that Otto Bock has complied with its obligations under the Order are insufficient.

C. Each compliance report shall be verified in the manner set forth in 28 U.S.C. § 1746 by the Chief Executive Officer or another officer or employee specifically authorized to perform this function. Otto Bock shall submit an original and 2 copies of each compliance report as required by Commission Rule 2.41(a), 16 C.F.R. § 2.41(a), including a paper original submitted to the Secretary of the Commission and electronic copies to the Secretary at ElectronicFilings@ftc.gov and to the Compliance Division at bccompliance@ftc.gov. In addition, Otto Bock shall provide a copy of each compliance report to the Monitor.[151]

IX.

IT IS FURTHER ORDERED[152] that Otto Bock shall notify the Commission at least 30 days prior to:[153]

A. Any proposed dissolution of Otto Bock;[154]

B. Any proposed acquisition of, or merger or consolidation involving Otto Bock, or[155]

C. Any other change in Otto Bock including assignment and the creation, sale, or dissolution of subsidiaries, if such change may affect compliance obligations arising out of this Order.[156]

X.

IT IS FURTHER ORDERED[157] that, for purposes of determining or securing compliance with this Order, and subject to any legally recognized privilege, upon written request and 5 days' notice to Otto Bock, made to its principal place of business as identified in this Order, registered office of its United States subsidiary, or its headquarters office, Otto Bock shall, without restraint or interference, permit any duly authorized representative of the Commission:[158]

A. Access, during business office hours of Otto Bock and in the presence of counsel, to all facilities and access to inspect and copy all business and other records and all documentary material and electronically stored information as defined in Commission Rules 2.7(a)(1) and (2), 16 C.F.R. § 2.7(a)(1) and (2), in the possession or under the control of Otto Bock related to compliance with this Order, which copying services shall be provided by Otto Bock at the request of the authorized representative of the Commission and at the expense of Otto Bock; and[159]

B. To interview officers, directors, or employees of Otto Bock, who may have counsel present, regarding such matters.[160]

XI.

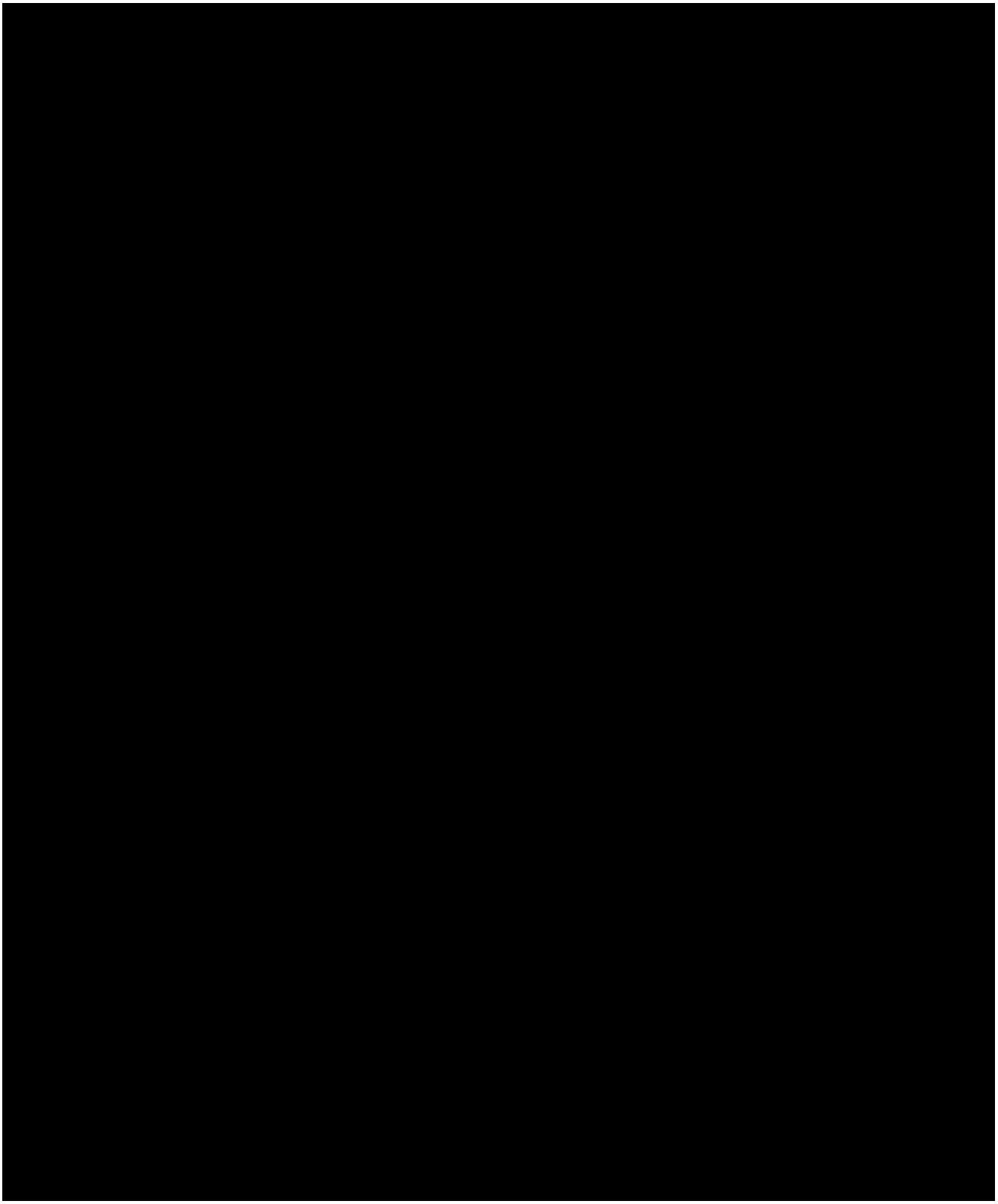
IT IS FURTHER ORDERED[161] that this Order shall terminate 10 years from the date it is issued.[162]

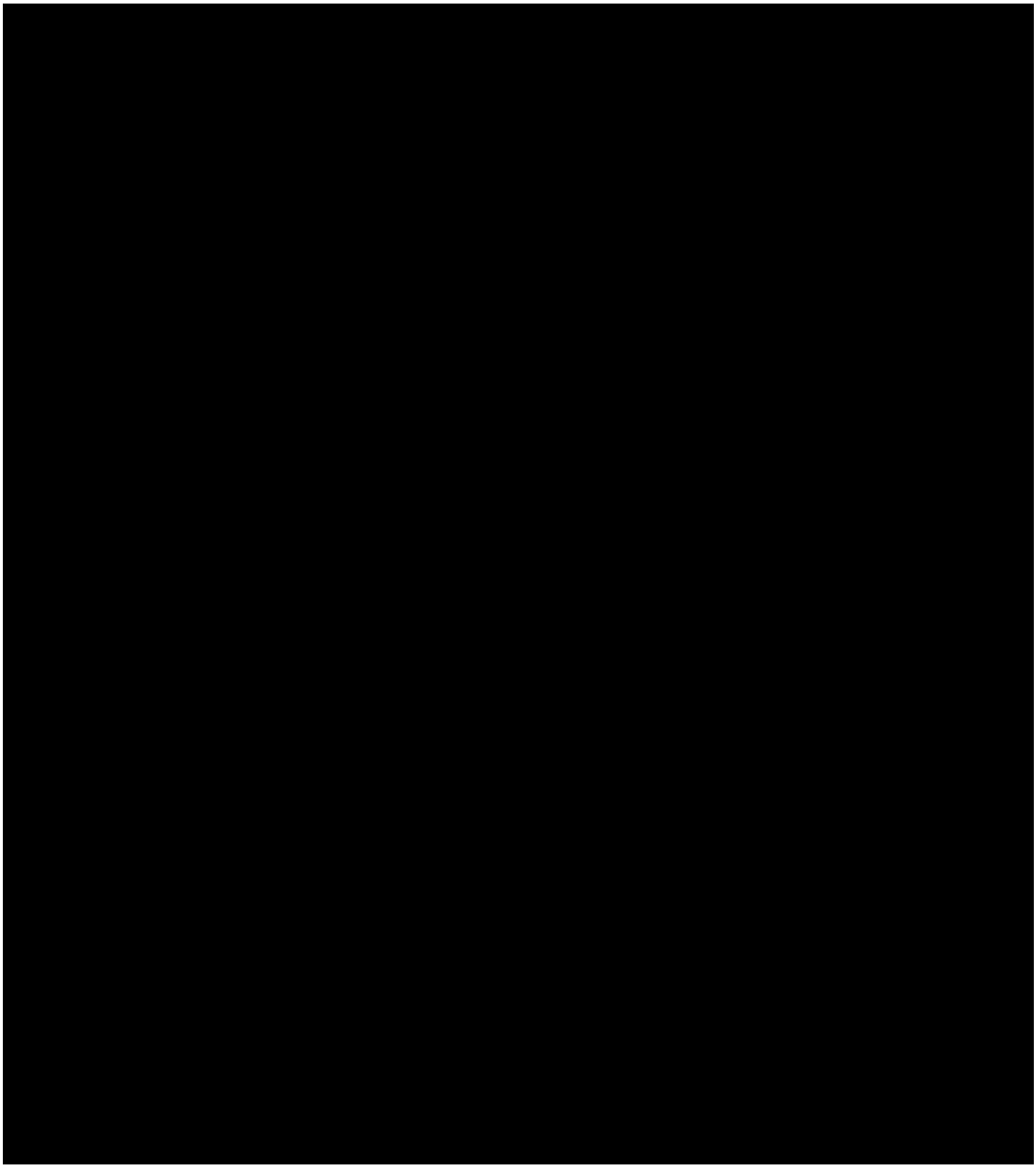
By the Commission.

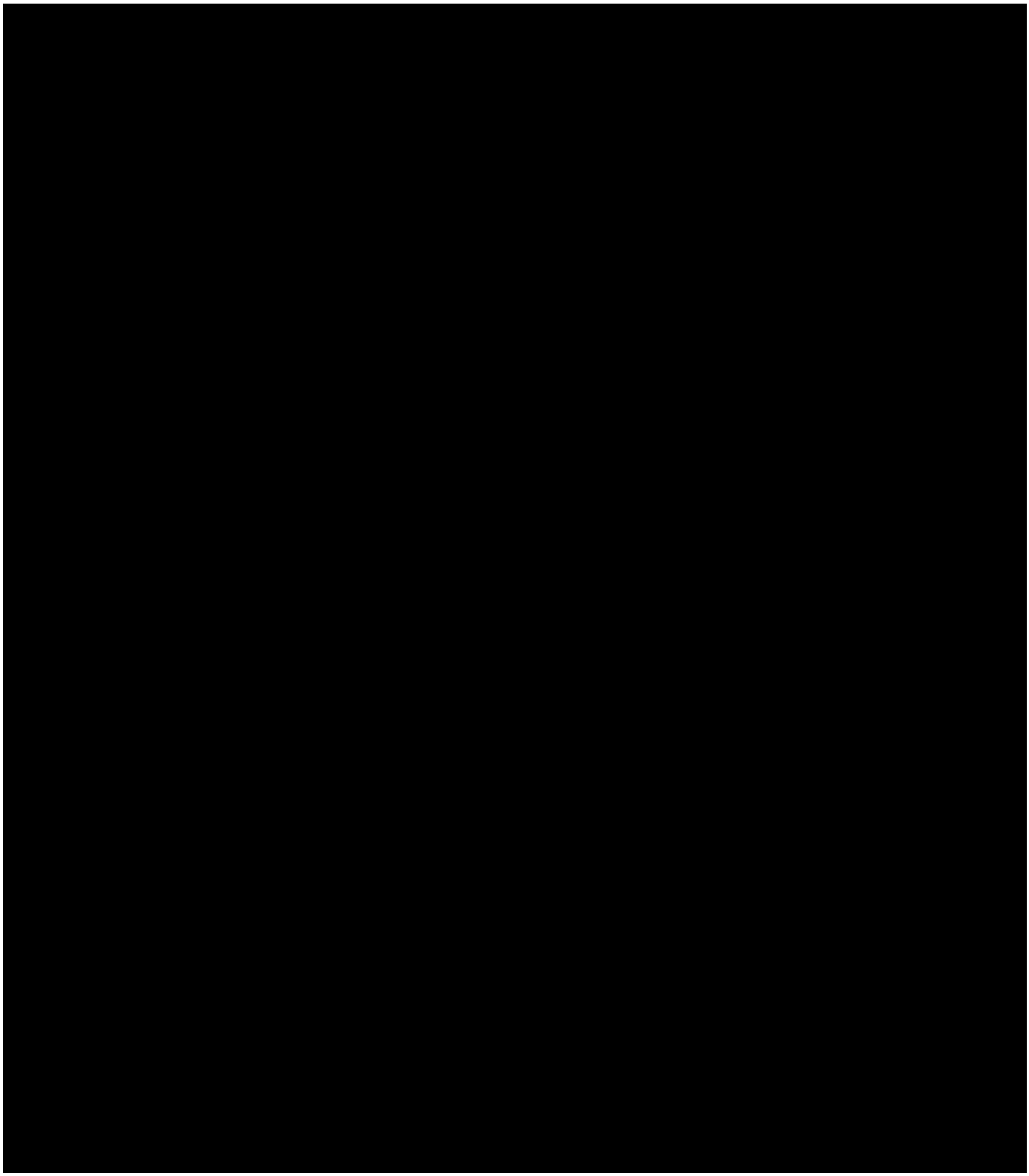
Donald S. Clark
Secretary

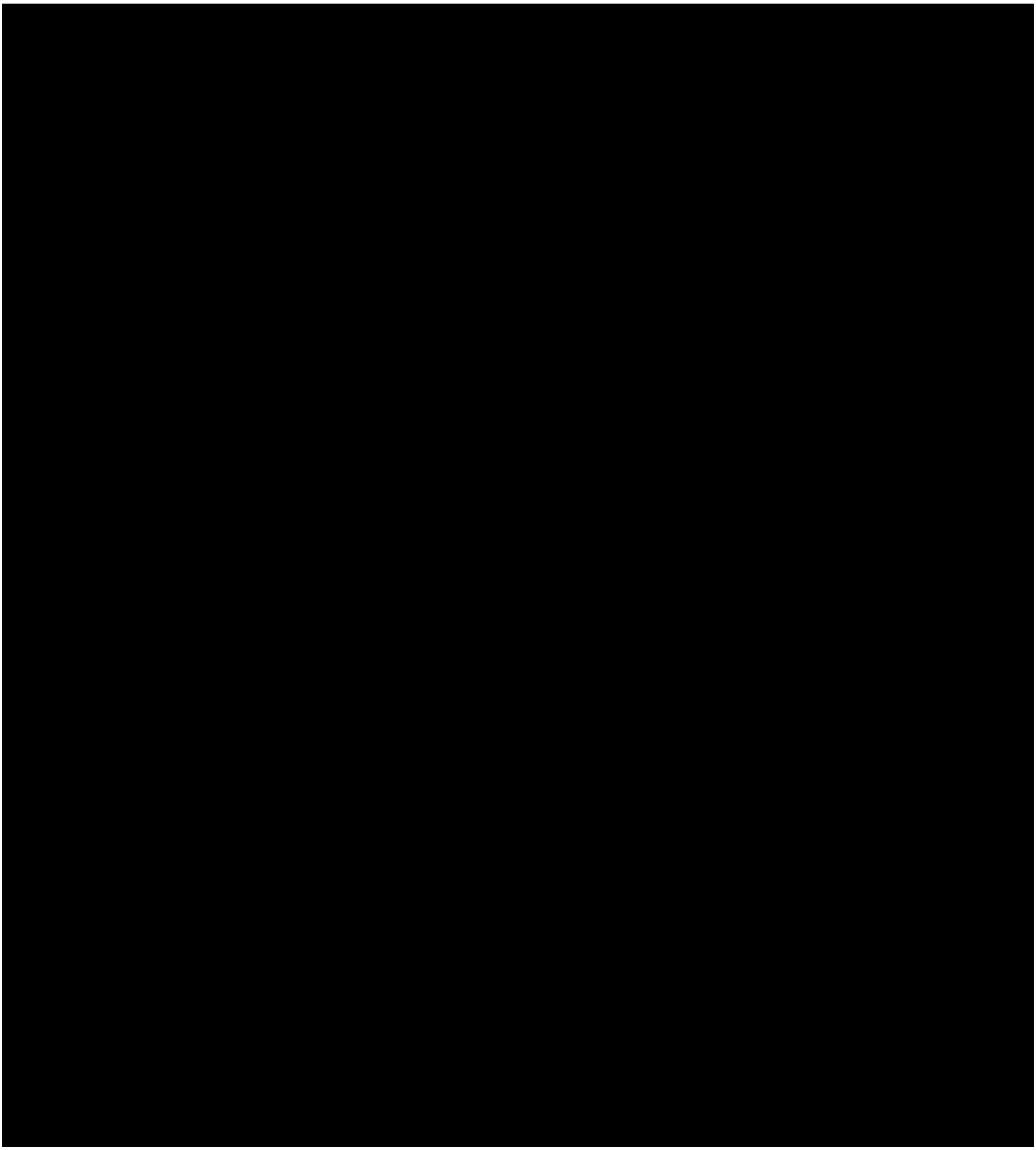
SEAL

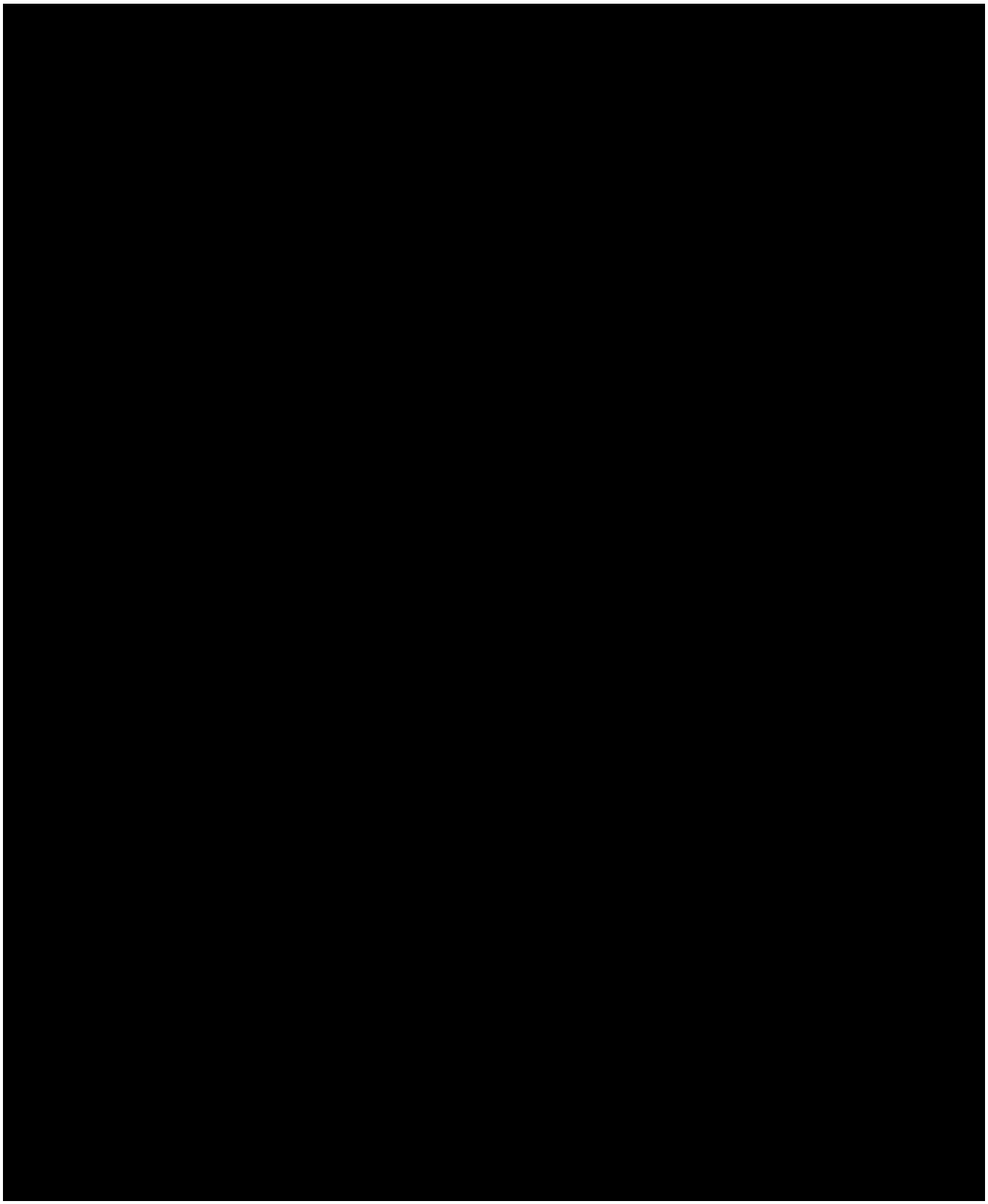
ISSUED:

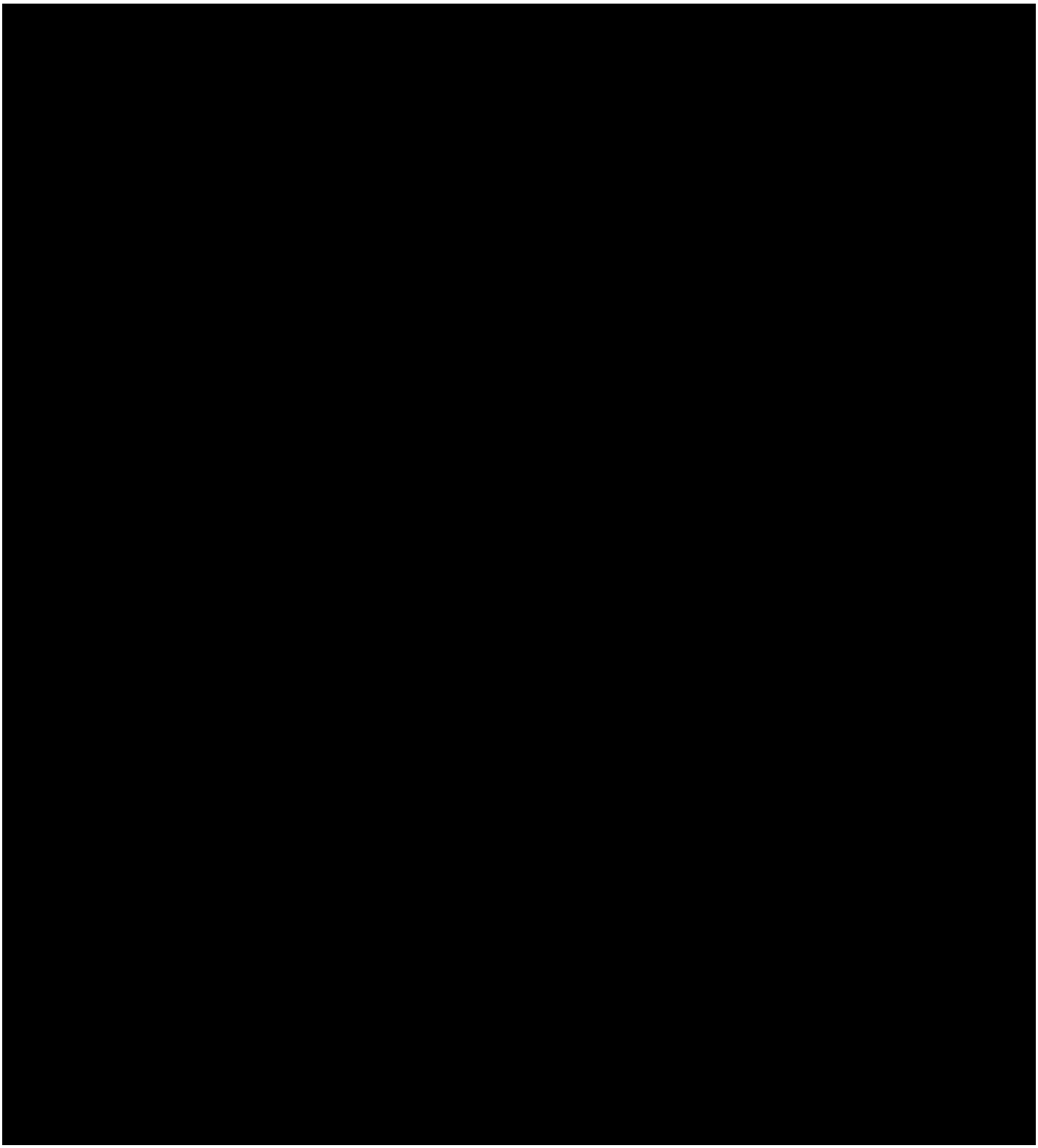


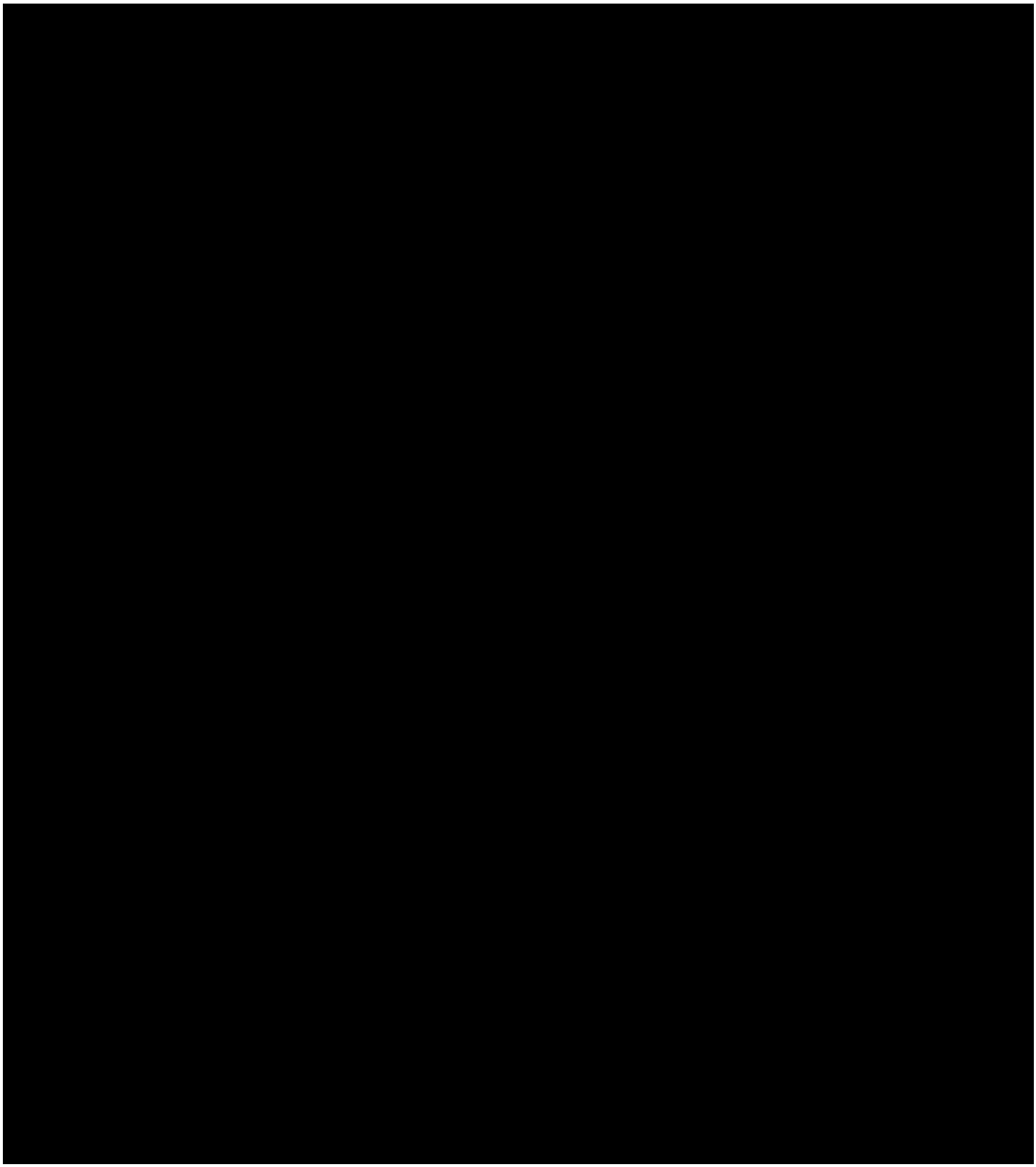


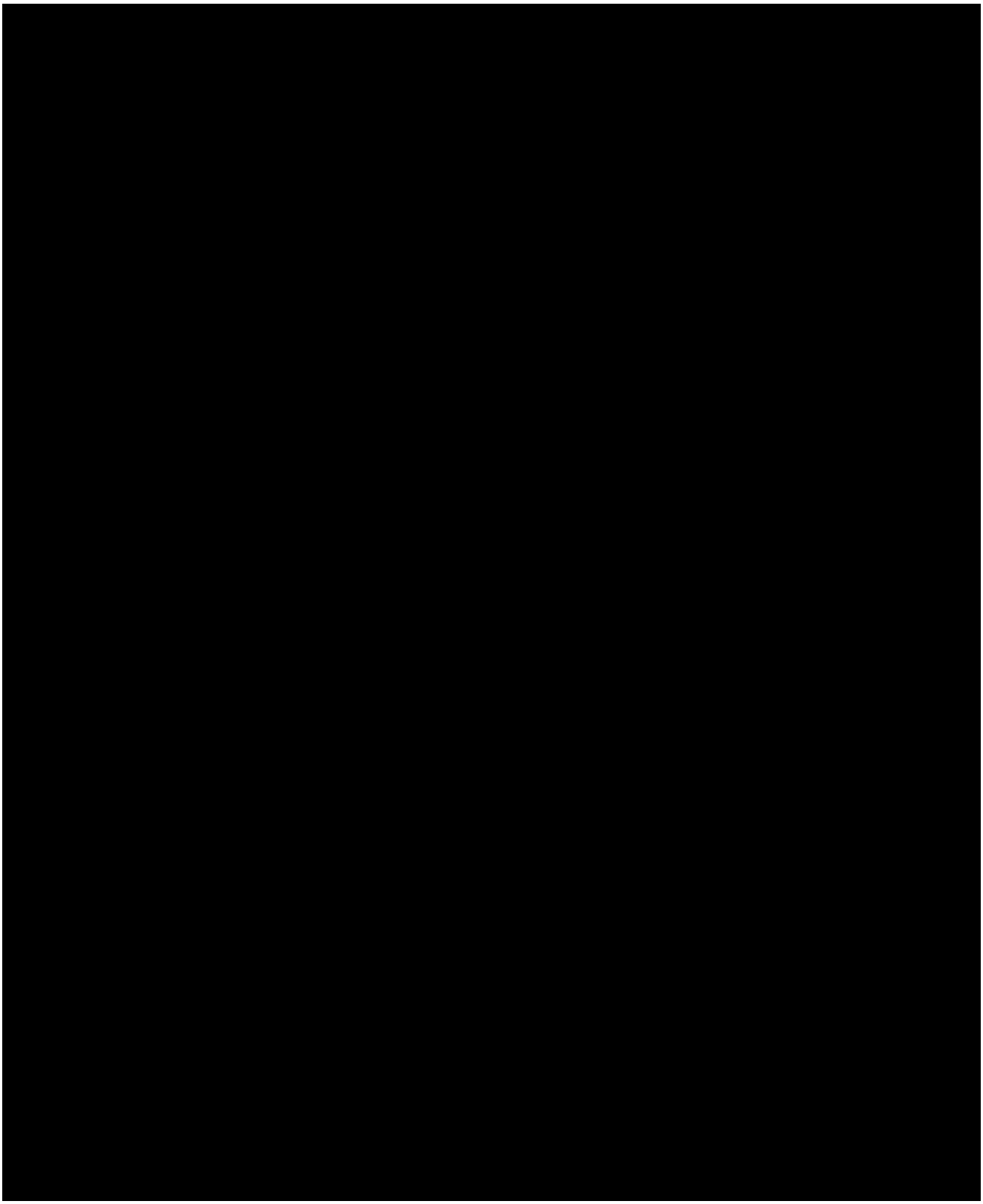


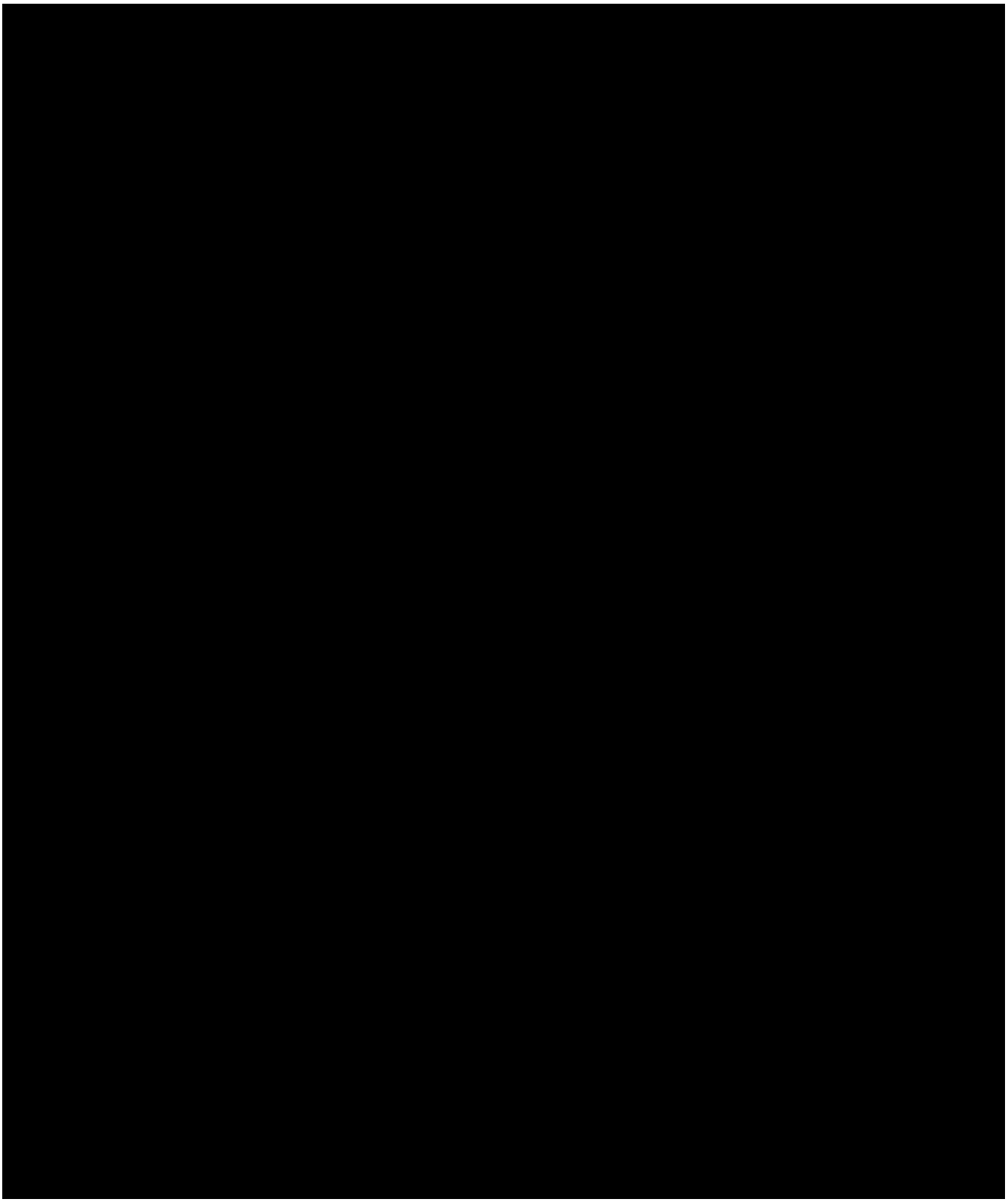


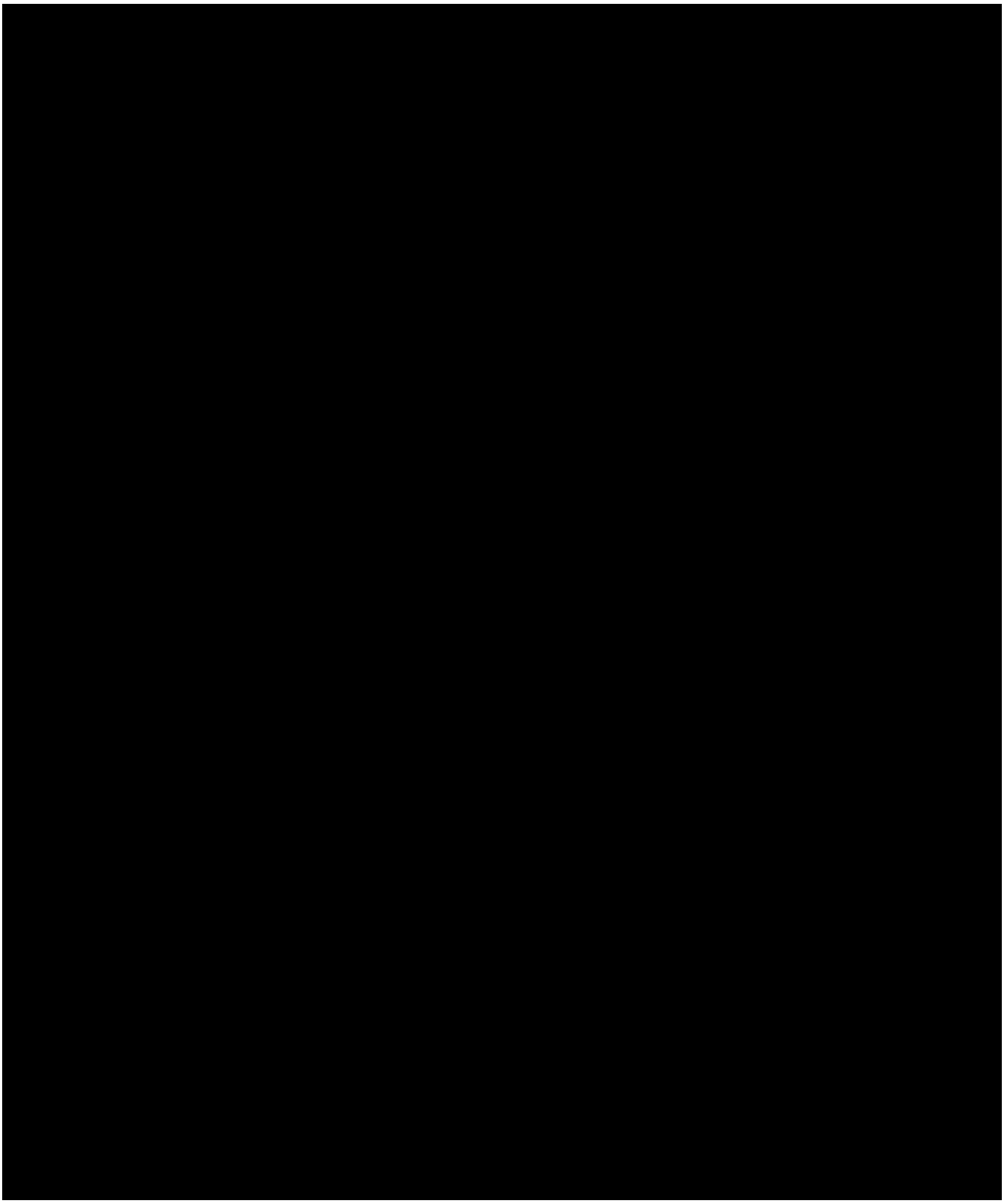


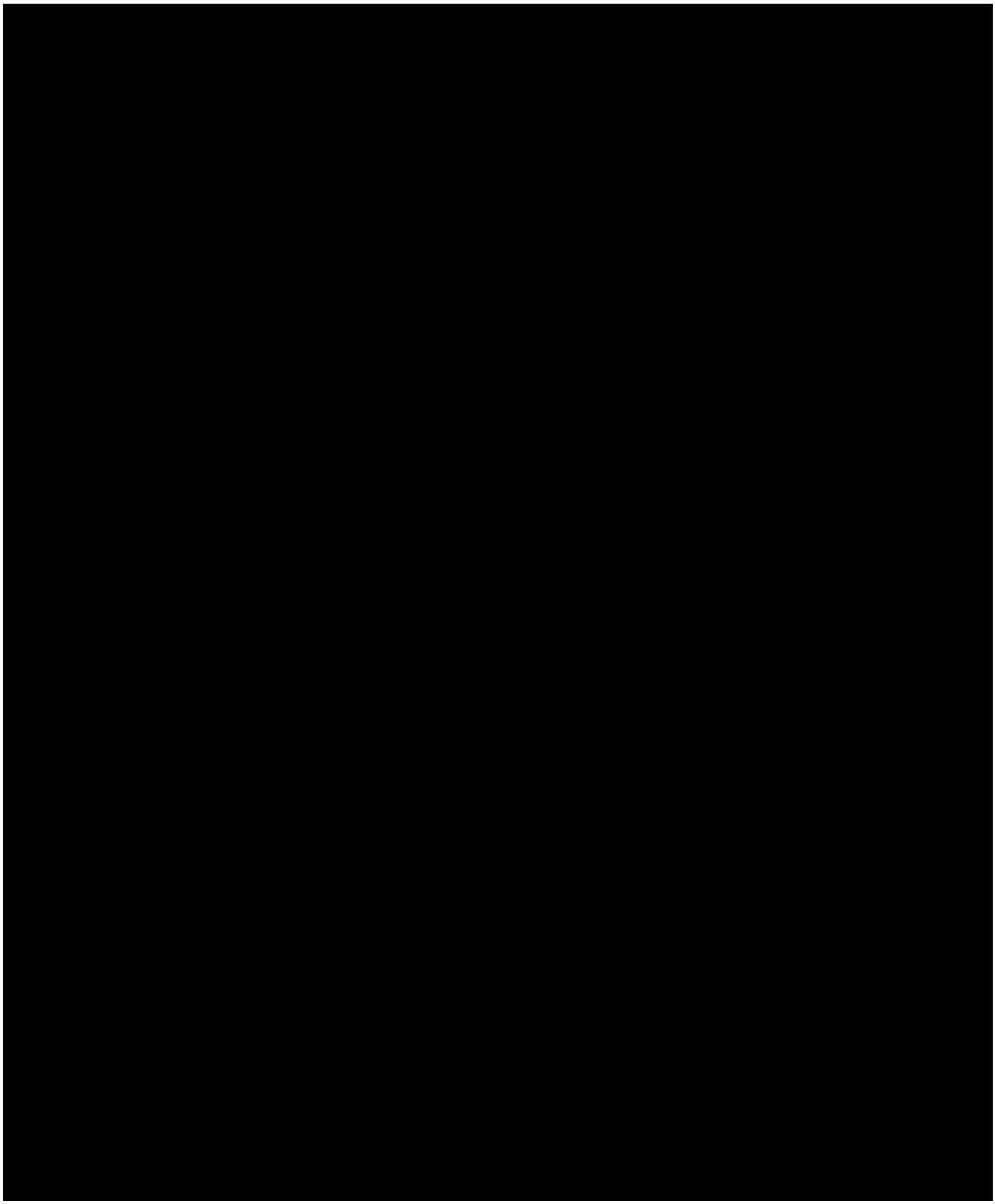


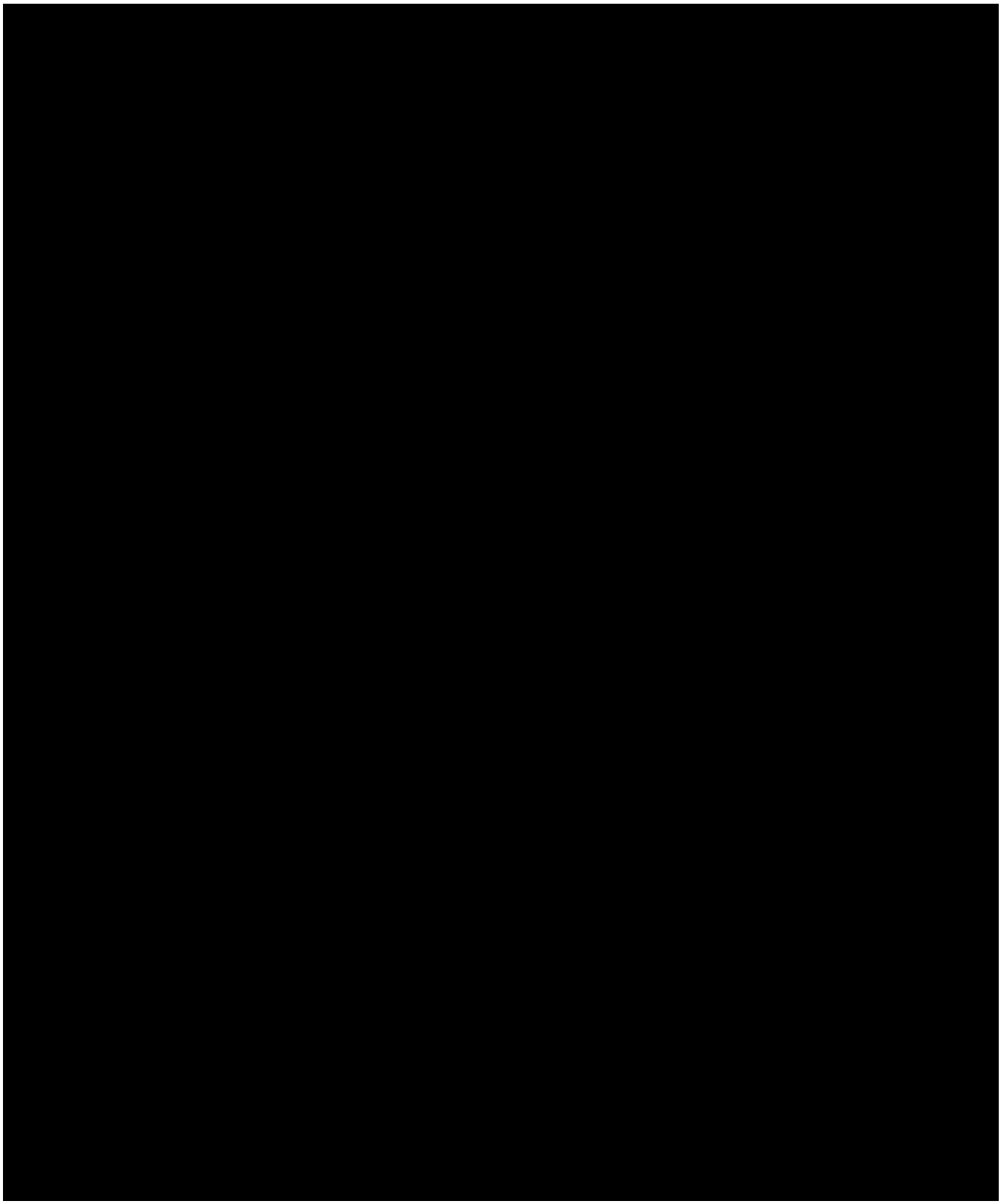


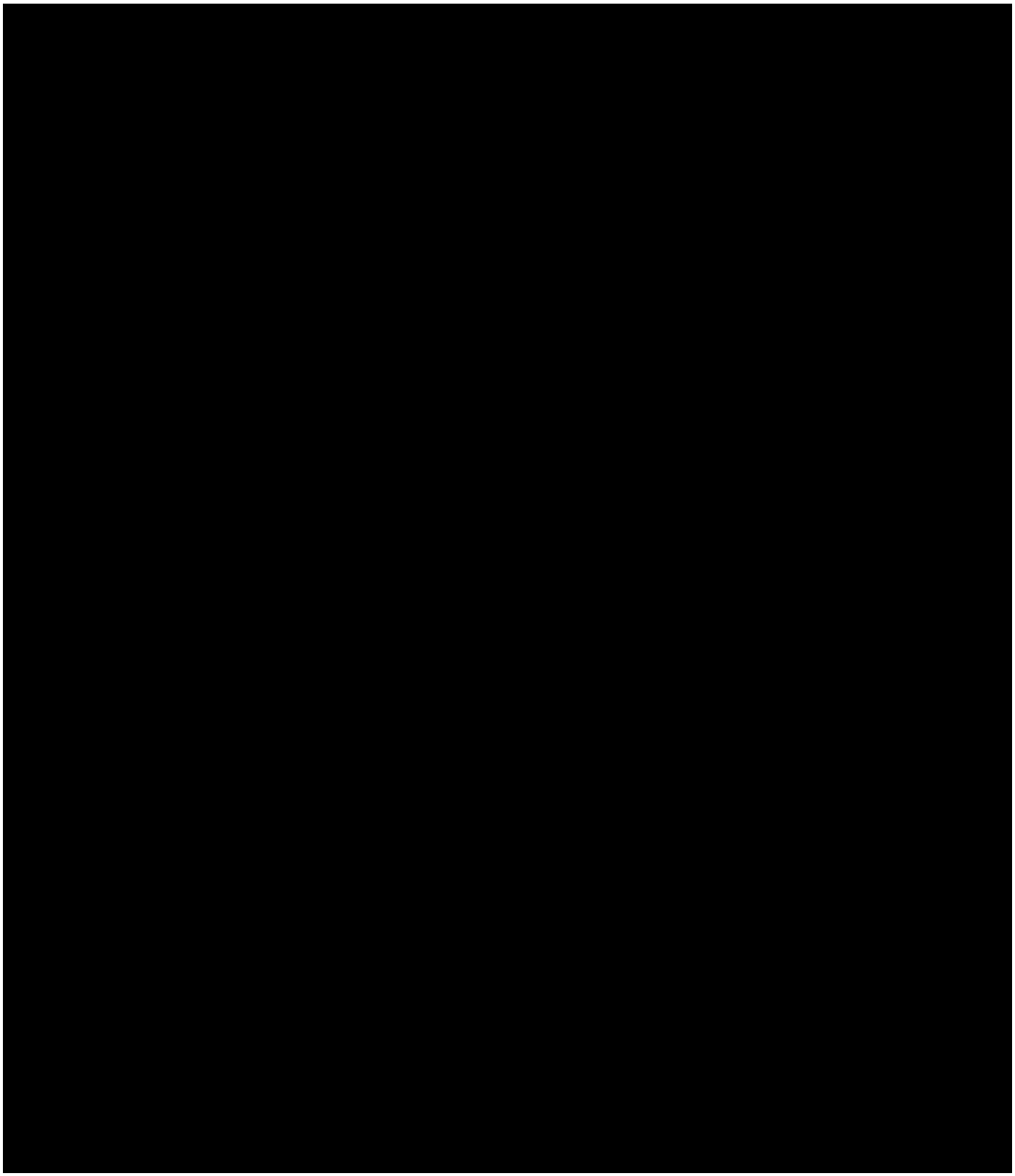












Attachment B

UNITED STATES OF AMERICA
BEFORE THE FEDERAL TRADE COMMISSION
OFFICE OF ADMINISTRATIVE LAW JUDGES

In the Matter of **Otto Bock HealthCare North America, Inc.,** **a corporation**. **Respondent**	**DOCKET NO. 9378**

ORDER

I.

IT IS ORDERED that, as used in the Order, the following definitions apply:

A. "Otto Bock" or "Respondent" means Otto Bock Healthcare North America, Inc., its directors, officers, employees, agents, representatives, successors, and assigns; and its joint ventures, subsidiaries, divisions, groups, and affiliates controlled by Otto Bock Healthcare North America, Inc., and the respective directors, officers, employees, agents, representatives, successors, and assigns of each.

B. "Commission" means the Federal Trade Commission.

C. "Acquirer" means the Person that acquires, with the prior approval of the Commission, the Freedom Assets and Business from Otto Bock pursuant to Paragraph II, or from the Divestiture Trustee pursuant to Paragraph VII of this Order.

D. "Acquisition" means the acquisition of the Freedom Assets and Business by Respondent Otto Bock pursuant to the Agreement and Plan of Merger dated September 22, 2017 and subsequent amendments and schedules.

E. "Acquisition Date" means September 22, 2017, the date on which Otto Bock acquired the Freedom Assets and Business.

F. "Confidential Business Information" means any non-public information relating to the Freedom Assets and Business either prior to or after the Effective Date of Divestiture, including, but not limited to, all customer lists, price lists, distribution or marketing methods, or Intellectual Property relating to Freedom Assets and Business and:

1. Obtained by Otto Bock prior to the Effective Date of Divestiture; or,

2. Obtained by Otto Bock after the Effective Date of Divestiture, in the course of performing Otto Bock's obligations under any Divestiture Agreement.

Provided, however, that Confidential Business Information shall not include:

1. Information that Otto Bock can demonstrate it obtained prior to the Acquisition Date, other than information it obtained during due diligence pursuant to any confidentiality or non-disclosure agreement;
2. Information that is in the public domain when received by Otto Bock;
3. Information that is not in the public domain when received by Otto Bock and thereafter becomes public through no act or failure to act by Otto Bock;
4. Information that Otto Bock develops or obtains independently, without violating any applicable law or this Order; and
5. Information that becomes known to Otto Bock from a third party not in breach of applicable law or a confidentiality obligation with respect to the information.

G. "Direct Cost" means the cost of direct material and direct labor used to provide the relevant assistance or service.

H. "Divestiture Agreement" means any agreement, including all exhibits, attachments, agreements, schedules and amendments thereto, that has been approved by the Commission pursuant to which the Freedom Assets and Business are divested by Otto Bock pursuant to Paragraph II, or by the Divestiture Trustee pursuant to Paragraph VII in this Order.

I. "Divestiture Products Group A" means all Freedom Assets and Business related to the products listed in Appendix A of this Order.

J. "Divestiture Products Group B" means all Freedom Assets and Business related to the products listed in Appendix B of this Order.

K. "Divestiture Trustee" means the Person appointed pursuant to Paragraph VII of this Order to divest the Freedom Assets and Business.

L. "Effective Date of Divestiture" means the date on which the divestiture of the Freedom Assets and Business to an Acquirer pursuant to Paragraph II or Paragraph VII of this Order is completed.

M. "Freedom Assets" means all of Otto Bock's right, title, and interest in and to the Freedom Business and all related assets, tangible or intangible, business, and properties, including any improvements or additions thereto made subsequent to the Acquisition, relating to the operation of the Freedom Business, including, but not limited to:

1. All Real Property of the Freedom Business;
2. All Tangible Personal Property;
3. All Intangible Property;
4. All consumable or disposable inventory;

5. All rights under any contracts and agreements, including, but not limited to, all rights to leases, service agreements, supply agreements and procurement contracts;
6. All rights and title in and to the use of the Freedom Business name and marks on a permanent and exclusive basis;
7. All Intellectual Property;
8. All governmental approvals, consents, licenses, permits, waivers, or other authorizations to the extent transferrable;
9. All rights under warranties and guarantees, express or implied;
10. All items of prepaid expense; and
11. Books, records, files, correspondence, manuals, computer printouts, databases, and other documents relating to the operation of the Freedom Business, electronic and hard copy, located on the premises of Freedom Business Real Property or in the possession of any Otto Bock Employee (or copies thereof where Otto Bock has a legal obligation to maintain the original document), including, but not limited to:
    a. Customer files and records, including customer lists, customer product specifications, customer purchasing histories, customer service and support materials, and customer information;
    b. Research and development data and files;
    c. Financial records;
    d. Personnel files;
    e. Maintenance records;
    f. Advertising, promotional and marketing materials, including website content;
    g. Documents relating to policies and procedures;
    h. Documents relating to quality control;
    i. Documents relating to Payors; and
    j. Documents relating to Suppliers.

Provided, however, Freedom Assets does not include any assets exclusively related to the Otto Bock business (including prosthetic products sold or marketed by Otto Bock) prior to the Acquisition Date, unless such assets were also used by the Freedom Business after the Acquisition Date.

N. "Freedom Business" means all activities relating to the manufacture and sale of prosthetics and other related products and services.

Provided however, the Freedom Business does not include any activities relating to Otto Bock's manufacture and sale of prosthetics and other related products and services prior to the Acquisition Date.

O. "Freedom Assets and Business" means the Freedom Assets and the Freedom Business.

P. "Freedom Employee(s)" means Any Person:

1. Employed by the Freedom Business as of the Acquisition Date; and/or

2. Employed by the Freedom Business at any time from the Acquisition Date through the Effective Date of Divestiture.

Q. "Freedom Key Employee(s)" means any Person listed in Confidential Appendix C Attached to this Order.

R. "Hold-Separate Agreements" means the Letter Agreement and Hold Separate and Asset Maintenance Agreement signed by Otto Bock and Bureau of Competition Staff on December 20, 2017, attached as Confidential Appendix D to this Order, and the Procedures, Terms and Conditions Agreement.

S. "Hold-Separate Manager Agreement" means the Agreement signed by Otto Bock and the Hold Separate Manager on December 22, 2017, attached as Confidential Appendix E to this Order.

T. "Hold-Separate Monitor Agreement" means the Agreement signed by Otto Bock and the Hold Separate Monitor on December 27, 2017, attached as Confidential Appendix F to this Order.

U. "Intangible Property" means intangible property relating to the operation of the Freedom Business including, but not limited to, Intellectual Property, the Freedom name and marks, trademarks, logos, and the modifications or improvements to such intangible property.

V. "Intellectual Property" means, without limitation: (i) all patents, patent applications, inventions, and discoveries that may be patentable; (ii) all know-how, trade secrets, software, technical information, data, registrations, applications for governmental approvals, inventions, processes, best practices (including clinical pathways), formulae, protocols, standards, methods, techniques, designs, quality-control practices and information, research and test procedures and information, and safety, environmental and health practices and information; (iii) all confidential or proprietary information, commercial information, management systems, business processes and practices, patient lists, patient information, patient records and files, patient communications, procurement practices and information, supplier qualification and approval practices and information, training materials, sales and marketing materials, patient support materials, advertising and promotional materials; and (iv) all rights in any jurisdiction to limit the use or disclosure of any of the foregoing, and rights to sue and recover damages or obtain injunctive relief for infringement, dilution, misappropriation, violation, or breach of any of the foregoing.

W. "Licensed Intangible Property" means Intangible Property licensed to Otto Bock or to the Freedom Business from a third party relating to Freedom Assets and Business including, but not limited to, Intellectual Property, software, computer programs, patents, know-how, goodwill, technology, trade secrets, technical information, marketing information, protocols, quality-control information, trademarks, trade names, service marks, logos, and the modification or improvements to such intangible property that are licensed to Otto Bock or to the Freedom Business ("Licensed Intangible Property" does not mean modifications and improvements to intangible property that are not licensed to Otto Bock).

X. "Monitor" means the Person appointed pursuant to Paragraph VI of the Order and with the prior approval of the Commission.

Y. "Monitor Agreement" means the agreement Otto Bock enters into with the Monitor and with the prior approval of the Commission.

Z. "Payor" means any Person that purchases, reimburses for, or otherwise pays for medical goods or services for themselves or for any other person, including, but not limited to: health insurance companies; preferred provider organizations; point-of-service organizations; prepaid hospital, medical, or other health-service plans; health maintenance organizations; government health-benefits programs; employers or other persons providing or administering self-insured health-benefits programs; and patients who purchase medical goods or services for themselves.

AA. "Person" means any natural person, partnership, corporation, association, trust, joint venture, government, government agency, or other business or legal entity.

BB. "Procedures, Terms and Conditions Agreement" means the Procedures, Terms, and Conditions Regarding Access to the Held-Separate Business for FTC Litigation Purposes Pursuant to Hold Separate and Asset Maintenance Agreement dated December 20, 2017, between Bureau of Competition Staff and Otto Bock, signed on January 31, 2018, and attached as Confidential Appendix G to this Order.

CC. "Real Property" means all real property interests (including fee simple interests and real property leasehold interests including all rights, easements and appurtenances, together with all buildings, structures, facilities) that Otto Bock acquired pursuant to the Acquisition and/or that Otto Bock acquired after the Acquisition to the extent the interests relate to the operation of the Freedom Business. Real Property includes, but is not limited to, the assets, which are identified and listed on Appendix H to this Order.

DD. "Supplier" means any Person that has sold to the Freedom Business or Otto Bock any goods or services for use in connection with the operation of the Freedom Business; provided, however, that "Supplier" does not mean an employee of Otto Bock.

EE. "Tangible Personal Property" means all machinery, equipment, spare parts, tools, and tooling (whether customer specific or otherwise); furniture, office equipment, computer hardware and software; supplies and materials; vehicles and rolling stock; and other items of tangible personal property of every kind whether owned or leased, together with any express or implied warranty by the manufacturers, sellers, or lessors of any item or

component part thereof, and all maintenance records and other documents relating thereto.

FF. "Technical Services Agreement" means the provision by Otto Bock at Direct Cost of all advice, consultation, and assistance reasonably necessary for any Acquirer to receive and use, in any manner related to achieving the purposes of this Order, any asset, right, or interest related to the Freedom Business.

GG. "Transitional Services" means the Technical Services Agreement and the Transition Services Agreement.

HH. "Transition Services Agreement" means an agreement requiring Otto Bock to provide at Direct Cost all services reasonably necessary to transfer administrative support services to the Acquirer, including, but not limited to, such services related to payroll, employee benefits, accounts receivable, accounts payable, and other administrative and logistical support.

II.

IT IS FURTHER ORDERED that:

A. Otto Bock shall:

1. No later than ninety (90) days from the date this Order becomes final and effective, divest absolutely and in good faith, and at no minimum price, the Freedom Assets and Business to an Acquirer that receives the prior approval of the Commission and in a manner, including pursuant to a Divestiture Agreement, that receives the prior approval of the Commission;

   Provided, however, that Otto Bock may retain any or all of the Divestiture Products Group A *unless* the Acquirer demonstrates to the Commission's satisfaction: (i) that any such asset is necessary to achieve the purpose of this Order; and (ii) that the Acquirer needs such asset to effectively operate the Freedom Business in a manner consistent with the purpose of this Order, and the Commission approves the divestiture with the divestiture of such asset.

   Provided, however, that Otto Bock must divest any or all of the Divestiture Products Group B *unless* the Acquirer demonstrates to the Commission's satisfaction: (i) that any such asset is not necessary to achieve the purpose of this Order; and (ii) that the Acquirer does not need such asset to effectively operate the Freedom Business in a manner consistent with the purpose of this Order, and the Commission approves the divestiture without the divestiture of such asset.

2. Comply with all terms of the Divestiture Agreement approved by the Commission pursuant to this Order, which agreement shall be deemed incorporated by reference into this Order; and any failure by Otto Bock to comply with any term of the Divestiture Agreement shall constitute a failure to comply with this Order. The Divestiture Agreement shall not reduce, limit or contradict, or be construed to

reduce, limit or contradict, the terms of this Order; *provided, however*, that nothing in this Order shall be construed to reduce any rights or benefits of any Acquirer or to reduce any obligations of Otto Bock under such agreement; *provided further*, that if any term of the Divestiture Agreement varies from the terms of this Order ("Order Term"), then to the extent that Otto Bock cannot fully comply with both terms, the Order Term shall determine Otto Bock's obligations under this Order. Notwithstanding any paragraph, section, or other provision of the Divestiture Agreement, any failure to meet any condition precedent to closing (whether waived or not) or any modification of the Divestiture Agreement, without the prior approval of the Commission, shall constitute a failure to comply with this Order.

3. Prior to the Effective Date of Divestiture, Otto Bock shall not rescind the Hold-Separate Agreements, the Hold-Separate Manager Agreement, the Hold-Separate Monitor Agreement, or the Procedures, Terms, and Conditions Agreement or any term of the above Agreements necessary to comply with any Paragraph of this Order.

4. No later than thirty (30) days from the date this Order becomes final and effective, Otto Bock shall offer to furnish to all prospective Acquirers, subject to customary confidentiality assurances, all information and documents relating to the Freedom Assets and Business customarily provided in a due diligence process except such information or documents subject to the attorney-client privilege or work-product doctrine.

   Provided further that Otto Bock shall permit prospective Acquirers of the Freedom Assets and Business to have reasonable access to personnel and to make inspections of the physical facilities; and access to any and all financial, operational, or other documents and information customarily provided as part of a due diligence process. *Provided, however*, that Otto Bock shall require all prospective Acquirers to sign a confidentiality agreement pursuant to which that prospective Acquirer shall be required to maintain all Confidential Business Information obtained as part of the due diligence process as strictly confidential, including the nondisclosure of that information to all other employees, executives, or other personnel of the potential Acquirer that were not involved in the due diligence process. Otto Bock shall require, as part of a confidentiality agreement, that the potential Acquirer limit access to Confidential Business Information to only those employees necessary to conduct sufficient due diligence.

5. Take all actions and shall effect all arrangements in connection with the divestiture of the Freedom Assets and Business necessary to ensure that the Acquirer can conduct the Freedom Assets and Business in substantially the same manner as operated prior to the Acquisition, including, but not limited to:

   a. Complying with the Hold-Separate Agreements, the Hold-Separate Manager Agreement, the Hold-Separate Monitor Agreement, or the Procedures, Terms, and Conditions Agreement or any term of the above

Agreements,

b. Providing Transitional Services,

c. Providing the opportunity to recruit and employ all Freedom Employees.

6. Convey as of the Effective Date of Divestiture to the Acquirer the right to use any Licensed Intangible Property (to the extent permitted by the third-party licensor), if such right is needed for the operation of the Freedom Business by the Acquirer and if the Acquirer is unable, using commercially-reasonable efforts, to obtain equivalent rights from other third parties on commercially-reasonable terms and conditions.

7. Otto Bock shall:

   a. Place no restrictions on the use by the Acquirer of the Freedom Assets and Business, including any Intangible Property;

   b. On or before the Effective Date of Divestiture, provide to the Acquirer contact information about customers, Payors, and Suppliers for the Freedom Assets and Business;

   c. With respect to contracts with Freedom Business Suppliers, at the Acquirer's option and as of the Effective Date of Divestiture:

      i. If such contract can be assigned without third-party approval, assign its rights under the contract to the Acquirer; and

      ii. If such contract can be assigned to the Acquirer only with third-party approval, assist and cooperate with the Acquirer in obtaining:

         a) Such third-party approval and in assigning the contract to the acquirer; or

         b) A new contract.

8. At the request of the Acquirer, for two (2) years from the Effective Date of Divestiture, with the option of the Acquirer to renew for two six (6) month periods with written notification to Commission staff, except as otherwise approved by the Commission, and in a manner (including pursuant to an agreement) that receives the prior approval of the Commission:

   a. Otto Bock shall provide Transitional Services to the Acquirer sufficient to enable the Acquirer to conduct the Freedom Business in substantially the same manner that the Freedom Business was conducted prior to the Acquisition and during the Hold-Separate Period.

   b. Otto Bock shall provide the Transitional Services required by this Paragraph II.A.8 at substantially the same level and quality as such services are provided by Otto Bock in connection with the Hold-Separate

Agreements.

Provided, however, that Otto Bock shall not (i) require the Acquirer to pay compensation for Transitional Services that exceeds Direct Cost of providing such goods and services, (ii) terminate its obligation to provide Transitional Services because of a material breach by the Acquirer of any agreement to provide such assistance, in the absence of a final order of a court of competent jurisdiction, or (iii) include a term in any agreement to provide Transitional Services that limits the type of damages (such as indirect, special, and consequential damages) that the Acquirer would be entitled to seek and in event of Otto Bock's breach of such agreement.

9. Otto Bock shall allow the Acquirer an opportunity to recruit and employ any Freedom Employee in connection with the divestiture of the Freedom Assets and Business, including as follows:

   a. No later than five (5) days after execution of a divestiture agreement, Otto Bock shall (i) identify each Freedom Employee, (ii) allow the Acquirer an opportunity to interview any Freedom Employee, and (iii) allow the Acquirer to inspect the personnel files and other documentation relating to any Freedom Employee, to the extent permissible under applicable laws.

   b. Otto Bock shall (i) not offer any incentive to any Freedom Employee to decline employment with the Acquirer, (ii) remove any contractual impediments that may deter any Freedom Employee from accepting employment with the Acquirer, including, but not limited to, any non-compete or confidentiality provisions of employment or other contracts with Otto Bock that would affect the ability of the Freedom Employee to be employed by the Acquirer, and (iii) not otherwise interfere with the recruitment of any Freedom Employee by the Acquirer.

   c. Otto Bock shall (i) vest all current and accrued pension benefits as of the date of transition of employment with the Acquirer for any Freedom Employee who accepts an offer of employment from the Acquirer no later than thirty (30) days from the Effective Date of Divestiture and (ii) if the Acquirer has made a written offer of employment to any Key Employee, as identified and listed on Confidential Appendix C to this Order, provide such Key Employee with reasonable financial incentives to accept a position with the Acquirer at the time of the Effective Date of Divestiture, including, but not limited to (and subject to Commission approval), payment of an incentive equal to up to three (3) months of such Key Employee's base salary to be paid only upon such Key Employee's completion of one (1) year of employment with the Acquirer.

      Provided, however, that Otto Bock and the Acquirer will work together in good faith to determine whether any additional Freedom Employee should be identified as a Key Employee and subject to the provisions of this Paragraph II.A.9.c.

d. For a period ending two (2) years after the Effective Date of Divestiture, Otto Bock shall not, directly or indirectly, solicit, hire, or enter into any arrangement for the services of any Freedom Employee employed by the Acquirer, unless such Freedom Employee's employment has been terminated by the Acquirer; provided, however, this Paragraph II.A.9.d shall not prohibit Otto Bock from: (i) advertising for employees in newspapers, trade publications, or other media not targeted specifically at the Freedom Employees, (ii) hiring employees who apply for employment with Otto Bock, as long as such employees were not solicited by Otto Bock in violation of this Paragraph II.A.9.d, or (iii) offering employment to a Freedom Employee who is employed by the Acquirer in only a part-time capacity, if the employment offered by Otto Bock would not, in any way, interfere with that employee's ability to fulfill his or her employment responsibilities to the Acquirer.

10. Otto Bock shall submit to the Acquirer, at Otto Bock's expense, all Confidential Business Information, and:

a. Deliver such Confidential Business information as follows: (i) in good faith; (ii) as soon as practicable, avoiding any delays in transmission of the respective information; and (iii) in a manner that ensures its completeness and accuracy and that fully preserves its usefulness;

b. Pending complete delivery of all such Confidential Business Information to the Acquirer, provide the Acquirer and Monitor with access to all such Confidential Business Information and employees who possess or are able to locate such information for the purposes of identifying the books, records, and files that contain such Confidential Business Information and facilitating the delivery in a manner consistent with this Order.

11. Except in the course of performing its obligations under this Order, Otto Bock shall:

a. Not provide, disclose, or otherwise make available any Confidential Business Information, including trade secrets or any sensitive or proprietary commercial or financial information relating to the Acquirer or the Freedom Business to any Person other than the Acquirer, and shall not share such information for any reason or purpose;

b. Disclose any Confidential Business Information trade secrets or any sensitive or proprietary commercial or financial information related to the Acquirer or the Freedom Business to any Person other than the Acquirer (i) only in the manner and to the extent necessary to satisfy Otto Bock's obligations under this Order and (ii) only to Persons who agree in writing to maintain the confidentiality of such information; and

c. Enforce the terms of this Paragraph II.A.11 as to any Person and take such action as is necessary, including training, to cause each such Person to

comply with the terms of this Paragraph II.A.11, including any actions Otto Bock would take to protect its own trade secrets or sensitive or propriety commercial or financial information.

Provided, *however*, that Otto Bock may provide, disclose, use, or otherwise make available any Confidential Business Information relating to any of the Divestiture Products Group A or Divestiture Products Group B retained under Paragraph II.A.1 of this Order to the extent that such Confidential Business Information is solely under the use or control of Otto Bock.

12. Otto Bock shall, no later than five (5) days after the date this Order becomes final and effective:

    a. Require that each employee of Otto Bock, including the Hold-Separate Manager and the Hold-Separate Monitor, who has, had, or may have had access to Confidential Business Information relating to the Freedom Assets and Business, and the direct supervisor(s) of any such employee, sign a confidentiality agreement pursuant to which that employee shall be required to maintain all Confidential Business Information related to the Freedom Assets and Business as strictly confidential, including the nondisclosure of that information to all other employees, executives, or other personnel of Otto Bock (other than as necessary to comply with the requirements of this Order), or the use of such Confidential Business Information in any way.

    b. Cause all Persons under Otto Bock's control, including all Otto Bock employees, the Hold-Separate Manager, and the Hold-Separate Monitor, having access to Confidential Business Information of or pertaining to the Freedom Assets and Business to submit a signed statement to the Commission's staff that the individual will maintain the confidentiality required by this Order.

    c. Provide written notification of the restrictions on the use and disclosure of the Confidential Business Information related to the Freedom Assets and Business by Otto Bock's personnel to all of its employees who (i) may be in possession of such Confidential Business Information or (ii) may have access to such Confidential Business Information. Otto Bock shall give the above-described notification by e-mail with return receipt requested or similar transmission, and keep a file of those receipts for two (2) years after the date this Order becomes final and effective. Otto Bock shall maintain complete records of all such notifications at Otto Bock's registered office within the United States and shall provide an officer's certification to the Commission affirming the implementation of, and compliance with, the acknowledgement program.

B. The purpose of the divestiture of the Freedom Assets and Business is to ensure the continued operation of the Freedom Business by the Acquirer, independent of Otto Bock, and to remedy the lessening of competition resulting from the Acquisition.

III.

IT IS FURTHER ORDERED that from the date this Order becomes final and effective (without regard to the finality of the divestiture requirements herein) until the Effective Date of Divestiture, Otto Bock shall abide by the Hold-Separate Agreements and shall not:

A. Sell or transfer any Freedom Assets;

B. Eliminate, transfer, or consolidate any service offered in connection with the Freedom Business;

C. Fail to maintain the employment of all Freedom Employees or otherwise fail to keep the Freedom Business staffed with sufficient employees; provided, however, that Freedom Employees may be terminated for cause as provided by the Hold-Separate Agreements (in which even Otto Bock shall replace such employees).

IV.

IT IS FURTHER ORDERED that:

A. From the date this Order becomes final and effective (without regard to the finality of the divestiture requirements herein) until the Effective Date of Divestiture, Otto Bock shall take such actions as are necessary to maintain the viability, marketability, and competitiveness of the Freedom Assets and Business, as provided in the Hold-Separate Agreements. Among other things that may be necessary, as provided for in the Hold-Separate Agreements, Otto Bock shall:

   1. Maintain the operations of the Freedom Business relating to the Freedom Assets in the Ordinary Course of Business and in accordance with the Hold-Separate Agreements;

   2. Use best efforts to maintain and increase revenues of the Freedom Business, and to maintain at budgeted levels for the year 2018 or the current year, whichever are higher, all administrative, technical, and marketing support for the Freedom Business and in accordance with the Hold-Separate Agreements;

   3. Use best efforts to maintain the current workforce and to retain the services of employees and agents in connection with the Freedom Business, including payments of bonuses as necessary, and maintain the relations and goodwill with customers.

B. No later than thirty (30) days from the date this Order becomes final and effective (without regard to the finality of the divestiture requirements herein), Otto Bock shall file a verified written report to the Commission that identifies (i) all assets included in the Freedom Assets, (ii) all assets originally acquired or that replace assets originally acquired as a result of the Acquisition, and (iii) all services, functions, and agreements that Otto Bock discontinued after the Acquisition.

V.

IT IS FURTHER ORDERED that no later than five (5) days from the date this Order becomes final and effective (without regard to the finality of the divestiture requirements herein), Otto Bock shall provide a copy of this Order to each of Otto Bock's officers, employees, or agents having managerial responsibility for any of Otto Bock's obligations under Paragraphs II, III, and IV of this Order.

VI.

IT IS FURTHER ORDERED that:

A. At any time after this Order becomes final and effective (without regard to the finality of the divestiture requirements herein), the Commission may appoint a Person ("Monitor") to monitor Otto Bock's compliance with its obligations under this Order, consult with Commission staff, and report to the Commission regarding Otto Bock's compliance with its obligations under this Order.

B. If a Monitor is appointed pursuant to Paragraph VI.A of this Order, Otto Bock shall consent to the following terms and conditions regarding the powers, duties, authorities, and responsibilities of the Monitor:

   1. The Monitor shall have the power and authority to monitor Otto Bock's compliance with the terms of this Order, and shall exercise such power and authority and carry out the duties and responsibilities of the Monitor pursuant to the terms of this Order and in a manner consistent with the purposes of this Order and in consultation with the Commission or its staff.

   2. Within ten (10) days after appointment of the Monitor, Otto Bock shall execute an agreement that, subject to the approval of the Commission, confers on the Monitor all the rights and powers necessary to permit the Monitor to monitor Otto Bock's compliance with the terms of this Order in a manner consistent with the purposes of this Order. If requested by Otto Bock, the Monitor shall sign a confidentiality agreement prohibiting the use or disclosure to anyone other than the Commission (or any Person retained by the Monitor pursuant to Paragraph VI.B.5 of this Order), of any competitively-sensitive or proprietary information gained as a result of his or her role as Monitor, for any purpose other than performance of the Monitor's duties under this Order.

   3. The Monitor's power and duties under this Paragraph VI shall terminate three (3) business days after the Monitor has completed his or her final report pursuant to Paragraph VI.B.8 of this Order or at such other time as directed by the Commission.

4. Otto Bock shall cooperate with any Monitor appointed by the Commission in the performance of his or her duties, and shall provide the Monitor with full and complete access to Otto Bock's books, records, documents, personnel, facilities, and technical information relating to compliance with this Order, or to any other relevant information, as the Monitor may reasonably request. Otto Bock shall cooperate with any reasonable request of the Monitor. Otto Bock shall take no action to interfere with or impede the Monitor's ability to monitor Otto Bock's compliance with this Order.

5. The Monitor shall serve, without bond or other security, at the expense of Otto Bock, on such reasonable and customary terms and conditions as the Commission may set. The Monitor shall have the authority to employ, at the expense of Otto Bock, such consultants, accountants, attorneys, and other representatives and assistants as are reasonably necessary to carry out the Monitor's duties and responsibilities. The Monitor shall account for all expenses incurred, including fees for his or her services, subject to the approval of the Commission.

6. Otto Bock shall indemnify the Monitor and hold the Monitor harmless against any losses, claims, damages, liabilities, or expenses arising out of, or in connection with, the performance of the Monitor's duties, including all reasonable fees of counsel and other expenses incurred in connection with the preparation for, or defense of, any claim, whether or not resulting in any liability, except to the extent that such losses, claims, damages, liabilities, or expenses result from the Monitor's gross negligence or willful misconduct. For purposes of this Paragraph VI.B.6, the term "Monitor" shall include all Persons retained by the Monitor pursuant to Paragraph VI.B.5 of this Order.

7. If at any time the Commission determines that the Monitor has ceased to act or failed to act diligently, or is unwilling or unable to continue to serve, the Commission may appoint a substitute to serve as Monitor in the same manner as provided by this Order.

8. The Monitor shall report in writing to the Commission (i) every sixty (60) days from the date this Order becomes final and effective (without regard to the finality of the divestiture requirements herein), (ii) no later than thirty (30) days from the date Otto Bock completes its obligations under this Order, and (iii) at any other time as requested by the staff of the Commission, concerning Otto Bock's compliance with this Order.

C. Otto Bock shall submit the following reports to the Monitor: (i) no later than twenty (20) days after the date the Monitor is appointed by the Commission pursuant to Paragraph VI.A of this Order, a copy of the Accounting required by Paragraph IV.B of this Order; and (ii) copies of all compliance reports filed with the Commission.

D. Otto Bock shall provide the Monitor with: (i) prompt notification of significant meetings, including date, time and venue, scheduled after the execution of the Monitor Agreement, relating to the regulatory approvals, marketing, sale and divestiture of the Freedom Assets and Business, and such meetings may be attended by the Monitor or his

representative, at the Monitor's option or at the request of the Commission or staff of the Commission; and (ii) the minutes, if any, of the above-referenced meetings as soon as practicable and, in any event, not later than those minutes are available to any employee of Otto Bock.

E. The Commission may, on its own initiative or at the request of the Monitor, issue such additional orders or directions as may be necessary or appropriate to assure compliance with the requirements of this Order.

F. The Monitor appointed pursuant to this Order may be the same Person appointed as Divestiture Trustee pursuant to Paragraph VII of this Order.

VII.

IT IS FURTHER ORDERED that:

A. If Otto Bock has not divested, absolutely and in good faith, the Freedom Assets and Business pursuant to the requirements of Paragraph II of this Order, within the time and manner required by Paragraph II of this Order, the Commission may at any time appoint one or more Persons as Divestiture Trustee to divest the Freedom Assets and Business, at no minimum price, and pursuant to the requirements of Paragraph II of this Order, in a manner that satisfies the requirements of this Order.

B. In the event that the Commission or the Attorney General of the United States brings an action pursuant to § 5(l) of the Federal Trade Commission Act, 15 U.S.C. § 45(l), or any other statute enforced by the Commission, Otto Bock shall consent to the appointment of a Divestiture Trustee in such action. Neither the appointment of a Divestiture Trustee nor a decision not to appoint a Divestiture Trustee under this Paragraph VII shall preclude the Commission or the Attorney General from seeking civil penalties or any other relief available to it, including appointment of a court-appointed Divestiture Trustee, pursuant to § 5(l) of the Federal Trade Commission Act, or any other statute enforced by the Commission, for any failure by Otto Bock to comply with this Order.

C. If a Divestiture Trustee is appointed by the Commission or a court pursuant to this Paragraph VII, Otto Bock shall consent to the following terms and conditions regarding the Divestiture Trustee's powers, duties, authority, and responsibilities:

1. Subject to the prior approval of the Commission, the Divestiture Trustee shall have the exclusive power and authority to effect the divestiture pursuant to the requirements of Paragraph II of this Order and in a manner consistent with the purposes of this Order.

2. Within ten (10) days after appointment of the Divestiture Trustee, Otto Bock shall execute an agreement that, subject to the prior approval of the Commission and, in the case of a court-appointed Divestiture Trustee, of the court, transfers to the Divestiture Trustee all rights and powers necessary to permit the Divestiture

Trustee to effect the divestiture and perform the requirements of Paragraph II of this Order for which he or she has been appointed.

3. The Divestiture Trustee shall have twelve (12) months from the date the Commission approves the agreement described in Paragraph VII.C.2 of this Order to accomplish the divestiture, which shall be subject to the prior approval of the Commission. If, however, at the end of the twelve-month period the Divestiture Trustee has submitted a plan of divestiture or believes that divestiture can be achieved within a reasonable time, the divestiture period may be extended by the Commission, or, in the case of a court appointed Divestiture Trustee, by the court.

4. Otto Bock shall provide the Divestiture Trustee with full and complete access to the personnel, books, records, and facilities related to the assets to be divested, or to any other relevant information, as the Divestiture Trustee may request. Otto Bock shall develop such financial or other information as the Divestiture Trustee may reasonably request and shall cooperate with the Divestiture Trustee. Otto Bock shall take no action to interfere with or impede the Divestiture Trustee's accomplishment of the divestiture. Any delays in divestiture caused by Otto Bock shall extend the time for divestiture under this Paragraph in an amount equal to the delay, as determined by the Commission or, for a court-appointed Divestiture Trustee, by the court.

5. The Divestiture Trustee shall use his or her best efforts to negotiate the most favorable price and terms available in each contract that is submitted to the Commission, but shall divest expeditiously at no minimum price. The divestiture shall be made only to an Acquirer that receives the prior approval of the Commission, and the divestiture shall be accomplished only in a manner that receives the prior approval of the Commission; provided, however, if the Divestiture Trustee receives bona fide offers from more than one acquiring entity, and if the Commission determines to approve more than one such acquiring entity, the Divestiture Trustee shall divest to the acquiring entity or entities selected by Otto Bock from among those approved by the Commission; provided, further, that Otto Bock shall select such entity within ten (10) business days of receiving written notification of the Commission's approval.

6. The Divestiture Trustee shall serve, without bond or other security, at the cost and expense of Otto Bock, on such reasonable and customary terms and conditions as the Commission or a court may set. The Divestiture Trustee shall have the authority to employ, at the cost and expense of Otto Bock, such consultants, accountants, attorneys, investment bankers, business brokers, appraisers, and other representatives and assistants as are necessary to carry out the Divestiture Trustee's duties and responsibilities. The Divestiture Trustee shall account for all monies derived from the divestiture and all expenses incurred. After approval by the Commission of the account of the Divestiture Trustee, including fees for his or her services, all remaining monies shall be paid at the direction of Otto Bock, and the Divestiture Trustee's power shall be terminated. The Divestiture Trustee's

compensation may be based in part on a commission arrangement contingent on the Divestiture Trustee's divesting the assets.

7. Otto Bock shall indemnify the Divestiture Trustee and hold the Divestiture Trustee harmless against any losses, claims, damages, liabilities, or expenses arising out of, or in connection with, the performance of the Divestiture Trustee's duties, including all reasonable fees of counsel and other expenses incurred in connection with the preparation for, or defense of any claim, whether or not resulting in any liability, except to the extent that such liabilities, losses, damages, claims, or expenses result from gross negligence or willful misconduct by the Divestiture Trustee. For purposes of this Paragraph VII.C.7, the term "Divestiture Trustee" shall include all Persons retained by the Divestiture Trustee pursuant to Paragraph VII.C.6 of this Order.

8. If the Divestiture Trustee ceases to act or fails to act diligently, the Commission may appoint a substitute Divestiture Trustee in the same manner as provided in this Paragraph VII for appointment of the initial Divestiture Trustee.

9. The Divestiture Trustee shall have no obligation or authority to operate or maintain the assets to be divested.

10. The Divestiture Trustee shall report in writing to the Commission every sixty (60) days concerning the Divestiture Trustee's efforts to accomplish the divestiture.

D. The Commission or, in the case of a court-appointed Divestiture Trustee, the court, may on its own initiative or at the request of the Divestiture Trustee issue such additional orders or directions as may be necessary or appropriate to accomplish the divestiture required by this Order.

E. The Divestiture Trustee appointed pursuant to this Paragraph may be the same Person appointed as the Monitor pursuant to Paragraph VI of this Order.

VIII.

IT IS FURTHER ORDERED that:

A. Otto Bock shall

1. Submit the complete Divestiture Agreement to the Commission at ElectronicFilings@ftc.gov and bccompliance@ftc.gov no later than 30 days after the Divestiture Date.

B. Otto Bock shall submit verified written reports ("compliance reports") in accordance with the following:

1. Otto Bock shall submit:

a. Interim compliance reports (i) no later than thirty (30) days after the Order becomes final and effective (without regard to the finality of the divestiture requirements herein), and every thirty (30) days thereafter until

the divestiture of the Freedom Assets and Business is accomplished, and (ii) thereafter, every sixty (60) days (measured from the Effective Date of Divestiture) until the date Otto Bock completes its obligations under this Order; and

b. Additional compliance reports as the Commission or its staff may request.

2. Otto Bock shall include in its compliance reports, among other things required by the Commission, a full description of the efforts being made to comply with the relevant Paragraphs of this Order, the identity of all parties contacted, copies of all written communications to and from such parties, internal documents and communications, and all reports and recommendations concerning the divestiture, the date of divestiture, and a statement that the divestiture has been accomplished in the manner approved by the Commission. Each compliance report shall contain sufficient information and documentation to enable the Commission to determine independently whether Otto Bock is in compliance with each Paragraph of the Order. Conclusory statements that Otto Bock has complied with its obligations under the Order are insufficient.

C. Each compliance report shall be verified in the manner set forth in 28 U.S.C. § 1746 by the Chief Executive Officer or another officer or employee specifically authorized to perform this function. Otto Bock shall submit an original and 2 copies of each compliance report as required by Commission Rule 2.41(a), 16 C.F.R. § 2.41(a), including a paper original submitted to the Secretary of the Commission and electronic copies to the Secretary at ElectronicFilings@ftc.gov and to the Compliance Division at bccompliance@ftc.gov. In addition, Otto Bock shall provide a copy of each compliance report to the Monitor.

IX.

IT IS FURTHER ORDERED that Otto Bock shall notify the Commission at least 30 days prior to:

A. Any proposed dissolution of Otto Bock;

B. Any proposed acquisition of, or merger or consolidation involving Otto Bock, or

C. Any other change in Otto Bock including assignment and the creation, sale, or dissolution of subsidiaries, if such change may affect compliance obligations arising out of this Order.

X.

IT IS FURTHER ORDERED that, for purposes of determining or securing compliance with this Order, and subject to any legally recognized privilege, upon written request and 5 days' notice to Otto Bock, made to its principal place of business as identified in this Order, registered office of its United States subsidiary, or its headquarters office, Otto Bock shall, without restraint

or interference, permit any duly authorized representative of the Commission:

A. Access, during business office hours of Otto Bock and in the presence of counsel, to all facilities and access to inspect and copy all business and other records and all documentary material and electronically stored information as defined in Commission Rules 2.7(a)(1) and (2), 16 C.F.R. § 2.7(a)(1) and (2), in the possession or under the control of Otto Bock related to compliance with this Order, which copying services shall be provided by Otto Bock at the request of the authorized representative of the Commission and at the expense of Otto Bock; and

B. To interview officers, directors, or employees of Otto Bock, who may have counsel present, regarding such matters.

XI.

IT IS FURTHER ORDERED that this Order shall terminate 10 years from the date it is issued.

By the Commission.

Donald S. Clark
Secretary

SEAL

ISSUED:

Appendix A
Divestiture Products Group A

1. Catapult Running
2. Defender
3. Freestyle Swim
4. LP Symes
5. Nitro Running
6. Promenade
7. Renegade and Renegade LP
8. Renegade AT and Renegade LP-AT
9. Renegade MX and Renegade LP-MX
10. Renegade SX and Renegade LP-SX
11. Runway
12. Senator
13. Silhouette and Silhouette LP
14. Silhoutte VS and Silhouette LP-VS
15. Slalom Ski
16. Thrive
17. WalkTek

Appendix B
Divestiture Products Group B

1. Agilix
2. DynAdapt
3. Highlander
4. Kinterra Foot/Ankle System
5. Maverick Comfort AT
6. Maverick Xtreme AT
7. Maverick Xtreme
8. Pacifica LP
9. Sierra

Appendices C – G

REDACTED IN ENTIRETY

Appendix H
Real Property

1. Irvine, California Facility—3 Morgan, Irvine, CA -Lease Agreement, dated September 8, 2006, between The Irvine Company LLC and Freedom Innovations, LLC (as successor in interest to Freedom Innovations, Inc.), as amended by the First Amendment, dated June 8, 2009, the Second Amendment, dated October 14, 2011, Third Amendment, dated November 30, 2012 and Fourth Amendment, dated August 30, 2017

1. Gunnison, Utah Facility—425 East 400 North, Gunnison, UT 84634 - Lease Agreement, dated September 19, 2017, between ACTA Property Holdings, L.L.C. and Freedom Innovations, LLC

Attachment C

PUBLIC

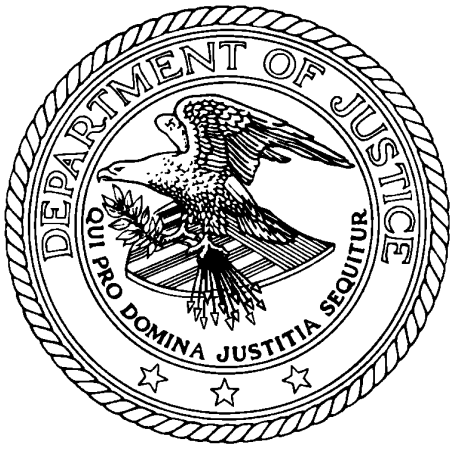
Commentary on the Horizontal Merger Guidelines

2006

Federal Trade Commission

U.S. Department of Justice

Commentary on the Horizontal Merger Guidelines



U.S. Department of Justice Federal Trade Commission

March 2006

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Foreword

Mergers between competing firms, i.e., "horizontal" mergers, are a significant dynamic force in the American economy. The vast majority of mergers pose no harm to consumers, and many produce efficiencies that benefit consumers in the form of lower prices, higher quality goods or services, or investments in innovation. Efficiencies such as these enable companies to compete more effectively, both domestically and overseas.

Fourteen years ago, to describe their application of the antitrust laws to horizontal mergers, the Federal Trade Commission and the U.S. Department of Justice (collectively, the "Agencies")—the two federal Agencies responsible for U.S. antitrust law enforcement—jointly issued the 1992 Horizontal Merger Guidelines (the "Guidelines"). In 1997, the Agencies jointly issued revisions to the Guidelines' section on Efficiencies. Since these publications were issued, the Agencies have consistently applied the Guidelines' analytical framework to the horizontal mergers under their review.

Today, to provide greater transparency and foster deeper understanding regarding antitrust law enforcement, the Agencies jointly issue this Commentary on the Guidelines.

The Commentary continues the Agencies' ongoing efforts to increase the transparency of their decision-making processes. These efforts include the Agencies' joint publication of Merger Challenges Data, Fiscal Years 1999–2003 (issued December 18, 2003), the Commission's subsequent publication of Horizontal Merger Investigation Data, Fiscal Years 1996–2003 (issued February 2, 2004 and revised August 31, 2004), the Department's Merger Review Process Initiative (issued October 12, 2001 and revised August 4, 2004), the Reforms to the Merger Review Process at the Commission (issued February 16, 2006), and the Department's and Commission's increased use of explanatory closing statements following merger investigations.

The Commentary follows on the Agencies' February 2004 Merger Enforcement Workshop. Over three days, leading antitrust practitioners and economists who have examined merger policy and the Guidelines' analytical framework discussed in detail all sections of the Guidelines. The Workshop focused on whether the analytical framework set forth by the Guidelines adequately serves the dual purposes of leading to appropriate enforcement decisions on proposed horizontal mergers, and providing the antitrust bar and the business community with reasonably clear guidance from which to assess the antitrust enforcement risks of proposed transactions.

Workshop participants generally agreed that the analytical framework set out in the Guidelines is effective in yielding the right results in individual cases and in providing advice to parties considering a merger. Thus, the Agencies concluded that a revamping of the Guidelines is neither needed nor widely desired at this time. Rather, the Guidelines' analytic framework has proved both robust and sufficiently flexible to allow the Agencies properly to account for the particular facts presented in each merger investigation.

The Agencies also have observed that the antitrust bar and business community would find useful and beneficial an explication of how the Agencies apply the Guidelines in particular investigations. This Commentary is intended to respond to this important public interest by enhancing the transparency of the analytical process by which the Agencies apply the antitrust laws to horizontal mergers.

Deborah Platt Majoras
Chairman
Federal Trade Commission

Thomas O. Barnett
Assistant Attorney General for Antitrust
U.S. Department of Justice

March 2006

Introduction

Governing Legal Principles

The principal federal antitrust laws applicable to mergers are section 7 of the Clayton Act, section 1 of the Sherman Act, and section 5 of the Federal Trade Commission Act. Section 7 proscribes a merger the effects of which "may be substantially to lessen competition." Section 1 prohibits an agreement that constitutes an unreasonable "restraint of trade." Section 5, which the Federal Trade Commission enforces, proscribes "unfair methods of competition." Over many decades, the federal courts have provided an expansive body of case law interpreting these statutes within the factual and economic context of individual cases.

The core concern of the antitrust laws, including as they pertain to mergers between rivals, is the creation or enhancement of market power. In the context of sellers of goods or services, "market power" may be defined as the ability profitably to maintain prices above competitive levels for a significant period of time. Market power may be exercised, however, not only by raising price, but also, for example, by reducing quality or slowing innovation. In addition, mergers also can create market power on the buying side of a market. Most mergers between rivals do not create or enhance market power. Many mergers, moreover, enable the merged firm to reduce its costs and become more efficient, which, in turn, may lead to lower prices, higher quality products, or investments in innovation. However, the Agencies challenge mergers that are likely to create or enhance the merged firm's ability—either unilaterally or through coordination with rivals—to exercise market power.

Following their mandate under the antitrust statutory and case law, the Agencies focus their horizontal merger analysis on whether the transactions under review are likely to create or enhance market power. The Guidelines set forth the analytical framework and standards, consistent with the law and with economic learning, that the Agencies use to assess whether an anticompetitive outcome is likely. The unifying theme of that assessment is "that mergers should not be permitted to create or enhance market power or to facilitate its exercise." Guidelines § 0.1. The Guidelines are flexible, allowing the Agencies' analysis to adapt as business practices and economic learning evolve.

In applying the Guidelines to the transactions that each separately reviews, the Agencies strive to allow transactions unlikely substantially to lessen competition to proceed as expeditiously as possible. The Agencies focus their attention on quickly identifying those transactions that could violate the antitrust laws, subjecting those mergers to greater scrutiny. Most mergers that pose significant risk to competition come to the Agencies' attention before they are consummated under the premerger notification and reporting requirements of the Hart-Scott-Rodino Antitrust Improvements Act of 1976, 15 U.S.C. § 18a ("HSR"). HSR requires that the parties to a transaction above a certain size notify the Agencies before consummation and prohibits consummation of the transaction until expiration of one or more waiting periods during which one of the Agencies reviews the transaction. The waiting periods provide the Agencies time to review a transaction before consummation.

For more than 95% of the transactions reported under HSR, the Agencies promptly determine—i.e., within the initial fifteen- or thirty-day waiting period that immediately follows HSR filings—that a substantial lessening of competition is unlikely. The Agencies base such expeditious determinations on material provided as part of the HSR notification, experience from prior investigations, and other market information. For many industries, a wealth of information is available from government reports, trade

directories and publications, and Internet resources. For some transactions, the parties volunteer additional information, and for some, the Agencies obtain information from non-public sources. The most important non-public sources are market participants, especially the parties' customers, who typically provide information voluntarily when the Agencies solicit their cooperation.

Evidence that the merged firm would have a relatively high share of sales (or of capacity, or of units, or of another relevant basis for measurement) or that the market is relatively highly concentrated may be particularly significant to a decision by either of the Agencies to extend a pre-merger investigation pursuant to HSR by issuing a request for additional information (commonly referred to as a "second request"). A decision to issue a second request must be made within the initial HSR thirty-day waiting period (fifteen days for cash tender offers), or the parties will no longer be prevented under HSR from consummating their merger. A second request may be necessary when it is not possible within thirty days to gather and analyze the facts necessary to address appropriately the competitive concerns that may arise at the threshold of the investigation, such as when parties to a merger appear to have relatively high shares in the market or markets in which they compete. Although the ultimate decision of whether a merger likely will be anticompetitive is based heavily on evidence of potential anticompetitive effects, the Agencies find that only in extraordinary circumstances can they conduct an extensive competitive effects analysis within thirty days. That is why market shares and concentration levels, which have some predictive value, frequently are used as at least a starting point during the initial waiting period.

Sometimes the Agencies also investigate consummated mergers, especially when evidence suggests that anticompetitive effects may have resulted from them. The Agencies apply Guidelines analysis to consummated mergers as well as to mergers under review pursuant to HSR.

Overview of Guidelines Analysis

The Guidelines' five-part organizational structure has become deeply embedded in mainstream merger analysis. These parts are: (1) market definition and concentration; (2) potential adverse competitive effects; (3) entry analysis; (4) efficiencies; and (5) failing and exiting assets.

Each of the Guidelines' sections identifies a distinct analytical element that the Agencies apply in an integrated approach to merger review. The ordering of these elements in the Guidelines, however, is not itself analytically significant, because the Agencies do not apply the Guidelines as a linear, step-by-step progression that invariably starts with market definition and ends with efficiencies or failing assets. Analysis of efficiencies, for example, does not occur "after" competitive effects or market definition in the Agencies' analysis of proposed mergers, but rather is part of an integrated approach. If the conditions necessary for an anticompetitive effect are not present—for example, because entry would reverse that effect before significant time elapsed—the Agencies terminate their review because it would be unnecessary to address all of the analytical elements.

The chapters that follow, in the context of specific analytical elements such as market definition or entry, describe many principles of Guidelines analysis that the Agencies apply in the course of investigating mergers. Three significant principles are generally applicable throughout.

The Agencies' Focus Is on Competitive Effects

The Guidelines' integrated process is "a tool that allows the Agency to answer the ultimate inquiry in merger analysis: whether the merger is likely to create or enhance market power or facilitate its exercise." Guidelines § 0.2. At the center of the Agencies' application of the Guidelines, therefore, is competitive effects analysis. That inquiry directly addresses the key question that the Agencies must answer: Is the merger under review likely substantially to lessen competition? To this end, the Agencies examine whether the merger of two particular rivals matters, that is, whether the merger is likely to affect adversely the competitive process, resulting in higher prices, lower quality, or reduced innovation.

The Guidelines identify two broad analytical frameworks for assessing whether a merger between competing firms may substantially lessen competition. These frameworks require that the

Agencies ask whether the merger may increase market power by facilitating coordinated interaction among rival firms and whether the merger may enable the merged firm unilaterally to raise price or otherwise exercise market power. Together, these two frameworks are intended to embrace every competitive effect of any form of horizontal merger. The Guidelines were never intended to detail how the Agencies would assess every set of circumstances that a proposed merger may present. As the Guidelines themselves note, the specific standards set forth therein must be applied to a broad range of possible factual circumstances.

Investigations Are Intensively Fact-Driven, Iterative Processes

Merger analysis depends heavily on the specific facts of each case. At the outset of an investigation, when Agency staff may know relatively little about the merging firms, their products, their rivals, or the applicable relevant markets, staff typically contemplates several broad hypotheses of possible harm.

For example, based on initial information, staff may hypothesize that a merger would reduce the number of competitors from four to three and, in so doing, may foster or enhance coordination by enabling the remaining firms profitably to allocate customers based on prior sales. Staff also might hypothesize that the products of the merging firms are particularly close substitutes with respect to product characteristics or geographic location such that unilateral anticompetitive effects are likely.

Staff evaluates potential competitive factors of this sort by gathering additional information and conducting intensive factual analysis to assess both the applicability of individual analytical frameworks and their implications for the likely competitive effects of the merger. As it learns more about the merging firms and the market environment in which they compete, staff rejects or refines its hypotheses of probable relevant markets and competitive effects, ultimately resulting in a conclusion about likelihood of harm. If the facts do not point to such a likelihood, the merger investigation is closed.

In testing a particular postulated risk of competitive harm arising from a merger, the Agencies take into account pertinent characteristics of the market's competitive process using data, documents, and other information obtained from the parties, their competitors, their customers, databases of various sorts, and academic literature or private industry studies. The Agencies carefully consider the views of informed customers on market structure, the competitive process, and anticipated effects from the merger. The Agencies further consider any information voluntarily provided by the parties, which may include extensive analyses prepared by economists or in consultation with economists. The Agencies also carefully consider prospects for efficiencies that the proposed transaction may generate and evaluate the effects of any efficiencies on the outcome of the competitive process.

The Same Evidence Often Is Relevant to Multiple Elements of the Analysis

A single piece of evidence often is relevant to several issues in the assessment of a proposed merger. For example, mergers frequently occur in markets that have experienced prior mergers. Sometimes evidence exists concerning the effects of prior mergers on various attributes of competition. Such evidence may be probative, for example, of the scope of the relevant product and geographic markets, of the likely competitive effects of the proposed merger, and of the likelihood that entry would deter or counteract any attempted exercise of market power following the merger under review. Similarly, evidence of actual or likely anticompetitive effects from a merger could be used in addressing the scope of the market or entry conditions.

An investigation involving potential coordinated effects may uncover evidence of past collusion and sustained supra-competitive prices in the market. This information can be relevant to several elements of the analysis. The product and geographic markets that were subject to collusion in the past may be probative of the relevant product and geographic markets today. That entry failed to undermine collusion in the past may be probative of whether entry is likely today. Of course, during its investigation, the Agency may discover facts that tend to negate these possibilities. For example, since collusion occurred, new production technologies may have emerged that have altered the ability or incentives of firms to coordinate their actions. Similarly, innovation may have led to the introduction of

new products that compete with the incumbent products and constrain the ability of the merging firms and their rivals to coordinate successfully in the future.

Commentary Outline

In the chapters that follow, the Commentary explains how the Agencies have applied particular Guidelines' provisions relating to market definition and concentration, competitive effects (including coordinated interaction and unilateral effects analysis), entry conditions, and efficiencies. Application of the Guidelines' provisions relating to failure and exiting assets is not discussed in the Commentary because those provisions are very infrequently applied. For convenience, the order of these chapters follows the order of the issues set forth in the Guidelines.

Included throughout the Commentary are short summaries of matters that the Agencies have investigated. They have been included to further understanding of the principles under discussion at that point in the narrative. None of the summaries exhaustively addresses all the pertinent facts or issues that arose in the investigation. No other significance should be attributed to the selection of the matters used as examples. (In some instances in the Efficiencies chapter, names and other key facts of actual matters are changed to protect the confidentiality of business and proprietary information. Each is noted as a "Disguised Example.") An Index at the end of the Commentary lists all of the mergers discussed in these case examples and provides citations to additional public information.

For the reader's convenience, the case examples briefly state how each investigation ended, i.e., whether it was closed because the Agency determined not to challenge the merger or because the parties abandoned the merger in response to imminent Agency challenge, or whether the investigation proceeded to a consent agreement or to litigation. The discussion within each case example pertains solely to the relevant Agency's analysis of the merger, and does not elaborate on any subsequent judicial or administrative proceedings.

1. Market Definition and Concentration

The Agencies evaluate a merger's likely competitive effects "within the context of economically significant markets—i.e., markets that could be subject to the exercise of market power." Guidelines § 1.0. The purpose of merger analysis under the Guidelines is to identify those mergers that are likely to create or enhance market power in any market. The Agencies therefore examine all plausible markets to determine whether an adverse competitive effect is likely to occur in any of them. The market definition process is not isolated from the other analytic components in the Guidelines. The Agencies do not settle on a relevant market definition before proceeding to address other issues. Rather, market definition is part of the integrated process by which the Agencies apply Guidelines principles, iterated as new facts are learned, to reach an understanding of the merger's likely effect on competition.

The mechanics of how the Agencies define markets using the Guidelines method has been the subject of extensive discussion in legal and economic literature and appears to be well understood in the antitrust community. This Commentary, accordingly, provides only a brief overview of the mechanics. The remainder of this chapter addresses a number of discrete topics concerning market definition issues that frequently arise in merger investigations.

Mechanics of Market Definition

The Guidelines define a market as "a product or group of products and a geographic area in which it is produced or sold such that a hypothetical profit-maximizing firm, not subject to price regulation, that was the only present and future producer or seller of those products in that area likely would impose at least a 'small but significant and nontransitory' increase in price, assuming the terms of sale of all other products are held constant." Guidelines § 1.0.

This approach to market definition is referred to as the "hypothetical monopolist" test. To determine the effects of this "'small but significant and nontransitory' increase in price" (commonly referred to as a "SSNIP"), the Agencies generally use a price increase of five percent. This test identifies which product(s) in which geographic locations significantly constrain the price of the merging firms' products.

The Guidelines' method for implementing the hypothetical monopolist test starts by identifying each product produced or sold by each of the merging firms. Then, for each product, it iteratively broadens the candidate market by adding the next-best substitute. A relevant product market emerges as the smallest group of products that satisfies the hypothetical monopolist test. Product market definition depends critically upon demand-side substitution—i.e., consumers' willingness to switch from one product to another in reaction to price changes. The Guidelines' approach to market definition reflects the separation of demand substitutability from supply substitutability—i.e., the ability and willingness, given existing capacity, of firms to substitute from making one product to producing another in reaction to a price change. Under this approach, demand substitutability is the concern of market delineation, while supply substitutability and entry are concerned with current and future market participants.

Definition of the relevant geographic market is undertaken in much the same way as product market definition—by identifying the narrowest possible market and then broadening it by

iteratively adding the next-best substitutes. Thus, for geographic market definition, the Agencies begin with the area(s) in which the merging firms compete respecting each relevant product, and extend the boundaries of those areas until an area is determined within which a hypothetical monopolist would raise prices by at least a small but significant and non-transitory amount.

***DaVita–Gambro* (FTC 2005)** DaVita Inc., proposed to acquire Gambro Healthcare, Inc. The firms competed across the United States in the provision of outpatient dialysis services for persons with end stage renal disease ("ESRD"). Commission staff found that the relevant geographic markets within which to analyze the transaction's likely competitive effects were local. Most ESRD patients receive treatments about 3 times per week, in sessions lasting 3–5 hours, and in general either are unwilling or unable to travel more than 30 miles or 30 minutes to receive kidney dialysis treatment. In the process of defining the geographic market, staff identified the Metropolitan Statistical Areas ("MSAs") within which both firms had outpatient dialysis clinics, then examined each area to determine if geographic factors such as mountains, rivers, and bays, and travel conditions, were such that the scope of the relevant market differed from the MSA's boundaries.

Within each such MSA, staff isolated the area immediately surrounding each dialysis clinic of both merging parties, and assessed whether a hypothetical monopolist within that area would impose a significant price increase. Staff expanded the boundaries of each area until the evidence showed that such a hypothetical monopolist would impose a significant price increase. From interviews with industry participants and analysis of documents, staff found that, in general, dialysis patients tend to travel greater distances in rural and suburban areas than in dense urban areas, where travel distances as small as 5–10 miles may take significantly more than 30 minutes, due to congestion, road conditions, reliance on public transportation, and other factors. Maps indicating the locations from which each clinic drew its patients were particularly useful. Thus, some MSAs included within their respective boundaries many distinct areas over which a hypothetical monopolist would exercise market power. The Commission entered into a consent agreement with the parties to resolve the concern that the transaction would likely lead to anticompetitive effects in 35 local markets. In an order issued with the consent agreement, the Commission required, among other things, the divestiture of dialysis clinics in the 35 markets at issue.

The Breadth of Relevant Markets

Defining markets under the Guidelines' method does not necessarily result in markets that include the full range of functional substitutes from which customers choose. That is because, as the Guidelines provide, a "relevant market is a group of products and a geographic area that is no bigger than necessary to satisfy [the hypothetical monopolist] test." Guidelines § 1.0. This is one of several points at which the Guidelines articulate what is referred to in section 1.21 as the "'smallest market' principle" for determining the relevant market. The Agencies frequently conclude that a relatively narrow range of products or geographic space within a larger group describes the competitive arena within which significant anticompetitive effects are possible.

***Nestle–Dreyer's* (FTC 2003)** Nestle Holdings, Inc., proposed to merge with Dreyer's Grand Ice Cream, Inc. The firms were rivals in the sale of superpremium ice cream. Ice cream is differentiated on the basis of the quality of ingredients. Compared to premium and non-premium ice cream, superpremium ice cream contains more butterfat, less air, and more costly ingredients. Superpremium ice cream sells at a substantially higher price than premium ice cream. Using scanner data, Commission staff estimated demand elasticities for the superpremium, premium, and economy ice cream segments. Staff's analysis showed that a hypothetical monopolist of superpremium ice cream would increase prices significantly. This, together with other documentary and testimonial evidence, indicated that the relevant market in which to analyze the transaction was superpremium ice cream. The Commission entered into a consent agreement with the merging firms, requiring divestiture of two

brands and of key distribution assets.

***UPM–MACtac* (DOJ 2003)** UPM-Kymmene Oyj sought to acquire (from Bemis Co.) Morgan Adhesives Co. ("MACtac"). They were two of the three largest producers of paper pressure-sensitive labelstock, from which "converters" make pressure-sensitive labels. End users peel pressure-sensitive labels off a silicon-coated base material and directly apply them to items being labeled. The Department challenged the acquisition on the basis of likely anticompetitive effects in two relevant product markets. One was paper labelstock used to make pressure sensitive labels for "variable information printing" ("VIP"). Some or all of the printing on VIP labels is done by end users as the label is applied. A familiar example is the price labeling of fresh meat sold in supermarkets. Although paper labelstock for VIP labels competes with plastic film labelstock, the Department found that film labels are of sufficiently higher cost that a hypothetical monopolist of paper labelstock for VIP labels would raise price significantly. The other relevant product market was paper labelstock used for "prime" labels. Prime labels are used for product identification and are printed in advance of application. Paper labelstock for prime labels, competes not just with film labelstock, but also with pre-printed packaging and other means of product identification. Nevertheless, the Department found that a hypothetical monopolist of paper labelstock for prime labels would raise price significantly because users of pressure-sensitive paper labels find them the least-cost alternative for their particular applications and because they would have to incur significant switching costs if they adopted an alternative means of product identification. After trial, the court enjoined the consummation of the acquisition.

***Tenet–Slidell* (FTC 2003)** Tenet Health Care Systems owned a hospital in Slidell, Louisiana (near New Orleans), and proposed to acquire Slidell's only other full-service hospital. There were many other full-service hospitals in the New Orleans area but all were outside of Slidell. Commission staff found that a significant number of Slidell residents and their employers required access to either of the two Slidell hospitals in their private health insurance plans. The Slidell hospitals competed against each other for inclusion in health plan networks. After merging, the combined hospital would have had no rival with "must have" network status among Slidell residents and employers. A hypothetical monopolist of the Slidell hospitals likely would have imposed a small but significant and non-transitory price increase on health plans selling coverage in Slidell, because neighboring hospitals outside of Slidell were not effective substitutes for network inclusion. The relevant geographic market, therefore, was limited to hospitals located in Slidell. Under Louisiana law, proposed acquisitions of not-for-profit hospitals must be approved by the Louisiana Attorney General. By invitation of the state Attorney General, Commission staff, in a public letter authorized by the Commission, advised the Attorney General of the staff's view that, based on the facts gathered in its then-ongoing investigation, the proposed acquisition raised serious competitive concerns. In a vote authorized by local law, parish residents subsequently rejected the proposed transaction, which never was consummated.

In sections 1.12 and 1.22, the Guidelines explain that the Agencies may define relevant markets on the basis of price discrimination if a hypothetical monopolist likely would exercise market power only, or especially, in sales to particular customers or in particular geographic areas. The Agencies address the same basic issues for any form of discrimination: Would price discrimination, if feasible, permit a significantly greater exercise of market power? Could competitors successfully identify the transactions to be discriminated against? Would customers or third parties be able to undermine substantially the discrimination through some form of arbitrage in which a product sold at lower prices to some customer groups is resold to customer groups intended by the firms to pay higher prices? In cases in which a hypothetical monopolist is likely to target only a subset of customers for anticompetitive price increases, the Agencies are likely to identify relevant markets based on the ability of sellers to price discriminate.

***Quest–Unilab* (FTC 2003)** Quest Diagnostics, Inc. and Unilab Corp., the two leading providers of clinical laboratory testing services to physician groups in Northern California, proposed to merge. Their combined market share would have exceeded 70%; the next largest rival had a market share of 4%. Clinical laboratory testing services are marketed and sold to various groups of customers, including physicians, health insurers, and hospitals. Commission staff determined that purchasers of these services cannot economically resell them to other customers, and that suppliers of the services can potentially identify the competitive alternatives available to physician group customers according to the group's base of physicians and geographic coverage. This information indicated that a hypothetical monopolist could discriminate on price among customer types. Suppliers' ability to price discriminate, combined with the fact that some types of customers had few competitive alternatives to contracting with suppliers that had a network of locations, led staff to define markets based on customer categories. The Commission issued a complaint alleging that the transaction would lessen competition substantially in one of the customer categories: the provision of clinical laboratory testing services to physician groups in Northern California. An accompanying consent order required divestiture of assets used to provide clinical laboratory testing services to physician groups in Northern California.

***Ingersoll-Dresser–Flowserve* (DOJ 2000)** Flowserve Corp. agreed to acquire Ingersoll-Dresser Pump Co. Both firms produced a broad array of pumps used in industrial processes. The Department challenged the proposed acquisition on the basis of likely anticompetitive effects in "API 610" pumps, which are used by oil refineries, and pumps used in electric power plants. Both sorts of pumps are customized according to the specifications of the particular buyer and are sold through bidding mechanisms. Customization of the pumps made arbitrage infeasible. The Department concluded that the competition in each procurement was entirely distinct and therefore that each procurement took place in a separate and distinct relevant market. The Department's challenge to the merger was resolved by consent decree.

***Interstate Bakeries–Continental* (DOJ 1995)** The Department challenged Interstate Bakeries Corp.'s purchase of Continental Baking Co. from Ralston Purina Co. The challenge focused on white pan bread, and the Department found that the purchase likely would have produced significant price increases in five metropolitan areas—Chicago, Milwaukee, Central Illinois, Los Angeles, and San Diego. Among the reasons the Department concluded that competition was localized to these metropolitan areas were that bakers charged different prices for the same brands produced in the same bakeries, depending on where the bread was sold, and that arbitrage was infeasible. Arbitrage was exceptionally costly because the bakers themselves placed their bread on the supermarket shelves, so arbitrage required removing bread from the shelves, reshipping it, and reshelving it. This process also would consume a significant portion of the brief period during which the bread is fresh. The Department settled its challenge to the proposed merger by a consent decree requiring divestiture of brands and related assets in the five metropolitan areas.

The Guidelines indicate that the relevant market is the smallest collection of products and geographic areas within which a hypothetical monopolist would raise price significantly. At times, the Agencies may act conservatively and focus on a market definition that might not be the smallest possible relevant market. For example, the Agencies may focus initially on a bright line identifying a group of products or areas within which it is clear that a hypothetical monopolist would raise price significantly and seek to determine whether anticompetitive effects are—or are not—likely to result from the transaction in such a candidate market. If the answer for the broader market is likely to be the same as for any plausible smaller relevant market, there is no need to pinpoint the smallest market as the precise line drawn does not affect the determination of whether a merger is anticompetitive. Also, when the analysis is identical across products or geographic areas that could each be defined as separate relevant markets using the smallest market principle, the Agencies may elect to

employ a broader market definition that encompasses many products or geographic areas to avoid redundancy in presentation. The Guidelines describe this practice of aggregation "as a matter of convenience." Guidelines § 1.321 n.14.

Evidentiary Sources for Market Definition

The Importance of Evidence from and about Customers

Customers typically are the best source, and in some cases they may be the only source, of critical information on the factors that govern their ability and willingness to substitute in the event of a price increase. The Agencies routinely solicit information from customers regarding their product and supplier selections. In selecting their suppliers, customers typically evaluate the alternatives available to them and can often provide the Agencies with information on their functional needs as well as on the cost and availability of substitutes. Customers also provide relevant information that they uniquely possess on how they choose products and suppliers. In some investigations, customers provide useful information on how they have responded to previous significant changes in circumstances. In some investigations, the Agencies are able to explore consumer preferences with the aid of price and quantity data that allow econometric estimation of the relevant elasticities of demand.

***Dairy Farmers–SODIAAL* (DOJ 2000)** The Department challenged the proposed acquisition by Dairy Farmers of America, Inc. of SODIAAL North America Corp. on the basis of likely anticompetitive effects in the sale of "branded stick and whipped butter in the Philadelphia and New York metropolitan areas." DFA sold the Breakstone brand, and SODIAAL sold the Keller's and Hotel Bar brands. The Department concluded that consumers of branded butter in these metropolitan areas so preferred it over private-label butter, as well as margarine and other substitutes, that a hypothetical monopolist over just branded butter in each of those areas would raise price significantly. This conclusion was supported by econometric evidence, derived from data collected from supermarkets, on the elasticity of demand for branded butter in Philadelphia and New York. The Department's complaint was resolved by a consent decree transferring the SODIAAL assets to a new company not wholly owned by DFA and containing additional injunctive provisions.

In the vast majority of cases, the Agencies largely rely on non-econometric evidence, obtained primarily from customers and from business documents.

***Cemex–RMC* (FTC 2005)** The proposed acquisition of RMC Group PLC by Cemex, S.A. de C.V. would have combined two of the three independent ready-mix concrete suppliers in Tucson, Arizona. Ready-mix concrete is a precise mixture of cement, aggregates, and water. It is produced at local plants and delivered as a slurry in trucks with revolving drums to construction sites, where it is poured and formed into its final shape. Commission staff determined from information received from customers that a hypothetical monopolist over ready-mix concrete would raise price significantly in the relevant area. Asphalt and other building materials were found not to be good substitutes for ready-mix concrete, due in significant part to concrete's pliability when freshly mixed and strength and permanence when hardened. Concerned that the transaction likely would result in coordinated interaction in the Tucson area, the Commission, pursuant to a consent agreement, ordered Cemex, among other things, to divest RMC's Tucson-area ready-mix concrete assets.

***Swedish Match–National* (FTC 2000)** Swedish Match North America, Inc. proposed to acquire National Tobacco Company, L.P. The acquisition would have combined the first- and third-largest producers of loose leaf chewing tobacco in the United States. Commission staff evaluated whether, as the merging firms contended, moist snuff should be included in the relevant market for loose leaf chewing tobacco. Swedish Match's own market research revealed that consumers would substitute less expensive loose leaf, but not more expensive snuff, if loose leaf prices increased slightly. Additional evidence from

the firms' own business documents, and customer testimony from distributors that purchase and resell the products to retailers, demonstrated that loose leaf chewing tobacco constitutes a distinct product market that does not include moist snuff. The acquisition would therefore have resulted in a merged firm with a high share of the relevant market for loose leaf chewing tobacco. The Commission successfully challenged the merger in federal district court.

In determining whether to challenge a transaction, the Agencies do not simply tally the number of customers that oppose a transaction and the number of customers that support it. The Agencies take into account that all customers in a relevant market are not necessarily situated similarly in terms of their incentives. For example, intermediate resellers' views about a proposed merger between two suppliers may be influenced by the resellers' ability profitably to pass along a price increase. If resellers can profitably pass along a price increase, they may have no objection to the merger. End-users, by contrast, generally lack such an incentive because they must absorb higher prices. In all cases, the Agencies credit customer testimony only to the extent the Agencies conclude that there is a sound foundation for the testimony.

Evidence of Effects May Be the Analytical Starting Point

In some investigations, before having determined the relevant market boundaries, the Agencies may have evidence that more directly answers the "ultimate inquiry in merger analysis," i.e., "whether the merger is likely to create or enhance market power or facilitate its exercise." Guidelines § 0.2. Evidence pointing directly toward competitive effects may arise from statistical analysis of price and quantity data related to, among other things, incumbent responses to prior events (sometimes called "natural experiments") such as entry or exit by rivals. For example, it may be that one of the merging parties recently entered and that econometric tools applied to pricing data show that the other merging party responded to that entry by reducing price by a significant amount and on a nontransitory basis while the prices of some other sellers that might be in the relevant market did not.

To be probative, of course, such data analyses must be based on accepted economic principles, valid statistical techniques, and reliable data. Moreover, the Agencies accord weight to such analyses only within the context of the full investigatory record, including information and testimony received from customers and other industry participants and from business documents.

Evidence pertaining more directly to a merger's actual or likely competitive effects also may be useful in determining the relevant market in which effects are likely. Such evidence may identify potential relevant markets and significantly reinforce or undermine other evidence relating to market definition.

***Staples–Office Depot* (FTC 1997)** Staples, Inc. proposed to acquire Office Depot, Inc., a merger that would have combined two of the three national retail chains of office supply superstores. The Commission found that in metropolitan areas where Staples faced no office superstore rival, it charged significantly higher prices than in metropolitan areas where it faced competition from Office Depot or the other office supply superstore chain, OfficeMax. Office Depot data showed a similar pattern: its prices were lowest where Staples and OfficeMax also operated, and highest where they did not. These patterns held regardless of how many non-superstore sellers of office supplies operated in the metropolitan area under review.

The Commission also found that evidence relating to entry showed that local rivalry from office supply superstores acted as the principal competitive constraint on Staples and Office Depot. Each firm regularly dropped prices in areas where they confronted entry by another office supply superstore, but did not do so in response to entry by other sellers of office supplies, such as Wal-Mart. Newspaper advertising and other promotional materials likewise reflected greater price competition in those areas in which Staples and Office Depot faced local rivalry from one another or from OfficeMax. Such evidence provided direct support for the conclusion that the acquisition would cause anticompetitive effects in the relevant product market defined as the sale of

consumable office supplies through office supply superstores, in those metropolitan areas where Staples and Office Depot competed prior to the merger. The Commission successfully challenged the merger in federal district court.

In some cases, competitive effects analysis may eliminate the need to identify with specificity the appropriate relevant market definition, because, for example, the analysis shows that anticompetitive effects are unlikely in any plausibly defined market.

***Federated–May* (FTC 2005)** Federated Department Stores, Inc. proposed to acquire The May Department Stores Co., thereby combining the two largest chains in the United States of so-called "traditional" or "conventional" department stores. Conventional department stores typically anchor enclosed shopping malls, feature products in the mid-range of price and quality, and sell a wide range of products. The transaction would create high levels of concentration among conventional department stores in many metropolitan areas of the United States, and the merged firm would become the only conventional department store at certain of the 1,200 malls in the United States.

If the relevant product market included only conventional department stores, then before the merger Federated had a market share greater than 90% in the New York–New Jersey metropolitan area. If the relevant product market also included, for example, specialty stores, then Federated's share in that geographic area was much smaller. The evidence that Commission staff obtained indicated that the relevant product market was broader than conventional department stores. For example, in the New York–New Jersey metropolitan area, Federated charged consumers the same prices that it charged throughout much of the eastern region of the United States, including where Federated faced larger numbers of traditional department store rivals. May and other department store chains, like Federated, also set prices to consumers that were uniform over very broad geographic areas and did not appear to vary local prices based on the number or identity of conventional department stores in malls or metropolitan areas.

This evidence provided support for the conclusion that the acquisition likely would not create anticompetitive effects. Staff also found no evidence that competitive constraints, e.g., rivalry from retailers other than department stores, in New York–New Jersey were not representative of other markets in which Federated and May competed. Further, evidence pertaining both to which firms the parties monitored for pricing and to consumer purchasing behavior also supported the conclusion that the relevant market was sufficiently broad that the merger was not likely to cause anticompetitive effects. The Commission closed the investigation.

Industry Usage of the Word "Market" Is Not Controlling

Relevant market definition is, in the antitrust context, a technical exercise involving analysis of customer substitution in response to price increases; the "markets" resulting from this definition process are specifically designed to analyze market power issues. References to a "market" in business documents may provide important insights into the identity of firms, products, or regions that key industry participants consider to be sources of rivalry, which in turn may be highly probative evidence upon which to define the "relevant market" for antitrust purposes. The Agencies are careful, however, not to assume that a "market" identified for business purposes is the same as a relevant market defined in the context of a merger analysis. When businesses and their customers use the word "market," they generally are not referring to a product or geographic market in the precise sense used in the Guidelines, although what they term a "market" may be congruent with a Guidelines' market.

***Staples–Office Depot* (FTC 1997)** In the blocked Staples–Office Depot transaction described above in this Chapter, the Commission alleged, and the district court found, that the relevant product market was "the sale of consumable office supplies through office supply superstores," with "consumable" meaning products that

consumers buy recurrently, like pens, paper, and file folders. Industry members in the ordinary course of business did not describe the "market" using this phrase. The facts showed that a hypothetical monopolist office supply superstore would raise price significantly on consumable office supplies. Many retail firms that are not office supply superstores—such as discount and general merchandise stores—sold consumable office supplies in areas near the merging firms. Despite the existence of such other sellers, evidence, including the facts identified above, justified definition of the relevant product market as one limited to the sale of consumable office products solely through office supply superstores.

It is unremarkable that "markets" in common business usage do not always coincide with "markets" in an antitrust context, inasmuch as the terms are used for different purposes. The description of an "antitrust market" sometimes requires several qualifying words and as such does not reflect common business usage of the word "market." Antitrust markets are entirely appropriate to the extent that they realistically describe the range of products and geographic areas within which a hypothetical monopolist would raise price significantly and in which a merger's likely competitive effects would be felt.

***Waste Management–Allied* (DOJ 2003)** Waste Management, Inc. agreed to acquire assets from Allied Waste Industries, Inc. that were used in its municipal solid waste collection operations in Broward County, Florida. The Department challenged the proposed acquisition on the basis of anticompetitive effects in "small container commercial hauling." Commercial haulers serve customers such as office buildings, apartment buildings, and retail establishments. Small containers have capacities of 1–10 cubic yards, and waste from them is collected using specialized, front-end loading vehicles. The Department found that this market was separate and distinct from markets for other municipal solid waste collection services. The Department concluded that a hypothetical monopolist in just small container commercial hauling would have raised prices significantly because it was uneconomical for homeowners to use the much larger containers used by commercial customers and uneconomical for commercial customers using large "roll-off" containers to switch to small commercial containers. The Department's challenge to the merger was resolved by a consent decree requiring divestiture of specified collection routes and the assets used on them.

***Pacific Enterprises–Enova* (DOJ 1998)** Pacific Enterprises (which owned Southern California Gas Co.) and Enova Corp. (which owned San Diego Gas & Electric Co.) agreed to combine the companies under a common holding company. The Department challenged the combination on the basis of likely anticompetitive effects arising from the ability of the combined companies to raise electricity prices by restricting the supply of natural gas. The Department concluded that the relevant market was the sale of electricity in California during periods of high demand. In high-demand periods, limitations on transmission capacity cause prices in California to be determined by power plants in California. Inter-temporal arbitrage was infeasible because there is only a very limited opportunity to store electric power. Thus, the Department concluded that a hypothetical electricity monopolist during just periods of high demand would raise prices significantly. The Department's complaint was resolved by a consent decree requiring divestiture of generating facilities and associated assets.

Market Definition and Integrated Analysis

Market Definition Is Linked to Competitive Effects Analysis

The process of defining the relevant market is directly linked to competitive effects analysis. In analyzing mergers, the Agencies identify specific risks of potential anticompetitive harm, and delineate the appropriate markets within which to evaluate the likelihood of such potential harm. This process could lead to different conclusions about the relevant markets likely to experience competitive harm for two similar mergers within the same industry.

***Thrifty–PayLess* (FTC 1994)** A proposed merger of Thrifty Drug Stores and PayLess Drug Stores would have combined retail drug store chains with store locations near one another in towns in California, Oregon, and Washington. Commission staff identified two potential anticompetitive effects from the merger: (1) that "cash" customers, i.e., individual consumers who pay out of pocket for prescription drugs, likely would pay higher prices; and (2) that third-party payers, such as health plans and pharmacy benefit managers ("PBMs"), likely would pay higher dispensing fees to chain pharmacy firms to obtain their participation in provider networks.

Cash customers tend to shop close to home or place of employment, suggesting small geographic markets for those customers. Third-party payers need network participation from chains having wide territorial coverage. The staff assessed different relevant markets for the two risks of competitive harm. In its complaint accompanying a consent agreement, the Commission alleged that the sale of prescription drugs in retail stores (i.e., sales to cash customers) was a relevant product market and that anticompetitive effects from the merger were likely in this market. The Commission did not allege a diminution in competition regarding the process by which pharmacies negotiate for inclusion in health plan provider networks and sought no relief in that market. The Commission ordered Thrifty, among other things, to divest retail pharmacies in the geographic markets of concern.

***Rite Aid–Revco* (FTC 1996)** The nation's two largest retail drug store chains, Rite Aid Corp. and Revco D.S., Inc., proposed to merge. They competed in many local markets, including in 15 metropolitan areas in which the merged firm would have had more than 35% of the retail pharmacies. As in the foregoing *Thrifty–PayLess* matter, Commission staff defined two markets in which harm potentially may have resulted: retail sales made to cash customers, and sales through PBMs, which contract with multiple pharmacy firms to form networks offering pharmacy benefits as part of health insurance coverage. Pharmacy networks often include a high percentage of local pharmacies because access to many participating pharmacies is often important to plan enrollees.

Rite Aid and Revco constrained one another's pricing leverage with PBMs in bargaining for inclusion in PBM networks. Each merging firm offered rival broad local coverage of pharmacy locations, such that PBMs could assemble marketable networks with just one of the firms included. A high proportion of PBM plan enrollees would have considered the merged entity to be their preferred pharmacy chain, leaving PBMs with less attractive options for assembling networks that did not include the merged firm. This would have empowered the merged firm successfully to charge higher dispensing fees as a condition of participating in a network.

Commission staff determined that the merger was likely substantially to lessen competition in the relevant market of sales to PBMs and similar customers who needed a network of pharmacies. The Commission voted to challenge the merger, stating that "the proposed Rite Aid-Revco merger is the first drug store merger where the focus has been on anticompetitive price increases to the growing numbers of employees covered by these pharmacy benefit plans, rather than exclusively focusing on the cash paying customer." The parties subsequently abandoned the deal.

Many mergers, in a wide variety of industries, potentially have effects in more than one relevant geographic market or product market and require independent competitive assessments for each market.

***Suiza–Broughton* (DOJ 1998)** The Department challenged the proposed acquisition of Broughton Foods Co. by Suiza Foods Corp. Suiza was a nationwide operator of milk processing plants with four dairies in Kentucky and Tennessee. Broughton operated two dairies, including the Southern Belle Dairy in Pulaski County, Kentucky. The two companies competed in the sale of milk and other dairy products to grocery stores, convenience stores, schools, and institutions. The Department's investigation focused on schools, many of which require daily, or every-other-day, delivery. School districts procured the milk through annual contracts, each of which the

Department found to be an entirely separate competition. Thus, the Department defined 55 relevant markets, each consisting of a school district in south central Kentucky in which the proposed merger threatened competition. The Department's complaint was resolved by a consent decree requiring divestiture of the Southern Belle Dairy.

NAT, L.C.–D.R. Partners **(DOJ 1995)** The Department and private plaintiffs challenged the consummated acquisition of the *Northwest Arkansas Times* by interests owning the competing *Morning News of Northwest Arkansas*. The Department concluded that the acquisition likely would harm subscribers of these newspapers as well as local advertisers, and defined separate relevant markets for readers and local advertisers. The Department found that both markets included only daily newspapers because of unique characteristics valued by readers and local advertisers, and concluded that the acquisition likely would harm both groups of customers. The courts required rescission of the acquisition.

Market Definition and Competitive Effects Analyses May Involve the Same Facts

Often the same information is relevant to multiple aspects of the analysis. For example, regarding mergers that raise the concern that the merged firm would be able to exercise unilateral market power, the Agencies often use the same data and information both to define the relevant market and to ascertain whether the merger is likely to have a significant unilateral anticompetitive effect.

General Mills–Pillsbury **(FTC 2001)** General Mills, Inc. proposed to acquire The Pillsbury Co. General Mills owned the Betty Crocker brand of pancake mix and the Bisquick brand of all-purpose baking mix, a product that can be used to make pancakes as well as other products. Pillsbury owned the Hungry Jack pancake mix brand. An issue was whether the relevant product market for pancake mixes included Bisquick. General Mills' Betty Crocker pancake mix had a relatively small share of a candidate pancake mix market that excluded Bisquick, suggesting that the merger likely would not raise significant antitrust concerns in the candidate pancake mix market should the relevant market exclude Bisquick.

In addition to obtaining information from industry documents and interviews with industry participants on the correct contours of the relevant product market, FTC staff analyzed scanner data to address whether Bisquick competed with pancake mixes. Demand estimation revealed significant cross-price elasticities of demand between Bisquick and most of the individual pancake mix brands, suggesting that Bisquick competed in the same relevant market as pancake mixes. Merger simulation based on the elasticities calculated from the scanner data showed that if General Mills acquired Pillsbury it likely would unilaterally raise prices. All of the evidence taken together further confirmed that Pillsbury's Hungry Jack and Bisquick were significant substitutes, and the staff concluded that the relevant market included both pancake mixes and Bisquick. The parties resolved the competitive concerns in this market by selling Pillsbury's baking product line. No Commission action was taken.

Interstate Bakeries–Continental **(DOJ 1995)** The Department challenged Interstate Bakeries Corp.'s purchase of Continental Baking Co. from Ralston Purina Co. on the basis of likely unilateral effects in the sale of white pan bread. Econometric analysis determined that there were substantial cross-elasticities of demand between the Continental and Interstate brands of white pan bread. The Department used the estimated cross-elasticities in a merger simulation, which predicted that the merger was likely to result in price increases for those brands of 5–10%. The data used to estimate these elasticities also were used to estimate the elasticity of demand for white pan bread in the aggregate and for just "premium" brands of white pan bread. The latter estimation indicated that the relevant market was no broader than all white pan bread, despite some limited competition from other bread products and other sources of carbohydrates. The Department's challenge to the proposed merger was settled by a consent decree requiring divestiture of brands and related assets in the five metropolitan areas.

Integrated Analysis Takes into Account that Defined Market Boundaries Are Not Necessarily Precise or Rigid

For mergers involving relatively homogeneous products and distinct, identifiable geographic areas, with no substitute products or locations just outside the market boundaries, market definition is likely to be relatively easy and uncontroversial. The boundaries of a market are less clear-cut in merger cases that involve products or geographic areas for which substitutes exist along a continuum. The simple dichotomy of "in the market" or "out of the market" may not adequately capture the competitive interaction either of particularly close substitutes or of relatively distant substitutes.

Even when no readily apparent gap exists in the chain of substitutes, drawing a market boundary within the chain may be entirely appropriate when a hypothetical monopolist over just a segment of the chain of substitutes would raise prices significantly. Whenever the Agencies draw such a boundary, they recognize and account for the fact that an increase in prices within just that segment could cause significant sales to be lost to products or geographic areas outside the segment. Although these lost sales may be insufficient to deter a hypothetical monopolist from raising price significantly, combined with other factors, they may be sufficient to make anticompetitive effects an unlikely result of the merger.

Significance of Concentration and Market Share Statistics

Section 2 of the Guidelines explains that "market share and concentration data provide only the starting point for analyzing the competitive impact of a merger." Indeed, the Agencies do not make enforcement decisions solely on the basis of market shares and concentration, but both measures nevertheless play an important role in the analysis. A merger in an industry in which all participants have low shares—especially low shares in all plausible relevant markets—usually requires no significant investigation, because experience shows that such mergers normally pose no real threat to lessen competition substantially. For example, if the merging parties are small producers of a homogeneous product, operating in a geographic area where many other producers of the same homogeneous product also are located, the Agencies may conclude that the merger likely raises no competition concerns without ever determining the precise contours of the market. By contrast, mergers occurring in industries characterized by high shares in at least one plausible relevant market usually require additional analysis and consideration of factors in addition to market share.

Section 1.51 of the Guidelines sets out the general standards, based on market shares and concentration, that the Agencies use to determine whether a proposed merger ordinarily requires further analysis. The Agencies use the Herfindahl-Hirschman Index ("HHI"), which is the sum of the squares of the market shares of all market participants, as the measure of market concentration. In particular, the Agencies rely on the "change in the HHI," which is twice the product of the market shares of the merging firms, and the "post-merger HHI," which is the HHI before the merger plus the change in the HHI. Section 1.51 sets out zones defined by the HHI and the change in the HHI within which mergers ordinarily will not require additional analysis. Proposed mergers ordinarily require no further analysis if (a) the post-merger HHI is under 1000; (b) the post-merger HHI falls between 1000 and 1800, and the change in the HHI is less than 100; or (c) the post-merger HHI is above 1800, and the change in the HHI is less than 50.

The Agencies' joint publication of Merger Challenges Data, Fiscal Years 1999–2003 (issued December 18, 2003), and the Commission's publication of Horizontal Merger Investigation Data, Fiscal Years 1996–2003 (issued February 2, 2004 and revised August 31, 2004), document that the Agencies have often not challenged mergers involving market shares and concentration that fall outside the zones set forth in Guidelines section 1.51. This does not mean that the zones are not meaningful, but rather that market shares and concentration are but a "starting point" for the analysis, and that many mergers falling outside these three zones nevertheless, upon full consideration of the factual and economic evidence, are found unlikely substantially to lessen competition. Application of the Guidelines as an integrated whole to case-specific facts—not

undue emphasis on market share and concentration statistics—determines whether the Agency will challenge a particular merger. As discussed in section 1.521 of the Guidelines, historical market shares may not reflect a firm's future competitive significance.

> ***Boeing–McDonnell Douglas*** **(FTC 1997)** The Boeing Co., the world's largest producer of large commercial aircraft with 60% of that market, proposed to acquire McDonnell Douglas Corp., which through Douglas Aircraft had a share of nearly 5% in that market. Airbus S.A.S. was the only other significant rival, and obstacles to entry were exceptionally high. Although McDonnell Douglas was not a failing firm, staff determined that McDonnell Douglas' significance as an independent supplier of commercial aircraft had deteriorated to the point that it was no longer a competitive constraint on the pricing of Boeing and Airbus for large commercial aircraft. Many purchasers of aircraft indicated that McDonnell Douglas' prospects for future aircraft sales were close to zero. McDonnell Douglas' decline in competitive significance stemmed from the fact that it had not made the continuing investments in new aircraft technology necessary to compete successfully against Boeing and Airbus. Staff's investigation failed to turn up any evidence that this situation could be expected to be reversed. The Commission closed the investigation without taking any action.

Indeed, market concentration may be unimportant under a unilateral effects theory of competitive harm. As discussed in more detail in Chapter 2's discussion of Unilateral Effects, the question in a unilateral effects analysis is whether the merged firm likely would exercise market power absent any coordinated response from rival market incumbents. The concentration of the remainder of the market often has little impact on the answer to that question.

2. The Potential Adverse Competitive Effects of Mergers

Section 2 of the Guidelines identifies two broad analytical frameworks for assessing whether a merger between rival firms may substantially lessen competition: "coordinated interaction" and "unilateral effects." A horizontal merger is likely to lessen competition substantially through coordinated interaction if it creates a likelihood that, after the merger, competitors would coordinate their pricing or other competitive actions, or would coordinate them more completely or successfully than before the merger. A merger is likely to lessen competition substantially through unilateral effects if it creates a likelihood that the merged firm, without any coordination with non-merging rivals, would raise its price or otherwise exercise market power to a greater degree than before the merger.

Normally, the likely effects of a merger within a particular market are best characterized as either coordinated or unilateral, but it is possible to have both sorts of competitive effects within a single relevant market. This possibility may be most likely if the coordinated and unilateral effects relate to different dimensions of competition or would manifest themselves at different times.

Although these two broad analytical frameworks provide guidance on how the Agencies analyze competitive effects, the particular labels are not the focus. What matters is not the label applied to a competitive effects analysis, but rather whether the analysis is clearly articulated and grounded in both sound economics and the facts of the particular case. These frameworks embrace every competitive effect of any form of horizontal merger. The Agencies do not recognize or apply narrow readings of the Guidelines that could cause anticompetitive transactions to fall outside of, or fall within a perceived gap between, the coordinated and unilateral effects frameworks.

In evaluating the likely competitive effects of a proposed merger, the Agencies assess the full range of qualitative and quantitative evidence obtained from the merging parties, their competitors, their customers, and a variety of other sources. By carefully evaluating this evidence, the Agencies gain an understanding of the setting in which the proposed merger would occur and how best to analyze competition. This understanding draws heavily on the qualitative evidence from documents and first-hand observations of the industry by customers and other market participants. In some cases, this understanding is enhanced significantly by quantitative analyses of various sorts. One type of quantitative analysis is, as explained in Chapter 1, the "natural experiment" in which variation in market structure (e.g., from past mergers) can be empirically related to changes in market performance.

The Agencies examine whatever evidence is available and apply whatever tools of economics would be productive in an effort to arrive at the most reliable assessment of the likely effects of proposed mergers. Because the facts of merger investigations commonly are complex, some bits of evidence may appear inconsistent with the Agencies' ultimate assessments. The Agencies challenge a merger if the weight of the evidence establishes a likelihood that the merger would be anticompetitive. The type of evidence that is most telling varies from one merger to the next, as do the most productive tools of economics.

In assessing a merger between rival sellers, the Agencies consider whether buyers are likely able to defeat any attempts by sellers after the merger to exercise market power. Large buyers rarely can negate the likelihood that an otherwise

anticompetitive merger between sellers would harm at least some buyers. Most markets with large buyers also have other buyers against which market power can be exercised even if some large buyers could protect themselves. Moreover, even very large buyers may be unable to thwart the exercise of market power.

Although they generally focus on the likely effects of proposed mergers on prices paid by consumers, the Agencies also evaluate the effects of mergers in other dimensions of competition. The Agencies may find that a proposed merger would be likely to cause significant anticompetitive effects with respect to innovation or some other form of non-price rivalry. Such effects may occur in addition to, or instead of, price effects.

The sections that follow address in greater detail the Agencies' application of the Guidelines' coordinated interaction and unilateral effects frameworks.

Coordinated Interaction

A horizontal merger changes an industry's structure by removing a competitor and combining its assets with those of the acquiring firm. Such a merger may change the competitive environment in such a way that the remaining firms—both the newly merged entity and its competitors—would engage in some form of coordination on price, output, capacity, or other dimensions of competition. The coordinated effects section of the Guidelines addresses this potential competitive concern. In particular, the Agencies seek to identify those mergers that are likely either to increase the likelihood of coordination among firms in the relevant market when no coordination existed prior to the merger, or to increase the likelihood that any existing coordinated interaction among the remaining firms in the relevant market would be more successful, complete, or sustainable.

A merger could reduce competition substantially through coordinated interaction and run afoul of section 7 of the Clayton Act without an agreement or conspiracy within the meaning of the Sherman Act. Even if a merger is likely to result in coordinated interaction, or more successful coordinated interaction, and violates section 7 of the Clayton Act, that coordination, depending on the circumstances, may not constitute a violation of the Sherman Act. As section 2.1 of the Guidelines states, coordinated interaction "includes tacit or express collusion, and may or may not be lawful in and of itself."

Most mergers have no material effect on the potential for coordination. Some may even lessen the likelihood of coordination. To identify those mergers that enhance the likelihood or effectiveness of coordination, the Agencies typically evaluate whether the industry in which the merger would occur is one that is conducive to coordinated behavior by the market participants. The Agencies also evaluate how the merger changes the environment to determine whether the merger would make it more likely that firms successfully coordinate.

In conducting this analysis, the Agencies attempt to identify the factors that constrain rivals' ability to coordinate their actions before the merger. The Agencies also consider whether the merger would sufficiently alter competitive conditions such that the remaining rivals after the merger would be significantly more likely to overcome any pre-existing obstacles to coordination. Thus, the Agencies not only assess whether the market conditions for viable coordination are present, but also ascertain specifically whether and how the merger would affect market conditions to make successful coordination after the merger significantly more likely. This analysis includes an assessment of whether a merger is likely to foster a set of common incentives among remaining rivals, as well as to foster their ability to coordinate successfully on price, output, or other dimensions of competition.

Successful coordination typically requires rivals (1) to reach terms of coordination that are profitable to each of the participants in the coordinating group, (2) to have a means to detect deviations that would undermine the coordinated interaction, and (3) to have the ability to punish deviating firms, so as to restore the coordinated status quo and diminish the risk of deviations. Guidelines § 2.1. Punishment may be possible, for example, through strategic price-cutting to the deviating rival's customers, so as effectively to erase the rival's profits from its deviation and make the rival less likely to "cheat" again. Coordination on prices tends to be easier the more transparent are rivals' prices, and coordination through allocation of customers tends to be easier

the more transparent are the identities of particular customers' suppliers. It may be relatively more difficult for firms to coordinate on multiple dimensions of competition in markets with complex product characteristics or terms of trade. Such complexity, however, may not affect the ability to coordinate in particular ways, such as through customer allocation. Under Guidelines analysis, likely coordination need not be perfect. To the contrary, the Agencies assess whether, for example, it is likely that coordinated interaction will be sufficiently successful following the merger to result in anticompetitive effects.

LaFarge–Blue Circle **(FTC 2001)** A merger of LaFarge S.A. and Blue Circle Industries PLC raised coordinated interaction concerns in several relevant markets, including that for cement in the Great Lakes region. In that market, the merger would have created a firm with a combined market share exceeding 40% and a market in which the top four firms would control approximately 90% of the supply. The post-merger HHI would have been greater than 3,000, with a change in the HHI of over 1,000. Cement is widely viewed as a homogeneous, highly standardized commodity product over which producers compete principally on price. Industry practice was that suppliers informed customers of price increases months before they were to take effect, making prices across rival suppliers relatively transparent.

Sales transactions tended to be frequent, regular, and relatively small. These factors heightened concern that, after the merger, incumbents were not only likely to coordinate profitably on price terms, but also that the firms would have little incentive to deviate from the consensus price. That possibility existed because the profit to be gained from deviation would be less than the potential losses that would result if rivals retaliated. The Commission challenged the merger, resolving it by a consent order that required, among other things, divestiture of cement-related assets in the Great Lakes region.

R.J. Reynolds–British American **(FTC 2004)** In a merger of the second- and third-largest marketers of cigarettes, R.J. Reynolds Tobacco Holdings, Inc. proposed to acquire Brown & Williamson Tobacco Corporation from British American Tobacco plc. Within the market for all cigarettes, the merger would have increased the HHI from 2,735 to 3,113. The Commission assessed whether the cigarette market was susceptible to coordinated interaction. Concluding that "the market for cigarettes is subject to many complexities, continual changes, and uncertainties that would severely complicate the tasks of reaching and monitoring a consensus," the Commission closed the investigation without challenging the merger. The Commission's closing statement points to the high degree of differentiation among cigarette brands, as well as sizable variation in firm sizes, product portfolios, and market positions among the manufacturers as factors that created different incentives for the different manufacturers to participate in future coordination. These factors made future coordination more difficult to manage and therefore unlikely.

Both RJR and Brown & Williamson had portfolios of cigarette brands that included a smaller proportion of strong premium brands and a larger proportion of vulnerable and declining discount brands than the other major cigarette competitors. At the time of the merger, both companies were investing in growing a smaller number of premium equity brands to maintain sales and market share. There was uncertainty about the results of these strategic changes. The Commission concluded that uncertainties of these types greatly increased the difficulty of engaging in coordinated behavior. The Commission also noted that competition in the market was driven by discount brands and by equity investment in select premium brands among the four leading rivals, and there was little evidence that Brown & Williamson's continued autonomy was critical to the preservation of either form of competition. Brown & Williamson had been reducing, not increasing, its commitment in the discount segment, and was a very small factor in equity brands.

The Commission also described variations in the marketing environment for cigarettes from state to state and between rural and urban areas. These variations made it more difficult and costly for firms to monitor their rival's activities and added to the complexity of coordination.

Coordination that reduces competition and consumer welfare could be accomplished using many alternative mechanisms. Coordinated interaction can occur on one or more competitive dimensions, such as price, output, capacity, customers served, territories served, and new product introduction. Coordination on price and coordination on output are essentially equivalent in their effects. When rivals successfully coordinate to restrict output, price rises. Similarly, when rivals successfully coordinate on price—that is, they maintain price above the level it would be absent the coordination—the rate of output declines because consumers buy fewer units.

Coordination on either price or output may pose difficulties that can be avoided by coordinating on customers or territories served. Rivals may coordinate on the specific customers with which each does business, or on the general types of customers with which they seek to do business. They also may coordinate on the particular geographic areas in which they operate or concentrate their efforts. Coordination also can occur with respect to aspects of rivalry, such as new product introduction. Rivals are likely to adopt the form of coordination for which it is easiest to spot deviations from the agreed terms of coordination and easiest to punish firms that deviate from those terms. Industry-specific factors thus are likely to influence firms' choices on how to coordinate their activities.

Concentration

The number of rival firms remaining after a merger, their market shares, and market concentration are relevant factors in determining the effect of a merger on the likelihood of coordinated interaction. The presence of many competitors tends to make it more difficult to achieve and sustain coordination on competitive terms and also reduces the incentive to participate in coordination. Guidelines § 2.0. The Guidelines' market share and concentration thresholds reflect this reality.

The Agencies do not automatically conclude that a merger is likely to lead to coordination simply because the merger increases concentration above a certain level or reduces the number of remaining firms below a certain level. Although the Agencies recently have challenged mergers when four or more competitors would have remained in the market, *see, e.g.*, *LaFarge–Blue Circle*, described above, when the evidence does not show that the merger will change the likelihood of coordination among the market participants or of other anticompetitive effects, the Agencies regularly close merger investigations, including those involving markets that would have fewer than four firms.

As discussed in Chapter 1, enforcement data released by the Agencies show that market shares and concentration alone are not good predictors of enforcement challenges, except at high levels. Market shares and concentration nevertheless are important in the Agencies' evaluation of the likely competitive effects of a merger. Investigations are almost always closed when concentration levels are below the thresholds set forth in section 1.51 of the Guidelines. In addition, the larger the market shares of the merging firms, and the higher the market concentration after the merger, the more disposed are the Agencies to concluding that significant anticompetitive effects are likely.

Additional Market Characteristics Relevant to Competitive Analysis

Section 2.1 of the Guidelines sets forth several general market characteristics that may be relevant to the analysis of the likelihood of coordinated interaction following a merger: "the availability of key information concerning market conditions, transactions and individual competitors; the extent of firm and product heterogeneity; pricing or market practices typically employed by firms in the market; the characteristics of buyers and sellers; and the characteristics of typical transactions." Section 2.11 of the Guidelines states that the ability of firms to reach terms of coordination "may be facilitated by product or firm homogeneity and by existing practices among firms, practices not necessarily themselves antitrust violations, such as standardization of pricing or product variables on which firms could compete." Further, "[k]ey information about rival firms and the market may also facilitate reaching terms of coordination." *Id.*

These market characteristics may illuminate the degree of transparency and complexity in the competitive environment. The existence or absence of any particular characteristic (e.g., product homogeneity or transparency in prices) in a relevant market, however, is neither a necessary

nor a sufficient basis for the Agencies to determine whether successful coordination is likely following a merger. In other words, these factors are not simply put on the left or right side of a ledger and balanced against one another. Rather, the Agencies identify the specific factors relevant to the particular mechanism for coordination being assessed and focus on how those factors affect whether the merger would alter the likelihood of successful coordination.

> ***Formica–International Paper*** **(DOJ 1999)** Formica Corp. and International Paper Co. were two producers of high-pressure laminates used to make durable surfaces such as countertops, work surfaces, doors, and other interior building products. Formica sought to acquire the high-pressure laminates business of International Paper Co. There were just four competitors in the United States, and the acquisition of International Paper Co.'s business would have given Formica and its largest remaining competitor almost 90% of total sales between them. The market appeared to have been performing reasonably competitively, but the Department was concerned that two dominant competitors would coordinate pricing and output after the acquisition.
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> One reason for this concern was that the small competitors remaining after the merger had relatively high costs and were unable to expand output significantly, so they would not have been able to undermine that coordination. In addition, the Department concluded that International Paper, with significant excess capacity, had the ability to undermine coordination and had done so. The Department also found that major competitors had very good information on each others' pricing and would be able to detect deviations from coordinated price levels. After the Department announced its intention to challenge the merger, the parties abandoned the deal.

Although coordination may be less likely the greater the extent of product heterogeneity, mergers in markets with differentiated products nonetheless can facilitate coordination. Although a merger resulting in closer portfolio conformity may prompt more intense, head-to-head competition among rivals that benefits consumers, an enhanced mutual understanding of the production and marketing variables that each rival faces also may result. Better mutual understanding can increase the ability to coordinate successfully, thus diminishing the benefits to consumers that the more intense competition otherwise would have provided. Sellers of differentiated products also may coordinate in non-price dimensions of competition by limiting their product portfolios, thereby limiting the extent of competition between the products of rival sellers. They also may coordinate on customers or territories rather than on prices.

> ***Diageo–Vivendi*** **(FTC 2001)** The Commission challenged a merger between Diageo plc and Vivendi Universal S.A., competitors in the manufacture and sale of premium rum—a product that is heterogeneous as to brand name and the type of rum, e.g., light or gold, flavored or unflavored—on the grounds, among others, that the transaction was likely to lead to coordinated interaction among premium rum rivals. Diageo, which owned the Malibu Rum brand with about an 8% share, was seeking to acquire Seagram's, which marketed Captain Morgan Original Spiced Rum and Captain Morgan Parrot Bay Rum brands and had about a 33% share. Bacardi USA, with its Bacardi Light and Bacardi Limon brands, was the largest competitor with about a 54% share. Thus, after the acquisition, Diageo and Bacardi USA would have had a combined share of about 95% in the U.S. premium rum market.
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> Significant differentiation among major brands of rum reduces the closeness of substitution among them. Nonetheless, the Commission had reason to believe that the acquisition would increase the likelihood and extent of coordinated interaction to raise prices. Having a single owner of both the Seagram's rum products and the Malibu brand created the substantial concern that coordination that was not profitable for Bacardi and Seagram's before the merger likely would have become profitable after the merger. Although a smaller rival before the merger, Diageo's Malibu imposed a significant competitive constraint on Seagram's and Bacardi. The Commission challenged the merger and agreed

to a settlement with the parties that required Diageo to divest its worldwide Malibu rum business to a third party.

Role of Evidence of Past Coordination

Facts showing that rivals in the relevant market have coordinated in the past are probative of whether a market is conducive to coordination. Guidelines § 2.1. Such facts are probative because they demonstrate the feasibility of coordination under past market conditions. Other things being equal, the removal of a firm via merger, in a market in which incumbents already have engaged in coordinated behavior, generally raises the risk that future coordination would be more successful, durable, or complete. Accordingly, the Agencies investigate whether the relevant market at issue has experienced such behavior and, if so, whether market conditions that existed when the coordination took place—and thus were conducive to coordination—are still in place. A past history of coordination found unlawful can provide strong evidence of the potential for coordination after a merger.

Air Products–L'Air Liquide **(FTC 2000)** Two of the four largest industrial gas suppliers, Air Products and Chemicals, Inc. and L'Air Liquide S.A., proposed acquisitions that would result in splitting between them the assets of a third large rival, The BOC Group plc. The proposed asset split would have resulted in three remaining industrial gas suppliers that were nearly the same in size, cost structure, and geographic service areas. Products involved in the asset split included bulk liquid oxygen, bulk liquid nitrogen, and bulk liquid argon (together referred to as atmospheric gases), various electronic specialty gases, and helium—each of which is a homogeneous product. Bulk liquid oxygen and nitrogen trade in regional markets, and the transactions would have affected multiple regional areas. In these areas, the four largest producers accounted for between 70% and 100% of the markets. The four suppliers also accounted for about 90% of the national market for bulk liquid argon.

The staff found evidence of past coordination. In 1991, the four major industrial air gas suppliers pled guilty in Canada to a charge of conspiring to eliminate competition for a wide range of industrial gases, including bulk liquid oxygen, nitrogen, and argon. Industrial gas technology is well-established, market institutions in the U.S. were similar to those in Canada, and nothing had changed significantly during the intervening period to suggest that coordination had become more difficult or less likely.

Other evidence also indicated that the markets were susceptible to coordinated behavior: firms announced price changes publicly, and industry-wide price increases tended to follow such announcements; a number of joint ventures, swap agreements, and other relationships among the suppliers provided opportunities for information sharing; and incumbents tended not to bid aggressively for rivals' current customers. Neither fringe expansion nor new entry was likely to defeat future coordination. Staff concluded that the proposed asset split would likely enable the remaining firms to engage in coordination more effectively. The parties abandoned the proposed transactions.

Suiza–Broughton **(DOJ 1999)** Suiza Foods Corp. and Broughton Foods Co. proposed to merge. Broughton owned the Southern Belle dairy in Somerset, Kentucky, and Suiza operated several dairies in Kentucky, including the Flav-O-Rich dairy in London, Kentucky. Six years earlier, when Flav-O-Rich and Southern Belle were independently owned, both pleaded guilty to criminal charges of rigging bids in the sale of milk to schools. The Department found that the proposed merger would have reduced from three to two the number of dairies competing to supply milk to thirty-two school districts in South Central Kentucky, including many that had been victimized by the prior bid rigging. The Department challenged the merger on the basis that it likely would lead to coordinated anticompetitive effects, and the demonstrated ability of these particular dairies to coordinate was a significant factor in the Department's decision. The Department's complaint was resolved by a consent decree requiring divestiture of the Southern Belle Dairy.

Degussa–DuPont **(FTC 1998)** Degussa Aktiengesellschaft, a producer of hydrogen peroxide, proposed to acquire rival E.I. du

Pont de Nemours & Co.'s hydrogen peroxide manufacturing assets. The Commission found that the relevant U.S. market was conducive to coordinated interaction based on evidence that showed, among other things, high concentration levels, product homogeneity, and the ready availability of reliable competitive information. Moreover, the same firms that would have been the leading U.S. producers after the merger had recently been found to have engaged in market division in Europe for several years. The Commission identified this history of collusion as a factor supporting its conclusion that the proposed transaction likely would result in anticompetitive effects from coordinated interaction. Under the terms of a consent agreement to resolve these competitive concerns, the acquirer was permitted to purchase one plant but not the entirety of the seller's hydrogen peroxide manufacturing assets.

Even when firms have no prior record of antitrust violations, evidence that firms have coordinated at least partially on competitive terms suggests that market characteristics are conducive to coordination.

***Rhodia–Albright & Wilson* (FTC 2000)** Rhodia entered into an agreement to acquire Albright & Wilson PLC, a wholly owned subsidiary of Donau Chemie AG. The merging firms were industrial phosphoric acid producers. The Commission developed evidence that the market was highly concentrated, that the relevant product was homogenous, and that timely competitive intelligence was readily available—all conditions that are generally conducive to coordination. Incumbent marketing strategies suggested a tendency to curb aggressive price competition and suggested a lack of competition.

The Commission found that industrial phosphoric acid pricing, unlike the pricing of other similar chemical products, had not historically responded significantly to changes in the rate of capacity utilization among producers. In most chemical product markets, when capacity utilization declines, prices often decline as well. In this market, however, during periods of decline in capacity utilization among industrial phosphoric acid producers, prices often remained relatively stable. All of these factors established that the relevant market—even before the proposed merger—was performing in a manner consistent with coordination. The Commission entered into a consent order requiring, among other things, divestiture of phosphoric acid assets.

When investigating mergers in industries characterized by collusive behavior or previous coordinated interaction, the Agencies focus on how the mergers affect the likelihood of successful coordination in the future. In some instances, a simple reduction in the number of firms may increase the likelihood of effective coordinated interaction. Evidence of past coordination is less probative if the conduct preceded significant changes in the competitive environment that made coordination more difficult or otherwise less likely. Such changes might include, for example, entry, changes in the manufacturing processes of some competitors, or changes in the characteristics in the relevant product itself. Events such as these may have altered the incumbents' incentives or ability to coordinate successfully.

Although a history of past collusion may be probative as to whether the market currently is conducive to coordination, the converse is not necessarily true, i.e., a lack of evidence of past coordination does not imply that future coordination is unlikely. When the Agencies conclude that previous episodes of coordinated interaction are not probative in the context of current market conditions—or when they find no evidence that rivals coordinated in the past—an important focus of the investigation becomes whether the merger is likely to cause the relevant market to change from one in which coordination did not occur to one in which such coordination is likely.

***Premdor–Masonite* (DOJ 2001)** Premdor Inc. sought to acquire (from International Paper Co.) Masonite Corp., one of two large producers of "interior molded doorskins," which form the front and back of "interior molded doors." Interior molded doors provide much the same appearance as solid wood doors but at a much lower cost, and Premdor was the world's largest producer. Premdor also held a substantial equity stake in a firm that supplied some of its doorskins. The vast

majority of doorskins, however, were produced by Masonite and by a third party that was also Premdor's only large rival in the sale of interior molded doors. The Department concluded that the upstream and downstream markets for interior molded doorskins and interior molded doors were highly concentrated and that the proposed acquisition would have removed significant impediments to coordination.

The Department found that the most significant impediment to upstream coordination was Premdor's ability, in the event of an upstream price increase, to expand production of doorskins, both for its own use and for sale to other door producers. The proposed acquisition, however, would have eliminated Premdor's incentive to undermine upstream coordination. The Department also found that a significant impediment to downstream coordination was Masonite's incentive and ability to support output increases by smaller downstream competitors. The proposed acquisition, however, would have eliminated Masonite's incentive to do so.

Finally, the Department found that the acquisition would have facilitated coordination by bringing the cost structures of the principal competitors into alignment, both upstream and downstream, and by making it easier to monitor departures from any coordination. The Department's challenge of the acquisition was resolved by a consent decree requiring, among other things, divestiture of a Masonite manufacturing facility.

Maverick and Capacity Factors in Coordination

A merger may make coordination more likely or more effective when it involves the acquisition of a firm or asset that is competitively unique. In this regard, section 2.12 of the Guidelines addresses the acquisition of "maverick" firms, i.e., "firms that have a greater economic incentive to deviate from the terms of coordination than do most of their rivals (e.g., firms that are unusually disruptive and competitive influences in the market)." If the acquired firm is a maverick, its acquisition may make coordination more likely because the nature and intensity of competition may change significantly as a result of the merger. In such a case, the Agency's investigation examines whether the acquired firm has behaved as a maverick and whether the incentives that are expected to guide the merged firm's behavior likely would be different.

Similarly, a merger might lead to anticompetitive coordination if assets that might constrain coordination are acquired by one of a limited number of larger incumbents. For example, coordination could result if, prior to the acquisition, the capacity of fringe firms to expand output was sufficient to defeat the larger firms' attempts to coordinate price, but the acquisition would shift enough of the fringe capacity to a major firm (or otherwise eliminate it as a competitive threat) so that insufficient fringe capacity would remain to undermine a coordinated price increase.

***Arch Coal–Triton* (FTC 2004)** The Commission challenged Arch Coal, Inc.'s acquisition of Triton Coal Co., LLC's North Rochelle mine in the Southern Powder River Basin of Wyoming ("SPRB"). Prior to the acquisition, three large companies—Arch, Kennecott, and Peabody (the "Big Three")—owned a large majority of SPRB mining capacity. The remaining capacity, including the North Rochelle mine, was owned by fringe companies with smaller market shares. The Commission's competitive concern was that, by transferring ownership of the North Rochelle mine from the fringe to a member of the Big Three, the acquisition would significantly reduce the supply elasticity of the fringe and increase the likelihood of coordination to reduce Big Three output. As a result of the reduction in fringe supply elasticity, a given reduction in output by the Big Three would be more profitable to each member of that group after the acquisition than would have been the case before the acquisition. Mine operators had, in the past, announced their future intentions with regard to production and had publicly encouraged "production discipline." The court denied the Commission's preliminary injunction request and, after further investigation, the Commission decided not to pursue further administrative litigation.

***UPM–MACtac* (DOJ 2003)** UPM-Kymmene Oyj sought to acquire (from Bemis Co.) Morgan Adhesives Co. ("MACtac"). Three

firms—MACtac, UPM's Raflatac, Inc. subsidiary, and Avery Dennison Corp.—were the only large producers of paper pressure-sensitive labelstock, which is used by "converters" to make paper self-adhesive labels for a range of consumer and commercial applications. The Department found that the proposed acquisition would result in UPM and Avery controlling over 70% of sales in the relevant market, and in smaller rivals having insufficient capacity to undermine a price increase by UPM and Avery. Prior to the announcement of its proposed acquisition of MACtac, UPM and Avery had exchanged communications about their mutual concerns regarding intense price competition, and there was evidence that they had reached an understanding to hold the line on further price cuts. MACtac, however, was not a party to this understanding, and it had both substantial excess capacity and the incentive to expand sales by cutting price.

The Department concluded that the proposed acquisition would eliminate the threat to coordination from MACtac and that no other competitor posed such a threat. Also significant was the fact that UPM was a major input supplier for Avery both because this relationship created opportunities for communication between the two and because it made possible mutual threats that could be used to induce or enforce coordination. The Department, therefore, concluded that Avery and UPM would be likely to coordinate after the acquisition and challenged the transaction on that basis. After trial, the district court enjoined the consummation of the acquisition.

Unilateral Effects

Section 2.2 of the Guidelines states that "merging firms may find it profitable to alter their behavior unilaterally following the acquisition by elevating price and suppressing output." The manner in which a horizontal merger may generate unilateral competitive effects is straightforward: By eliminating competition between the merging firms, a merger gives the merged firm incentives different from those of the merging firms. The simplest unilateral effect arises from merger to monopoly, which eliminates all competition in the relevant market. Since the issuance of the Guidelines in 1992, a substantial proportion of the Agencies' merger challenges have been predicated at least in part on a conclusion that the proposed mergers were likely to generate anticompetitive unilateral effects.

Section 2.2 of the Guidelines explains: "Unilateral competitive effects can arise in a variety of different settings. In each setting, particular other factors describing the relevant market affect the likelihood of unilateral competitive effects. The settings differ by the primary characteristics that distinguish firms and shape the nature of their competition." Section 2.2 does not articulate, much less detail, every particular unilateral effects analysis the Agencies may apply.

The Agencies' analysis of unilateral competitive effects draws on many models developed by economists. The simplest is the model of monopoly, which applies to a merger involving the only two competitors in the relevant market. One step removed from monopoly is the dominant firm model. That model posits that all competitors but one in an industry act as a "competitive fringe," which can economically satisfy only part of total market demand. The remaining competitor acts as a monopolist with respect to the portion of total industry demand that the competitive fringe does not elect to supply. This model might apply, for example, in a homogeneous product industry in which the fringe competitors are unable to expand output significantly.

In other models, two or more competitors interact strategically. These models differ with respect to how competitors interact. In the Bertrand model, for example, competitors interact in the choice of the prices they charge. Similar to the Bertrand model are auction models, in which firms interact by bidding. There are many auction models with many different bidding procedures. In the Cournot model, competitors interact in the choice of the quantities they sell. And in bargaining models, competitors interact through their choices of terms on which they will deal with their customers.

Formal economic modeling can be useful in interpreting the available data (even with natural experiments). One type of modeling the Agencies use is "merger simulation," which "calibrates" a model to match quantitative aspects (e.g., demand

elasticities) of the industry in which the merger occurs and uses the calibrated model to predict the outcome of the competitive process after the merger. Merger simulation can be a useful tool in determining whether unilateral effects are likely to constitute a substantial lessening of competition when a particular model mentioned above fits the facts of the industry under review and suitable data can be found to calibrate the model. The fit of a model is evaluated on the basis of the totality of the evidence.

Section 2.2 of the Guidelines does not establish a special safe harbor applicable to the Agencies' consideration of possible unilateral effects. Section 2.2.1 provides that significant unilateral effects are likely with differentiated products when the combined market share of the merging firms exceeds 35% and other market characteristics indicate that market share is a reasonable proxy for the relative appeal of the merging products as second choices as well as first choices. Section 2.2.2 provides that significant unilateral effects are likely with undifferentiated products when the combined market share of the merging firms exceeds 35% and other market characteristics indicate that non-merging firms would not expand output sufficiently to frustrate an effort to reduce total market output.

As an empirical matter, the unilateral effects challenges made by the Agencies nearly always have involved combined shares greater than 35%. Nevertheless, the Agencies may challenge mergers when the combined share falls below 35% if the analysis of the mergers' particular unilateral competitive effects indicates that they would be likely substantially to lessen competition. Combined shares less than 35% may be sufficiently high to produce a substantial unilateral anticompetitive effect if the products are differentiated and the merging products are especially close substitutes or if the product is undifferentiated and the non-merging firms are capacity constrained.

Unilateral Effects from Merger to Monopoly

The Agencies are likely to challenge a proposed merger of the only two firms in a relevant market. The case against such a merger would rest upon the simplest of all unilateral effects models. Relatively few mergers to monopoly are proposed. Some proposed mergers affecting many markets would have resulted in monopolies in one or more of these markets.

Franklin Electric–United Dominion **(DOJ 2000)** Subsidiaries of Franklin Electric Co. and United Dominion Industries were the only two domestic producers of submersible turbine pumps used for pumping gasoline from underground storage tanks at retail stations. The parent companies entered into a joint venture agreement that would have combined those subsidiaries. The Department found that entry was difficult and that other pumps, including foreign-produced pumps, were not good substitutes. Hence, the Department concluded that the formation of the joint venture likely would create a monopoly and thus give rise to a significant unilateral anticompetitive effect. After trial, the district court granted the Department's motion for a permanent injunction.

Glaxo Wellcome–SmithKline Beecham **(FTC 2000)** When Glaxo Wellcome plc and SmithKline Beecham plc proposed to merge, each manufactured and marketed numerous pharmaceutical products. For most products, the transaction raised no significant competition issues, but it did raise concerns in several product lines. Among them was the market for research, development, manufacture, and sale of second generation oral and intravenous antiviral drugs used in the treatment of herpes. Glaxo Wellcome's Valtrex and SmithKline Beecham's Famvir were the only such drugs sold in the United States. Having concern both for the market for currently approved drugs and the market for new competing drugs, the Commission alleged that the merger would have prompted a unilateral increase in prices and reduction in innovation in this monopolized market. The matter was resolved by a consent order, pursuant to which the merged firm was required, among other things, to divest SmithKline's Famvir-related assets.

Suiza–Broughton **(DOJ 1999)** Suiza Foods Corp. and Broughton Foods Co. competed in the sale of milk to school districts, which procured the milk through annual contracts entered into after taking bids. The Department found that competition for each of the school

districts was entirely separate from the others, so each constituted a separate geographic market. The Department sought to enjoin the proposed merger of the two companies after finding that it threatened competition in 55 school districts in south central Kentucky and would have created a monopoly in 23 of those districts. The matter was resolved by a consent order, pursuant to which the merged firm was required to divest the dairy in Kentucky owned by Broughton.

Unilateral Effects Relating to Capacity and Output for Homogeneous Products

In markets for homogeneous products, the Agencies consider whether proposed mergers would, once consummated, likely provide the incentive to restrict capacity or output significantly and thereby drive up prices.

Georgia-Pacific–Fort James **(DOJ 2000)** Georgia-Pacific Corp. and Fort James Corp. were the two largest producers in the United States of "away-from-home" tissue products (i.e., paper napkins, towels, and toilet tissue used in commercial establishments). These products are produced in a two-stage process, the first stage of which is the production of massive parent rolls, which also are used to make at-home tissue products. Georgia-Pacific's proposed acquisition of Fort James would have increased Georgia-Pacific's share of North American parent roll capacity to 36%. Investigation revealed that the industry was operating at nearly full capacity, that capacity could not be quickly expanded, and that demand was relatively inelastic. These factors combined to create a danger that, after the merger, Georgia-Pacific would act as a dominant firm by restricting production of parent rolls and thereby forcing up prices for away-from-home tissue products. Merger simulation indicated that the acquisition would cause a significant price increase. The Department's challenge to the acquisition was settled by a consent decree requiring the divestiture of Georgia-Pacific's away-from-home tissue business.

Unilateral Effects Relating to the Pricing of Differentiated Products

In analyzing a merger of two producers of differentiated consumer products, the Agencies examine whether the merger will alter the merged firm's incentives in a way that leads to higher prices. The seller of a differentiated consumer product raises price above marginal cost to the point at which the profit gain from higher prices is balanced by the loss in sales. Merging two sellers of competing differentiated products may create an incentive for the merged firm to increase the price of either or both products because some of the sales lost as a result of the increase in the price of either of the two products would be "recaptured" by the other.

As section 2.21 of the Guidelines explains, what matters in determining the unilateral effect of a differentiated products merger is whether "a significant share of sales in the market [is] accounted for by consumers who regard the products of the merging firms as their first and second choices." Consumers typically differ widely with respect to both their most preferred products and their second choices. If a significant share of consumers view the products combined by the merger as their first and second choices, the merger may result in a significant unilateral effect.

In all merger cases, the Agencies focus on the particular competitive relationship between the merging firms, and for mergers involving differentiated products, the "diversion ratios" between products combined by the merger are of particular importance. An increase in the price of a differentiated product causes a decrease in the quantity sold for that product and an increase in the quantities sold of products to which consumers switch. The diversion ratio from one product to another is the proportion of the decrease in the quantity of the first product purchased resulting from a small increase in its price that is accounted for by the increase in quantity purchased for the other product. In general, for any two products brought under common control by a transaction, the higher the diversion ratios, the more likely is significant harm to competition.

A merger may produce significant unilateral effects even though a large majority of the substitution away from each merging product goes to non-merging products. The products of

the merging firms need only be sufficiently close to each other (that is, have sufficiently high diversion ratios) that recapturing the portion of the lost sales indicated by the diversion ratios provides a significant incentive to raise prices. Significant unilateral effects are unlikely if the diversion ratios between pairs of products brought together by a merger are sufficiently low.

A merger may produce significant unilateral effects even though a non-merging product is the "closest" substitute for every merging product in the sense that the largest diversion ratio for every product of the merged firm is to a non-merging firm's product. The unilateral effects of a merger of differentiated consumer products are largely determined by the diversion ratios between pairs of products combined by the merger, and the diversion ratios between those products and the products of non-merging firms have at most a secondary effect.

In ascertaining the competitive relationships in mergers involving differentiated products, the Agencies look to both qualitative and quantitative evidence bearing on the intensity or nature of competition. The Agencies make use of any available data that can shed light on diversion ratios, and when possible estimate them using statistical methods. Often, however, the available data are insufficient for reliable estimation of the diversion ratios. The absence of data suitable for such estimation does not preclude a challenge to a merger. The Agencies also rely on traditional sources of evidence, including documentary and testimonial evidence from market participants. Even when the Agencies estimate diversion ratios, documentary and testimonial evidence typically are used to corroborate the estimates.

General Electric–Agfa NDT **(FTC 2003)** General Electric Co. proposed to acquire Agfa NDT Inc. from Agfa-Gevaert N.V. Through their subsidiaries, the firms were the two largest suppliers of ultrasonic non-destructive testing ("NDT") equipment in the United States. NDT equipment is used to inspect the structure and tolerance of materials without damaging them or impairing their future usefulness. Manufacturers and end users in a variety of industries use ultrasonic NDT equipment for quality control and safety purposes. Unilateral concerns arose in three relevant product markets: portable flaw detectors, corrosion thickness gauges, and precision thickness gauges. In each of these markets, the merging parties were the two largest firms, and the combined firm would have had a market share of greater than 70% in each of the markets. Documents and testimonial evidence indicated that the rivalry between GE and Agfa was particularly close, and that, for a wide variety of industry participants, the products of the two firms were their first and second choices. The evidence also showed that the two firms frequently were head-to-head rivals and that this competition benefitted consumers through aggressive price competition and innovation. Evidence also suggested that the remaining fringe manufacturers would not be able to constrain a unilateral price increase by the merged firm. The Commission obtained a consent order requiring divestiture of GE's NDT business.

In many matters involving differentiated consumer products, the Agencies have analyzed price and quantity data generated at the point of sale, particularly by scanners at supermarket checkouts, to assess the likely effect of the merger on prices.

Nestle–Dreyer's **(FTC 2003)** Nestle Holdings, Inc., proposed to merge with Dreyer's Grand Ice Cream, Inc. The firms were rivals in the sale of "superpremium ice cream." Compared to premium and non-premium ice cream, superpremium ice cream contains more butterfat, less air, and more costly ingredients, and sells at a substantially higher price. Nestle sold the Haagen-Dazs brand in competition with the Dreyer's Dreamery, Godiva, and Starbucks brands. Together Nestle and Dreyer's accounted for about 55% of superpremium ice cream sales, and Unilever, through its Ben & Jerry's brand, accounted for nearly all of the rest. Commission staff developed evidence showing that the merger was likely to result in unilateral anticompetitive effects, reflecting the close rivalry between the merging firms. Dreyer's recently had expanded on a large scale into superpremium ice cream production and increased its share in this relatively mature market to above 20%. Analysis suggested that, by expanding, Dreyer's induced increased

competition from incumbent superpremium firms. Econometric analysis showed that the diversion ratios between the Nestle and Dreyer's superpremium brands were sufficient to make a significant unilateral price increase by the merged firm likely. The diversion ratios with Unilever's superpremium brands also were high. The analysis implied that the merged firm would be likely to raise its prices anticompetitively and that Unilever would also likely raise its Ben & Jerry's prices in the post-merger environment. The Commission entered into a consent agreement with the merging firms requiring divestiture of two brands and key distribution assets.

***General Mills–Pillsbury* (FTC 2001)** General Mills, Inc.'s proposed purchase of The Pillsbury Co. from Diageo plc, involved the sale of some of the most widely recognized food products in the United States. Most of the products involved in the transaction did not raise antitrust concerns, but there were overlaps of potential concern in a handful of product lines, including flour. The Pillsbury and General Mills (Gold Medal) brands were the only two national flour brands, and after the merger General Mills would account for over half of total U.S. retail flour sales. Private label sales comprised less than 25% of sales nationwide, with the balance accounted for by numerous regional firms. Evidence tended to indicate that regional brands were not a significant constraint on General Mills and Pillsbury. The regional brands generally were highly differentiated, specialty brands and were not viewed as close substitutes for the more commodity-like General Mills and Pillsbury brands. The degree of constraint provided by private label brands was mixed, with some evidence suggesting that private label brands were a significant constraint but other evidence suggesting otherwise.

Commission staff used scanner data to estimate demand elasticities. Because the strength of private label and regional flour brands varied across geographic regions, staff estimated elasticities for groups of markets defined according to the presence of regional brands. The cross-price elasticities between Gold Medal and Pillsbury brands and between these brands and private label and regional brands differed across regions. For example, the results suggested that Gold Medal and Pillsbury were the closest substitutes in some markets, while private label alternatives were an equally close substitute in other markets. Some regional brands also were found to be relatively close substitutes for Gold Medal and Pillsbury, while others were not. Commission staff used the estimated elasticities to simulate the expected price effect from the merger using the Bertrand model. The results suggested that the merging parties would raise their prices more than 10% even in markets where private label and regional brands were estimated to be equally close substitutes for Gold Medal and Pillsbury.

Commission staff also examined whether pricing for flour varied across markets in relation to the amount of competition from private label or other brands. In particular, staff compared prices in geographic markets that were supplied predominantly by Gold Medal and private label, with prices in markets where Pillsbury or another brand was also strong. The results indicated that Pillsbury generally played an important role in constraining Gold Medal prices. These results were consistent with the elasticity results discussed above, and both suggested that the proposed merger would lead to price increases for flour. The parties resolved the competitive concerns in this market by selling Pillsbury's product line. No Commission action was taken.

***Kimberly-Clark–Scott* (DOJ 1995)** Kimberly-Clark Corp. and Scott Paper Co. were two of the nation's leading producers of consumer paper products when they announced their intention to merge. In facial tissue, Kimberly-Clark and Scott, together with Procter & Gamble, accounted for nearly 90% of all sales, and Kimberly-Clark's Kleenex brand itself accounted for over half of sales. By estimating the relevant demand elasticities using scanner data, the Department determined that Scott's facial tissue products, which were "value" products (sold at relatively low prices) and accounted for only 7% of sales, imposed a significant constraint on Kimberly-Clark's prices. Likewise, in baby wipes, in which Kimberly-Clark and Scott's brands together accounted for approximately 56% of sales, the Department's analysis indicated that each was

the other's most significant competitive constraint. Hence, the Department concluded that acquiring Scott's facial tissue and baby wipes businesses likely would give Kimberly-Clark an incentive to increase prices significantly for the merging brands. The Department's challenge to the proposed merger was settled by a consent decree requiring the divestiture of assets relating to facial tissue and baby wipes.

Interstate Bakeries–Continental **(DOJ 1995)** The Department undertook significant analysis of scanner data in evaluating Interstate Bakeries Corp.'s purchase of Continental Baking Co. from Ralston Purina Co. At the time, Continental, with its Wonder brand, was the largest baker of fresh bread in the United States, and Interstate was the third-largest. The Department's investigation focused on white pan bread. White pan bread is the primary sandwich and toasting bread in the United States, and market participants viewed it as a highly differentiated product. Price differences were a clear indication of consumer preference for premium brands over supermarket private label brands; the price of the premium brands was at least twice the price of the private label products. Econometric evidence confirmed that there was only limited competitive interaction between premium and private label brands. Marketing, econometric, and other evidence also indicated that there were significant preferences among individual premium brands. The Department's investigation focused on five metropolitan areas (Chicago, Milwaukee, Central Illinois, Los Angeles, and San Diego) in which Continental and Interstate had the two largest-selling premium brands, or two of the three largest-selling brands.

Econometric analysis determined that there were substantial cross-elasticities of demand between the Continental and Interstate brands of white pan bread, consistent with a likelihood of significant unilateral anticompetitive effects following the merger. The Department used the estimated cross elasticities in a Bertrand merger simulation, which predicted that the merger was likely to result in price increases of 5–10% for those brands. The Bertrand model was considered reliable for several reasons, including that it accurately predicted pre-merger price-cost margins. In addition, retailers marked up every wholesale price by the same percentage, so estimated retail-level demand elasticities were the same as those at the wholesale level. The Department concluded that the proposed acquisition likely would result in significant price increases for premium white pan bread in five metropolitan areas. The Department's challenge to the proposed merger was settled by a consent decree requiring divestiture of brands and related assets in the five metropolitan areas.

The Agencies challenge only a tiny fraction of proposed mergers. (In fiscal years 1999–2003, over 14,000 transactions were notified to the Agencies under HSR; the Agencies collectively challenged fewer than 200.) The following matters illustrate, for differentiated consumer products, the sort of evidence that has formed the basis of decisions not to challenge particular transactions.

Fortune Brands–Allied Domecq **(FTC 2005)** Fortune Brands, Inc., owner of the Knob Creek brand of bourbon, proposed to acquire Allied Domecq's Maker's Mark brand of bourbon. Commission staff analyzed whether the acquisition would create or enhance unilateral market power for premium bourbon. Staff analysis of information discovered in the investigation suggested that several other large whiskey brands, including bourbons, competed strongly with Maker's Mark and with Knob Creek. Econometric analysis of retail scanner pricing data indicated substantial cross-price elasticities among the several whiskey brands. Using these cross-price elasticities staff estimated the diversion ratios involving Maker's Mark and Knob Creek. The results showed that, in the event of a Maker's Mark price increase, very few of the sales lost would go to Knob Creek. The analysis also found no support for the proposition that Maker's Mark would receive a substantial proportion of the substitution away from Knob Creek in the event of an increase in the price of the latter. The staff closed the investigation.

Maybelline–Cosmair **(DOJ 1996)** The Department investigated and decided not to challenge the proposed merger of Maybelline,

Inc., a leading U.S. cosmetics company, and Cosmair, Inc., the U.S. subsidiary of French cosmetics giant L'Oreal S.A. Maybelline and L'Oreal were leading brands, and both were sold almost exclusively through mass-market outlets. Although the merger involved many products, the investigation focused largely on mascara, in which Maybelline had the leading share among brands sold through mass-market outlets, and L'Oreal ranked third. They combined to account for 52% of sales. Some evidence suggested that the images associated with the merging brands were quite different, and demand estimation was employed to determine whether there was substantial direct competition between them.

As in many other investigations involving differentiated consumer products, the Department relied on weekly data generated by scanners at the point of retail sale. Estimated demand elasticities were used to simulate the effects of the proposed merger using the Bertrand model. The analysis indicated that a significant anticompetitive effect was not likely, and the Department decided not to challenge the proposed merger.

Although the Agencies commonly use scanner data in analyzing the likely competitive effects of mergers involving differentiated products, such data do not exist for many such products. When scanner data do not exist, if feasible, it may be useful to conduct a consumer survey.

***Vail Resorts–Ralston Resorts* (DOJ 1997)** Vail Resorts, Inc. and Ralston Resorts, Inc. were the two largest owner-operators of ski resorts in Colorado. In 1996, Vail proposed to acquire three ski areas operated by Ralston, which would have given Vail control of five ski areas in the "front range" area west of Denver, accounting for 38–50% of front range skier-days. Relying in part on a survey of skiers, the Department found that the Vail and Ralston facilities were close, premium-quality competitors and that skiers were likely to switch from one to the other on the basis of small changes in price, whereas consumers were much less likely to switch to several other resorts considered to be of lesser quality.

Bertrand merger simulation based on the survey data suggested the merger likely would cause a significant increase in lift-ticket prices at the acquiring firm's resorts. The Department therefore challenged the merger. The merger simulation also indicated that divestiture of Ralston's Arapahoe Basin resort would substantially prevent price increases, and that remedy was implemented through a consent decree.

Before challenging a merger involving differentiated consumer products, the Agencies consider the possibility of product repositioning by non-merging firms in accord with section 2.212 of the Guidelines. Consideration of repositioning closely parallels the consideration of entry, discussed below, and also focuses on timeliness, likelihood, and sufficiency. The Agencies rarely find evidence that repositioning would be sufficient to prevent or reverse what otherwise would be significant anticompetitive unilateral effects from a differentiated products merger. Repositioning of a differentiated product entails altering consumers' perceptions instead of, or in addition to, altering its physical properties. The former can be difficult, especially with well-established brands, and expensive efforts at doing so typically pose a significant risk of failure and thus may not be undertaken.

Unilateral Effects Relating to Auctions

In some markets, buyers conduct formal auctions to select suppliers and set prices. In such markets, the Agencies account for the fact that competition takes place through an auction. To an extent, the effects of a merger may depend on the specific auction format employed, and the Agencies also account for the specific format of the auction. The basic effects of mergers, however, may be quite similar in different auction formats.

Procurement through an auction tends to be simple for a homogeneous industrial product.

***Cargill–Akzo Nobel* (DOJ 1997)** Cargill, Inc. proposed to acquire the western hemisphere salt-producing assets of Akzo Nobel, N.V. Cargill and Akzo Nobel were two of only four competitors engaged in the production of rock salt used for de-icing purposes in an area of the United States centered on the eastern portion of Lake Erie, and de-icing salt was sold primarily to government agencies through formal sealed bid auctions. To gauge the likely

unilateral effect of the merger, the Department conducted an econometric analysis of data on winning bids in the area of interest and found that bids had been significantly lower when there were four bids than when there were three. Partly on the strength of that evidence, the Department challenged the merger on the basis of a likely unilateral price increase, and the case was settled by a consent decree requiring divestitures.

Procurement using an auction is also observed with more complex and customized products. With customized products, arbitrage between customers is likely to be infeasible, and the Agencies have sometimes found that there was a separate competition in each auction because vendors tailored their prices and other terms to the particular situation of each customer.

Chicago Bridge–Pitt-Des Moines **(FTC 2005)** The Commission issued an administrative ruling that the consummated acquisition by Chicago Bridge & Iron Co. of certain assets from Pitt-Des Moines, Inc., violated section 7 of the Clayton Act and section 5 of the FTC Act. The companies designed, engineered, and built storage tanks for liquified natural gas ("LNG"), liquified petroleum gas ("LPG"), and liquid atmospheric gases such as nitrogen, oxygen, and argon ("LIN / LOX"); they also designed, engineered, and built thermal vacuum chambers ("TVC"). It was uncontested that each of these "field-erected" products was a distinct relevant market. The Commission found that, in all four markets, respondents were each other's closest pre-acquisition rival and that together they largely had dominated sales since 1990. Field-erected tanks for LNG, LPG, and LIN / LOX, and TVCs are custom-made to suit each purchaser's needs, and customers place great emphasis upon a supplier's reputation for quality and service.

For each of the relevant products, customers generally seek competitive bids from several suppliers. Customers in the tank markets use a second round of bidding to negotiate price, and sometimes inform bidders of the existence of competition to reduce the prices that are bid. TVC customers select one bidder with which to negotiate a best and final offer, or they negotiate such offers from multiple bidders. Chicago Bridge exerted substantial competitive pressure on Pitt-Des Moines, and vice-versa. The companies closely monitored each other's activities, and customers frequently were able to play one firm against the other in order to obtain lower prices. Although other firms sometimes were awarded bids, the Commission found that most pre-merger competition was between Chicago Bridge and Pitt-Des Moines.

The bidding evidence also showed that the markets were not characterized by easy entry and expansion and that Chicago Bridge and Pitt-Des Moines would have continued to dominate the competition for years. The Commission considered specific instances of bidding by entrants into the relevant markets but concluded that these instances of bidding did not demonstrate that the entrants would be able to gain enough market share to affect prices and provide sufficient competition to replace the competition that was lost through the merger. In most instances, entrants' bids were rejected because the entrants lacked requisite reputation and experience. To remedy the transaction's anticompetitive effects, the Commission ordered Chicago Bridge, among other things, to reorganize its business into two stand-alone divisions, and divest one of them.

Metso Oyj–Svedala **(FTC 2001)** In a merger involving producers of rock-crushing equipment, Metso Oyj proposed acquiring Svedala Industri AB. Rock-crushing equipment is used in mining and aggregate production to make small rocks out of big rocks. Rock-crushing equipment includes cone crushers, jaw crushers, primary gyratory crushers, and grinding mills. Each of these types of equipment was determined to be a separate relevant product market. In some of these markets, Metso and Svedala were the largest and second largest competitors, and the combined firm would have had a market share many times higher than any other competitor. Competition in these markets was analyzed in an auction model. Metso and Svedala regularly bid against each other for rock-crushing equipment sales in each of the relevant markets. By eliminating competition between these two leading suppliers, the proposed acquisition would have allowed Metso to raise prices unilaterally for certain

bids and to reduce innovation. The Commission resolved the competitive concerns by requiring divestitures in the relevant markets of concern.

Ingersoll-Dresser–Flowserve **(DOJ 2001)** Flowserve Corp. proposed to acquire Ingersoll-Dresser Pump Co. These companies were two of the largest U.S. manufacturers of specialized, highly engineered pumps used in oil refining ("API 610 pumps") and electrical generation facilities ("power plant pumps"), and only two other suppliers competed to sell these pumps in the United States. These pumps are procured through formal sealed-bid auctions and then manufactured to meet the buyers' specifications. The Department found that each of these auctions was an entirely separate competition, and therefore each constituted a distinct relevant market. The Department also found that there were only four competitors in these markets and concluded that the merger likely would cause the remaining competitors unilaterally to increase their bids significantly. Each competitor would realize that eliminating a bidder in these auctions would increase the probability of winning the auction associated with any given bid. The Department's challenge to the acquisition was settled by a consent decree requiring divestiture of Flowserve brands as well as manufacturing and repair facilities.

The procurement process for many complex products tends to be rather involved, and competition may occur in several distinct stages with extensive discussions between buyer and seller at such stages. The Agencies have often found that such competition could be understood in terms of an auction model with the procurement process working much like multiple rounds of bidding in an oral auction.

Arch Wireless–Metrocall **(DOJ 2004)** The Department investigated and decided not to challenge the proposed acquisition of Metrocall Holdings, Inc. by Arch Wireless, Inc. The two firms were the two largest providers of paging services in the United States. The Department focused on possible unilateral anticompetitive effects in the sale of one-way paging services to businesses in many individual metropolitan areas within the United States. In these areas, the combined firm would have accounted for a share of all pager units in service from less than 15% to over 80%. Because many paging customers had switched to other technologies, such as cellular or PCS telephony, the Department focused on the customers least likely to switch, notably many hospitals and emergency "first responders."

The Department observed that the competition at any one hospital was separate from the competition at any other, and that each hospital paid a price determined by that hospital's particular needs and the local rivalry among alternative technologies. This suggested that competition was best analyzed as an oral auction. The Department ultimately concluded that the merger likely would not substantially lessen competition primarily because most customers have sufficient alternatives to Arch and Metrocall. These alternatives included other paging providers, self-provision of paging services, and emerging technologies, such as wireless local area networks. Although some customers may not have sufficient alternatives, the Department concluded that service providers competing for their business would not be able to identify such customers and therefore likely would act as if they faced substantial competition.

Quest Diagnostics–Unilab **(FTC 2003)** Quest Diagnostics, Inc. and Unilab Corp. were the two leading providers of clinical laboratory testing services to physician groups in Northern California, with a combined market share of approximately 70% (the next largest competitor had approximately 4%). Delivery of health care in California was distinguished by high penetration by managed care organizations, which often delegated the financial risk for providing health care services to physician groups. Independent physician associations ("IPAs") in Northern California that assumed the financial risk for laboratory services, generally under a capitated arrangement, constituted a significant category of purchasers of laboratory services. IPA arrangements with the laboratories typically consisted of exclusive or semi-exclusive contracts, pursuant to which the physician group paid the laboratory a set amount per month for each patient affiliated with the pre-

paid health plans.

An auction model best represented competition for these capitated contracts with the IPAs. Quest and Unilab were the first- and second-lowest bidders for a substantial portion of these contracts, and thus the merger was likely to cause prices to rise to the constraining level of the next-lowest-price seller. The Commission resolved by consent agreement its concern that the merger was likely to result in anticompetitive effects. Pursuant to the consent agreement, the Commission ordered, among other things, that the merged firm divest assets used to provide clinical laboratory testing services to physician groups in Northern California.

Unilateral Effects Relating to Bargaining

In some markets, individual sellers negotiate with individual buyers on a transaction-by-transaction basis to determine prices and other terms of trade. The merger of competing sellers in such markets may enhance the ability of the combined seller to bargain for a more favorable result. That may be most apt to occur if, before the merger, the buyer viewed a bargain with either of the two merging parties as significantly better than a bargain with any other seller. In that event, the merger could cause the buyer to be willing to accept worse terms from the merged seller rather than to strike no bargain at all. That willingness normally would cause a bargain to be struck on terms less favorable for the buyer.

***Aspen Technology–Hyprotech* (FTC 2004)** The Commission challenged the consummated acquisition by Aspen Technology, Inc. of Hyprotech, Ltd. Prior to the acquisition, they were two of the three significant vendors of process engineering simulation software. This software is used in the petroleum, chemical, and pharmaceutical industries to design new, and model existing, processes to produce intermediate and finished products. The combined firm accounted for between 67% and 82% of various process engineering simulation software markets, and a single other firm made virtually all other sales. The Commission's complaint alleged that the transaction may have allowed AspenTech unilaterally to exercise market power in seven global markets. The firms' software offerings were differentiated in their respective capabilities and in how well they met customers' needs and equipment. Evidence showed that AspenTech and Hyprotech were the two closest competitors on price and on innovation in each of the markets. Evidence also showed that, prior to the merger, AspenTech and Hyprotech discounted prices to win or maintain customers, and that, due to the merger, customers would no longer be able to obtain a lower price from AspenTech by threatening to switch to Hyprotech. The third firm in the market was declining and represented a less credible threat for customers to use in price negotiations. This suggested that competition was best analyzed in a bargaining framework. Staff concluded that the transaction would have allowed AspenTech to profit by unilaterally raising prices and reducing innovation because a significant portion of the sales that may otherwise have been lost to the other merging partner as a consequence of such actions would be retained because of the acquisition. The Commission resolved these competitive concerns by issuing a consent order requiring divestiture of certain process engineering simulation software assets.

The Agencies have used bargaining theory to analyze the effects of hospital mergers on the prices they charge managed care organizations ("MCOs"). MCOs market health care plans in which subscribers' health care costs are, in whole or in part, paid for directly by the plan or reimbursed after being paid by the subscriber. MCOs negotiate with health care providers, especially hospitals, the charges they or their subscribers pay. A subscriber's out-of-pocket costs of using a particular hospital depends significantly on whether that subscriber's plan has contracted with that hospital and on what terms.

To market a plan successfully in a given area, an MCO seeks to contract on favorable terms with a wide array of hospitals so that the hospitals preferred by many potential subscribers are available to them on favorable terms. Subscribers are attracted to a plan by the ability to get care from providers they prefer on favorable terms resulting from the MCO having negotiated discounts off the providers' usual rates. The

strength of a hospital's bargaining position with respect to MCOs is determined in large part by the proximity of other hospitals offering a similar or broader package of services with a similar or higher perceived quality. For example, close head-to-head competition between two hospitals allows an MCO credibly to threaten both that it will contract with, and steer its patients to, only the other. The elimination of such competition through a merger, therefore, can enable the hospitals to negotiate higher prices.

***Carilion–Centra* (FTC 2005)** The Commission investigated a consummated joint venture between Carilion Health System, the largest hospital system in southwest Virginia, and Centra Health, Inc. Carilion owns and operates two large hospitals in Roanoke, Virginia, while Centra owns two hospitals in Lynchburg, Virginia. Prior to the transaction, Carilion also was the sole owner of a small community hospital located in Bedford County, halfway between Roanoke and Lynchburg, about 30 miles from each city. In connection with the joint venture transaction, Carilion sold half of its interest in Bedford to Centra, so that the two hospital systems each had a 50% interest in the Bedford facility.

The joint venture partners, Carilion and Centra, were the two largest hospital competitors in the Bedford area prior to the joint venture. Staff examined whether the joint venture would result in an increase in prices in Bedford County as a result of reduced competition between Carilion and Centra to attract Bedford area patients. Staff found that, after the creation of the joint venture, the Bedford hospital negotiated its prices separately from the Carilion or Centra systems and that Bedford prices either declined substantially or remained roughly the same. Staff closed the investigation.

***Slidell Memorial–Tenet* (FTC 2003)** Tenet Health Care Systems, which operated NorthShore Regional Medical Center in Slidell, Louisiana, proposed to acquire Slidell Memorial Hospital. The transaction would have combined the only full-service acute care hospitals in Slidell. Evidence suggested to Commission staff that Slidell residents and their employers demanded health insurance plans that included either Slidell Memorial or NorthShore Regional as network participants, and that a nearby small surgical hospital and cardiac specialty hospital were inadequate substitutes because they were not full-service hospitals.

If Tenet purchased Slidell Memorial, health insurance companies would face the choice either of meeting Tenet's price terms, or, alternatively, excluding both NorthShore Regional and Slidell Memorial from their provider networks. The latter action would likely make the health plan far less marketable, particularly to employers and their employees who desire access to a Slidell hospital. In addition, a health plan that did not include these hospitals could offer services only from physicians willing and able to treat the plan's patients at hospitals located outside of Slidell. Information received from local employers, residents, and health insurance plans suggested to Commission staff that health insurance companies would be unlikely to risk losing NorthShore Regional, Slidell Memorial, and the physician base of the hospitals, and instead likely would agree to a price increase. Commission staff set forth its competition analysis in public comments to the Louisiana Attorney General, subsequent to which local citizens, prior to conclusion of the Commission's investigation, voted to reject the proposed acquisition. The deal was never consummated.

***Rite Aid–Revco* (FTC 1996)** The nation's two largest retail drug store chains, Rite Aid Corp. and Revco D.S., Inc., sought to merge. The firms competed with each other in many local markets, including in 15 metropolitan areas in which the merged firm would have had more than 35% of the retail pharmacies. Commission staff analyzed the merger's effect on retail sales made through pharmacy benefit plans. Pharmacy benefit managers ("PBMs") contract with multiple pharmacy firms to form networks offering pharmacy benefits as part of health insurance coverage. Pharmacy networks often include a high percentage of local pharmacies because access to many participating pharmacies is often important to plan enrollees.

Rite Aid and Revco each offered a significant portion of the broad local coverage

that payers demanded on behalf of their enrollees. Marketable networks could be assembled with just one of the firms participating. After the merger, a high proportion of plan enrollees would have considered the merged entity to be their most preferred pharmacy chain, leaving PBMs with less attractive options for assembling networks that did not include the merged firm. The merged firm as a result unilaterally could have demanded higher dispensing fees as a condition of participating in a network. The Commission voted to challenge the transaction, after which the parties abandoned it.

Mergers can create or enhance market power on the part of buyers as well as on the part of sellers. The Agencies, therefore, consider the possibility that a merger would produce a significant anticompetitive effect by eliminating competition between the merging firms in a relevant market in which they compete for an input. By eliminating an important alternative for input suppliers, a merger can lessen competition for an input significantly.

***Aetna–Prudential* (DOJ 1999)** Aetna, Inc. proposed to acquire assets relating to health insurance from The Prudential Insurance Co. of America. The acquisition would have eliminated head-to-head competition between Aetna and Prudential in the sale of health maintenance organization ("HMO") and HMO-based point-of-service health plans in Dallas and Houston. The Department challenged the proposed acquisition on the basis of likely anticompetitive effects in the purchase of physicians services for these two types of health plans and on the basis of likely anticompetitive effects in the sale of those plans. The Department concluded that the proposed merger would have allowed Aetna to reduce physician reimbursement rates because it would have significantly increased the number of patients enrolled in Aetna health plans and therefore also the number of patients a physician would have lost by terminating participation in Aetna health plans. The Department's challenge to the acquisition was settled by a consent decree requiring, among other things, the divestiture of interests Aetna had acquired in two other health plans operating in Dallas and Houston.

3. Entry Analysis

As explained by section 3.0 of the Guidelines, an anticompetitive merger can create "sales opportunities available to entrants," and consequently a "merger having anticompetitive effects can attract . . . entry, profitable at premerger prices, that would not have occurred" without the merger. In evaluating the competitive effects of a proposed merger, the Agencies therefore ask whether the merger would attract entry that "would be timely, likely, and sufficient in its magnitude, character and scope to deter or counteract the competitive effects" of the merger, thereby causing "prices to fall to their premerger levels or lower." To address this question, the Agencies examine industry conditions to determine whether a merger is likely to attract entry, as well as whether entry would be likely to prevent, or to reverse in a timely fashion, any anticompetitive effects of a merger.

In evaluating the likely competitive effects of a proposed merger, the Agencies distinguish among different sorts of firms that potentially would supply the relevant product in the event of an attempt to exercise market power. Section 3 of the Guidelines addresses "committed entry," which is defined as "new competition that requires expenditure of significant sunk costs." Costs associated with entry are "sunk" if they cannot be recovered by reversing the entry decision. Section 1.32 of the Guidelines addresses "uncommitted entry," which refers to supply responses not incurring significant sunk costs. Uncommitted entry normally takes the form of incumbent firms using their existing assets to make products or perform services those firms do not currently make or perform.

The focus of this chapter is Section 3 of the Guidelines, which addresses committed entry, referred to here simply as "entry." Other sections of the Guidelines separately consider three specific types of supply responses to mergers: output increases by maverick incumbent firms that potentially would frustrate coordination among the merged firm and its rivals (§ 2.12 & n.20); output increases by market incumbents with excess capacity that potentially would frustrate the unilateral exercise of market power with undifferentiated products (§ 2.22 & n.24); and product repositioning by non-merging firms that potentially would frustrate the unilateral exercise of market power with differentiated products (§ 2.212 & n.23). As with entry, the examination of these supply responses focuses on the likelihood, timeliness, and sufficiency of the supply response.

Entry may be considered successful if the entrant generates sufficient revenue to cover all costs apart from the sunk costs of entry. Such entry succeeds in the sense that the entrant becomes and remains a viable competitor in the market. Defined in this way, successful entry into some markets may require nothing more than the investment of time and money. In such a market, an anticompetitive merger nevertheless will not attract entry if the sunk cost is so great that the entry offers little prospect of a reasonable return on that investment. Significant sunk costs may be associated, for example, with building a manufacturing facility, developing a product, achieving regulatory approvals, and gaining customer acceptance. An anticompetitive merger also will not attract entry if the risk of failed entry, and the associated loss of the entry investment, is so great that potential rewards do not justify making that investment. The Agencies therefore examine the sunk costs and likely returns associated with entry.

In other markets, successful entry may not be possible despite the investment of time and money because success may depend on factors over which a potential entrant has little control. For example, an anticompetitive merger may not attract entry because entry is regulated or even

legally barred, or because entrants' efforts would be stymied by the intellectual property rights of incumbents or by the unavailability of essential inputs. An anticompetitive merger also may not attract entry because entrants would suffer significant cost disadvantages in competing with incumbents. This situation can occur for a variety of reasons, but tends to be most important when entrants would be unlikely to achieve the economies of scale (i.e., reductions in average cost from operating at a higher rate of output) and scope (i.e., reductions in cost from producing several products together) already achieved by incumbents. The Agencies therefore examine obstacles to entry and possible cost disadvantages for entrants.

If a merger does attract entry, that entry still may be insufficient to deter or fully counteract the merger's anticompetitive effect, or the entrant may take so long to achieve market significance that the merger nevertheless produces sustained anticompetitive effects. The Agencies therefore examine how long entry would take and how it likely would affect the merger's competitive consequences. The discussion that follows addresses in more detail the Guidelines' concepts of likelihood, timeliness, and sufficiency of entry.

Likelihood of Entry

The Agencies do not assess merely whether firms *could* commit incremental resources to the relevant market, but more importantly whether the proposed merger *would* be likely to induce firms to do so in a timely fashion and in a sufficient magnitude to deter or counteract the merger's anticompetitive effects. Thus, information regarding such factors as technical capability, know-how, sunk costs, and other requirements for successful entry is necessary, but not sufficient, for the Agencies' evaluation of entry conditions. The Agencies must also determine whether firms would have an adequate profit incentive to enter at prices prevailing before the merger, i.e., the prices to which the market likely would return following entry sufficient to deter or counteract the merger's anticompetitive effects. In evaluating the likelihood of entry, the Agencies thus focus on the sales opportunities created by the proposed merger.

Sunk Costs and Risks Associated with Entry

Consumer Products

The Agencies commonly find that proposed mergers involving highly differentiated consumer products would not attract the entry of new brands because entry would not be profitable at pre-merger prices. In a market populated by well-established brands, successful entry usually requires a substantial investment in advertising and promotional activity over a long period of time to build share and achieve widespread distribution through retail channels. Moreover, making such investments by no means assures success.

***Nestle–Dreyer's* (FTC 2003)** Nestle Holdings, Inc. proposed to merge with Dreyer's Grand Ice Cream, Inc. The firms were two of the top three rivals in the superpremium ice cream market. Those three combined for 98% of sales. Grocery retailer private label sales accounted for the remaining 2%. Evidence showed entry to be difficult, both because of the need to develop brand equity to compete effectively, and the need to obtain effective distribution, which is difficult in this market because the product must be maintained at a particular freezing temperature throughout the distribution process. The Commission determined that entry was unlikely to prevent or reverse the merged firm's likely unilateral anticompetitive price increase and challenged the merger. To resolve the competitive concerns, the Commission entered into a consent agreement with the parties requiring divestiture of two brands.

***Staples–Office Depot* (FTC 1997)** The Commission successfully challenged a merger between Staples, Inc. and Office Depot, Inc., two of the three national office supply superstore retail chains. The Commission found, and the court agreed, that entry was unlikely to prevent anticompetitive effects arising from the merger. Important to this finding was that the three incumbent office superstores had saturated many of the local markets such that a new office superstore entrant would have difficulty in achieving economies of scale in, among other things,

advertising and distribution.

Kimberly-Clark–Scott **(DOJ 1995)** The Department found that entry would be unlikely to be attracted by the proposed merger of Kimberly-Clark Corp. and Scott Paper Co., which the Department challenged on the basis of unilateral anticompetitive effects in facial tissue and in baby wipes. Brand recognition was very important for both products, and the Department concluded that the costs and risks associated with establishing new brands likely would prevent the sort of entry that could prevent or reverse the likely anticompetitive effects of the merger. The Department's challenge to the proposed merger was settled by a consent decree requiring the divestiture of assets relating to facial tissue and baby wipes.

Successful prior entry can provide evidence that an anticompetitive merger would attract entry despite the need to make a substantial investment in advertising and promotional activity. Successful prior entry, however, is by no means proof that entry likely would occur following a proposed merger, or that any such entry would be sufficient to prevent significant anticompetitive effects. Evidence of the severity of entry obstacles sometimes is found in an inability of past entrants to gain consumer acceptance.

L'Oreal–Carson **(DOJ 2000)** In considering L'Oreal's proposed acquisition of Carson, Inc., the Department found that several brands of hair relaxer kits introduced in recent years had been unable to generate significant sales. That evidence reinforced the Department's conclusion that the proposed merger would not attract entry sufficient to deter or counteract the likely anticompetitive effects of the merger. The Department's challenge to the merger was resolved by a consent decree requiring the divestiture of relevant brands and associated assets, including a manufacturing facility.

Swedish Match–National **(FTC 2000)** Swedish Match North America, Inc., proposed to acquire National Tobacco Company, L.P. The companies were the first- and third-largest producers of loose leaf chewing tobacco in the United States, with shares of 42% and 18%. Swedish Match's loose leaf products included the Red Man premium brands. National Tobacco produced the Beech-Nut line of premium brands. The Commission successfully challenged the merger in district court, asserting that the transaction would result in anticompetitive effects in the U.S. market for loose leaf chewing tobacco. The evidence showed that entry would be thwarted by, among other things, the substantial sunk costs required to overcome strong brand loyalty. The evidence included prior unsuccessful efforts at introducing new brands by established rivals.

Mergers involving differentiated consumer products also may be unlikely to attract entry because no customer has an incentive to sponsor entry. Wholesale customers often are retailers, and there are circumstances under which retailers suffer little from wholesale price increases because they pass the price increases on to final consumers. Moreover, retailers can benefit from a merger of manufacturers if the retailers sell private label products in competition with the merging manufacturers. A merger involving differentiated consumer products also is unlikely to attract entry when its anticompetitive effects would be felt in just a few local markets or if there are important local brands catering to local tastes and traditions.

Interstate Bakeries–Continental **(DOJ 1995)** The Department challenged the proposed purchase of Continental Baking Co. by Interstate Bakeries Corp. on the basis of anti-competitive effects in the sale of white pan bread within five metropolitan areas. Anticompetitive effects in these five metropolitan areas would have been unlikely to attract entry by a national brand because the overall effect of the merger on national price would have been insignificant. In each of the five metropolitan areas, only one of the leading premium brands was sold nationally, while the others were regional or strictly local. Anticompetitive effects in these areas would have been unlikely to attract local entry because the sunk costs of brand development would be spread over relatively few sales and because important media used for advertising and promotion cannot be effectively targeted at limited metropolitan areas. The Department's challenge to the proposed

merger was settled by a consent decree requiring divestiture of brands and related assets in the five metropolitan areas.

Industrial Products

The sources of the sunk costs associated with entry into markets for industrial products vary from one market to the next. In many markets, the only significant sunk costs are those associated with the construction or acquisition of productive facilities, such as manufacturing plants. In other markets, substantial investments are required for product development and to establish support organizations for distribution and service. And in some markets, additional sunk costs are associated with demonstrating product performance and reliability to potential customers. The sunk costs from each of these sources can be large or small. Mergers of industrial products manufacturers may be unlikely to attract entry if customers are unwilling to purchase products without a well-established record of satisfactory performance. A merger is especially unlikely to attract entry if product failure imposes a substantial cost on customers.

Ingersoll-Dresser–Flowserve **(DOJ 2001)** The Department challenged the proposed acquisition of Ingersoll-Dresser Pump Co. by Flowserve Corp. on the basis of likely unilateral anticompetitive effects in markets for specialized pumps used in oil refining and electrical generation facilities. The Department found that the design and testing of an array of such pumps would entail substantial sunk costs. The Department also found that an entrant could not effectively compete in the relevant markets without incurring additional sunk costs in the establishment of a network of service and repair facilities. And because pump failure could shut down part of a refinery or electric generation plant, the Department found that many customers in the relevant markets would not purchase from a supplier that had not demonstrated the reliability and efficiency of its pumps in the particular use for which the pump was being sought. This fact added additional sunk entry costs and extended yet further the substantial time successful entry would take. The Department's challenge to the acquisition was settled by a consent decree requiring divestiture of Flowserve brands as well as manufacturing and repair facilities.

Metso Oyj–Svedala **(FTC 2001)** The Commission investigated a proposed merger between leading manufacturers of mining equipment, Metso Oyj and Svedala Industri AB. Both firms made equipment used in mining, including gyratory crushers, jaw crushers, cone crushers, and grinding mills. Operational failure by any of these machines would require shutting down the entire mining circuit. Purchasers would deal only with well-established companies producing equipment with a proven track record of reliability. A new entrant would face significant sunk costs in developing and testing a new piece of equipment and in gaining customer acceptance. Although several potential entrants could manufacture this equipment within two years, it was unlikely that customers would purchase new and untested equipment within this period. The Commission resolved the competitive concerns by requiring divestitures in the relevant markets of concern.

Exxon–Mobil **(FTC 1999)** Prior to merging, Exxon Corp. and Mobil Corp. were leading producers of jet turbine oil. Jet turbine engines require a specialized lubricant that can operate in an extreme environment. Failure by the lubricant could lead to engine failure, requiring the engine to be taken out of service for an extended period of time for repairs or overhaul. This lubricant, although expensive for a lubricating oil, was inexpensive relative to the cost of losing use of an engine for any period of time as well as to the cost of repairing or replacing an engine. To secure sales to customers, jet turbine oil producers submitted their products for extensive product testing, including testing on the customer's specific model engine. After developing a satisfactory lubricant, therefore, a new entrant would have to invest substantial sunk costs in product testing and incur substantial time delay in entering. The Commission, therefore, concluded that entry would not eliminate competitive concerns. The Commission and the parties entered into a settlement that required, among other things, divestiture of Exxon's jet turbine oil business.

Precision Castparts–Wyman-Gordon **(FTC 1999)** Precision Castparts Corp. and Wyman-Gordon Co., two leading manufacturers of titanium, stainless steel, and nickel-based superalloy cast components for jet engine and airframe applications, proposed to merge. Several companies worldwide had the capability of manufacturing these types of cast parts, but customers were not likely to purchase them from companies lacking a proven, years-long track record of producing products that did not fail. The Commission concluded that entry would not be timely, likely, and sufficient to thwart anticompetitive effects from the merger. It resolved its competitive concerns in a consent order that, among other things, required divestiture of a titanium foundry and a large cast parts foundry.

The Agencies have sometimes found that sunk costs did not pose a significant entry obstacle. In such cases, expected returns justified any required investment in new productive facilities, and successful entry typically did not require the establishment of a brand or reputation for quality.

ADS–Hancor **(FTC 2005)** The FTC closed its investigation into the acquisition by Advanced Drainage Systems, Inc. of Hancor Holding Corp. Both firms were major producers of corrugated high density polyethylene ("HDPE") pipe used for underground water drainage. Staff found that demand for HDPE was growing, that a new HDPE manufacturing plant could be constructed at relatively low cost and could be in operation within a short period, that several firms had entered de novo in the prior ten years, and that several fringe incumbents were expanding output. Also, existing manufacturers of certain other, non-HDPE pipes could enter at relatively little sunk cost. Many of them served common customers already and thus did not have to establish a new marketing organization. The Commission concluded that entry conditions were such that anticompetitive effects from the merger were unlikely.

Omnicare–NeighborCare **(FTC 2005)** The largest provider of pharmacy services to long-term care facilities ("LTC pharmacy"), Omnicare, Inc., offered to acquire a large rival LTC pharmacy, NeighborCare, Inc. The combined firm would have under contract more than half of skilled nursing facility beds in multiple states, and the post-merger market structure would be highly concentrated in many areas. The Commission's decision not to challenge the acquisition was based in part on relatively easy entry conditions in the then-current marketplace. Sunk costs were relatively low, illustrated by many historical examples of entry, including entry by former employees of incumbent LTC pharmacies, expansion by retail pharmacies into the LTC business, and vertical integration by skilled nursing facility operators.

Wrigley–Kraft **(FTC 2005)** Wm. Wrigley Jr. Co. proposed to acquire certain confectionary assets from Kraft Foods, Inc., including certain well-known breath mint and chewing gum brands. Commission staff assessed whether sunk costs that would have to be incurred in acquiring the capacity to produce or market breath mints or chewing gum would pose significant impediments to post-merger competitive entry. Staff found that new entrants would have relatively easy access to third-party "co-manufacturers" for the production of the relevant products and thereby could avoid costly expenditures in developing manufacturing expertise or in building a new facility. Entrants also could competitively distribute their products by outsourcing those functions to third-parties. Staff also found evidence of significant recent branded entry. Based in part on this evidence concerning entry conditions, staff closed its investigation.

Playbill–Stagebill **(DOJ 2002)** In its analysis of the consummated acquisition of certain assets of Stagebill Media by Playbill Inc., the Department found that sunk costs of entry were insignificant. Prior to the acquisition, Playbill was the nation's largest publisher of theater programs and Stagebill was its largest competitor in many cities. The Department found that the merger was not likely to be anticompetitive because the printing itself could be out-sourced, so an entrant did not need to incur significant sunk costs. Indeed, the Department found that entry based on out-sourcing had occurred. The Department also

found that theaters could contract directly with printers and some had done so. Finally, the Department found that prices of theater programs had not increased. Consequently, the Department took no action against the acquisition.

Although many purchasers of differentiated consumer products are reluctant to switch from brands they know and trust, purchasers of industrial commodities may be more likely to switch and be willing to sponsor entry when they perceive a lack of competition.

***National Oilwell–Varco* (DOJ 2005)** Entry considerations were a major factor in the Department's decision not to challenge the acquisition by National Oilwell Inc. of Varco, Inc. Those firms were among the very few significant competitors in the sale of various products and services relating to offshore drilling for oil and gas, and that fact initially gave the Department serious concerns about the competitive effects of the acquisition. Nevertheless, the Department found that several major customers for these products and services believed that they would be able to sponsor successful entry by committing to make purchases from firms with little or no current market presence. The Department also identified sellers of related products and services interested in entering.

In some markets, it is clear that a merger would not attract entry simply because the sunk costs of entry are far too great in comparison to the likely rewards.

***General Dynamics–Newport News* (DOJ 2001)** General Dynamics Corp. proposed to acquire Newport News Shipbuilding Inc. These were the only firms that built nuclear submarines for the U.S. Navy. The manufacture of a nuclear submarine requires much highly specialized equipment, personnel, and know-how, all of which combined to make the sunk cost of entry extraordinarily high. As a result, the merger was not likely to attract entry, especially in view of the fact that an entrant might never make a single sale. The proposed acquisition was abandoned after the Department filed suit to enjoin it.

Other Significant Obstacles to Successful Entry

Entry may not be attracted by an anticompetitive merger for many reasons. In some markets, entry is explicitly regulated, and in others, government regulation can effectively bar entry. The Agencies have found legal obstacles to entry to be significant in some instances.

For example, many states have certificate of need ("CON") programs barring entry into health care markets unless a potential entrant makes an expensive and time-consuming demonstration that there is an unmet need for its services. Regulation of this sort increases sunk costs and the time it takes to enter, and it also creates a significant risk that entry ultimately will be prohibited. For several hospital mergers challenged by the Agencies, as well as a merger of outpatient surgical centers, CON regulation was a factor in the Agencies' determination that the mergers would not attract entry.

***Mercy Health–Finley* (DOJ 1994)** The Department challenged the formation of a partnership between Mercy Health Services and Finley Tri-States Health Group, Inc. The companies owned the only general acute care hospitals in Dubuque, Iowa, and the Department concluded that Iowa's CON statute would prevent the construction of any new general acute care hospital in Dubuque. That no new hospital would be built was stipulated at trial, but the district court rejected the Department's challenge to the merger on other grounds. The case became moot before the Department's appeal could be decided because the parties abandoned the merger.

Environmental and zoning regulations are other examples of rules that may make entry difficult.

***Florida Rock–Harper Bros.* (DOJ 1999)** Florida Rock Industries, Inc. proposed to acquire Harper Bros., Inc. These companies competed in the sale of aggregate and silica sand in southwest Florida and together accounted for at least 60% of the sales of each product. The Department concluded that the acquisition would be likely to lessen competition substantially and challenged the acquisition. The Department found many reasons why the

acquisition would not attract entry, including environmental regulation at the local, state, and federal levels that made it very difficult to open a new aggregate or silica sand production facility in the area. The Department's challenge to the merger was resolved by a consent decree requiring the divestiture of a quarry and sand mine.

In the telecommunications and pharmaceutical industries, federal regulation may pose a significant obstacle to entry. Entry into some telecommunications markets is constrained by the need to have a licence from the Federal Communication Commission for use of part of the electromagnetic spectrum, while the introduction of pharmaceuticals requires approval by the Food and Drug Administration.

Cingular–AT&T Wireless **(DOJ 2004)** Cingular Wireless Corp., a joint venture of SBC Communications Inc. and BellSouth Corp., proposed to acquire AT&T Wireless Services, Inc. Both Cingular and AT&T Wireless provided mobile wireless telecommunications service ("MWTS") throughout the United States. The Department concluded that the acquisition likely would be anticompetitive in ten local MWTS markets and challenged the acquisition partly on that basis. MWTS is provided using electromagnetic spectrum, the rights to which are licensed by the Federal Communications Commission. Among the reasons the Department concluded that the acquisition would not attract entry was difficulty in obtaining licenses to the necessary spectrum. The Department's challenge to the merger was resolved by a consent decree requiring divestitures in particular locations.

Cephalon–Cima **(FTC 2004)** Cephalon, Inc. proposed to acquire Cima Labs, Inc. Cephalon was the only firm selling a breakthrough cancer pain ("BTCP") drug in the United States. Evidence suggested that Cima was the most likely first entrant with a BTCP drug to rival Cephalon's product, and that entry subsequent to Cima's was unlikely for at least the next four years. The time needed to secure FDA approval was a significant factor in reaching this conclusion. The Commission resolved its competitive concerns with a consent order that required Cephalon, among other things, to grant an irrevocable, fully paid license to a specific third party for the manufacture and sale of a generic formulation of Cephalon's BTCP drug.

Intellectual property rights such as patents can at times pose a significant entry obstacle. Intellectual property can be important in both high-tech and low-tech industries.

3D Systems–DTM **(DOJ 2001)** 3D Systems Corp. proposed to acquire DTM Corp., a competitor in industrial rapid prototyping systems, which are used to make functional and non-functional prototypes of new products or components. The Department challenged the acquisition in part because the two companies held extensive patent portfolios that likely created an insuperable entry obstacle even for well-established competitors outside the United States. The Department's challenge to the merger was resolved by a consent decree requiring divestiture of a package of intellectual property rights.

Franklin Electric–United Dominion **(DOJ 2000)** The Department challenged the proposed joint venture between subsidiaries of Franklin Electric Co. and United Dominion Industries because it would have eliminated competition between the only two domestic producers of submersible turbine pumps used for pumping gasoline from underground storage tanks at retail stations. The Department found that the proposed merger would be unlikely to attract entry for several reasons, including the necessity of designing around Franklin Electric's patents. After trial, a district court granted the Department's motion for a permanent injunction.

American Home Products–Solvay **(FTC 1997)** American Home Products Corp. proposed to acquire the animal health business of Solvay S.A. The Commission found that the proposed acquisition raised serious competitive concerns in three, highly concentrated, relevant product markets for the production and sale of animal vaccines. The Commission found, moreover, that post-merger entry was unlikely to mitigate the competitive concerns because entry would not be likely, timely, or sufficient. For each relevant market, entry would require the expenditure of significant resources over a

period of many years with no assurance that a viable commercial product would result. The time required to enter the relevant markets could be further lengthened by the need to obtain U.S. Department of Agriculture approvals to sell the vaccines. Significantly, the existence of broad patents governing the manufacture of each of the relevant products enhanced the difficulty of entry. As a result, the Commission issued a complaint challenging the proposed acquisition, and ultimately reached a settlement with the parties that called for, among other things, divestiture of Solvay's intellectual property rights relating to the three vaccines.

Patents need not impose a significant obstacle to entry, even in a high-tech industry with many important patents. The Agencies may find that the requisite technology is nevertheless reasonably available, for example, because required patents could easily be licensed or invented around.

***Cinram–AOL Time Warner* (DOJ 2003)** The Department decided not to challenge the acquisition by Cinram International Inc. of the DVD and CD replication assets of AOL Time Warner Inc. in part because the requisite technology was readily available for license from patent pools. The Department also found that sunk costs were relatively low and that the prospects for recovering them were good due to high demand growth.

A merger may lead to price increases without attracting entry because potential entrants would be unable to obtain a source of supply for essential inputs, for example, when entry requires access to scarce natural resources.

***Imetal–English China Clays* (DOJ 1999)** Imetal proposed to acquire English China Clays, plc, both of which produced water-washed kaolin and calcined kaolin. These products are produced from kaolin clay, which is quite scarce. Much of the world's highest quality kaolin is found in a small area within Georgia. Among the reasons why the Department concluded that the proposed merger was unlikely to attract significant entry was that an entrant would have difficulty in acquiring suitable kaolin deposits. The Department's challenge to the merger was resolved by a consent decree requiring divestiture of a plant and associated assets such as kaolin reserves.

Difficulty in securing essential inputs can impede entry in a variety of contexts, particularly when incumbents own or control access to the inputs. In some cases, an entrant might find it difficult to secure a source of supply for a manufactured input product. In other cases, gaining access to physical facilities built and owned by third parties can pose a significant entry obstacle. In addition, access to human resources may pose a significant entry obstacle in some markets.

***DaVita–Gambro* (FTC 2005)** DaVita Inc. proposed to acquire Gambro Healthcare, Inc. The firms were rivals in the provision of outpatient dialysis services. The Commission alleged that anticompetitive effects would result from the transaction in 35 local markets where the firms competed. Laws applicable to dialysis clinics required that each such clinic must have a nephrologist as its medical director. In addition, the medical director is the clinic's primary source of referrals and thus is essential to the clinic's competitiveness. A lack of available nephrologists with an established referral stream was an obstacle to entry into each of the relevant geographic markets at issue. To resolve the Commission's concerns, the parties entered into a consent agreement that required, among other things, divestiture of dialysis clinics in the markets at issue.

***Central Parking–Allright* (DOJ 1999)** The unavailability of facilities that had to be provided by others made entry unlikely after the proposed merger of Central Parking Corp. and Allright Holdings, Inc. Both companies operated off-street parking facilities in the central business districts of many U.S. cities. In these areas, land was scarce and typically had uses higher-valued than parking lots, so adding additional parking spaces typically required the construction of a new office building, and higher parking rates were not likely to spur the construction of new office buildings. The Department's challenge to the merger was resolved by a consent decree requiring divestiture of parking facilities in many cities.

Cost Disadvantages of Entrants

A merger may lead to price increases but not attract entry because entrants would suffer a significant cost disadvantage relative to incumbents. The most common reason for a cost disadvantage is the presence of significant economies of scale and scope. In other situations, entrants may be significantly disadvantaged by economies of density in route delivery systems (i.e., reductions in cost from increasing volume, holding the size of a network fixed).

***Waste Management–Allied* (DOJ 2003)** Waste Management, Inc. agreed to acquire the assets Allied Waste Industries, Inc. used in small container commercial waste hauling in Broward County, Florida. This portion of the municipal solid waste business entails the collection, transportation, and disposal of waste generated by commercial establishments. The Department challenged the acquisition in part because an entrant would be unable to operate efficiently and provide meaningful price competition. To be efficient, a competitor must achieve a high route density by contracting with a large number of commercial establishments in a relatively small area. Doing so was found to be exceptionally difficult for an entrant because incumbents had secured many existing customers through long-term contracts. The Department's challenge to the merger was resolved by a consent decree requiring divestiture of specified routes and the assets used on them.

***Federal-Mogul–T&N* (FTC 1998)** In the merger of Federal-Mogul Corp. and T&N PLC, one of the markets the staff examined was the manufacture and sale of engine bearings to the aftermarket for repairing and overhauling engines. Each engine bearing is designed for and used in a particular truck or car engine, and each engine can use only bearings designed and built to its specifications. The parties acquired the tooling for their broad line of aftermarket bearings when engines were first in production, allowing them to amortize the cost of that tooling over a longer time and over a larger number of bearings. A new entrant that attempted to match an incumbent's product line would have been able to amortize the tooling for many bearings only over a portion of the engine's life, and would necessarily have higher relative costs. This would have put any entrant in the aftermarket at a substantial cost disadvantage to the incumbent firms. Thus, the Commission found that entry would not be timely or likely to prevent anticompetitive effects. The Commission resolved the matter with a consent order that required, among other things, divestiture of T&N's engine bearing business.

Timeliness of Entry

Section 3.2 of the Guidelines states that entry generally is considered timely only if "achieved within two years from initial planning to significant market impact." Even if a proposed merger likely would attract entry that eventually reverses any likely anticompetitive effect from a merger, the Agencies nonetheless would challenge the merger if they determined the entry would not be timely. For many of the proposed mergers discussed in this chapter, the Agencies found that entry having a material effect on competition would take significantly longer than the two-year period specified by the Guidelines.

***Alcan–Pechiney* (DOJ 2003)** The Department challenged the proposed acquisition of Pechiney, S.A. by Alcan, Inc. on the basis of likely anticompetitive effects in the production and sale of a class of aluminum alloys called "brazing sheet." Manufacturing brazing sheet requires an expensive rolling mill, which the Department found would take at least three years to construct. The Department also found that successfully selling brazing sheet requires the mastery of alloy technologies and that it likely would take several additional years after a new mill commenced production to "qualify" its output with major customers and begin making significant sales. Thus, the Department concluded that entry was unlikely and would necessarily take far longer than two years if it did occur. The Department's challenge to the merger was resolved by a consent decree requiring divestiture of Alcan's brazing sheet business, including a smelting facility, rolling mill, and associated intellectual property.

Healthtrust–Holy Cross **(FTC 1994)** In a merger between Healthtrust, Inc. - The Hospital Co. and Holy Cross Health Services of Utah, there was no CON regulation that would preclude or delay entry into the market, and prior entry of hospitals had occurred in the geographic market. Nonetheless, the Commission concluded that timely entry was unlikely to prevent anticompetitive effects from the merger under investigation because it takes many years to plan and build a new hospital. The Commission resolved its competitive concerns arising from the transaction by reaching a consent agreement with the parties that, among other things, included an order requiring divestiture of one of the acquired firm's hospitals.

In evaluating the timeliness of entry, the Agencies include the time to complete any necessary preliminary steps, such as establishing a reputation or the development of specialized inputs into the production of the product in question.

Federal-Mogul–T&N **(FTC 1998)** Federal-Mogul Corp. and T&N PLC, which proposed to merge, competed in selling thin-wall engine bearings, light-duty engine bearings, and heavy-duty engine bearings to original equipment manufacturers ("OEMs") and to customers in the aftermarket. These bearings required specialized alloys developed for specific applications. Entry required time to develop such alloys, to design the specific bearings for particular applications, and to test and qualify in particular applications. For each type of bearing, as to both OEM and aftermarket customers, FTC staff found that timely entry would not prevent anticompetitive effects in the relevant markets. Further, in the aftermarket, effective entry required brand name recognition that took additional time to develop. The Commission resolved the matter with a consent order that required, among other things, divestiture of T&N's engine bearing business.

Sufficiency of Entry

Section 3.0 of the Guidelines states that "[e]ntry that is sufficient to counteract the competitive effects of concern will cause prices to fall to their premerger levels or lower." Thus, even if the evidence suggests that timely entry into the relevant market is likely, the entry analysis is not complete. The entry must also be of a character and magnitude that it would "deter or counteract the competitive effect of concern."

Chicago Bridge–Pitt-Des Moines **(FTC 2005)** The Commission ruled that the consummated acquisition by Chicago Bridge & Iron Co. of certain assets from Pitt-Des Moines, Inc., violated Section 7 of the Clayton Act and Section 5 of the FTC Act. The merging parties designed, engineered, and built storage tanks for liquified natural gas ("LNG"), liquified petroleum gas ("LPG"), and liquid atmospheric gases such as nitrogen, oxygen, and argon ("LIN/LOX"). They also designed, engineered, and built thermal vacuum chambers ("TVC"). TVCs and field-erected tanks for LNG, LPG, and LIN/LOX are custom-made to suit each purchaser's needs, and customers place great emphasis upon a supplier's reputation for quality and service. For each of the relevant products, customers generally seek competitive bids from several suppliers.

The Commission found that some timely entry into each of these markets might occur, but that it was unlikely to be sufficient to prevent anticompetitive effects from the merger. Although new firms had appeared and fringe firms had the intent to compete, these firms were not found to be significant competitors capable of replacing the competition lost due to the merger. With respect to the LNG tank market, the Commission found that new entrants lacked the reputation and experience that most customers demand, and they lacked the requisite personnel skills. With respect to the LPG and the LIN/LOX tank markets, the Commission found that, although the merging parties identified a number of actual and potential entrants, entry of those firms would not prevent the anticompetitive effects of the merger because the firms would not have the attributes desired by most customers. The record evidence showed no attempted entry into the TVC tank market by any suppliers. The Commission ordered, among other things, divestiture of assets and other remedial action

to restore the competition lost as a result of the transaction.

The Agencies' reasons for concluding that entry would not face significant obstacles also can be relevant to determining whether entry would be sufficient.

***Sherwin-Williams–Duron* (FTC 2004)** The Sherwin-Williams Co., the nation's largest manufacturer of architectural paint, proposed to acquire Duron, Inc., a leading architectural paint manufacturer in the eastern United States. The firms were head-to-head competitors in several metropolitan areas where each had a relatively large number of store locations. A focus of the Commission's investigation was on the potential effects of the merger on professional contractors, which in significant numbers patronize architectural paint stores rather than other retailers of paint (such as home improvement stores and other big-box retailers). Staff concluded that this class of customers made purchasing decisions largely based on local market conditions that determine price and service, rather than on national or regional contracts with paint suppliers.

The investigation assessed whether entry would require a network of store locations to compete effectively for professional painters' business. Data analysis revealed that even professional painters who use numerous company stores during a year spend the vast majority of their dollars at a limited number of favored stores. Thus, the evidence showed that professional painters did not rely on an extended store network and would not likely pay a premium to do business with firms that operate a network of stores in a region. In addition, even if a network of some size were required, the requirements to open additional stores did not pose an entry barrier. Few significant obstacles appeared to prevent firms with established brand names from opening paint stores to serve professional painters. No Commission action was taken.

4. Efficiencies

Merging parties may reduce their costs by combining complementary assets, eliminating duplicate activities, or achieving scale economies. Mergers also may lead to enhanced product quality or to increased innovation that results in lower costs and prices or in more rapid introduction of new products that benefit consumers.

As the Guidelines state, efficiencies "can enhance the merged firm's ability and incentive to compete, which may result in lower prices, improved quality, enhanced service, or new products." Guidelines § 4. Moreover, when a merged firm achieves such efficiencies, it may induce competitors to strive for greater efficiencies in order to compete more effectively. Consumers benefit from such increased competition.

Efficiencies may directly prevent the consumer harm that otherwise would result from a merger. The Agencies thus do not challenge a proposed merger "if cognizable efficiencies . . . likely would be sufficient to reverse the merger's potential to harm consumers in the relevant market, e.g., by preventing price increases in that market." Guidelines § 4. In analyzing mergers, including the likely effects of cost reductions, the Agencies assume that firms maximize profits. Other things equal, a reduction in any cost that depends on a firm's output rate causes a profit-maximizing firm to reduce prices. This effect may be sufficient to counteract a merger's anticompetitive effects.

For example, one potential concern is that a proposed merger would increase the likelihood that competitors will coordinate pricing and output decisions in a way that harms consumers. In the presence of other conditions conducive to coordination, uniform cost structures across incumbent competitors may facilitate coordination. Therefore, some mergers that appreciably reduce the uniformity of costs across competitors may disrupt existing coordination or otherwise make coordination less likely. As a lower-cost producer, the merged firm may find it profitable to reduce prices notwithstanding its rivals' likely reactions. Similarly, sufficiently large reductions in the marginal costs of producing and selling the products of one or both of the merging firms may eliminate the unilateral incentive to raise prices that the merger might otherwise have created. In both of these situations, the Agencies integrate efficiencies into their assessments of competitive effects. In so doing, the Agencies assess the effects of the elimination of competition between the merging firms in light of any cognizable, merger-specific efficiencies.

Efficiencies in the form of quality improvements also may be sufficient to offset anticompetitive price increases following a merger. Because a quality improvement involves a change in product attributes, a simple comparison of pre- and post-merger prices could be misleading. A careful analysis of the effects of changes in product attributes and prices on consumer welfare is likely to be necessary.

Efficiencies the Agencies Consider

Section 4 of the Guidelines provides that, to be considered by the Agencies, an efficiency must be "merger-specific" and "cognizable."

Merger-Specific Efficiencies

Efficiencies are not taken into account by the Agencies if they are not merger-specific. Merger-specific efficiencies are "those efficiencies likely to be accomplished with the proposed merger and unlikely to be accomplished in the absence of either the proposed merger or another means having comparable anticompetitive effects." The Guidelines explain that, although the Agencies ask whether the efficiencies can be achieved by means other than the merger, "[o]nly alternatives that are

practical in the business situation faced by the merging firms will be considered in making this determination; the Agency will not insist upon a less restrictive alternative that is merely theoretical."

The Agencies recognize that the merging parties often have information with respect both to how they plan to integrate after the merger and to the effect of the integration on the merged firm. Accordingly, the Agencies give full consideration to the parties' reasonable and well-supported explanations of merger-specific cost savings.

Any efficiency that enables the combined firm to achieve lower costs for a given quantity and quality of product than the firms likely would achieve without the proposed merger is merger-specific. For example, if a merged firm would combine the production from two small or underutilized facilities (one from each of the merging firms) at one facility that has lower costs, and if such a cost reduction could not practically be achieved without the merger (e.g., by one of the merging firms combining two of its own underutilized facilities or through rapid internal growth), this cost reduction is merger-specific. Such a cost reduction benefits consumers to the extent that it makes the merged firm a more vigorous competitor, reduces prices, or expands output.

That an efficiency theoretically could be achieved without a merger—for example, through a joint venture or contract—does not disqualify it from consideration in the analysis. Many joint venture agreements or contracts may not be practically feasible or may impose substantial transaction costs (including monitoring costs). In their assessment of proffered efficiency claims, the Agencies accord appropriate weight to evidence that alternatives to the merger are likely to be impractical or relatively costly.

> ***Alpha–Beta*** **(Disguised FTC Matter)** A proposed merger of two of the largest gizmo manufacturers ("Alpha" and "Beta") would create a firm with a market share in excess of 30%. In addition to its manufacturing business, Alpha owned a subsidiary company engaged in industrial packaging. At the time of the proposed merger, Alpha's packaging subsidiary had unutilized capacity. Among the subsidiary's customers was Beta, which owned Get-To, Inc., a company that dispenses gizmos to customers located in isolated areas not otherwise served by normal distribution channels. The parties planned to combine Alpha's unused packaging capacity with Get-To's demand for packaging. The parties claimed that this combination would yield significant cost savings. Commission staff concluded that, although such an arrangement may yield savings, the savings would not be merger-specific. Beta already was an Alpha customer, and the evidence suggested that, even in the absence of the merger, Alpha and Beta were in the position readily to expand their existing packaging services contract to achieve the claimed savings. The Commission did not challenge the merger because evidence was insufficient to show that the merger was likely to cause competitive harm.
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> ***Nucor–Birmingham Steel*** **(DOJ 2002)** Nucor Corp.'s acquisition of substantially all of the assets of Birmingham Steel Corp. raised competitive concerns because the firms owned two of the three mills producing certain types of steel bar in the western United States. The Department concluded, however, that the third western mill and other domestic mills would substantially constrain any post-merger price increases and that the merger likely would generate significant efficiencies. The Department found that the acquisition would allow the merged firm to close some distribution facilities and to supply some customers from a closer mill at a lower delivered cost. The Department also found that the acquisition would provide a Nucor mill with a lower cost input supply from Birmingham, although some of the savings might have been obtainable through a contractual arrangement. Even though some of the latter efficiencies may not have been merger specific, the Department concluded that plausible merger-specific reductions in variable costs were significant relative to the worst case scenario of anticompetitive effects from the acquisition, and the Department granted early termination under HSR.

Competition spurs firms to implement cost reduction initiatives, and those likely to be implemented without a proposed merger do not yield merger-specific efficiencies. For example, the parties may believe that they can reduce costs

by adopting each other's "best practices" or by modernizing outdated equipment. But, in many cases, these efficiencies can be achieved without the proposed merger. The presence of other firms in the industry unilaterally adopting similar "best practices" would suggest that such cost savings are not merger-specific. By contrast, if a "best practice" is protected by intellectual property rights, then it could be the basis for a merger-specific efficiency claim.

Merging parties also may claim cost savings from combining sales and realizing economies of scale. These types of economies, however, might be realized from internal growth. If such unilateral changes are likely without the proposed merger (for example, if they have already been planned), they are not merger-specific. Timing can be an important factor in the consideration of such claims. If a merger can be expected significantly to accelerate the achievement of economies of scale due to increased sales as compared to internal growth, the Agencies credit the merger with merger-specific acceleration of the cost reduction.

Cognizable Efficiencies

The Guidelines define cognizable efficiencies to be "merger-specific efficiencies that have been verified and do not arise from anticompetitive reductions in output or service." Moreover, "[c]ognizable efficiencies are assessed net of costs produced by the merger or incurred in achieving those efficiencies." Guidelines § 4.

The parties can facilitate the Agencies' assessment of whether efficiency claims are cognizable by providing documentation that is logical, coherent, and grounded on facts and business experience. It is in the parties' interest to provide detailed information on the likelihood, magnitude, and timing of claimed efficiencies. They may, for example, draw on a detailed business plan that describes how the merged firm intends to achieve the efficiencies. If not already included in the business plan, the parties should also consider providing supporting evidence that justifies the planning methods and shows the reasonableness of applied assumptions.

When efficiencies are an important business motive for the merger, information pertinent to verification will often exist prior to the Agencies' antitrust review of the merger. In other situations—particularly when projected efficiencies are not a principal motive for the merger and evidence to substantiate claims has not been prepared prior to the merger agreement—the parties can elect to develop and submit to the reviewing Agency evidence (e.g., documents, data, consultant reports, or evidence from past experiences) to substantiate the claimed efficiencies.

***Arch Coal–Triton* (FTC 2004)** Pursuant to a Commission action in federal district court to enjoin the proposed merger of Arch Coal, Inc. and Triton Coal Co. LLC, the parties claimed merger-specific efficiencies totaling $130 million to $140 million over a five-year period. The parties' efficiency claims included cost-savings from equipment and operator reductions, the ability to extract additional coal through redeployment of coal mining equipment, insurance premium reductions, and safety improvements. Commission staff found that Arch Coal failed to substantiate many of its claimed savings and, in some instances, employed a methodology that overstated savings. Therefore, the staff determined that a substantial portion of Arch's claimed savings were not cognizable. For example, staff found that claims related to the ability to extract additional coal through redeployment of coal mining equipment were overstated because staff believed Triton would recover the additional coal absent the merger, just not as quickly as Arch would be able to in the combined operation. The court denied the Commission's preliminary injunction request and, after further investigation, the Commission decided not to pursue further administrative litigation.

***Oracle–PeopleSoft* (DOJ 2004)** Oracle Corp. made an unsolicited tender offer for PeopleSoft, Inc. Oracle and PeopleSoft competed in the sale of Enterprise Resource Planning software, which provides tools for automating essential operating functions within large organizations. Oracle Corp. claimed that the proposed takeover would produce cost reductions of more than $1 billion per year. Although these claims were based on projections made by a high ranking executive, the Department's attempts to verify these claims revealed that they were predicated on

little more than unsupported speculation with no allowance having been made for the costs of integrating the two companies. Moreover, the Department concluded that at least a significant portion of the projected cost savings were a consequence of projected reductions in sales that would be the result of eliminating the R&D and sales staffs of PeopleSoft. The Department found that, for the most part, the cost reductions would stem from anticompetitive reductions in innovation, service, and output, and therefore did not reflect cognizable efficiencies. The Department filed suit to block the transaction, but the district court declined, on other grounds, to enjoin it.

Verification of Efficiency Claims

After the parties have presented substantiation for their claimed merger-specific efficiencies, the Agencies attempt to verify those claims. The verification process usually includes, among other things, an assessment of the parties' analytical methods, including the accuracy of their data collection and measurement, an evaluation of the reasonableness of assumptions in the analysis, and scrutiny into how well the parties' conclusions stand up to modifications in any assumptions (i.e., the "robustness" of the parties' analysis). To evaluate the parties' efficiency claims, the Agencies typically review the parties' internal documents and data, as well as the statements of knowledgeable company personnel. In some cases, to evaluate further how realistic the claimed efficiencies are, the Agencies also contact third parties, for example, to learn what efficiencies others have been able to achieve and how they have achieved those efficiencies.

The Agencies recognize that assessing a proposed merger's potential efficiency benefits, like its competitive effects, necessarily involves projections about the future. The Agencies do not automatically reject a claim due to minor discrepancies uncovered in the verification process. Nor do the Agencies reject an efficiency claim solely because the efficiency has never before been accomplished. Shortcomings in the substantiation of a particular efficiency claim may cause the Agencies to reduce the magnitude of the efficiencies associated with that claim rather than to reject the claim altogether. Similarly, the fact that one stand-alone efficiency claim cannot be verified does not necessarily result in rejection of other claims.

The stronger the supporting evidence, the more credence the Agencies are likely to give the claimed efficiencies in the competitive effects analysis. Efficiency claims that are vague, speculative, or unquantifiable and, therefore, cannot be verified by reasonable means, are not credited. For example, a general claim that the acquiring firm will save 20% of the acquired firm's expenses, without substantiation, generally would not be credited.

***Fine Look–Snazzy* (Disguised FTC Matter)** In a proposed merger of two consumer products packagers, Fine Look and Snazzy, the parties claimed efficiencies from rationalization and consolidation of packaging facilities ("PFs"); elimination of duplicate corporate overhead; and combining specialty packaging operations. Commission staff determined that a portion, but not all, of the savings claimed through consolidation of PFs was merger-specific and cognizable, but rejected the other claims because they could not be reasonably verified and thus were not cognizable. The Commission did not challenge the merger because evidence was insufficient to show that the merger was likely to cause competitive harm. The Commission credited the portion of the parties' efficiency claims that staff found to be merger-specific and cognizable.

First, the staff considered the consolidation of PFs. Fine Look operated 30 PFs and Snazzy operated 20. The parties planned to operate 35 PFs after the merger by closing 15 owned by Fine Look and 10 owned by Snazzy, and by building 10 new PFs. The parties claimed that sales from the closed Fine Look PFs would be shifted to Snazzy PFs and that this shift would result in reduced operating and delivery costs at the Snazzy PFs. Similarly, savings would derive from reduced operating costs at Fine Look PFs because of transferred sales from closed Snazzy PFs. The parties also claimed reduced inventory costs tied to reducing the number of PFs.

In estimating the potential savings from closing PFs, the parties assumed that all PF costs would be eliminated except for certain variable costs that would be shifted to the

remaining PFs. In the case of the 15 Fine Look PFs projected to be closed, the parties provided reasonable substantiation of these cost savings derived from Fine Look cost records. Nonetheless, the parties' estimates assumed that, in each case of a closing, the remaining post-merger PFs would retain 100% of the customers of the closed PFs. The parties provided no analysis respecting how sensitive their estimates were to this key assumption.

In addition, at least some of the consolidations for which the parties claimed efficiencies were purely intra-Snazzy (i.e., closing one Snazzy PF in proximity to another Snazzy PF). Staff concluded that such consolidations would not be merger-specific. Furthermore, the claimed savings from closings of the Snazzy PFs were not substantiated from cost records, but instead were conjecture. Staff could not accept these claims.

Based on all of the claims respecting PF consolidation, staff concluded that only savings associated with the 15 Fine Look closings for which substantiation was provided were cognizable. But because no sensitivity analysis was performed regarding the assumption on the retention of customers, staff considered the estimated savings from the closing of the Fine Look PFs to be only an upper bound on the potential savings.

Second, the staff considered the corporate savings. The parties made a very rough calculation of projected savings through consolidation of various corporate functions. They contended that 75% of one party's corporate expenses would be eliminated by this consolidation. The calculation, however, was unsubstantiated conjecture rather than an analysis based on objective data that Agency staff could evaluate. Staff thus found the claim not to be cognizable.

Third, the staff considered the specialty packaging operations. Both Fine Look and Snazzy operated specialty packaging facilities for high-end luxury widgets, independent of their other PFs. The parties planned to consolidate Fine Look's specialty business into Snazzy's specialty business. They claimed that this consolidation would reduce costs because it would yield savings of 50% in operating expenses. In deposition, a senior executive admitted that the 50% figure was merely an unsupported assumption. Staff concluded that the parties' failure to provide sufficient evidence in support of the claim made the efficiency claim unverifiable and therefore not cognizable.

The Agencies may accord less significance to shortcomings in the documentation of claimed efficiencies when the weight of evidence suggests that merger-specific efficiencies appear to be significant and likely to be achieved.

> ***Genzyme–Novazyme* (FTC 2004)** Genzyme Corp. acquired Novazyme Pharmaceuticals, Inc., combining the world's only firms engaged in developing the first enzyme replacement therapy ("ERT") to treat Pompe disease, a rare, fatal disease that affects about 10,000 people worldwide. Whether either firm's Pompe drug would make it to market was not certain, but the acquisition left Genzyme as the only firm engaged in developing Pompe ERT treatments. Genzyme asserted that, even without competition from Novazyme, it had the incentive to bring its Pompe product to market in the fastest possible time frame.
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> Genzyme also asserted that the acquisition had resulted in significant efficiencies. Genzyme claimed that each firm had unique skills and expertise, and that, by combining, the merged firm could accelerate development of Genzyme's and Novazyme's Pompe drugs. Genzyme asserted that it possessed certain unique capabilities and technologies that it was applying to Novazyme's Pompe drug. The Commission voted to close the investigation without challenging the transaction due, in part, to the evidence supporting the claim that the merger would accelerate development of the drug.

The best way to substantiate an efficiency claim is to demonstrate that similar efficiencies were achieved in the recent past from similar actions. Documentation must be based on appropriate methods and realistic assumptions, and ideally would be grounded on actual experience. For example, a firm that recently combined its own distribution centers, or consolidated distribution centers after a recent merger, could use its actual cost savings experiences in those instances as a

basis for, and to substantiate claims made about, efficiency claims arising from combining distribution centers after a proposed merger.

If the parties cannot point to similar efficiencies achieved in the recent past, they should use the best information available to substantiate their efficiency claims. For example, the parties might do an internal study and analysis of expected efficiencies using recent cost records and other pertinent objective data. In addition, some parties have found outside consultants helpful in substantiating efficiency claims.

The Agencies may verify and accept part of an efficiency claim. For example, an acquiring firm might estimate a particular efficiency by assuming that all of the acquired firm's customers and sales will transfer to the merged entity when experience suggests that customers and sales are not likely to transfer completely. Or, a party may estimate the dollar value of a particular efficiency using a discount rate that is significantly different from the discount rate it normally uses, without any justification for the difference. In such cases, the differences between the parties' efficiencies estimates and ones using the more supported assumptions are not verifiable, and those portions of the efficiency claims are unlikely to be credited.

A-1 Goods–Bingo **(Disguised FTC Matter)** In a proposed merger of consumer products companies, A-1 Goods, Inc. and Bingo Co., the parties claimed cost savings of several million dollars from a reduction in the sales force and a combining of certain manufacturing facilities. Commission staff concluded that the parties' estimates were exaggerated. Staff credited some, but not the entire dollar amount of the claims.

First, the staff considered the sales force reduction. The parties claimed that the merger would permit the post-merger firm to eliminate the equivalent of 90% of one of the party's pre-merger sales force, representing approximately 40% of the combined pre-merger sales employees. For calculating the estimated efficiencies, the parties assumed that the combined post-merger output would be the same as that before the merger. They also assumed that pre-merger levels of marketing and selling support to customers would be maintained. Achieving these efficiencies would require one-time costs approximating almost 80% of the projected annual cost savings.

These one-time costs derived from severance payments and relocation expenses. Evidence from the parties suggested that the claims were based on aggressive assumptions. For this reason, Commission staff discounted the parties' estimates. Applying more reasonable assumptions, the staff credited most of the parties' claimed cost savings, from which the one-time cost of achieving the efficiencies was subtracted.

Second, the staff considered the consolidation of manufacturing facilities. The parties claimed several million dollars in projected savings from the expected consolidation of certain manufacturing facilities. The parties planned to shut down an A-1 production facility and consolidate its output into a Bingo plant. The post-merger output rate was to be the same as on a combined, pre-merger basis, but with fewer people needed to run the consolidated manufacturing operations. To maintain the same rate of pre-merger output, the parties envisioned that 70% of A-1's manufacturing equipment in the shut-down facility would be moved to unused space at the Bingo facility, adding to the overall manufacturing capacity of that facility. In addition, a number of A-1 employees would be relocated to the Bingo plant, while other employees would be let go. Certain retooling and capital expenditures related to integrating manufacturing operations would have to be incurred.

The parties claimed that no arrangement other than the proposed merger would generate the efficiencies claimed. They contended that any non-merger arrangement would raise insurmountable issues of control, allocation of savings between owners, transfer pricing problems, and issues dealing with the sharing of proprietary knowledge. To buttress this point, the parties presented Commission staff with evidence that the parties considered entering into contract manufacturing arrangements, joint ventures, and other internal measures to save money on production, but concluded that these were impractical or could not bring about the desired level of efficiencies. Based in part on this evidence, Commission staff concluded that

the claimed efficiencies were merger-specific and cognizable.

The Commission ultimately decided not to challenge the merger on the grounds that it posed no substantial threat to competition, irrespective of any efficiency claims.

When parties to a merger base an efficiency claim on past experience, the Agencies examine whether the experience is indicative of what is likely to occur with the merger. If the experience was far out of the ordinary (e.g., during bankruptcy, a worker's strike, drought, or war), the Agencies may not credit the claims.

Sufficiency of Efficiencies

As noted in section 4 of the Guidelines, the Agencies seek to determine "whether cognizable efficiencies likely would be sufficient to reverse the merger's potential to harm consumers in the relevant market, e.g., by preventing price increases in that market." Within the integrated analysis framework for evaluating competitive effects, "efficiencies are most likely to make a difference in merger analysis when the likely adverse competitive effects, absent the efficiencies, are not great." Efficiencies are a significant factor in the Agencies' decisions not to challenge some mergers that otherwise are likely to have, at most, only slight anticompetitive effects.

***Toppan–DuPont* (DOJ 2005)** Photomasks are the masters from which integrated circuits are produced. Toppan Printing Co., Ltd. was a Japanese company that had recently begun competing in the United States. Toppan was proposing to acquire DuPont Photomasks, Inc., which was one of its three competitors for U.S. sales of the highest technology photomasks. The Department found that competition was best modeled as an auction process, with each auction essentially a separate relevant market. The Department's economists used a formal auction model to estimate the likely price effects of the transaction. This exercise indicated that, even without any efficiencies, the acquisition most likely would lead to, at most, only small price increases. Incorporating the portion of the claimed efficiencies the Department determined to be merger-specific and cognizable indicated that the transaction would not lessen the welfare of U.S. customers under the assumptions considered most plausible. Accordingly, the Department did not challenge the merger.

***PayPal–eBay* (DOJ 2002)** PayPal, Inc. and eBay, Inc. provided competing person-to-person payment systems used largely to complete transactions following eBay auctions. Even though the person-to-person payment systems offered advantages over the other means of payment, the Department decided not to challenge eBay's acquisition of Pay Pal principally because other means of payment substantially constrained eBay's ability to increase fees after the acquisition. Efficiencies to be gained by integrating PayPal with eBay were also a factor in the Department's analysis. Integrating the two would make transactions more convenient for eBay buyers and also improve the detection of fraud by combining the information that had been separately amassed by the two companies.

***DirecTV–Dish Network* (DOJ 2002)** DirecTV Enterprises Inc. was owned by Hughes Electronics Corp., which was owned by General Motors Corp. DirecTV operated one of two direct broadcast satellite ("DBS") services in the United States. EchoStar Communications Corp., which operated the other DBS service, Dish Network, proposed to acquire Hughes. Economists working for the parties and economists in the Department both engaged in extensive modeling of the competition between the two DBS services and with cable television operators with which the DBS services competed in providing "multichannel video programming distribution."

The Department concluded that this modeling supported the conclusion that the acquisition would substantially harm consumers and filed suit to prevent its consummation. Shortly thereafter, the acquisition was abandoned. The Department's modeling indicated that efficiencies claimed by the parties would be insufficient to prevent the merger from creating significant anticompetitive effects.

One source of claimed efficiencies was the reduction of programming costs. Incorporating the Department's best estimate of those reductions into the modeling only

slightly reduced the likely price increase from the proposed acquisition. A second source of claimed efficiencies was a quality improvement; by combining the two services, it would be possible to offer local programming in many additional metropolitan areas with the available satellite bandwidth. The Department's analysis indicated that the consumer benefits from this quality improvement were far from sufficient to prevent the merger from harming consumers and also would be realized without the merger.

Enerco–KleenBurn **(Disguised FTC Matter)** Enerco and KleenBurn Refinery, Inc. were gasoline refining and distribution firms that proposed to merge. The transaction involved the markets for bulk supply of conventional gasoline in the "Plains Corridor" and for bulk supply of reformulated gasoline ("RFG") in Metropolis. The parties claimed that the transaction would create substantial efficiencies in refinery and pipeline operations.

Enerco asserted that the KleenBurn refinery could, with relative ease, be integrated into Enerco's nearby refinery, which, in turn, would enable Enerco to generate substantial operational efficiencies by enhancing its ability to (1) coordinate the acquisition of crude oil and lower raw material costs; (2) align more efficiently the production processes of various light petroleum products, including conventional gasoline and RFG; (3) increase available storage to permit Enerco to manufacture and sell more gasoline grades; and (4) better plan and consolidate shipments. Commission staff concluded that at least some portion of the parties' efficiency claims were likely to be cognizable.

Enerco documents showed that it based a large portion of its bid on the value of expected synergies. When the expected synergies were counted, the refinery's value was estimated to increase four-fold over the KleenBurn refinery's stand-alone value. This estimated increase was about the same amount that Enerco offered to pay. Enerco's willingness to pay upfront for these synergies lent credence to its claims.

Enerco contended that the savings from these efficiencies would enable it to continue operating the KleenBurn refinery beyond the date that the refinery otherwise would have been expected to be decommissioned. Enerco further claimed that its previous efforts to meet new low-sulphur gasoline standards would enable KleenBurn to comply with those standards sooner and at lower cost. Thus, Enerco could, with less investment, maintain or exceed Kleenburn's historical production levels. Enerco financial analyses confirmed that it planned to run the KleenBurn refinery at or above current output rates.

Enerco asserted that it would connect the KleenBurn refinery to Enerco's Metropolis-area refineries, and reallocate Kleenburn barrels for sale in neighboring states, while reserving Metropolis-area barrels for shipment west. The Plains Feeder Line Pipeline tariff was substantially higher from the KleenBurn facility than from Enerco's refineries, and Enerco claimed that it would save over $1 million in variable delivery costs.

Enerco planned to ship several million barrels per day of combined refinery output into the Plains Corridor on Plains Feeder Line under this lower tariff. Because most bulk conventional gasoline shipped into the Plains Corridor was purchased FOB refinery gate in Metropolis, the tariff savings would, in most instances, inure directly to customers in the Plains Corridor. These customers had the existing shipping rights on Plains Corridor gasoline during the summer months when the pipeline is frequently prorated.

The Commission ultimately decided not to challenge the merger on the grounds that it posed no substantial threat to competition, irrespective of any efficiency claims.

"Out-of-Market" Efficiencies

In some cases, merger efficiencies are "not strictly in the relevant market, but so inextricably linked with it that a partial divestiture or other remedy could not feasibly eliminate the anticompetitive effect in the relevant market without sacrificing the efficiencies in the other market(s)." Guidelines § 4 at n.36. If out-of-market efficiencies are not inextricably linked to the relevant market, the Agencies often find an acceptable narrowly tailored remedy that preserves the efficiencies while preventing

anticompetitive effects.

***Genzyme–Ilex* (FTC 2004)** Genzyme Corp. proposed to acquire Ilex Oncology, Inc. Ilex had one FDA-approved product, Campath, an oncology product used off-label in the solid organ transplant field. Genzyme did not compete with Campath in oncology but had a drug that was Campath's closest competitor in the market for solid organ transplant acute therapy drugs. The acquisition would have eliminated direct competition between Genzyme's market-leading drug, Thymoglobulin, and Campath.

The companies asserted that the transaction would yield significant efficiencies for oncology treatment and development. The primary efficiency encompassed several diagnostic tests that could aid the expansion of Campath for treatments in leukemia and other oncology and immune-related diseases by identifying patients who are most likely to benefit from Campath treatment.

After investigation and analysis of this efficiency, Commission staff concurred that Genzyme likely would improve Campath's quality and breadth of treatment in oncology. The companies did not demonstrate, however, that credible efficiencies would result in the solid transplant organ area. In light of the efficiencies in oncology and immune-related disease areas, the Commission tailored a remedy to alleviate the competitive concern in the market for solid organ transplant drugs while allowing the merged company to realize the potential efficiencies in oncology and other areas. In a consent order, the Commission required Genzyme, among other things, to divest contractual rights to Campath for use in solid organ transplant.

Inextricably linked out-of-market efficiencies, however, can cause the Agencies, in their discretion, not to challenge mergers that would be challenged absent the efficiencies. This circumstance may arise, for example, if a merger presents large procompetitive benefits in a large market and a small anticompetitive problem in another, smaller market.

***Gai's–United States Bakery* (DOJ 1996)** United States Bakery and Gai's Seattle French Bakery Co. proposed a joint venture, which the Department viewed as a merger. The two companies sold bread products in competition with one another in the Pacific Northwest, and the Department was concerned about the competitive effects of the transaction on restaurants and institutional accounts, particularly fast food restaurants, because the two companies accounted for more than 90% of the bread sales to such customers. Supplying such customers required a higher level of service (e.g., much more frequent deliveries) than supplying retail stores, and few bakeries provided that level of service. Without entirely resolving issues relating to competitive effects and entry, the Department decided not to challenge the transaction, concluding that the efficiencies likely would cause the merger to benefit the merged firm's customers as a whole.

Critical to the Department's assessment was the fact that the merger-specific efficiencies would benefit all customers, and the restaurant and institutional customers potentially of concern accounted for only about 20% of the companies' sales. The two groups of customers were buying essentially the same products, produced with the same facilities. Because it was otherwise impossible to preserve the efficiency benefits to all customers, the Department did not challenge the merger.

Fixed-Cost Savings

Merger-specific, cognizable efficiencies are most likely to make a difference in the Agencies' enforcement decisions when the efficiencies can be expected to result in direct, short-term, procompetitive price effects. Economic analysis teaches that price reductions are expected when efficiencies reduce the merged firm's marginal costs, i.e., costs associated with producing one additional unit of each of its products. By contrast, reductions in fixed costs—costs that do not change in the short-run with changes in output rates—typically are not expected to lead to immediate price effects and hence to benefit consumers in the short term. Instead, the immediate benefits of lower fixed costs (e.g., most

reductions in overhead, management, or administrative costs) usually accrue to firm profits.

Exceptions to this general rule, however, exist. For example, under certain market or sales circumstances, fixed-cost savings may result in lower prices in the short term. Selling prices that are determined on a "cost-plus basis" (e.g., cost-based contracts) can be influenced by changes in fixed costs. Contractual arrangements also may allow fixed-cost savings to be passed through.

The Agencies consider merger-specific, cognizable reductions in fixed costs, even if they cannot be expected to result in direct, short-term, procompetitive price effects because consumers may benefit from them over the longer term even if not immediately. As with any other type of efficiency, reductions in fixed costs must be substantiated by the parties and verified by reasonable means.

***Verizon–MCI*; *SBC–AT&T* (DOJ 2005)** In 2005 Verizon Communications, Inc. and SBC Communications, Inc., the nation's two largest regional Bell operating companies, sought to acquire MCI Inc. and AT&T Corp., the nation's two largest inter-exchange (long distance) and competitive local exchange (local service) carriers. To a significant extent, the pairs of firms proposing to merge were engaged in complementary activities. Verizon and SBC dominated local exchange and access service in their respective territories but had limited long-haul networks and only moderate success with large enterprise customers. MCI and AT&T had extensive long-haul networks and were the leading providers of telecommunications services to large businesses. The Department concluded that the proposed mergers would substantially lessen competition only in the facilities-based local private line services to many buildings for which the merging pairs of firms owned the only lines.

The Department investigated the effects of the transactions on competition in residential local and long distance telephone service, internet backbone services, and a variety of other telecommunications services. A significant factor in the Department's decision not to challenge the proposed mergers was that the transactions were likely to produce substantial efficiencies. The merging inter-exchange carriers, AT&T and MCI, sell advanced retail products to enterprise customers and generally have relied on local exchange carriers, such as their merger partners, for customer access. The merging local exchange carriers, SBC and Verizon, similarly have relied on inter-exchange carriers in selling advanced retail products to multi-region and out-of-region enterprises. The merger allowed each of the firms to provide these products at a lower cost to the customers by making inputs and complementary products available at a lower cost.

***IMC Global–Western Ag* (DOJ 1997)** IMC Global Inc. proposed to acquire Western Ag-Minerals Co. The two companies operated the only potash mines and processing facilities in the Carlsbad region of New Mexico, which contains the only known reserves of langbeinite in the Western Hemisphere. Langbeinite is a mineral used to produce an agricultural fertilizer supplying magnesium, potassium, and sulfur, which are important in the production of certain crops and in correcting deficiencies in certain soils. Critically, langbeinite supplies these important elements without also containing significant amounts of chlorine.

It is possible to produce a fertilizer with the same qualities from other minerals, but the Department's preliminary analysis indicated that a single owner of both langbeinite mines would find it optimal to raise prices significantly in the absence of any efficiencies from combining the mines. The Department, nevertheless, decided not to challenge the merger because of substantial merger-specific efficiencies. The parties provided the Department with studies indicating that combining the two mining and processing operations would result in substantial efficiencies that could be achieved in no other way.

To verify these claims, the Department hired a consulting mining engineer to conduct an independent study of both the benefits of combining the two operations and alternative means of achieving particular efficiencies. The independent study concluded that the parties' efficiency claims were conservative. Among

other things, the study concluded that IMC would avoid substantial costs by transporting the Western-Ag ore through its mine to its processing plant at the mine mouth. Western-Ag had been shipping the ore to its off-site processing plant. The study found additional efficiencies in combining the mining and processing of the other important mineral, sylvite, found on the adjoining IMC and Western-Ag properties.

The evidence ultimately indicated that the annual dollar savings from the merger would be as much as ten times the likely annual increase in customer costs from the merger, absent any efficiencies. Because the magnitude of the merger-specific cost savings dwarfed any potential effects exclusive of factoring in these savings, the Department did not separately evaluate the extent to which the efficiencies were likely to affect fixed costs versus variable costs.

Supporting Documentation

As with the Guidelines, the Commentary addresses how the Agencies assess the likely competitive effects of horizontal mergers but not the assignment of burdens of proof or burdens of coming forward with evidence. In litigation, the parties have the burden on any efficiencies claim (Guidelines § 0.1 n.5), and it is to their advantage to present efficiency claims (including supporting documents and data) to the reviewing Agency as early as possible. The Agencies, for their part, make a serious effort to assess each efficiency claim made. Early receipt of documentation relating to the nature and size of efficiencies allows the Agencies to factor fully the cognizable efficiencies into an integrated analysis of the likely overall competitive effects of the merger. In particular, the parties may want to highlight significant documents that support their claims and to make their experts (for example, accountants, engineers, or economists) available as early as feasible to discuss specifics regarding efficiencies. Doing so helps underscore the seriousness of efficiency claims and assists the Agencies in according the appropriate weight to efficiency considerations in assessing the mergers before them.

The Agencies recognize that, in many cases, substantiation of efficiency claims requires the collection, compilation, and analysis of competitively significant data and information from both of the merging parties. The sharing between rivals of proprietary information having potential competitive significance necessarily raises concerns about violations of section 1 of the Sherman Act, 15 U.S.C. § 1, and section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45. Furthermore, the Hart-Scott-Rodino Act, 15 U.S.C. § 18a, prohibits changes in beneficial ownership prior to the end of the HSR waiting period.

Although prudent firms are cognizant of so-called "gun jumping" concerns, they can adopt appropriate safeguards to enable them to collect the information necessary to substantiate their efficiency claims. Information exchanges reasonably related to due diligence and integration planning that are accompanied by safeguards that prevent any other pre-merger use of that information are unlikely to be unlawful. The Agencies are mindful of the parties' need to provide sensitive efficiencies-related information and, in that vein, the Agencies note that the antitrust laws are flexible enough to allow the parties to adopt reasonable means to achieve that end lawfully.

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Attachment D

ANTITRUST DIVISION POLICY GUIDE

TO

MERGER REMEDIES

U. S. DEPARTMENT OF JUSTICE
Antitrust Division

October 2004

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I. Overview

The Antitrust Division is authorized to challenge acquisitions and mergers ("mergers") under Section 15 of the Clayton Act, 15 U.S.C. § 25, and Section 4 of the Sherman Act, 15 U.S.C. § 4. If the Division has concluded that a merger may substantially lessen competition, it can "fix" the problem in several ways. The Division may seek a full-stop injunction that would prevent the parties from consummating the transaction. The Division may choose, instead, to negotiate a settlement (a consent decree) or accept a "fix-it-first" remedy that allows the merger to proceed with modifications that restore or preserve the competition.[1]

The purpose of this Guide is to provide Antitrust Division attorneys and economists with a framework for fashioning and implementing appropriate relief short of a full-stop injunction in merger cases. The Guide focuses on the remedies available to the Division and is designed to ensure that those remedies are based on sound legal and economic principles and are closely related to the identified competitive harm. The Guide also sets forth policy issues that may arise in connection with different types of relief and offers Division attorneys and economists guidance on how to resolve them.

This Guide is a policy document, not a practice handbook. It is not a compendium of decree provisions, and it does not list or give "best practices" or the particular language or provisions that should be included in any given decree. Rather, it sets forth the policy considerations that should guide Division attorneys and economists when fashioning remedies for

[1] A consent decree is a binding agreement between the Division and defendants that is filed publicly in federal district court and, upon entry, becomes a binding court order. With a fix-it-first remedy, in contrast, the parties modify or "fix" the transaction before consummation to eliminate any competitive concern. There is no complaint or other court filing. Although a fix-it-first remedy technically preserves, rather than restores, competition, this Guide uses the terms restore and preserve interchangeably. *See infra* Section IV.A.

anticompetitive mergers. The Guide is intended to provide Division attorneys and economists with the tools they need — the pertinent economic and legal principles, appropriate analytical framework, and relevant legal limitations — to craft and implement the proper remedy for the case at hand.

Remedial provisions in Division decrees must be appropriate, effective, and principled. While there is no need to reinvent the wheel with each decree, neither is it appropriate to include a remedy in a decree merely because a similar provision was included in one or more previous decrees, particularly where there has been no clear articulation of the purpose behind the inclusion of that provision. There must be a significant nexus between the proposed transaction, the nature of the competitive harm, and the proposed remedial provisions. Focusing carefully on the specific facts of the case at hand will not only result in the selection of the appropriate remedies but will also permit the adoption of remedies specifically tailored to the competitive harm.

The Guide has five sections. The section immediately following this Overview describes guiding principles governing merger remedies. The third section discusses the policies for fashioning merger remedies, while the fourth addresses implementation of those remedies. Each of these sections sets forth the Antitrust Division's general policies for a variety of remedial issues, including the legal and economic support for those policies and the caveats to those policies.

Finally, the last section of the Guide addresses steps the Division will take to ensure that, once a remedy is established, it is effectively complied with and enforced.

II. Guiding Principles

The following principles guide the development of remedies in all Antitrust Division merger cases:

- **The Antitrust Division Will Not Accept a Remedy Unless There Is a Sound Basis for Believing a Violation Will Occur.** Before recommending a specific remedy, there should be a sound basis for believing that the merger would violate Section 7 of the Clayton Act and that the resulting harm is sufficient to justify remedial action. The Division should not seek decrees or remedies that are not necessary to prevent anticompetitive effects, because that could unjustifiably restrict companies and raise costs to consumers. Consequently, even though a party may be willing to settle early in an investigation, the Division must have sufficient information to be satisfied that there is a sound basis for believing that a violation will otherwise occur before negotiating any settlement.

- **Remedies Must Be Based upon a Careful Application of Sound Legal and Economic Principles to the Particular Facts of the Case at Hand.** Carefully tailoring the remedy to the theory of the violation is the best way to ensure that the relief obtained cures the competitive harm.[2] Before recommending a proposed remedy to an anticompetitive merger, the staff should satisfy itself that there is a close, logical nexus between the recommended remedy and the alleged violation — that the

[2] Ford Motor Co. v. United States, 405 U.S. 562, 575 (1972) (In a Section 7 action, relief "necessarily must 'fit the exigencies of the particular case.'"); Zenith Radio Corp. v. Hazeltine Research, Inc., 395 U.S. 100, 133 (1969); United States v. United States Gypsum Co., 340 U.S. 76, 89 (1950) ("In resolving doubts as to the desirability of including provisions designed to restore future freedom of trade, courts should give weight to . . . the circumstances under which the illegal acts occur."); United States v. Bausch & Lomb Optical Co., 321 U.S. 707, 726 (1944) ("The test is whether or not the required action reasonably tends to dissipate the restraints and prevent evasions."); Massachusetts v. Microsoft Corp., 373 F.3d 1199, 1228 (D.C. Cir. 2004) ("[T]he court carefully considered the 'causal connection' between Microsoft's anticompetitive conduct and its dominance of the market . . . ."); United States v. Microsoft Corp., 253 F.3d 34, 105-07 (D.C. Cir. 2001) (Relief "should be tailored to fit the wrong creating the occasion for the remedy."); Yamaha Motor Co. v. FTC, 657 F.2d 971, 984 (8th Cir. 1981) (Relief barring certain vertical restrictions "goes beyond any reasonable relationship to the violations found."); United States v. Microsoft Corp., 231 F. Supp. 2d 144, 154, 202 (D.D.C. 2002), *aff'd sub nom,* 373 F.3d 1199 (D.C. Cir. 2004).

remedy fits the violation and flows from the theory of competitive harm. Effective remedies preserve the efficiencies created by a merger, to the extent possible, without compromising the benefits that result from maintaining competitive markets.

This assessment will necessarily be fact-intensive. It will normally require determining (a) what competitive harm the violation has caused or likely will cause and (b) how the proposed relief will remedy that particular competitive harm. Only after these determinations are made can the Division decide whether the proposed remedy will effectively redress the violation and, just as importantly, be no more intrusive on market structure and conduct than necessary to cure the competitive harm. Basing remedies on the application of sound economic and legal analysis to the particular facts of each case avoids merely copying past relief proposals or adopting relief proposals divorced from guiding principles.

- **Restoring Competition Is the Key to an Antitrust Remedy.** Once the Division has determined that the merger is anticompetitive, the Division will insist on a remedy that resolves the competitive problem. Accepting remedies without analyzing whether they are sufficient to redress the violation involved is a disservice to consumers.

  Although the remedy should always be sufficient to redress the antitrust violation, the purpose of a remedy is not to enhance premerger competition but to restore it. The Division will insist upon relief sufficient to restore competitive conditions the merger would remove. Restoring competition is the "key to the whole question of an antitrust remedy,"[3] and restoring competition is the only appropriate goal with respect to crafting merger remedies.

[3] United States v. E.I. du Pont de Nemours & Co., 366 U.S. 316, 326 (1961).

The Supreme Court has stressed repeatedly that the purpose of an antitrust remedy is to protect or restore competition.[4] Restoring competition requires replacing the competitive intensity lost as a result of the merger rather than focusing narrowly on returning to premerger HHI levels. Thus, for example, assessing the competitive strength of a firm purchasing divested assets requires more analysis than simply attributing to this purchaser past sales associated with those assets.

- **The Remedy Should Promote Competition, Not Competitors.** Because the goal is reestablishing competition — rather than determining outcomes or picking winners and losers — decree provisions should promote competition generally rather than protect or favor particular competitors.[5]

- **The Remedy Must Be Enforceable.** A remedy is not effective if it cannot be enforced.[6] Remedial provisions that are too vague to be enforced or that could be construed when enforced in such a manner as to fall short of their intended purpose can render useless the enforcement effort that went into investigating the transaction and obtaining the decree, leaving the competitive harm unchecked. The same is true of a decree that fails to bind a person or entity necessary to implementing the remedy. A defendant will scrupulously obey a decree only when the decree's

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[4] *Ford Motor Co.*, 405 U.S. at 573; *du Pont*, *id*.

[5] *E.g.*, Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 223 (1993); Spectrum Sports, Inc. v. McQuillan, 506 U.S. 447, 458-59 (1993); Atlantic Richfield Co. v. USA Petroleum Co., 495 U.S. 328, 338 (1990); Cargill, Inc. v. Monfort, Inc., 479 U.S. 104, 116-17 (1986); Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc., 429 U.S. 477, 488 (1977); Brown Shoe Co. v. United States, 370 U.S. 294, 320 (1962); Massachusetts v. Microsoft Corp., 373 F.3d at 1211, 1230; United States v. Microsoft Corp., 253 F.3d at 58.

[6] *See, e.g.*, New York v. Microsoft Corp., 224 F. Supp. 2d 76, 137 (D.D.C. 2002), *aff'd sub nom.* Massachusetts v. Microsoft Corp., 373 F.3d 1199 (D.C. Cir. 2004) ("Plaintiffs' definition is vague and ambiguous, rendering compliance with the terms of Plaintiffs' remedy which are reliant on this definition to be largely unenforceable.").

meaning is clear, and when the defendant and its agents know that they face the prospect of fines or imprisonment if they disregard the decree. Courts are certain to impose such sanctions only when (a) the decree provisions are clear and understandable and (b) the defendant's agents knew, or should have known, about the decree provisions.[7]

Consequently, decree provisions must be as clear and straightforward as possible, always focusing on how a judge not privy to the settlement negotiations is likely to construe those provisions at a later time.[8] Likewise, care must be taken to avoid potential loopholes and attempted circumvention of the decree. Attention must also be given to identifying those persons who must be bound by the decree to make the proposed relief effective and to ensuring that the judgment contains whatever provisions are necessary to put them on notice of their responsibilities.

- **The Antitrust Division Will Commit the Time and Effort Necessary to Ensure Full Compliance with the Remedy.** It is contrary to our law enforcement responsibilities to obtain a remedy and then not monitor and, if necessary, enforce it. Our work is not over until the remedies mandated in our consent

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[7] *E.g.*, United States v. Microsoft Corp., 147 F.3d 935, 940 (D.C. Cir. 1998); United States v. NYNEX Corp., 8 F.3d 52, 54 (D.C. Cir. 1993) ("There are three essential elements of criminal contempt under 18 U.S.C. § 401(3): (1) there must be a violation, (2) of a clear and reasonably specific order of the court, and (3) the violation must have been willful. United States v. Turner, 812 F.2d 1552, 1563 (11th Cir. 1987). The Government carries the burden of proof on each of these elements, and the evidence must be sufficient to establish guilt beyond a reasonable doubt."); United States v. Smith International, Inc., 2000-1 Trade Cas. ¶ 72,763 (D.D.C. 2000).

[8] *See* New York v. Microsoft Corp., 224 F. Supp. 2d at 100 ("Moreover, the case law counsels that the remedial decree should be 'as specific as possible, not only in the core of its relief, but in its outward limits, so that parties may know [ ] their duties and unintended contempts may not occur.'"); International Salt Co. v. United States, 332 U.S. 392, 400 (1947).

> decrees have been fully implemented, which means that decrees that place continuing obligations on defendants must be monitored. This requires, in the first instance, that decrees be drafted with sufficient reporting and access requirements to keep us apprised of how the decree is being implemented, and then a continuing commitment of Division resources to decree compliance and enforcement. Responsibility for enforcing all of the Division's outstanding judgments lies with its civil sections, to which the judgments are assigned according to the current allocation of industries or commodities among those sections, with assistance from a criminal section in criminal contempt cases.

III. Fashioning the Remedy

Merger remedies take two basic forms: one addresses the *structure* of the market, the other the *conduct* of the merged firm. Structural remedies generally will involve the sale of physical assets by the merging firms. In some instances, market structure can also be changed by requiring, for example, that the merged firm create new competitors through the sale or licensing of intellectual property ("IP") rights.[9] A conduct remedy usually entails injunctive provisions that would, in effect, manage or regulate the merged firm's postmerger business conduct. As discussed below, in some cases the remedy may require both structural and conduct relief.

A. Structural Remedies Are Preferred

The speed, certainty, cost, and efficacy of a remedy are important measures of its potential effectiveness. Structural remedies are preferred to conduct remedies in merger cases because they are relatively clean and certain, and generally avoid costly government entanglement in the market. A carefully crafted divestiture decree is "simple, relatively easy to administer,

[9] U.S. v. 3D Systems Corp., 2002-2 Trade Cas. ¶ 73,738. (D.D.C. 2001).

and sure" to preserve competition.[10] A conduct remedy, on the other hand, typically is more difficult to craft, more cumbersome and costly to administer, and easier than a structural remedy to circumvent.

Conduct remedies suffer from at least four potentially substantial costs that a structural remedy can in principle avoid. First, there are the direct costs associated with monitoring the merged firm's activities and ensuring adherence to the decree. Second, there are the indirect costs associated with efforts by the merged firm to evade the remedy's "spirit" while not violating its letter. As one example, a requirement that the merged firm not raise price may lead it profitably, and inefficiently, to reduce its costs by cutting back on quality — thereby effecting an anticompetitive increase in the "quality adjusted" price.

Third, a conduct remedy may restrain potentially procompetitive behavior. For instance, a requirement that the merged firm not discriminate against its rivals in the provision of a necessary input can raise difficult questions of whether cost-based differences justify differential treatment and thus are not truly discriminatory. Firms often sell to a wide range of customers, some of which have very intense demands for the product and would be willing to pay a high price based on that demand and others of which are not willing to pay nearly so much. When this is the case, and when price discrimination is feasible, permitting the firm to charge low prices to customers that have a low demand for the product and higher prices to customers that have a high demand for the product can increase not only the firm's profits, but total output and consumer welfare as a whole. Requiring the firm to charge a single price to all may, in such circumstances, result in a price that excludes the low demand group entirely.

Fourth, even where "effective," efforts to regulate a firm's future conduct may prevent it from responding efficiently to changing

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[10] United States v. E.I. du Pont de Nemours & Co., 366 U.S. 316, 331 (1961); *see generally* California v. American Stores Co., 495 U.S. 271, 280-81 (1990) ("[I]n Government actions divestiture is the preferred remedy for an illegal merger or acquisition.").

market conditions. For all of these reasons, structural merger remedies are strongly preferred to conduct remedies.[11]

B. A Divestiture Must Include All Assets Necessary for the Purchaser To Be an Effective, Long-Term Competitor

The assets consolidated in a merger may be tangible (factories capable of producing automobiles or raw materials used in the production of some other final good) or intangible (patents, copyrights, trademarks, or rights to facilities such as airport gates or landing slots). The goal of a divestiture is to ensure that the purchaser[12] possesses both the means and the incentive to maintain the level of premerger competition in the market(s) of concern.[13]

This requires a clear identification of the assets a competitor needs to compete effectively in a timely fashion and over the long-term. Any divestiture should address whatever obstacles (for example, lack of a distribution system or necessary know-how) lead to the conclusion that a competitor, absent the divestiture, would not be able to discipline a merger-generated increase in market power.[14] That is, the divestiture assets must be substantial enough to enable the purchaser to maintain the premerger level of competition, and should be sufficiently comprehensive that the purchaser will use them in the relevant market and be unlikely to liquidate or redeploy

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[11] *See* discussion *infra* Section III.E.

[12] The use of "purchaser" in this Guide refers to the third-party purchaser of the divested tangible or intangible assets from the merging firms.

[13] *See* Ford Motor Co. v. United States, 405 U.S. 562, 573 (1972) ("The relief in an antitrust case must be 'effective to redress the violations' and 'to restore competition.'. . . Complete divestiture is particularly appropriate where asset or stock acquisitions violate the antitrust laws.") (citation omitted).

[14] S*ee, e.g.*, White Consol. Indust. Inc. v. Whirlpool Corp., 612 F. Supp. 1009 (N.D. Ohio), *vacated on other grounds*, 619 F. Supp. 1022 (N.D. Ohio 1985), *aff'd*, 781 F.2d 1224 (6th Cir. 1986) (court analyzes sufficiency of a proposed divestiture package to restore effective competition).

them.[15]

If, for example, a constraint is the time or the incentive necessary for a potential entrant or small incumbent to construct production facilities, then sufficient production facilities should be part of the divestiture package. If the assets being combined through the merger are valuable brand names or other intangible rights, then the divestiture package should include a brand or a license that enables its purchaser to compete quickly and effectively. In markets where an installed base of customers is required in order to operate at an effective scale, the divested assets should either convey an installed base of customers to the purchaser or quickly enable the purchaser to obtain an installed customer base.

In any event, there are certain intangible assets that likely should be conveyed whenever tangible assets are divested. Many of these simply provide valuable information to the purchaser — for example, documents and computer records providing the purchaser with customer information or production information, research results, computer software, and market evaluations. Others pertain to patents, copyrights, trademarks, other IP rights, licenses, or access to key intangible inputs (for example, access to a particular range of broadcast spectrum) that are necessary to allow for the most productive use of any tangible assets being divested, or of any tangible assets already in the hands of the purchaser.

The package of assets to be divested must not only allow a purchaser quickly to replace the competition lost due to the merger, but also provide it

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[15] *See* Chemetron Corp. v. Crane Co., 1977-2 Trade Cas. ¶ 61,717 at 72,930 (N.D. Ill. 1977). In a merger between firm A and firm B, the Division generally would be indifferent as to which firm's assets are divested, despite possible qualitative differences between the firms' assets, so long as the divestiture restores competition to the premerger level. However, if the divestiture of one firm's assets would not restore competition, then the other firm's assets must be divested. For example, if firm A's productive assets can only operate efficiently in combination with other assets of the firm, while firm B's productive assets are free standing, the Division likely would require the divestiture of firm B's assets.

with the *incentive* to do so.[16] Unless the divested assets are sufficient for the purchaser to become an effective and efficient competitor, the purchaser may have a greater incentive to deploy them outside the relevant market.

A final issue to consider is whether and when it may be appropriate to permit flexibility in the specification of the divestiture assets. Although the appropriate identification of the divestiture assets is sometimes obvious, either due to the nature of the business or the homogeneity of potential purchasers, this is not always the case. The circumstances of potential bidders may vary in ways that affect the scope of the assets each would need to compete quickly and effectively. For example, one potential purchaser might require certain distribution assets and another may not. In other cases, the Division may be indifferent between two alternative sets of divestiture assets — for example, a manufacturing facility owned by merging firm A versus a similar facility owned by merging firm B, or even two differently configured sets of assets, either of which would enable a purchaser to maintain the premerger level of competition in the affected market(s). The Division recognizes the need for flexibility in defining the divestiture assets in such cases.

However, once the Division files a proposed consent decree, Division policy requires that the decree include a precise description of the package of assets that, when divested, will resolve the Division's competitive concerns by maintaining competition at premerger levels.[17] This will ordinarily require the identification of a single set of divestiture assets in the consent decree. In rare circumstances, the decree may include a description of more than one set of assets the divestiture of which would be acceptable to the Division, with the defendant permitted to sell any of the described asset packages during the initial divestiture period.[18] If, at any time after the decree is filed, the Division

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[16] See *infra* Section IV.D. for a further discussion of the characteristics of an acceptable purchaser.

[17] Nothing, however, prohibits the merged firm from selling *additional* assets not specified in the decree.

[18] The decree may specify that a selling trustee have similar flexibility to sell the

(continued...)

and the defendant agree that the sale of an asset package not described in the consent decree will resolve the competitive concerns raised by the proposed transaction, the consent decree must be modified to describe this new divestiture package and the reasons this new divestiture is appropriate must be set forth in the moving papers.[19]

C. Divestiture of an Existing Business Entity Is Preferred

As stated above, any divestiture must contain at least the minimal set of assets necessary to ensure the efficient current and future production and distribution of the relevant product and thereby replace the competition lost through the merger. The Division favors the divestiture of an existing business entity that has already demonstrated its ability to compete in the relevant market.[20] An existing business entity should possess not only all the physical assets, but also the personnel, customer lists, information systems, intangible assets, and management infrastructure necessary for the efficient production and distribution of the relevant product. Where an existing business entity lacks certain of these characteristics, additional assets from the merging firms will need to be included in the divestiture package.

An existing business entity provides current and potential customers with a track record they can evaluate to assure themselves that the unit will continue to be a reliable provider of the relevant products. Importantly, an existing business entity's track record establishes a strong presumption that it can be a viable and effective competitor in the markets of concern going forward. It has, in a very real sense, been tested by the market.

Conversely, a set of assets that comprises only a portion of an existing

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[18](...continued)
alternative sets of assets or may require the trustee to sell only one of the described sets of assets.

[19] However, a minor deletion of assets from the divestiture package may not require a decree modification.

[20] In some cases, an existing business entity may be a single plant that produces and sells the relevant product; in other cases, it may be an entire division.

business entity has not demonstrated the ability effectively to compete. Such a divestiture almost invariably raises greater concern about the viability or competitiveness of the purchaser, perhaps because it is missing some unanticipated yet valuable component.

The Division should scrutinize carefully the merging firm's proposal to sell less than an existing business entity because the merging firm has an obvious incentive to sell fewer assets than are required for the purchaser to compete effectively going forward. Further, at the right price, a purchaser may be willing to purchase these assets even if they are insufficient to produce competition at the premerger level. A purchaser's interests are not necessarily identical to those of the public, and so long as the divested assets produce something of value to the purchaser (possibly providing it with the ability to earn profits in some other market or enabling it to produce weak competition in the relevant market), it may be willing to buy them at a fire-sale price regardless of whether they cure the competitive concerns.

Caveats: 1. Divestiture of Less than an Existing Business Entity May Be Considered if There Is No Existing Business Entity Smaller than Either of the Merging Firms and a Set of Acceptable Assets Can Be Assembled from Both of the Merging Firms

- There may be situations where there is no obvious existing business entity smaller than either of the merging firms. In limited circumstances, it may be possible to assemble an acceptable set of assets from both of the merging firms to create a viable divestiture. However, the Division must be persuaded that these assets will create a viable entity that will restore competition.

2. Divestiture of Less than an Existing Business Entity Also May Be Considered When Certain of the Entity's Assets Are Already in the Possession of, or Readily Obtainable in a Competitive Market by, the Potential Purchaser

- The Division will approve the divestiture of less than an existing business entity if the evidence clearly demonstrates that certain of the entity's assets already are in the possession of, or readily obtainable in a competitive market by, the potential purchaser (e.g., general accounting or computer programming services). For example, if the likely purchaser already has its own distribution system, then insisting that a comparable distribution system be included in the divestiture package may create an unwanted and costly redundancy. In such a case, divesting only the assets required efficiently to design and build the relevant product may be appropriate.

3. Divestiture of More than an Existing Business Entity May Be Considered when It Is Necessary to Restore Competition

- Divesting an existing business entity, even if the divestiture includes all of the production and marketing assets responsible for producing and selling the relevant product, will not always enable the purchaser fully to replicate the competition eliminated by the merger. For example, in some industries, it is difficult to compete without offering a "full line" of products. In such cases, the Division may seek to include a full line of products in the divestiture package, even when our antitrust concern relates to only a subset of those products. Similarly, although the merger creates a competitive problem in a United States market, divestiture of a world-wide business may be necessary to restore competition. More generally, integrated firms can provide scale and scope economies that a purchaser may not be able to achieve after obtaining the divested assets. When available evidence suggests that this is likely to be the case (such as where only large integrated firms manage to remain viable in the marketplace), the entity that needs to be divested may actually be the firm itself, and blocking the entire transaction rather than accepting a divestiture

may be the only effective solution.

D. The Merged Firm Must Divest Rights to Critical Intangible Assets

Where the critical asset is an intangible one — e.g., where firms with alternative patent rights for producing the same final product are merging — structural relief must provide one or more purchasers with rights to that asset.[21] Such rights can be provided either by sale to a different owner or through licensing.[22]

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[21] A critical asset is one that is necessary for the purchaser to compete effectively in the market in question. When a patent covers the right to compete in multiple product or geographic markets, yet the merger adversely affects competition in only a subset of these markets, the Division will insist only on the sale or license of rights necessary to maintain competition in the affected markets. In some cases, this may require that the purchaser or licensee obtain the rights to produce and sell only the relevant product. In other circumstances, it may be necessary to give the purchaser or licensee the right to produce and sell other products (or use other processes), where doing so permits the realization of scale and scope economies necessary to compete effectively in the relevant market.

[22] United States v. National Lead Co., 332 U.S. 319, 348 (1947) (courts may order mandatory patent licensing as relief in antitrust cases where necessary to restore competition). When the divestiture involves licensing, the Division will generally insist on fully paid-up licenses rather than running royalties for two reasons. First, running royalty payments, even if they are less expensive to the licensee over the lifetime of the license, add a cost to the licensee's production and sale of incremental units, tending to increase the licensee's profit-maximizing price. The result will be less competition than the two merging firms had previously been providing. Second, running royalties require a continued relationship between the merged firm and the purchaser, which could soften competition between them. However, the Division may consider the use of running royalties if (a) no deal would otherwise be struck between the merged firm and the licensee (perhaps because the firms differ greatly in their estimates of future revenue streams under the license) and (b) blocking the deal entirely would likely sacrifice merger-specific efficiencies worth preserving.

Also, the Division will not generally require royalty free licenses since parties should ordinarily be compensated for the use or sale of their property, intangible as well as tangible. *See id.* at 349 ("[T]o reduce all royalties automatically to a total of zero, regardless of their nature and regardless of their number, appears, on its face, to be inequitable without special proof to support such a conclusion."); Massachusetts v. Microsoft Corp., 373 F.3d 1199, 1231

(continued...)

When the remedy requires divestiture of intangible assets, often an issue arises as to whether the merged firm can retain rights to these assets, such as the right to operate under the divested patent itself. Because such intangible assets have the peculiar economic property that use of the asset by one party need not preclude unlimited use of that very same asset by others, there may be in this sense no cost to allowing the seller to retain the same rights as the purchaser.

Nonetheless, in the context of a merger, permitting the merged firm to retain access to the critical intangible assets may present a significant competitive risk. Because the purchaser of the intangible assets will not have the right to exclude all others (specifically, the merged firm), it may face a greater challenge in differentiating its product from rivals and therefore be a lesser competitive force in the market. Also, if the purchaser is required to share rights to an intangible asset (like a patent or a brand name), it may not engage in competitive conduct (including investments and marketing) that it might have engaged in otherwise. For example, the purchaser may face greater risks of misappropriation by its rival of future "add on" investments or marketing activities. Where the purchaser is unable effectively to differentiate its offering from that of the merged firm, this may weaken its ability and incentive to compete as aggressively as the two formerly independent firms had been competing premerger. Moreover, where multiple firms have rights to the same trademark or copyright, *none* may have the proper incentive to promote and maintain the quality and reputation of the brand. In these circumstances, the Division is likely to conclude that permitting the merged firm to retain rights to the critical intangible assets will prevent the purchaser from restoring effective competition and, accordingly, will require that the merged firm relinquish all rights to the intangible assets.[23]

However, there may be other circumstances when the merged firm

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[22](...continued)
(D.C. Cir. 2004).

[23] For example, the Division required the exclusive licensing of brand names in United States v. Interstate Bakeries Corp., 1996-1 Trade Cas. ¶ 71,271 (N.D. Ill. 1995).

needs to retain rights to the intangible assets to achieve demonstrable efficiencies – which are not otherwise obtainable through an efficient licensing agreement with the purchaser following divestiture – and a non-exclusive license is sufficient to restore competition and assure the purchaser's future viability and competitiveness. These conditions are more likely to be satisfied in, for example, the case of production process patents than with final product patents, copyrights, or trademarks. This is because the purchaser is almost certain to rely on the latter to distinguish its products from incumbent products. In contrast, patented production technology that is shared, in addition to having the beneficial effect of lowering both producers' marginal costs, is less likely significantly to affect competition since the production process generally does not affect the purchaser's ability to differentiate its product. Under these circumstances, the merged firm will likely be permitted to retain certain rights to the critical intangible assets and may only be required to provide the purchaser with a non-exclusive license.[24]

There also may be circumstances when licensing the intangible assets to multiple firms – or perhaps even to "all comers" – is necessary to replace the competition lost through the merger.[25] This might be the case, for example, if the number one and two firms merge and there is a significant gap between those firms and the competitive significance of smaller firms. Licensing to more than one of those smaller firms or new entrants may be required to replace the competition eliminated by the merger.

E. Conduct Relief Is Appropriate Only in Limited Circumstances

As discussed above, conduct remedies generally are not favored in merger cases because they tend to entangle the Division and the courts in the operation of a market on an ongoing basis and impose direct, frequently substantial, costs upon the government and public that structural remedies can

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[24] *See, e.g.,* United States v. 3D Systems Corp., 2002-2 Trade Cas. ¶ 73,738 (D.D.C. 2001).

[25] *See, e.g.,* United States v. Miller Industries, Inc., 2001-1 Trade Cas. ¶ 73,132 (D.D.C. 2000); United States v. Cookson Group plc, 1994-1 Trade Cas. ¶ 70,666 (D.D.C. 1993).

avoid. However, there are limited circumstances when conduct remedies will be appropriate: (a) when conduct relief is needed to facilitate transition to or support a competitive structural solution, i.e., when the merged firm needs to modify its conduct for structural relief to be effective or (b) when a full-stop prohibition of the merger would sacrifice significant efficiencies and a structural remedy would also sacrifice such efficiencies or is infeasible. In either circumstance, the costs of the conduct relief must be acceptable in light of the expected benefits.

1. Conduct Relief as an Adjunct to a Structural Remedy

Limited conduct relief can be useful in certain circumstances to help perfect structural relief. One example of a potentially appropriate transitional conduct provision is a *short-term* supply agreement. While *long-term* supply agreements between the merged firm and third parties on terms imposed by the Division are generally undesirable,[26] *short-term* supply agreements on occasion can be useful when accompanying a structural remedy. For example, if the purchaser is unable to manufacture the product for a limited transitional period (perhaps as plants are reconfigured or product mixes are altered), a short-term supply agreement can help prevent the loss of a competitor from the market, even temporarily. In such a case, the potential problems arising from supply agreements are more limited, given their short duration, and may be outweighed by their ability to maintain another competitor during the interim.

Similarly, *temporary* limits on the merged firm's ability to reacquire personnel assets as part of a divestiture may at times be appropriate to ensure

[26] Given the merged firm's incentive not to promote competition with itself, competitors reliant upon the merged firm for product or key inputs are likely to be disadvantaged in the long term. Contractual terms are difficult to define and specify with the requisite foresight and precision, and a firm compelled to help another compete against it is unlikely to exert much effort to ensure the products or inputs it supplies are of high quality, arrive as scheduled, match the order specifications, and satisfy other conditions that are necessary to restore competition. Moreover, close and persistent ties between two or more competitors (as created by such agreements) can serve to enhance the flow of information or align incentives that may facilitate collusion or cause the loss of a competitive advantage.

that the purchaser will be a viable competitor. The divestiture of any portion of a business unit would normally involve the transfer of personnel from the merging firms to the purchaser of the assets. Incumbent employees often are essential to the productive operation of the divested assets, particularly in the period immediately following the divestiture (i.e., they may be integral to efficient operation of the other assets that are being divested). Current employees may have uncommon technical knowledge of particular manufacturing equipment or may be the authors of essential software. While knowledge is often transferrable or reproducible over time, the immediate loss of certain employees may substantially reduce the ability of the divested entity to compete effectively, at least at the outset. To protect against this impairment, the Division may prohibit the merged firm from re-hiring these employees for some limited period.[27]

Restricting the merged firm's right to compete in final output markets or against the purchaser of the divested assets, even as a transitional remedy, is strongly disfavored. Such restrictions directly limit competition in the short term, and any long-term benefits are inherently speculative. For this reason, the Division is unlikely to impose them as part of a merger remedy. When the purchaser appears incapable of surviving or competing effectively against the merged firm without such restrictions, the Division is likely to seek a full-stop injunction against the transaction.

Finally, in addition to temporary or transitional conduct remedies, there may be occasions when continuing conduct relief is needed to effectuate or bolster the structural remedy. For example, there can be instances under the Capper-Volstead Act, 7 U.S.C. § 291, and other statutes where antitrust exemptions could become applicable if the divested assets were owned by

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[27] *See, e.g.*,United States v. AlliedSignal, Inc., 2000-2 Trade Cas. ¶ 73,023 (D.D.C. 2000); United States v. Aetna, Inc., 1999-2 Trade Cas. ¶ 72,730 (N.D.Tex. 1999). Of course, in a situation in which there are a limited number of key employees who are essential to any purchaser competing effectively in the market, the Division will scrutinize very carefully whether divestiture is an appropriate remedy. If the Division cannot be satisfied that the key personnel are likely to become and remain employees of the purchaser, a more appropriate action may be to block the entire transaction.

persons having certain characteristics. In those rare situations, a conduct provision providing that the merged firm and the purchaser of the divested assets cannot sell the divested assets to a person having those characteristics might be appropriate, if the efficiencies gained from allowing the merger to go forward are high.[28]

2. Stand-Alone Conduct Relief

While conduct remedies are used in limited circumstances as an adjunct to structural relief in merger cases, the use of conduct remedies standing alone to resolve a merger's competitive concerns is rare[29] and almost always in industries where there already is close government oversight. Stand-alone conduct relief is only appropriate when a full-stop prohibition of the merger would sacrifice significant efficiencies and a structural remedy would similarly eliminate such efficiencies or is simply infeasible.

Both horizontal and vertical mergers present the potential to create efficiencies.[30] Where merger-specific scale, scope, or other economies are

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[28] An example of such a provision is found in the Final Judgment in United States v. Dairy Farmers of America, 2001-1 Trade Cas. ¶ 73,136 (E.D. Pa. 2000).

[29] For example, between October 1, 1993 and September 30, 2003, the Division filed about 113 merger cases. Less than ten had conduct relief without any structural remedy, and most of those cases involved the regulated telecommunications industry and the defense industry. *See* United States v. MCI Communications Corp, 1994-2 Trade Cas. ¶ 70,730 (D.D.C. 1994), *modified*, 1997-2 Trade Cas. ¶ 71,935 (D.D.C. 1997) (transparency provision); United States v. Sprint Corp., 1996-1 Trade Cas. ¶ 71,300 (D.D.C. 1996) (same); United States v. Tele-Communications, Inc., 1996-2 Trade Cas. ¶ 71,496 (D.D.C. 1994) (fair dealing provision); United States v. AT&T Corp., 59 Fed. Reg. 44158 (D.D.C. 1994) (same); United States v. Northrop Grumman Corp., 68 Fed. Reg. 1861 (D.D.C. 2003) (fair dealing and firewall provisions); and United States v. Lehman Bros. Holdings, Inc., 1998-2 Trade Cas. ¶ 72,269 (D.D.C. 1998) (firewall provision and prohibitions on certain joint bidding agreements). *See also* United States v. Morton Plant Health System, Inc., 1994-2 Trade Cas. ¶ 70,759 (M.D. Fla. 1994) (firewall provision and prohibitions on certain joint pricing).

[30] Horizontal and vertical mergers often produce different types of efficiencies. Examples of possible horizontal-merger-related efficiencies include achieving economies of

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significant but the merger is on balance anticompetitive, requiring a structural divestiture might remedy the competitive concerns only at the cost of unnecessarily sacrificing significant efficiencies. In such situations, a stand-alone conduct remedy may be appropriate. However, for the prospect of potentially attainable efficiencies to justify accepting a pure conduct remedy, the efficiencies in question need to be cognizable rather than merely asserted. Moreover, they must be unattainable (at reasonable cost) if there is a structural divestiture. Analogizing to the Merger Guidelines, the Division requires them to be "conduct-remedy specific."

Mergers may also present the situation where any possible structural remedy that would undo the competitive harm would result in the loss of pre-existing internal efficiencies, i.e., efficiencies already achieved by a merging firm, prior to the merger, that are not due to the merger. For example, in order to minimize costs a firm may use the same distribution system for the widgets and gadgets that it produces. A divestiture that requires breaking up the distribution system into a widget distribution system, entirely separate from the gadget distribution system, may eliminate efficiencies that had been created by their original consolidation. The Division would give consideration to a conduct remedy that retained these efficiencies and still remedied the anticompetitive concern arising from the proposed merger.

There also may be situations where a structural remedy is infeasible**.** Certain vertical mergers in particular may simply not be amenable to any type of structural relief, as is typically found in the case of an upstream firm with a single plant acquiring a downstream firm with a single plant. Where such a

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[30](...continued)
scale or scope, and rationalization of sales forces, design teams, and distribution networks. Examples of vertical-merger-related efficiencies include elimination of the double-marginalization problem (i.e., the vertically integrated firm has an incentive to charge a lower price for the final good compared to the price that results from each of the merging firms setting prices independently), coordination of the design of intermediate and final products, and perhaps reduction or elimination of other types of transaction costs. See D. Carlton & J. Perloff, Modern Industrial Organization 377-417 (3rd ed. 2000) for an explanation of the various efficiencies that can arise from a vertical merger. For a discussion of the efficiencies that can arise from a horizontal merger, see Section 4 of the Horizontal Merger Guidelines.

merger may substantially lessen competition yet would likely result in significant efficiencies, the Division's choice necessarily will come down to stopping the transaction or imposing a conduct remedy.

In deciding whether a conduct remedy is appropriate, the Division will also consider the costs of monitoring and enforcing the remedy. Monitoring and enforcing a conduct remedy may be easier in markets in which regulatory oversight is already being employed and data on the merged firm's conduct would regularly be collected and audited in any event. Although those regulators will not generally have the same incentives and goals as the competition authorities, the greater transparency of market conduct that they permit can lower the cost to the Division and the courts of monitoring and enforcement.[31]

The most common forms of stand-alone conduct relief are firewall, fair dealing, and transparency provisions. As discussed below, however, their

ongoing use, along with that of all other forms of stand-alone conduct relief, can present substantial policy and practical concerns.

a. Firewall Provisions

Firewalls are designed to prevent the dissemination of information within a firm. Suppose, for example, that an upstream monopolist proposes to merge with one of three downstream firms, all three of whom compete in the same relevant market. The Division may be concerned that the upstream firm will share information with its acquired downstream firm (and perhaps with

[31] This will not, however, eliminate all mechanisms through which conduct-regulated firms can evade the conduct remedy. For instance, suppose the Division is considering a conduct remedy partly because a government agency accurately monitors the prices in the industry (but only the prices). One way to comply with the pricing provision (such as a non-discrimination provision) might be to keep prices the same, but decrease quality. However, if quality is not easily altered, or if there are other restraints on the merged firm's incentive to decrease quality, then the conduct remedy may be more acceptable.

the two other downstream firms) that will facilitate anticompetitive behavior.[32] A properly designed and enforced firewall could prevent that.

The problems with firewalls are those of every regulatory provision. The first concern is the considerable time and effort the Division and the courts have to expend in monitoring and enforcing such provisions. The second problem is devising a provision that will ensure that the pertinent information will not be disseminated in any event. The third is that a firewall may frequently destroy the very efficiency that the merger was designed to generate.

For these reasons, the use of firewalls in Division decrees is the exception and not the rule. They are infrequently used in horizontal mergers because, no matter how carefully crafted, the risks that the merging firms will act collaboratively in spite of the firewall are great. However, they have occasionally been used in some defense industry mergers, and in vertical and other non-horizontal mergers when both the loss of efficiencies from blocking the merger outright and the harm to competition from allowing the transaction to go unchallenged are high.

b. Fair Dealing Provisions

Fair dealing provisions include the concepts of equal access, equal efforts, and non-discrimination. However, as discussed previously, a non-discrimination requirement presents the difficult question of whether cost-based differences justify differential prices and thus are not truly discriminatory.[33]

Suppose, for example, an upstream monopolist proposes to merge with one of three downstream firms. The three downstream firms all compete in

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[32] While coordination is perhaps the chief concern in such instances, such information sharing could also lead rivals concerned about misappropriation of their proprietary information to under-invest in product development and thus stifle innovation.

[33] See *supra* Section III.A. for a discussion of non-discrimination provisions.

the same relevant market. A concern arising from this merger could be that the upstream firm will now have an incentive to favor the acquired downstream firm by offering less attractive terms to the acquired firm's two downstream competitors.

In such a case, consideration may be given to a fair dealing clause whereby the upstream firm must offer the same terms to all three downstream competitors. As with most forms of regulation, however, enforcing (and even drafting) this sort of requirement can be problematic. In the first instance, if the upstream and downstream firms have merged in such a manner that the sales price to the acquired downstream firm becomes a mere internal accounting factor, the upstream firm could set a high, non-discriminatory price to downstream firms that would nonetheless disadvantage the acquired downstream firm's competitors. A fair dealing provision might then be ineffective. Even where this is not the case, e.g., where regulation at one level dictates how transfer prices are measured or the vertical integration is only partial, difficulties remain with fair dealing provisions. In order to accept such a remedy, the Division must be convinced that it has protected against problems where the independent downstream firms get lesser quality product, slower delivery times, reduced service, or unequal access to the upstream firm's products.

Such provisions should not be undertaken without careful analysis. Fair dealing provisions have a great potential for harm as well as good, and the Division must always evaluate and weigh the benefits of using such a provision against the risks. When used at all in Division decrees, such provisions invariably require careful crafting so that the judgment accomplishes the critical goals of the antitrust remedy without damaging market performance.

c. Transparency Provisions

The Division on occasion has used so-called transparency provisions as the sole or principal form of relief in vertical merger cases. Such provisions usually require the merged firm to make certain information available to a

regulatory authority that the firm would not otherwise be required to provide. For example, a telecommunications firm may be required to inform a regulatory authority of what prices the firm is charging customers for telephone equipment even though the regulatory agency may not have authority to regulate those prices. The theory is that the additional information will aid the regulatory authority in curtailing the telecommunications firm from engaging in regulatory evasion by, for example, charging telephone equipment clients with which it competes for telephone services higher prices than it charges its other telephone equipment customers.

Transparency provisions present the same problems that other regulatory provisions entail. First, they present the difficulty of devising a provision that will not be circumvented. Second, they require the Antitrust Division to educate the regulator on the significance of the additional information and ensure that the information is reviewed. Third, they require the Division and the courts to expend considerable resources in monitoring and enforcing the provision. For these reasons, transparency provisions are also used sparingly in Division decrees.

d. Other Types of Conduct Remedies

While firewall, fair dealing, and transparency provisions are the most common forms of stand-alone conduct relief (and even these provisions are quite rare), other conduct remedies are also possible. These include so-called competitive-rule joint ventures ("CRJV"),[34] non-compete clauses, long-term

[34] A CRJV operates under a set of structural and behavioral rules designed to maintain the independence of multiple selling entities by ensuring that they will obtain the relevant product (or key input) at or near true marginal cost. Though theoretically appealing, the technical
requirements for a CRJV to perform as advertised are many and subtle, and there are several potential pitfalls. Owners have a clear incentive to classify some fixed costs as variable costs, thereby increasing participants' marginal cost of production and reducing output. The Division might also need to insert firewalls to remove concerns about information sharing that would facilitate collusion and would have to exert resources to monitor the process. The Division has
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supply contracts, and restrictions on reacquisition of scarce personnel assets.[35]

IV. Implementing the Remedy

A. A Fix-It-First Remedy Is Acceptable if It Eliminates the Competitive Harm

A fix-it-first remedy is a structural remedy that the parties implement and the Division accepts before a merger is consummated.[36] A fix-it-first remedy eliminates the Division's antitrust concerns and therefore the need to file a case.[37]

The Division does not discourage acceptable fix-it-first remedies. If parties express an interest in pursuing a fix-it-first remedy that satisfies the conditions discussed below, the Division will consider the proposal. Indeed, in certain circumstances, a fix-it-first remedy may restore competition to the market more quickly and effectively than would a decree. This would be particularly important, for example, where a rapid divestiture would prevent asset dissipation or ensure the resolution of competitive concerns before an upcoming bid.

If an acceptable fix-it-first remedy can be implemented, the Division will exercise its Executive Branch prerogative to forego filing a case and conclude its investigation without imposing additional obligations on the

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[34](...continued)
used a CRJV only once, in United States v. Alcan Aluminum, Inc., 605 F. Supp. 619 (W.D. Ky. 1985).

[35] *See supra* Section III.E.1.

[36] The parties may always *unilaterally* decide to restructure their transaction to eliminate any potential competitive harm. While this may obviate the need for the Division to further investigate the transaction, it is not considered a fix-it-first remedy for the purposes of this Guide since the Division did not "accept" the fix.

[37] A fix-it-first remedy usually involves the sale of a subsidiary or division, or specific assets of one or both of the merging parties, to a third party.

parties. A fix-it-first remedy restores premerger competition, removes the need for litigation, allows the Division to use its resources more efficiently, and saves society from incurring real costs. Moreover, a fix-it-first remedy may provide more flexibility in fashioning the appropriate divestiture. Because different purchasers may require different sets of assets to be competitive, a fix-it-first remedy allows the assets to be tailored to a specific proposed purchaser. A consent decree, in contrast, must identify all of the assets necessary for effective competition by any potentially acceptable purchaser.

The Division will accept a fix-it-first remedy when it eliminates the competitive harm otherwise arising from the proposed merger. The same internal review is given to fix-it-first remedies as is given to consent decrees. Before exercising its prerogative not to file a case, the Division must be satisfied that the fix-it-first remedy will protect the market from any adverse competitive effects attributable to the proposed transaction. A fix-it-first remedy will not eliminate the Division's concerns unless the Division is confident that the proposed fix will indeed preserve the premerger level of competition. In addition, Antitrust Division attorneys reviewing fix-it-first remedies should carefully screen the proposed divestiture for any relationships between the seller and the purchaser, since the parties have, in essence, self-selected the purchaser. An acceptable fix-it-first remedy should contain no less substantive relief than would be sought if a case were filed.[38] The Division, therefore, needs to conduct an investigation sufficient to determine both the nature and extent of the likely competitive harm and whether the proposed fix-it-first remedy will resolve it.[39]

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[38] The parties should provide a written agreement regarding the fix-it-first remedy. The agreement should specify which assets will be sold, detail any conditions on those sales (e.g., regulatory approval), provide that the Division be notified when the assets are sold, and state that the agreement constitutes the entire understanding with the Division concerning the divested assets. Unless the parties also enter into a timing agreement, a signed stipulation and consent decree (i.e., a "pocket decree") should be obtained that will be filed if the parties fail timely to comply with the written agreement.

[39] Although the parties may propose a fix-it-first remedy because they face substantial

(continued...)

Caveat: A Fix-It-First Remedy Is Unacceptable if the Remedy Must Be Monitored

- If the competitive harm requires remedial provisions that entail some continued obligations on the part of the merged firm (e.g., the use of firewalls or other conduct relief), a fix-it-first solution is unacceptable. In such situations, a consent decree is necessary to enforce and monitor any ongoing obligations. For example, a fix-it-first remedy would be unacceptable if the merged firm as part of the solution is required to provide the purchaser with a necessary input pursuant to a supply agreement. The Division would insist upon having recourse to a court's contempt power in such circumstances so as to ensure the merged firm's complete compliance with the agreement and the protection of competition.

B. A Hold Separate Provision Is a Necessary Component of Most Consent Decrees

Consent decrees requiring divestiture after the transaction closes should require defendants to take all steps necessary to ensure that the assets to be divested are maintained as separate, distinct, and saleable. A hold separate provision is designed to maintain the independence and viability of the divested assets as well as competition in the market during the pendency of the divestiture.

It is unrealistic, however, to think that a hold separate provision will entirely preserve competition. For example, managers operating entities kept apart by a hold separate provision are unlikely to engage in vigorous competition. Likewise, customers during the period before divestiture may be influenced in their purchasing decisions by the merger, even if the to-be-divested assets are being operated independently of the merged firm pursuant

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time pressures, the Division must allow itself adequate time to conduct the necessary investigation, including an evaluation of the proposed purchaser. *See* discussion *infra* Section IV.D.

to a hold separate provision. Similarly, there may be some dissipation of the soon-to-be-divested assets during the period before divestiture, notwithstanding the presence of a hold separate agreement — valuable employees may leave and critical investments may not be made. For these reasons, a hold separate agreement does not eliminate the need for a speedy divestiture.

Nevertheless, hold separate provisions are extremely important in Division merger enforcement. To ensure that there will be an independent, effective competitor after divestiture, the divestiture assets must remain independent and economically viable before divestiture.

C. The Divestiture Should Be Accomplished Quickly

The Division will require the parties to accomplish any divestiture quickly. A quick divestiture has two clear benefits. First, it restores premerger competition to the marketplace as soon as possible. Second, it mitigates the potential dissipation of asset value associated with a lengthy divestiture process. The Division recognizes that a comprehensive "shop" of the assets, the need for due diligence on the part of potential purchasers, and Division review of the purchaser take time. The Division will balance these considerations in developing an appropriate timetable for the divestiture process.

Depending on the size and complexity of the divestiture assets, the divesting firm normally will be given 60 to 90 days to locate a purchaser on its own.[40] The consent decree may also permit the Division to exercise

[40] The Tunney Act provides for a 60-day waiting period before the court can enter a proposed consent decree. 15 U.S.C. § 16(b). The Division will not oppose the sale of the divestiture assets to a purchaser acceptable to the Division before the judgment is entered if (a) the court is notified of the plan to complete the sale before the court enters the judgment and (b) there is no objection from the court. However, under no circumstance will such a sale preclude the Division from proceeding to trial, dismissing the case, or requesting additional or different relief if the court ultimately rejects the proposed decree. *See generally* United States v. BNS, Inc., 858 F.2d 456, 466 (9th Cir. 1988).

discretion in granting short extensions when it appears that the divesting firm is making good faith efforts and an extension seems likely to result in a successful divestiture. On the other hand, the Division may insist upon more rapid divestiture in cases where critical assets appear likely to deteriorate quickly or there will be substantial competitive harm before the purchaser can operate the assets. In situations where an investment banker or other intermediary conducts the shop, the Division may require that the intermediary's compensation be based in part on speed of the sale.[41]

The Division will require regular reports on the divestiture process in order to ensure good faith efforts and to facilitate a quick review once a final settlement is proposed. Once a purchaser is proposed, the Division may require additional information to evaluate both the purchaser and the process by which the purchaser was chosen. The divesting firm and the proposed purchaser ordinarily will be required to respond to requests for such information within 30 days.

D. The Antitrust Division Must Approve Any Proposed Purchaser

The Division must approve any proposed purchaser.[42] Its approval will be conditioned on three fundamental tests. First, divestiture of the assets to the proposed purchaser must not itself cause competitive harm. For example, if the concern is that the merger will enhance an already dominant firm's ability unilaterally to exercise market power, divestiture to another large competitor in the market is not likely to be acceptable, although divestiture to a fringe incumbent might. On the other hand, if the concern is one of coordinated effects among a small set of postmerger competitors, divestiture

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[41] See *infra* Section IV.I. for a discussion of the role of a trustee.

[42] As discussed above, the Division focuses on specifying in the decree the appropriate set of assets to be divested quickly rather than on the identification of an acceptable buyer ("up front buyer") before entering into a consent decree. If the Division has done this correctly, then an acceptable buyer should be forthcoming. Moreover, the merging firms are always free to identify an acceptable buyer in a fix-it-first remedy.

to any firm in that set would itself raise competitive problems. In that situation, the Division would likely only approve divestiture to a firm outside that set.[43]

Second, the Division must be certain that the purchaser has the incentive to use the divestiture assets to compete in the relevant market. Even if the choice of a proposed purchaser does not raise competitive problems, the need for additional review arises because the seller has an obvious incentive not to sell to a purchaser that will compete effectively. A seller may wish to sacrifice a higher price for the assets today in return for selling to a rival that will not be especially competitive in the future. This is in contrast to a situation in which the firm selling the assets is itself exiting the market. The incentive of the latter firm is simply to identify and accept the highest offer.

Because the purpose of divestiture is to preserve competition in the relevant market, the Division will not approve a divestiture if the assets will be redeployed elsewhere.[44] Thus, there should be evidence of the purchaser's intention to compete in the relevant market. Such evidence might include business plans, prior efforts to enter the market, or status as a significant producer of a complementary product.[45] In addition, customers and suppliers of firms in the relevant market are often an important source of information concerning a proposed purchaser's intentions and ability to compete. Accordingly, their insights and views will be considered. However, in no case will they be given veto power over a proposed purchaser.

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[43] Indeed, if harmful coordination is feared because the merger is removing a uniquely-positioned maverick, the divestiture would likely have to be to a firm with maverick-like interests and incentives.

[44] *See supra* Section III.B.

[45] Complementary businesses often have a strong independent interest in maintaining competition in the relevant market, because higher prices in that market would impact them adversely as sellers of complementary goods or services. Further, if others in the relevant market are not also vertically integrated, creation of a vertically integrated rival may serve to disrupt postmerger coordinated conduct. *See* Horizontal Merger Guidelines ¶ 2.11.

Third, the Division will perform a "fitness" test to ensure that the purchaser has sufficient acumen, experience, and financial capability to compete effectively in the market over the long term. Divestiture decrees state that it must be demonstrated to plaintiff's sole satisfaction that the purchaser has the "managerial, operational, technical and financial capability" to compete effectively with the divestiture assets.

In determining whether a proposed purchaser is "fit," the Division will evaluate the purchaser strictly on its own merits. The Division will not compare the relative fitness of multiple potential purchasers and direct a sale to that purchaser that it deems the fittest. The appropriate remedial goal is to ensure that the selected purchaser will be an effective, viable competitor in the market, according to the requirements in the consent decree, not that it will necessarily be the best possible competitor.

If the divestiture assets have been widely shopped and the seller commits to selling to the highest paying, competitively acceptable bidder, then the review under the incentive/intention and fitness tests may be relatively simple.[46] Ideally, assets should be held by those who value them the most and, in general, the highest paying, competitively acceptable bidder will be the firm that can compete with the assets most effectively.[47] On the other hand, if (a) the seller has proposed a specific purchaser, (b) the shop has been narrowly focused, or (c) the Division has any other reason to believe that the proposed purchaser may not have the incentive, intention, or resources to

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[46] The Division may identify specific firms that the seller should contact when the staff has learned of potential purchasers in the course of its original investigation. In addition, the Division may, under limited circumstances, require that an investment banker or other intermediary conduct the shop from the outset when the Division is concerned that the defendant will not complete the divestiture within a reasonable time. See *infra* Section IV.I. for a discussion of the role of a trustee.

[47] However, even when the divestiture assets have been widely shopped, it may sometimes be difficult reliably to rank competing offers. Ranking difficulties materialize when potential purchasers bid for different packages of assets or when offers are qualified by contingencies or otherwise depart from simple cash terms. In such cases, the Division may have to examine the competing offers more closely.

compete effectively, then a more rigorous review may be warranted.

E. A Successful Divestiture Does Not Depend on the Price Paid for the Divestiture Assets

The Antitrust Division's interest in divestiture lies in the preservation of competition, not with whether the divesting firm or the proposed purchaser is getting the better of the deal. Therefore, the Division is not directly concerned with whether the price paid for the divestiture assets is "too low" or "too high." The divesting firm is being forced to dispose of assets within a limited time frame. Potential purchasers know this. If there are few potential purchasers to bid up the price, the divesting firm may fail to realize full competitive value. On the other hand, if there are many interested purchasers, the divesting firm may actually get a price above the appraised market value. In either event, the Division will not consider the price of the divestiture assets unless, as discussed below, it raises concerns about the effectiveness or viability of the purchaser.

Caveat: The Purchase Price Will Not Be Approved if It Clearly Indicates that the Purchaser Is Unable or Unwilling to Compete in the Relevant Market

- **"Too Low" a Price**. A purchase price that is "too low" may suggest that the purchaser does not intend to keep the assets in the market. In determining whether a price is "too low," the Division will look at the assets' liquidation value. Liquidation value is defined here as the highest value of the assets when redeployed to some use outside the relevant market. Liquidation value will be used as a constraint on minimum price only when (a) liquidation value can be reliably determined and (b) the constraint is needed as assurance that the proposed purchaser satisfies the fundamental test of intending to use the divestiture assets to compete in the relevant market. In many cases, however, liquidation value is difficult to determine reliably. Also, sale at a price below liquidation value does not *necessarily* imply that the assets will be

redeployed outside the relevant market. It may simply mean the purchaser is getting a bargain. Therefore, if the Division has other sufficient assurances that the proposed purchaser intends to compete in the relevant market, the Division will not require that the price exceed liquidation value.

- **"Too High" a Price**. In theory, a price that appears to be unusually high for the assets being sold could raise concerns for two reasons. First, it could indicate that the proposed purchaser is paying a premium for the acquisition of market power. However, this concern is adequately and more directly addressed in applying the fundamental test that the proposed purchaser must not itself raise competitive concerns. Second, a purchaser who pays too high a price might be handicapped by debt or lack of adequate working capital, increasing the chance of bankruptcy. Thus, a price that is unusually high may be taken into account when evaluating the financial ability of the purchaser to compete.

F. Restraints on the Resale of Divestiture Assets Will Ordinarily Not Be Permitted

Although the Division will insist that the purchaser have both the intention and ability to compete in the market for the foreseeable future, the Division will not insist that the assets, once successfully divested, continue to be employed in the relevant market indefinitely. Conditions change over time, and the divested assets may in the future be employed more productively elsewhere.

The market for corporate control is imperfect. In unusual cases, an unfit, poorly informed potential purchaser may overbid and win the divestiture assets. The Division is not able consistently to foresee and correct faulty market outcomes. Also, even when in retrospect the market for corporate control has made a mistake, the market itself tends to correct the mistake as long as the purchaser is free to resell the divestiture assets to the firm capable of operating them most efficiently. Therefore, the Division will not attempt to

limit the purchaser's ability to resell the divestiture assets, nor will it permit the seller to do so.

Caveat: In Unusual Circumstances, the Purchaser's Ability To Sell the Divestiture Assets to a Particular Entity or Type of Entity Will Be Limited

- Where the Division is confident that during the life of the consent decree the resale of the divestiture assets to a particular entity or type of entity would be anticompetitive, it may seek to limit the purchaser's ability to sell those assets to such an entity.[48]

- There may also be circumstances when the merging firm will be permitted to limit a licensee's further licensing of the divested intangible assets. For example, suppose the remedy includes the right to use a particular brand name in the relevant market but not elsewhere. If the value of the brand name elsewhere is both significant and reasonably dependent on how the brand name is used in the relevant market, the merging firm may have a legitimate interest in limiting the licensee's ability to re-license the brand name rights.

G. Seller Financing of Divestiture Assets Is Strongly Disfavored

Seller financing of the divestiture assets, whether in the form of debt or equity, raises a number of potential problems.[49] First, the seller may retain some partial control over the assets, which could weaken the purchaser's

[48] Division decrees also prohibit defendants from reacquiring the divested assets. *Cf. infra* Section V.A. This prohibition on reacquisition of assets is the key reason that the term of the decree in merger cases exceeds the completion of the divestiture. The typical term of Division merger decrees is 10 years.

[49] The Division may permit the purchaser to make staggered payments to the seller, such as disbursement out of an escrow account pending final due diligence. This is typically not considered seller financing.

competitiveness. Second, the seller's incentive to compete with the purchaser may be impeded because of the seller's concern that vigorous competition may jeopardize the purchaser's ability to repay the financing. Similarly, the purchaser may be disinclined to compete vigorously out of concern that it may cause the seller to exercise various rights under the loan. Third, the seller may have some legal claim on the divestiture assets in the event the purchaser goes bankrupt. Fourth, the seller may use the ongoing relationship as a conduit for exchanging competitively sensitive information. Finally, the purchaser's inability to obtain financing from banks or other lending institutions raises questions about the purchaser's viability.

For these reasons, the Division is strongly disinclined ever to permit the seller to finance the sale of the divestiture assets. The Division will consider seller financing only when it is persuaded that none of the possible concerns discussed above exist. For example, in the relatively rare case where the information financial institutions need adequately to evaluate the purchaser's business prospects is either unavailable or costly to obtain relative to the amount of the financing, very limited seller financing may be considered.

H. Crown Jewel Provisions Are Strongly Disfavored

A crown jewel provision typically requires the addition of certain specified — and generally more valuable — assets to the initial divestiture package if the parties are unable to sell the initially agreed-upon divestiture assets to a viable purchaser within a certain period. The Division disfavors the use of crown jewel provisions because generally they represent acceptance of either less than effective relief at the outset or more than is necessary to remedy the competitive problem.

In some circumstances there may be a trade-off between requiring a somewhat smaller, less valuable package of divestiture assets and accepting greater risk that the remedy will prove inadequate, or demanding a more substantial divestiture in order to be highly confident that postmerger competition will be fully preserved. Because the Antitrust Division must be highly confident that the merger will not harm competition, its preference is to

demand at the outset a remedy that provides this confidence — rather than one that may turn out later to require the addition of more assets, e.g., a crown jewel.

The staff's investigation should allow it to determine whether a particular package of assets proposed for divestiture will (a) solve the competitive problems with the proposed merger and (b) be sufficiently attractive to viable purchasers. Moreover, because restoring competition, rather than punishing the merging firm, is the goal of a merger remedy, the consent decree should not require the divestiture of crown jewel assets that exceed the assets necessary to remedy the competitive problem.

Crown jewel provisions also provide an opportunity for purchaser manipulation. If there are only a few potential purchasers and they are aware of the crown jewel provision in the decree, they may intentionally delay negotiating for the agreed-upon divestiture assets so that they may later purchase the crown jewels at an attractive price.[50]

I. Selling Trustee Provisions Must Be Included in Consent Decrees

For divestiture to be an effective merger remedy, the Division must have the ability to seek appointment of a trustee to sell the assets if a defendant is unable to complete the ordered sale within the period prescribed by the decree.[51] A selling trustee provision provides a safeguard that ensures the decree is implemented in a timely and effective manner. In addition, to the extent that defendants desire to control to whom the decree assets are sold and

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[50] As discussed in Section III.B. *supra*, the Division may permit the merging firms to offer two different asset packages for sale simultaneously in the rare circumstance where either package would remedy the competitive problem. Such a parallel shop does not present the same concerns raised by the use of crown jewel provisions.

[51] Indeed, even in cases in which a defendant has been ordered to divest the assets to a designated buyer, a trustee is necessary in the event that the ordered sale is not completed for some unforeseen reasons. *See* United States v. Cargill Inc., 1997-2 Trade Cas. ¶ 71,893 (W.D.N.Y. 1997).

the price at which they are sold, the potential for a selling trustee to assume that responsibility provides an incentive for defendants to divest the assets promptly. Thus, every decree in a Division merger case must include provisions for the appointment of a selling trustee.

In the vast majority of cases, the Division will allow the defendant a reasonable opportunity to divest the decree assets to an acceptable purchaser before it asks the court to appoint a trustee to complete the sale. The assumption is that the defendant, at least initially, is best positioned to have complete information about the operation and value of the assets to be divested and to communicate that information quickly to prospective buyers, thereby facilitating a speedy divestiture to an acceptable purchaser. However, as discussed in Section IV.D. *supra*, because a divestiture would introduce a viable new competitor into the market, the defendant also has economic incentives to delay or otherwise frustrate the ordered divestiture. Therefore, the Division will permit the defendant only a limited time to effect the ordered divestiture before seeking appointment of a trustee.

A defendant may fail to complete a divestiture to an acceptable purchaser for any number of reasons. The defendant's selling efforts may have been dilatory. It may have sought a more favorable price or other terms than potential purchasers were willing to pay. A decree-ordered divestiture may also languish for reasons unrelated to the defendant's diligence in seeking to divest the assets, *e.g.*, an inability to obtain necessary approvals from a third party such as a government permitting agency, or the purchaser backed out of the deal at the last minute.

The divestiture decree should provide that whenever a divestiture has not been completed by the prescribed deadline for any reason, the Division may promptly nominate, and move the court to appoint, a trustee with responsibility for completing the divestiture to a purchaser acceptable to the Division as soon as possible. In addition, when the proposed remedy is contingent on the approval of a third party, and that approval will not be obtained prior to the entry of the decree, the decree should include a

contingency provision setting forth alternative relief in the event that the required approval ultimately is not forthcoming.

Caveats: 1. The Immediate Appointment of a Selling Trustee May Be Required in the Rare Instance when the Defendant Will Not Complete the Divestiture Within a Reasonable Time

- A decree that provides for the immediate appointment of a trustee to sell the divestiture assets is an unusual merger remedy, reserved for those situations in which the Division has reason to believe at the outset that a defendant will not complete an ordered divestiture within a reasonable time. For example, if the assets deteriorate quickly such that the seller has an incentive to delay divestiture, the Division may require the immediate appointment of a selling trustee. Also, when a defendant has taken an inordinately long time to complete an ordered divestiture in a previous case, the Division may conclude that the assets are likely to be promptly divested only if a selling trustee is immediately appointed to divest the assets in the current case.

2. An Operating Trustee May Be Required in the Rare Instance when the Defendant Is Unlikely to Manage the Divestiture Assets During the Divestiture Period Without Impairing Their Value

- An operating trustee is responsible for day-to-day management of all or part of a business ordered to be divested pursuant to the terms of a decree. Installing a trustee to run a business before divestiture is an extraordinary remedy. It is highly unlikely that an operating trustee will have adequate knowledge and incentive in the short term to run the business effectively. Therefore, the Division will only require an operating trustee in the very rare instance in which the Division believes that the defendant is likely to mismanage the assets during the typical divestiture period and

thereby impair the likelihood that the divestiture will restore effective competition. For example, this might occur if the nature of the assets to be divested is such that their competitive value could quickly deteriorate if inappropriately managed during the divestiture period. Appointment of an operating trustee might be warranted when intangible property such as computer software has been ordered divested, and under-investment in the development and improvement of the software in a rapidly changing business environment may irreparably impair the sale of the assets as a viable product to any acceptable purchaser.

3. A Monitoring Trustee May Be Required in the Rare Instance when the Trustee's Expertise Is Critical to an Effective Divestiture

- A monitoring trustee is responsible for reviewing a defendant's compliance with its decree obligations to sell the assets to an acceptable purchaser as a viable enterprise and to abide by injunctive provisions to hold separate certain assets from a defendant's other business operations. In a typical merger case, a monitoring trustee's efforts would simply duplicate, and could potentially conflict with, the Division's own decree enforcement efforts. For this reason, appointment of a monitoring trustee should be reserved for relatively rare situations where a monitoring trustee with technical expertise unavailable to the Division could perform a valuable role.

V. Consent Decree Compliance and Enforcement

Whether structured as a fix-it-first or a consent decree including structural or conduct provisions, the remedy agreed upon by the Antitrust Division and the parties must maintain competition at premerger levels. It is incumbent upon the Division, pursuant to its responsibility to the public interest, as well as to the court in the case of a consent decree, to ensure strict

implementation of and compliance with the agreed-upon remedy.[52] To do so, Division attorneys must first ensure that the decree correctly binds the appropriate parties, provides sufficient notice of the decree to any persons against whom the decree may be enforced, and provides a means for Division attorneys to gather information necessary to monitor compliance. The Division will commit substantial resources to monitor parties' implementation of and compliance with the remedy and will not hesitate to bring actions to enforce consent decrees, typically through the use of civil or criminal contempt proceedings.[53]

A. The Consent Decree Must Bind the Entities Against Which Enforcement May Be Sought

For a decree to be effective, it must bind the parties needed to fulfill the consent decree objectives. Both parties to the transaction are generally named defendants even if only one will be making the required divestitures.[54] Furthermore, the decree should include language to bind the defendants' successors and assigns, so that a defendant cannot sell its interest in the assets to be divested before divestiture, thereby frustrating the sale of the divestiture package to the approved purchaser. If it is anticipated that a non-party to a decree could be instrumental to its enforcement, the decree should require that

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[52] The Antitrust Division will likewise commit all resources necessary to ensure that parties comply with a fix-it-first remedy. Because a fix-it-first divestiture will occur before or simultaneously with the closing of the main transaction, the attorney assigned to the matter will likely review the same materials with similar considerations — *e.g.*, viable purchaser and no limitation on ability to compete — as if the divestiture were taking place under a consent decree.

[53] Non-parties are not permitted to enforce Division decrees. The court in New York v. Microsoft Corp., 224 F. Supp. 2d 76, 181 (D.D.C. 2002), *aff'd sub nom.* Massachusetts v. Microsoft, 373 F.3d 1199 (D.C. Cir. 2004), likewise recently noted that "non-parties should not be allowed direct access to the enforcement mechanisms." *See also* Massachusetts v. Microsoft, 373 F.3d at 1243-1244.

[54] Naming both parties to the transaction as defendants increases the likelihood that (a) the assets to be divested are maintained as separate, distinct, and saleable until they are transferred to the purchaser, (b) the assets to be divested are actually divested, and (c) the Division can obtain appropriate relief in the event the court does not accept the decree or later orders revisions.

actual notice of the decree be given to such a person.[55] The decree should also prohibit defendants from reacquiring or otherwise exerting control over the assets ordered to be divested.[56]

B. The Consent Decree Must Provide a Means to Investigate Compliance

Consent decrees must have provisions allowing the Division to monitor compliance. They may require defendants to submit written reports and permit the Division to inspect and copy all books and records, and to interview defendants' officers, directors, employees, and agents as necessary to investigate any possible violation of the decree. Although civil investigative demands may also be issued to investigate compliance,[57] access terms should nonetheless be included in the decree, both to monitor compliance and to examine possible decree modification or termination.

C. The Antitrust Division Will Ensure that Remedies Are Fully Implemented

Resources will be devoted before and after a decree is entered to ensure that the decree is fully implemented. Every decree is assigned to staff responsible for monitoring implementation and compliance. The specific steps necessary to ensure compliance with a decree will vary depending on its nature. For a divestiture decree, staff will closely monitor the sale, including reviewing (a) the sales process, (b) the financial and managerial viability of the purchaser, (c) any documents related to the sale, and (d) any relationships

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[55] The parties' agents and employees, and others who are in active concert or participation with the parties, will be bound by the decree so long as they receive actual notice of the order. Fed. R. Civ. P. 65(d). If other non-parties are needed for effective enforcement, consideration should be given to joining them as parties, Fed. R. Civ. P. 19, 15 U.S.C. § 25, or otherwise obtaining their agreement to be bound by the decree.

[56] However, the decree may permit the merging firm in limited circumstances to retain rights to intangible assets. *See* discussion *supra* Section III.D.

[57] 15 U.S.C. §§ 1311(c), 1312(a).

between the purchaser and defendants, to ensure that no such relationship will inhibit the purchaser's ability or incentive to compete vigorously.

Where a decree requires affirmative acts, such as the submission of periodic reports, Division staff will determine whether the required acts have occurred and evaluate the sufficiency of compliance. With respect to decrees that prohibit certain actions, staff may also need to conduct periodic inquiries to determine whether defendants are observing the prohibitions.[58]

D. The Antitrust Division Will Enforce Consent Decrees

If the Antitrust Division concludes that a consent decree has been violated, the Division will institute an enforcement action. There are two types of contempt proceedings, civil and criminal, and either or both may be used. Civil contempt has a remedial purpose — compelling compliance with the court's order or compensating the complainant for losses sustained.[59] Staff may consider seeking both injunctive relief and fines that accumulate on a daily basis until compliance is achieved.[60] Criminal contempt is not remedial — its purpose is to punish the violator, to vindicate the authority of the court, and to deter others from engaging in similar conduct in the future.[61] Criminal contempt is established under 18 U.S.C. § 401(3) by proving beyond a reasonable doubt that there is a clear and definite order, applicable to the

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[58] Use of special masters for Division decree enforcement is disfavored, Fed. R. Civ. P. 53(b); New York v. Microsoft Corp., 224 F. Supp. 2d at 179-82.

[59] *See* United Mine Workers v. Bagwell, 512 U.S. 821, 826-30 (1994); IBM v. United States, 493 F.2d 112, 115 (2d Cir. 1973).

[60] *See* United States v. United Mine Workers, 330 U.S. 258 (1947); United States v. Work Wear Corp., 602 F.2d 110 (6th Cir. 1979). Moreover, courts have recognized that, under appropriate circumstances, other equitable remedies may also be available (for example, compensation for harm or disgorgement of profits as a proxy for harm). In re General Motors Corp., 110 F.3d 1003, 1018 n.16 (4th Cir. 1997).

[61] A criminal contempt proceeding may be instituted by indictment, *see* United States v. Snyder, 428 F.2d 520, 522 (9th Cir. 1970), or by petition following a grand jury investigation, *see* United States v. General Dynamics Corp., 196 F. Supp. 611 (E.D.N.Y. 1961).

person charged, which was knowingly and willfully disobeyed. The penalty may be a fine or imprisonment, or both.

The Antitrust Division has instituted a number of contempt proceedings to enforce its judgments and will continue to do so where appropriate in the future.[62] In some situations, rather than seeking sanctions for contempt where the correct interpretation of a judgment is disputed, it may be appropriate simply to obtain a court order compelling compliance with the judgment.[63]

[62] *See, e.g., Work Wear Corp.*, 602 F.2d 110; United States v. Greyhound Corp., 508 F.2d 529 (7th Cir. 1974); United States v. Morton Plant Health System, Inc., No. CIV.A. 94-748-CIV-T-23E, 2000 WL 33223244 (M.D. Fla. July 14, 2000); United States v. Smith International, Inc., 2000-1 Trade Cas. ¶ 72,763 (D.D.C. 2000); United States v. North Suburban Multi-List, Inc., 1981-2 Trade Cas. ¶ 64,261 (W.D. Pa. 1981); United States v. FTD Corp., 1996-1 Trade Cas. ¶ 71,395 (E.D. Mich. 1995). *See also* United States v. Microsoft Corp., 147 F.3d 935, 940 (D.C. Cir. 1998); United States v. NYNEX Corp., 8 F.3d 52 (D.C. Cir. 1993).

[63] *See, e.g.*, United States v. CBS Inc., 1981-2 Trade Cas. ¶ 64,227 (C.D. Cal. 1981).

Attachment E

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES FEDERAL TRADE COMMISSION,	:	CA Number 13-1021
Plaintiff,	:	
v.	:	Washington, D.C.
	:	Tuesday, September 24, 2013
ARDAGH GROUP, S.A., et al.,	:	10:04 a.m.
	:	

TRANSCRIPT OF PRE-HEARING CONFERENCE
BEFORE THE HONORABLE BARBARA J. ROTHSTEIN
UNITED STATES DISTRICT JUDGE

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P R O C E E D I N G S

THE DEPUTY CLERK: The matter before the Court, Civil Action Number 13-1021, the United States Federal Trade Commission versus Ardagh Group S.A., et al.

Counsel, please come forward and identify yourselves for the record.

MR. HASSI: Good morning, Your Honor. I'm Ed Hassi. I'm with the Federal Trade Commission. With me at counsel table are Brendan McNamara, Cathy Moscatelli, and Angelike Mina.

THE COURT: Okay, good morning.

MR. SCHWED: Good morning, Your Honor. Richard Schwed of Shearman & Sterling for the Defendant Ardagh Group, and with me from Shearman & Sterling are Alan Goudiss and Heather Kafele.

MR. EVEN: Good morning, Your Honor. Yonatan Even with Cravath, Swaine & Moore, for Defendant Saint-Gobain.

THE COURT: Well, good morning, counsel.

I don't know if you were prepared to address me, but why don't we start out by my telling you my concerns, and then you probably can fill me in on your plans.

I know we're having a hearing in about a month, and my concern was just the structure of that hearing and what you anticipate will take place there, and giving you some idea of what I would expect in terms of the procedures

you will use, and my sort of idiosyncrasies in terms of conducting a hearing like this.

My first concern would be that all exhibits be pre-marked and pre-admitted. I can't imagine that there would be any dispute about exhibits at a hearing like this, but I could be wrong and you can tell me if I am wrong. I don't want to -- you know, we only have that short period of time, and I know you're intending to fill it. I don't want to fill it with arguments about exhibits.

Just a word of caution. If it turns out both sides are using the same exhibit, pick a number, any number. I don't care whose side it is. Just don't use two different numbers. It's only going to confuse me, all right? One number will be enough. If you really can cooperate, you could number them consecutively, and then it will be very easy for the clerk and for me.

Are there any exhibits that you would like for me to review in advance that you think might speed things along? Now, let me just give you an idea of where I am coming from. I can't review them really in advance because I'm coming back from a trip just the day before, and I'm not taking them with me, I can tell you that. But like if you have some the night before the next day of the hearing you think it would be good for me to take a look at, keep that in mind. I'm willing to do so that I sort of have a nodding

acquaintance with them before a witness takes the stand.

That's my next question. Are there going to be witnesses? If so, tell me. Tell me how many, both sides. Will you agree on an order? Will they be here, be ready to go? If you're going to have witnesses and they are kind of experts in their field of some kind, I can read CVs faster than they can tell me what they've done and what they've published, and where they went to school. You can take me as far back as high school as long as you put it in writing because then I can read it really fast.

I will throw out an idea, and I assume you're going to say, yes, there are going to be witnesses. One way of speeding things along -- I'm not sure it will work here. I just throw it out to you to think about -- many times in hearings like this it can be helpful to prepare the direct in the form of a statement and then have me read the statement, ask questions if there's something in there I don't understand, and then just proceed with cross-examination. Or with a limited direct if there are charts to show me to help me along. I don't know if that's helpful or not. Sometimes it is, sometimes it isn't.

It is helpful if you think that you've asked for three days and then all of a sudden you find you're going five and I don't have those five days, and then directs would be helpful. But if you're staying within your time

and you think it would be easier for me to get it with the person here and then being able to -- pros and cons. I will let you decide. I don't feel strongly about it because sometimes my ability to ask questions of the witness, I could do even with a written direct. You decide. It may be acceptable for some witnesses and not others.

I'd like to hear from you if you've made any allocation of time. Are you splitting it? FTC is plaintiff, so usually you would get a rebuttal, although I'm not sure rebuttal really applies to something like this. But if you're thinking you want a rebuttal, then let's split the time, and you carefully reserve some time. I think we should try to keep the time in mind.

I will try to give you an hourly day so that you know how much time you have. I don't believe in chess clocks. I think they ruin the ambiance of the courtroom, but I do expect that my clerk will keep time. So I think you should be thinking of staying within your time limits.

Okay, I've given you my concerns. Who wants to lead off? You look like you're ready to go, counsel.

MR. HASSI: Yes, I think I am, Your Honor. Again, Ed Hassi for the Federal Trade Commission.

There are some concerns we have and some issues, some of which you have already addressed. I wanted to start out with scheduling. After our discussion with your law

clerk, we've had a further discussion about scheduling. We have some minors changes to the scheduling order. They are agreed by all parties. We can send in a revised scheduling order today, and I can walk you through those changes or we can simply send it in, however Your Honor would like to proceed.

THE COURT: Tell me now, and also send it in.

MR. HASSI: Okay. So the changes -- I'm sorry, I've got a black line here that shows it, which I can hand up if Your Honor would like --

THE COURT: Sure.

MR. HASSI: -- to the scheduling order.

THE COURT: Thank you.

MR. HASSI: So the changes don't start until page 6, paragraph 21, and that is as we've -- we just completed expert discovery on Friday. It may be that one or both parties choose to make Daubert motions, and so we've built into the schedule a briefing schedule for potential Daubert motions.

THE COURT: But you must know by now whether you're going to bring Daubert motions. It's not the 27th, but you must have a pretty good idea. You guys wouldn't start a brief on the night of the 26th. I know you better.

MR. HASSI: Your Honor, I think it's our expectation that we will bring one or more Daubert motions.

We, to be fair, are still evaluating that, but, yes, there is someone back at the office working on Daubert motions.

THE COURT: Why would I think that might be the case, but let me explore this. You're bringing a Daubert motion to exclude the expert from this hearing?

MR. HASSI: To exclude the expert, some of the experts or some of the experts' testimony.

THE COURT: Now, you're aware that in order to make that ruling I need to hear from the expert, right?

MR. HASSI: Yes, Your Honor. I understand the Catch 22 involved.

THE COURT: Yes. You still think that's a worthwhile motion to make? Is it because you don't want me to consider what that expert is saying, is that it?

MR. HASSI: I think what our intention is, is to limit -- there are some opinions that are being offered here by, for example, experts in the field that are going to say, "Well, there's a trend, for example, to beer in cans," and at least one of these experts thinks that he knows better than the people that are -- the businesspeople that in the field. It's not based on any methodology, anything testable. It's just, "Gee, I've done this before, and I know better than the people that are running these multimillion dollar businesses."

We think that that should be brought to light. I

understand it can be brought to light in cross-examination. The concern we really have here is the limited period of time that we have before Your Honor, and we thought that if we could address some of these issues in advance in the form of a motion, it might help speed things along at the trial.

THE COURT: Okay. I can tell you right now that I probably will not have time to review those motions. I don't want to -- I don't want to nip in the bud any wonderful briefs that you're doing, but I'm going to hear these witnesses anyway.

MR. HASSI: Okay.

THE COURT: Well, you can give me the -- I'll hear the witnesses. Just know that I'm not going to be reading those motions before I hear the witnesses, but I will read them, and if it's correct that the testimony I've heard should have been excluded or doesn't qualify as an expert, then I can do that later on. But in terms of your timekeeping, that's what I'm trying to help you with.

MR. HASSI: I appreciate that.

THE COURT: In terms of the timekeeping, I won't be in a position to exclude anybody before the hearing, okay?

MR. HASSI: Okay, Your Honor.

THE COURT: So count on the fact that whoever you're objecting to will testify, and if I do any excluding

of testimony, it will be later on when I have had a chance to read the briefs. Okay?

MR. HASSI: I understand.

THE COURT: So it's not going to help you in time, but it may still help. I didn't mean to say that you shouldn't pursue. It's just that in terms of timing, it's not going to happen beforehand, okay?

MR. HASSI: Okay. We will keep that in mind in terms of whether we file or don't file, Your Honor.

THE COURT: An updated witness list --

MR. HASSI: Witness list, and I think taking into account what Your Honor has already said this morning, we have this week to sort of work that out and try to provide each other with clear indications of who will actually be called to testify live at the hearing versus, for example, being submitted by deposition testimony. So that's scheduled to happen on Friday.

Some of these changes, for example, paragraph 23, these were made previously. In terms of the briefing schedule, we are just annotating them here. Our brief and reply will be due on September 30th. We propose to exchange exhibit lists, copies of exhibits and deposition designations, instead of on the 30th, on October 2nd, so moving that back by a couple of days.

Paragraph 25 goes to oppositions to Daubert

motions.

Paragraph 26, we propose to exchange objections instead of on -- to exhibits and counter deposition designations, instead of on October 3rd, on October 9th. And then we have reply briefs on any Daubert motions scheduled for October 9th.

In the post trial briefing -- in paragraph 31, we corrected the hearing dates and times. And then for the post trial briefing, what we would propose to do is, since the trial will continue into that Monday, instead of having the findings of fact due that Friday, we've pushed them to the following Monday. And then the reply findings of fact, instead of October 30th, to November 1st.

So those are the proposed changes. As I mentioned, they are agreed to by all parties.

THE COURT: Sounds good to me.

MR. HASSI: Okay.

THE COURT: I think that is a reasonable schedule, and if it gives you more time to get everything prepared, so much the better.

MR. HASSI: The parties will submit a proposed ordered this afternoon.

THE COURT: Great. Let me ask you your opinion. Do you think there is going to be any problem with exhibits?

MR. HASSI: I hope not, Your Honor. I think for

the most part these are going to be business documents out of the companies' files and/or third parties' file, so I hope not.

THE COURT: Good.

MR. HASSI: I understand with Your Honor's schedule -- we've already talked about the fact that we really need to work this out given when the hearing starts and we don't have -- that this is our opportunity for pretrial, and so we'll try to resolve that as much as possible.

THE COURT: Okay. Let me make one suggestion because I've found that's often where the best intentions can flounder.

If you are using the demonstrative exhibits, charts, things like that with your experts, and you might because they probably would be helpful to the Court -- if you're not using -- I say charts, and that's a --

MR. HASSI: We hope they will be helpful, Your Honor.

THE COURT: -- that's a give-away of my generation. If you're using something that you're going to put on the computer since nobody makes charts anymore, show it to the other side so that they don't see it for the first time the morning of and then say, "No, no, that's inaccurate. Can you make a change?" Since it's usually

very difficult to make a change at the last minute, include those as exhibits that you talk about, okay, so that --

MR. HASSI: Okay.

THE COURT: It's just a matter of time, you know. Do you want to waste time saying, no, that should be this percentage and not that percentage?

MR. HASSI: Okay.

THE COURT: Just a word of advice.

MR. HASSI: Okay.

THE COURT: It sounds like you have anticipated pretty much everything. Is there anything else we need to talk about?

MR. HASSI: There are some housekeeping matters that I think we would like to address. There is also one, I think, fairly significant substantive matter that we wanted to raise with Your Honor as well. I can do those in either order. The substantive matter may be, in some respect, the elephant in the room, and so why don't I do that first?

And that is, if Your Honor has read Ardgh's brief that was filed last week, there's an 11th hour suggestion in that brief that they're going to propose a remedy here, to sell off four glass plants. That's news to us. It's news that comes after the close of fact discovery. It comes after our expert reports were in. It comes after our briefs were in.

Now, Ardagh has known for months that the Federal Trade Commission has concerns about this transaction. Indeed, they understood that there were antitrust concerns when they entered into the transaction.

They decided not to address those concerns when they were in the investigatory stage. They decided not to address those concerns when they came before the Commission, and they decided not to address them in a timely fashion so that we could take fact discovery on that.

What they now propose to do is put these plans, hopes, wants, intentions in front of the Court at trial with no discovery whatsoever, and to ask you to evaluate that remedy without us having the opportunity to evaluate it, without us having the opportunity to take discovery on it, and without us having the opportunity to give Your Honor our views on whether that remedy is sufficient. Clearly, at this point it isn't. I mean, at this point it's just an intention to sell.

They haven't identified a buyer. They haven't identified how much these are being sold for. They haven't given us a chance to evaluate what they're proposing to do, is to sell four plants, two each from two of the companies. And they say, "Well, that will form a business that will restore competition in this market."

We don't know if those four plants can be combined

into a business, and so there are a lot of very serious questions we have about that. And we don't think that he gamesmanship that's being played here by waiting until the 11th hour should be addressed at this hearing. We don't think that that evidence should come in without us having a chance to have had discovery, and without us having had a chance to evaluate it, and, frankly, until the facts are jelled, if you will. I mean, there's not an agreement for sale here.

The parties cite in their briefs three cases in which remedies have been litigated before. The first of those, Arch Coal, was a case that the FTC brought. In fact, it was Ms. Moscatelli's shop that brought it. In that case, the changes to the proposed transaction were two months before the case was first filed by the FTC. So they had a chance to address it in discovery, and they had a chance to consider it, and the Commission had a chance. When I say the "Commission," I mean the commissioners had a chance to evaluate it and vote on it. That hasn't happened here.

They cite Franklin Electric. That's a case involving the DOJ. In Franklin Electric, they changed the joint venture one day after the DOJ filed. Again, well before the -- I mean, the discovery period hadn't even started yet, and so the parties had a chance to address it and address it in discovery.

The final case they cite is Libby, and in Libby that was the latest of the three. But in Libby, it was one month into -- one month after the complaint was filed they made changes. And when I say "made changes," it's not like here where they're saying, "Gee, we're going to sell these four plants."

They said, "Here's what we're going to do. Here's the modified agreement. Here's who's involved," and the parties had a chance to vet that in discovery. Here what they're saying is --

THE COURT: Let me ask you something.

MR. HASSI: Yes, Your Honor.

THE COURT: What are you asking the Court to do? Are you asking the Court to just not allow testimony on this at all?

MR. HASSI: Yes, Your Honor. We're asking -- we can do this as a motion in limine, but we don't think that evidence of this 11th hour proposal -- it comes after fact discovery -- should be heard in these proceedings.

THE COURT: All right. Let me -- let me play out a scenario here, okay?

MR. HASSI: Yes, Your Honor.

THE COURT: It is in the Court's interest not to render advisory opinions or opinions that are going to be moot in about a day or two after I render it. Let's say I

grant whatever motion, whatever form you're going to bring a motion in, and I exclude all that evidence. Then I give you a ruling one way or the other. Obviously if I rule against the FTC, then the whole thing is moot, but if I rule for the FTC, then I presume they would come back with the excluded information and bring the whole thing all over again, right?

MR. HASSI: Well, Your Honor, I think in light of the fact that this is a 13(B) proceeding, and that what we're asking Your Honor to do here is to preserve the status quo pending the trial, before the FTC and before the Commission, I'm not sure that that's correct. In other words, if there is a remedy to be fashioned, the Commission ought to have a chance to fashion that remedy.

What we're asking Your Honor to do is to decide are there serious and substantial questions going to this transaction such that I should require the parties -- that Your Honor should require the parties to preserve the status quo, and that's all we're asking here. Whether that remedy, the sale of those four plants and the possible buyer that they may or may not come up with -- and they're just starting to talk to buyers -- whether that remedy suffices can be addressed, if necessary, in a merits trial. And I think that depends on whether they get to a deal and whether they get to a buyer, et cetera. But we don't think that these proceedings should be held up, or that Your Honor

should be deciding -- with no evidence, frankly. I mean, if you look at their brief, there's not a footnote, there's not a citation to any evidence. This is just they're going to put somebody on the stand who says either: "Here's what we intend to do," or, "Here's what we've done in the weeks since discovery has closed." We think we're severely prejudiced by that, Your Honor.

THE COURT: Okay. Did you want to address -- well, I'll tell you what, let's address this now from the other side, and then we'll go into your housekeeping matters.

MR. HASSI: Very well, Your Honor.

THE COURT: Okay.

MR. SCHWED: Thank you, Your Honor. Richard Schwed for Ardagh Group.

I think maybe I can start by backing up and explaining the revised transaction that we've proposed, and this isn't something that's a gambit. It's not an 11th hour strategy. Basically, since this case was filed, we've been trying to come up with the FTC to a consensual arrangement. We have not been able to do that. We've discussed a number plants. We have not been able to reach an agreement. We finally decided that there was not going to be time or ability to get that done, and that we would unilaterally agree to divest four of the plants that were going to be

part of the combined entity, two that we already own and two that we're purchasing.

This is relevant -- I'm not sure how much Your Honor -- since you've been recently reassigned to this case -- has gotten into the -- what the case is all about, but essentially the fundamental question in this case is whether glass bottles compete with other forms of packaging, and, in particular, the most important is cans for beer and plastics for spirits, alcohol. There is a fundamental question that that brings up which is sort of the starting point of all cases, which is what is the product market.

We strongly believe that we can win this on the definition of the product market. That's the exact same case that -- the exact same product market issue that was addressed by the Supreme Court in Continental Can 50 years ago, and by this court about 25 years ago in the O-I Brockway case and by the FTC, where both courts have said that cans and glass are in the same product market. It is a rare case when you have a merger case and there's a relevant product market, and there's a Supreme Court case and a binding case that have said that the product market that the FTC is claiming is not the right product market, and, in fact, the FTC Commission itself has found that that is not the right product market.

Now, the revised transaction we are proposing is

one that addresses the question: Well, what if Your Honor does not agree with us on the product market? Because it is our view that there is not going to be a diminution in competition with this transaction even in the revised product market, even if their product market is correct. But out of an abundance of caution, what we have done is agreed to sell these four plants which we believe 100 percent addresses the concerns that have been raised by the Commission.

There are three plants that make beer. Those plants combined have -- their beer sales that they have made in this past year are 110 percent of what Ardgh's beer sales were itself. So in other words, we're selling more than our own beer business effectively. And so the combined entity will have less beer business than just one of the two -- the bigger of the two entities had before the transaction.

THE COURT: Are you going to do that even if the Court rules with you?

MR. SCHWED: Well, we are going to enter into a definitive purchase agreement because we recognize time is short, and we don't have time, necessarily, to wait for the Court to issue a ruling, and, then, if things don't go our way, to circle back and then complete this transaction and get this deal closed by the drop-dead date of mid-January. So what we have decided to do in order to make sure that

this can all be done in time, is to enter into binding agreements that are -- obviously they have to be contingent on the transaction closing because we can't sell what we don't own, but the binding agreements -- a single binding agreement with them to buy the four plants, and then immediately upon closing the transaction, those four plants will be transferred to the buyer.

THE COURT: So if I rule in your favor about the market question, you will still go ahead with this plan?

MR. SCHWED: We will still go ahead with it. That's the situation we've agreed to be in.

THE COURT: Don't you think that the FTC should get a crack at what you're planning? You're telling me it's definitive. What I heard from counsel was that they don't even know that you have a binding contract.

MR. SCHWED: Well we don't yet have a binding contract. We're in negotiations. They've known for -- they've known for two weeks now that we are -- the identity of the four plants we are planning to sell. Since then, they have deposed our CEO and asked him extensively about the plans to sell the four plants. They have deposed our chairman who is running the process and asked him extensively about the plans to sell the plants. It was the primary focus of the deposition. There is nothing else that they have identified to us that they need that prevents them

from -- they're saying that we want try this without giving them a chance to put on their case about it, but they've known about -- they have detailed information about each of these four plants that they've had for a long time.

THE COURT: Two weeks?

MR. SCHWED: No. I'm saying the detailed information about the four plants they've had for months. In other words, we've given them plant by plant detail in the whole discovery process, even before the lawsuit was filed. They have had plant by plant detail, and they have known about the exact contours of the transaction, the exact four plants, for two weeks.

Now, two weeks may not sound like a lot, but that ends up putting them about five weeks before the hearing, and a number of the cases that are cited by both sides in this were decided in the entire case, from the date it was filed until the date of the hearing, was between five and eight weeks. So it's not -- in the context of maybe a five-year litigation, something that's five weeks before the actual hearing date may sound like the 11th hour, but in the context of lawsuits that often take five, six, seven, eight weeks, five weeks before the hearing gives them plenty of time to address what is really only one sub-issue of the case. It a doesn't affect the product market analysis, it doesn't affect the geographic market analysis, it only

affects the question of the harm to competition and --

THE COURT: Only?

MR. SCHWED: I'm sorry?

THE COURT: Only affects the harm to --

MR. SCHWED: Well, just in terms of the amount of analysis. In other words, what I'm saying, Your Honor, is that there have been entire cases, from product market through the end of the case, that have been tried in six weeks.

THE COURT: Let me ask you something. Do you think there is a chance that if the commissioners had your current plan in front of them they might come out with a different result?

MR. SCHWED: We don't know. The FTC, frankly, has gone radio silent on us. We had originally proposed this as a settlement and never got an answer, so we don't know what the Commission would do. Frankly, I wish we could explore that, but the problem we have here is we have a mid-January drop-dead date. This transaction will terminate, and our ability to purchase the company will end by mid-January. So we don't have the luxury of time to explore that question.

THE COURT: Okay. Let me hear from --

MR. SCHWED: If I may just add one more point?

THE COURT: Yes.

MR. SCHWED: The arguments Mr. Hassi made are the

exact same arguments that were made in Arch Coal, which was they're trying to fashion their own remedy. They're trying to take the job of the Commission by deciding which plants get sold. They can't change the transaction. And this Court said, "I'm not going to get involved in a fiction. I'm not going to hear a case about a transaction that is no longer the transaction that's being proposed."

Thank you.

THE COURT: Thank you. Wait, that's what the Court said in Arch Coal?

MR. SCHWED: In Arch Coal, yes, Your Honor.

THE COURT: Okay.

MR. SCHWED: Thank you, Your Honor.

THE COURT: Let me hear back from Mr. Hassi.

MR. HASSI: Your Honor, I will start with Arch Coal and some of the differences.

The difference here for Arch Coal is, the Arch Coal court found it was integral to the deal, and it was done in good faith.

And the Libby court -- it cited the Libby court. In its footnote 27 of the Libby court opinion, they talk about the good faith of the parties in an effort to resolve the FTC's concerns.

Dropping these facts on us the night before the CEO's deposition, which is already being taken after the

close of discovery, that's not in good faith, Your Honor. This isn't a good-faith effort to resolve this.

In terms of the questions that the commissioners would have, if -- our website has a whole section on divestitures and what a party has to do to try and satisfy the Commission on divestitures, and one of the main issues is, who is the buyer? How are they funded? Can they make this a go?

And then we talked to customers, and I will tell you -- this was announced on Friday to the public -- we've been hearing from customers already. They don't like this. So we haven't had a chance to vet that, and the Commission hasn't had a chance to vet that.

THE COURT: All right. I'm going to ask Mr. Schwed the same question. I will probably get a different answer, but I am concerned.

Mr. Hassi, do you believe there is still some benefit to be gained from -- let's say I exclude everything about the sale to -- the four different sales or the divestiture, whatever you would call it -- I exclude that and I don't hear any testimony on that, which is quite likely what I'm going to do because it doesn't sound like you are prepared to respond to it. If I did that, is there anything to be gained from going ahead with the rest of the hearing and getting a ruling from me on the market, the

geography, the whole thing?

MR. HASSI: There absolutely is, Your Honor.

THE COURT: Okay.

MR. HASSI: We think the product market issue is an important one here. We don't think it's a close call, but we do think if Your Honor takes a hard look at that, it would be helpful to the parties.

THE COURT: Okay.

What you think, Mr. Schwed?

MR. SCHWED: Your Honor, as a --

THE COURT: You had better come to the podium.

MR. SCHWED: Your Honor, we certainly don't want to put off the hearing because, as I've mentioned, we're basically running up against the clock. From the date of the hearing until the date that this deal must close, we have roughly three months, a little less from the last day of hearings.

We recognize that the parties are going to spend a week or so -- a little bit more -- submitting briefs, and then Your Honor has to decide weighty issues and will take -- you know, will need some time in order to do that. These are not things that can be decided on the spot overnight. So we recognize that all of this is going to take time, and, then, potentially, whichever side loses is going to try to take an emergency appeal up to the D.C.

Circuit. So we don't have the luxury of putting this off. I guess, in an ideal world, we would say let's delay this hearing, get some more time. But our view is that whatever needs to be done -- so the first answer is, yes, we need to have a hearing. And then so the question is, what can be covered in that hearing. Our view is that, whatever needs to be done in order to have the FTC probe this deal can be done in three weeks.

All of this -- in the CCC case, which is the most recent case that was before this court, the entire discovery record took about three weeks, and that was over Christmas. So our view is, there's a minimal amount that needs to be done in order to vet this process. They are in contact with the customers. They can talk to the customers, and there's no reason that this can't be fully teed up by this -- by the start of the hearing.

THE COURT: Let me talk to the side that's going to be doing the discovery.

Speaking with all due speed -- and don't tell me it's going to take six months because if you tell me it is going to take six months, I won't believe you -- how long would you need to do the discovery on the four transactions they are talking about?

MR. HASSI: Your Honor, I'm not sure I can answer that question and the reason is, is because a very important

part of what the FTC wants to consider here -- and, again, it's public, it's on our website -- is the identity of the buyer. Who is going to run these plants? How are these four plants going to fit together? Who is going to manage them? How well-capitalized are they?

THE COURT: Well, they have binding contracts ready to go, so they could tell you today. Probably as soon as I get out of here, they'll tell you who the buyers are.

Right? Am I right, Mr. Schwed?

MR. SCHWED: No. We are still negotiating with buyers. We have identified to the FTC who will be managing the plants. Since this is an open courtroom, I won't say who it is, but we have identified to the FTC the type of buyer, that it is somebody who has got industrial experience and exactly who will be running the plants.

THE COURT: No, no. But you haven't told them who the buyers are? Please get to the microphone.

MR. SCHWED: Yes, Your Honor. We're still negotiating with two to three buyers.

THE COURT: Then they can't do their discovery in three weeks. You don't even have a definitive name for them to do discovery from or ask about. That's not reasonable, is it?

MR. SCHWED: Well, Your Honor, I think if you look at what discovery needs to be done, I think, frankly, the

identity of the buyer is a bit of a red herring here in the sense that the key question is: Do the divestiture of these plants satisfy their concerns about the power in the market that they are claiming that Ardagh will have? So we are now saying that Ardagh is going to have a new company that has less beer business than VNA had before. It's going to have a capacity in spirits that -- or it's giving away enough capacity that they basically will be a competitor that replaces Ardagh in the market.

THE COURT: Let me tell you right now, I do not believe that that can be thoroughly investigated in the three weeks between now and my hearing. I just don't see it. I just don't think the negotiations are far enough along the line, and I don't think it's fair to the other side to ask them to do that.

So given what I have heard today, I would not be considering that factor in my decision. I just do not believe that you would both be in a position to present to me -- I don't think the FTC would be in a position in three weeks to present their side or their opinion about whether this really is an adequate cure to their concern about competition.

My sole question at this point, given that I don't think I am going into -- I can't go into that. I think it would be premature and precipitous for me to even look at

that.

My question to both of you is -- look, I would love to have the hearing, set the days aside, sounds very interesting. I've got nothing else to do those three days. I'm all yours. On the other hand, as I sort of led into this, if this is going possibly to be a remedy that would resolve the situation, why am I going through all this about market, and geography, and all of this if, indeed, the divestiture would solve the problem of the competitive concerns that the FTC has? As I say, it is an interesting question, and I'm sure I'll enjoy good briefing, but, you know, I do have other cases that I probably could be attending to in those three days.

I'm just concerned that we're going to go through all of this, you'll get a ruling from me, and then you are going to have to go through this anyway. You are going to have to go through it. I mean, you already have a plan that you think, at least based on what I have heard today, would satisfy there concerns. Why not give them a crack at taking a look at it?

MR. SCHWED: Well, Your Honor, we would be more than happy to have the Commission agree that this satisfies their concerns and to make this all go away. Obviously, we're willing to do that deal. We've come out publicly and said it. We've said it to this Court.

The problem is that it's been a good two weeks since we proposed those four plants to the FTC staff, and we have not heard one way or the other whether they view those four plants as being sufficient. And so we just can't, frankly -- in my client's interest, I can't just sit back and say we're going to wait forever for the FTC to decide whether this is enough because their time is going to come and go.

THE COURT: Okay.

Mr. Hassi, let me ask you this.

MR. HASSI: Yes, Your Honor.

THE COURT: I'm not buying into the fact that two weeks is enough for you to give a decision about whether the FTC is satisfied or not satisfied. I think I can tell what your answer is going to be, which is that you need more information, you need to do some discovery, and you need to know more facts surrounding the divestiture plans.

What do you need and how long would it take you to come up with a list of what you need for them to give it to you? I mean, you can't just sit there and say, no, we're going to go ahead with this hearing because we just heard about this yesterday. I understand your frustration and your concern, but let's move on from the fact that you just heard about it. I've already told you I'm not going to go into this at the hearing, so you're safe on that point,

okay?

MR. HASSI: Yes, Your Honor.

THE COURT: So now you can just sit back and say, "Okay, how long, what do I need, and how will that timing mesh with the hearing?"

I have already said I don't think you can do everything in three weeks. I don't think you can. But if you made a list and they gave you -- I mean, they really want to accelerate this, and so it's in their interest to give accelerated discovery. If you give them a list of what you need, I think what Mr. Schwed is saying is that he will do everything to get you the information that you need. Now, that doesn't mean you can look at the information, get the commissioners to look at it, do the whole thing. But at least you could get the information.

Can you guys work on that in the three weeks and give me an idea of timing and how it would mesh with the hearing? I mean, if you're talking about a timing where another week or two would make a difference, that is important for me to know because then we could have a hearing on the whole thing, or maybe have no hearing at all is what I am saying.

I'm reluctant to put the hearing over because I have a tight schedule and these are your three days. On the other hand, I'm also reluctant to have a hearing -- I

suppose I could just have the hearing, listen to everything, not give you a decision, and then you can tell me that it was a nice three days but we've worked it out. I don't mind that, but if putting the hearing over, if it were at all possible -- I'll look at my calendar. What do you think? How much more time would you need? I understand three weeks isn't enough, and I understand that two weeks wasn't enough, but what are we looking at?

MR. HASSI: I think the problem is the starting date, and that is, we need to start from a definitive agreement, an identified buyer and a contract with that buyer. There are a ton of questions. You know, I'm tempted to bring Dan Ducore up. He's the head of our Compliance Section, and he's the one -- he and his team vet these things. So if you want to have an extended discussion about that, I can ask Dan to come up.

But there are a lot of unanswered questions here that can't be answered until we've got a contract. I mean, the idea that they've got somebody identified to manage the plants but they don't have a buyer yet, what makes anybody think that that buyer is going to accept that manager? Those questions have to be answered first, and then we can look at the discovery. Whether it is a matter of weeks or months, I don't know, but we need to have a definitive agreement to work from. We need to know what it is we're

shooting at.

THE COURT: Mr. Schwed, what are we dealing with in terms of a definitive agreement here?

MR. SCHWED: We are working diligently to negotiate. I mean, let me just make this one point. The management team, or the lead manager -- it's not somebody we're imposing on the buyer, it's somebody who the buyer wants to work with and that person wants to work with the buyer. This isn't just some fantasy.

But my understanding is that the FTC fashions consent decrees all the time where there is -- and negotiates consent decrees without there being a definitive agreement. They don't go up to somebody who is considering divesting some plants and say, "I'm not even going to consider your divestiture proposal until you have a definitive agreement," and they're supposed to sign a definitive agreement and then they hand it over, and then FTC says, "No, this isn't a good plan. I'd rather have it be different."

They are able to when they want to, when it's in their interest, they're able to figure out what is good and bad for competition without a definitive agreement. When they don't want to, all of a sudden they need a definitive agreement. So I think it's a little bit of an unfair standard to say they can't even start thinking about this

without a definitive agreement. They know what the plants are. They can make an assumption that it will be sold to a well-capitalized buyer who is reputable. And I think the -- the analysis doesn't really change based on which well-capitalized, reputable person, who is not in the industry, has no competitive concerns -- it's not somebody -- it's somebody with industrial experience, but not somebody who, you know, is in the rigid packaging industry, owns a can company or anything like that. So they can assess this --

THE COURT: Well, you have already disclosed a lot about the buyer. You may not have given the name, but you have already given them a lot to work with.

What I am concerned about is -- I will tell you what -- I mean, obviously, you guys are going back and forth in what is turning out to be a discovery dispute. I recognize one when I see it. I think the most I can do at this point is say we will go ahead with the hearing as scheduled. It will concern the issues that I understood it to concern before I came out here today, i.e., we will not be discussing any divestiture of plants that one side sort of knows about and the other side doesn't. It's not going to be fruitful for me to hear any testimony on that.

What I would urge you to do, and I'm not sure my sitting up here and going through this any further today

will be a help to you, but what I would urge you to do -- if necessary, I would -- if there were a way I could order you to do it, I would -- is to sit down and talk about this in the coming three weeks. I think the FTC needs to express a willingness to examine the plans. I think the defendants need an opportunity to put those plans in as much detail as they can so that they are presenting something -- I use the word "definitive" in a sort of sliding scale here -- but enough for them to be able to do some evaluating of what you're suggesting. I think it's very important that you discuss this because you are going to be spending three days, and you may get a ruling that turns out to be an advisory opinion because, in fact, this is all going to go away if you like the divestiture plans.

I'm going to leave the hearing as scheduled. If the FTC hears enough to make them think that a week or two would help, then you should call my chambers and see what the alternatives are.

I'm trying to be realistic in the fact that you have witnesses scheduled, many of whom, you know, you have prepared for these three days. I don't know how flexible these people are. I realized there is an end line to this whole thing, but, frankly, it would do you more good than harm if the end result were that the whole thing went away and the divestiture plan was approved, and then the January

date would be fine. But right now I am going to leave the hearing date as scheduled, but I made a ruling on what we are going to hear at the hearing date, and I really urge counsel to -- I mean, I don't know if I need to set a date for you both -- both -- everybody else here -- to meet. I don't think I need to do that. You all know what is at stake here. I just urge you to get together, talk about the new plan.

Forget about the fact that it was sprung on you at the last moment, Mr. Hassi. Forget -- I mean, I realize to a litigator that's a bad thing, but right now you've got your hearing date and you've got your limited ruling. Now is the time to switch gears and see if this thing -- if there is a chance this can go away.

If you are working something out, the first call you need to make is to my chambers so that we don't spend time on this, okay? But otherwise, I will see you here in a month, or three weeks, or whatever we've got.

Now, housekeeping.

MR. HASSI: Housekeeping, and, Your Honor, I didn't mean to suggest that -- I mean, this was sprung on us at the last minute. We have had constructive discussions and we will continue to do that.

THE COURT: Okay.

MR. HASSI: The way this was approached, we think,

was the wrong way to approach it.

THE COURT: Okay.

MR. HASSI: But housekeeping issues. The first question I had, Your Honor mentioned concerns before you came out here this morning, that we have a limited amount of time before Your Honor. If there are specific issues you would like us to address -- I mean, it's true we've lined up certain witnesses to come, and we have our own conception of what we think is important for you to hear. If there are specific questions you want answered, or things you want addressed, we would be happy to try and address those in the limited time we have before Your Honor.

THE COURT: I think you both hit on the issues that are going to be the important ones, and that's market, the production market and that geographic market, though I think one is probably of more concern than the other. I think it is what -- what effect aluminum cans have on this, and plastic.

MR. HASSI: We thought that might be one of your questions, your Honor.

In terms of the hearing dates themselves, do you want openings and closings, or do you want to jump right in with testimony? We didn't know if you had a preference. We think it would be helpful, before putting a witness on the stand, to give you sort of an overview of what we're going

to try to present over the two-and-a-half days.

THE COURT: I think it be would very helpful, but how much time do you need? Half-hour each, would that do it?

MR. HASSI: Could we say 45 minutes?

THE COURT: Forty-five minutes. Well, let me ask you, could you do that in writing, or do you think it would be more helpful to -- would you be using demonstratives?

MR. HASSI: We would be using demonstratives, and I think it would be more helpful to walk through some exhibits.

THE COURT: Okay, 45 minutes.

MR. HASSI: Forty-five minutes is fine. Thank you, Your Honor.

In terms of closing, sometimes those are done at the end of the hearing dates, and sometimes they are done after the findings of fact. Our end, do you have a --

THE COURT: Why don't we wait and I'll let you know. Why don't we wait. First of all, let's see the timing; and, second of all, it may be useful after I get the findings of fact to have the closings.

MR. HASSI: Okay.

THE COURT: All right.

MR. HASSI: One of the questions we had was the courtroom technology. I assume we will be in this courtroom

and there's somebody that we can liaise with in your absence to --

THE COURT: You're looking at her right now.

MR. HASSI: Okay. We'll be in touch with her.

THE COURT: She will help you, and both of you should make an appointment to come see her and arrange things.

MR. HASSI: We will do that, Your Honor.

Confidentiality issues, there -- because this is dealing with on-going business, customers, contracts, prices -- there are a lot -- we will try to do as much as we can to sort of sanitize the presentation so that we're not discussing that kind of thing, but I'm not certain that we can remove all of it. Does Your Honor have a preference in terms of the way you handle information that parties, and in particular third parties witnesses, care about maintaining confidentiality over?

THE COURT: Well, testimony is a little more difficult. I don't see a problem with exhibits because you can use sanitized exhibits here, and then have a separate set that you give to either the clerk on my law clerk that you want us to see in chambers. Testimony, we'll have to play it as it goes. We'll see how we can handle that.

MR. HASSI: Yes, Your Honor.

THE COURT: I don't know how much testimony there

is going to be that really will be touching on this. I can't tell yet, but you will let me know and we will work it out.

MR. HASSI: Okay, Your Honor. Then, finally, if Your Honor has a preference in terms of filings, things on paper, things on three-ring binders, that sort of thing. If Your Honor wants to let us know, we'll --

THE COURT: Three-ring binders is my preference because I still like paper.

MR. HASSI: I do, too, Your Honor.

THE COURT: And if you could give us a set each, you know, plaintiff's set and defendant's set, and I don't know if the defendants are going to have a joint set.

I would assume you will have one set, right?

MR. SCHWED: Yes, Your Honor.

THE COURT: That really will keep things a lot more simple. So let's just call it the defendants' set, and just number yours consecutively, and plaintiff's set. I think that's probably the easiest way. Just have them for me and I can flip through them. Or if they're going to be on here, it may be easier.

MR. HASSI: We'll try to do a lot of it electronically, but if -- I was also thinking of exhibits to the brief. I know we provided a three-ring binder, but that was -- we had asked Judge Collyer what she wanted, and I

just want to make sure that we are providing what is most useful to you.

THE COURT: Okay.

MR. HASSI: Those are all of the questions I had, your Honor. Unless you have anything else --

THE COURT: Did you have any housekeeping matters?

MR. SCHWED: Only one quick thing, Your Honor. I'm just trying to get a -- so we can plan out our witnesses, just how long is a trial day, just in terms of what time you start, what time you end?

THE COURT: I knew you were going to ask me that. I'm trying to -- I'm looking at the person on whom it is the hardest, which is our court reporter.

I am perfectly willing to start out -- well, what time are we starting on Thursday? Is it 2:00?

THE DEPUTY CLERK: Yes, Your Honor.

THE COURT: So let's go 2:00 to 5:00 on Thursday. Let's start with 9:00 to 4:30 on Friday. Monday would be, I guess, 9:00 to 4:30, too. I would like to take an hour and a-half for lunch, but that's not really necessary. You know, I will be asking you all how we're doing. We can cut the lunch hour to an hour. I'm just thinking back to my trial days. It's easy for me to set up something like, you know, 9:00 to 5:00 and an hour for lunch and, you know, 15 minutes. You guys are the ones who have to go back and do

some work in the evenings, and maybe even need a lunch hour to talk -- a longer lunch hour to talk to your witnesses and things. So you tell me, would you prefer an hour and a-half for lunch?

MR. SCHWED: Personally, I think, given that we are on a very compressed schedule, I would suggest that we assume an hour, but we can see how the time is going as we progress.

THE COURT: Okay.

MR. HASSI: I agree.

MR. SCHWED: But this is very helpful, at least, just to give us -- as Your Honor mentioned, this can be flexible, but this at least gives us some guideposts for how much time we have.

THE COURT: Yes. I mean, we can stretch from 4:30 to 5:00, and we can -- but let's start out thinking that we'll end at 4:30. We'll start at 9:00 and we'll have an hour for lunch.

Does that fit? I mean, do you think you can fit within that? But the first day we will go from 2:00 to 5:00 because we're starting late, okay?

MR. HASSI: Yes, Your Honor.

THE COURT: Okay. See you back here unless, of course, you work it all out. Just don't work it out after I give you a decision and go through all that trouble. Work

it out sometime in between, okay?

MR. SCHWED: Thank you, Your Honor.

MR. HASSI: Thank you, Your Honor.

(Whereupon, the proceedings in the above-entitled matter were concluded at 10:59 a.m.)

CERTIFICATE OF REPORTER

I certify that the foregoing is a correct transcript from the record of proceedings in the above-entitled matter.

_____

Theresa M. Sorensen, CVR-CM

Official Court Reporter

Attachment F

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

Edith Ramirez	Chairwoman
Maureen K. Ohlhausen	Commissioner
Terrell McSweeny	Commissioner
Deborah L. Feinstein	Director, Bureau of Competition
Ginger Zhe Jin	Director, Bureau of Economics

The study was a joint project of the FTC's Bureaus of Competition and Economics. The team included: Daniel P. Ducore, Assistant Director; Naomi Licker, Angelike Mina, Jeffrey Dahnke, Kelly Signs, Elizabeth Jex, and Andrea Zach, Attorneys; Jacqueline Tapp, Compliance Specialist; Taylor Colwell, Haydn Forrest, Benjamin Hayes, Eleanor Hudson, Antoinetta Kelly, Sarah Margulies, Phillip McSpadden, Michael Pesin, and Brittney Wilson, Honors Paralegals, Bureau of Competition; and Peter Aun, Jonathan Baer, Stephanie Block-Guedez, Marianela Bosco, Maurice Hicks, Parker Kobayashi, Christian Kruger, Jordan Rosman, Martin Sicilian, Eric Yde, and Amy Zhang, college interns.

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Lisa Harrison, Deputy General Counsel, and Gary Greenfield, attorney, Office of the General Counsel; and Russell W. Damtoft, attorney, Office of International Affairs provided valuable assistance throughout the study.

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Contents

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-

[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

[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

[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.

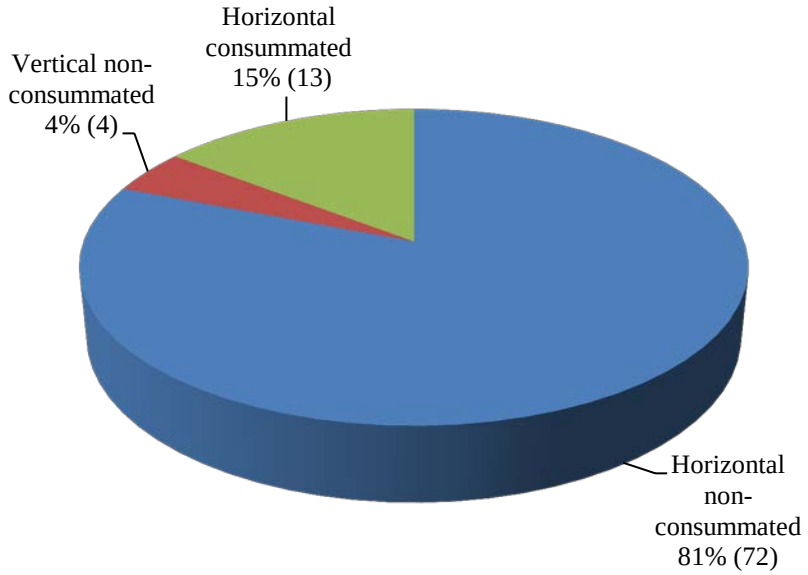
The concerns identified by buyers did not necessarily affect the ability of any particular buyer in the study to maintain or restore competition, but they represent potential gaps and risks that may adversely affect merger remedies. Addressing these concerns does not require a change in the Commission's 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.

[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.

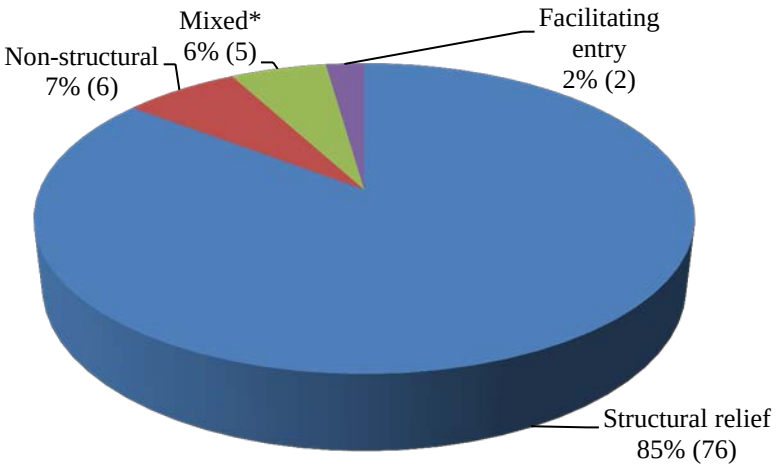
FIGURE 1: Percent of Orders by Merger Type and Consummation Status



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.

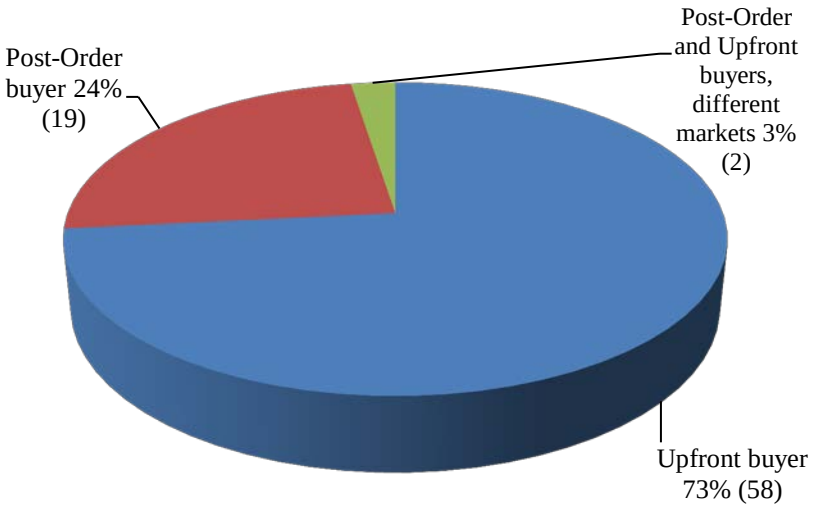
FIGURE 2: Type of Remedy



* "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%.

[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

[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.

[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.

[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]

[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]

	Remedy Outcome		
Type	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.

[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.

[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.

[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.

Attachment G

Negotiating Merger Remedies

Statement of the Bureau of Competition of the Federal Trade Commission

Richard Feinstein
Director

January 2012

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

Statement of the Federal Trade Commission's Bureau of Competition on Negotiating Merger Remedies

The Federal Trade Commission's Bureau of Competition has revised this Statement, which provides guidance to those negotiating a settlement in a merger case.[1] This guidance should answer many of the questions that frequently arise and should expedite negotiations.[2] In addition, merging parties should review the Commission's past complaints, orders, and related documents, to see various order provisions that the Commission has required in past cases.[3] Each merger is unique, however, and any proposed remedy is evaluated on the particular facts of the case. Accordingly, that the Commission has accepted a particular provision in the past will not on that basis alone be persuasive that the same provision should be accepted in a new matter. The Commission and its staff are constantly learning from their experiences; provisions in previous cases that proved insufficient may not be acceptable in a subsequent case.

This statement assumes that the staff have identified concerns with a proposed or consummated transaction, and that the merging parties and staff are negotiating a settlement. This statement addresses issues arising in the following areas: (1) the assets to be divested, (2) an acceptable buyer, (3) the divestiture agreement, (4) additional order provisions, (5) orders to hold separate and/or maintain assets pending divestiture, (6) divestiture applications, and (7) timing.[4]

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[1] See http://www.ftc.gov/bc/bestpractices/index.shtm for transcripts and related submissions of the 2002 workshops that the Bureau held on merger remedies; see, also, Frequently Asked Questions about Merger Consent Order Provisions at http://www.ftc.gov/bc/mergerfaq.shtm, and the Bureau of Competition's Divestiture Study at http://www.ftc.gov/os/1999/08/divestiture.pdf.

[2] The Commission's Rules of Practice and Procedure are available at 16 C.F.R. §§ 1.1 *et seq.*, and on the FTC web site at http://www.ftc.gov/os/rules/index.htm and at http://ecfr.gpoaccess.gov/cgi/t/text/text-idx?sid=3ad5b48a02eb1707974872e00175bbb5&c=ecfr&tpl=/ecfrbrowse/Title16/16cfrv1_02.tpl.

This Statement is intended to supplement available information. It is not intended to be exhaustive, nor is it a statement of law. The staff compiled it, and it reflects their views; it does not necessarily reflect the Commission's view or any individual Commissioner's view. It is intended to be illustrative only, and as such, cannot be used to bind the staff, the Commission, or any individual Commissioner.

[3] Commission Enforcement Database (containing merger cases since 1996) is available at http://www.ftc.gov/bc/caselist/merger/index.shtml.

[4] Once a complaint and order are issued, the named party is a "respondent," a term that will be used throughout this Statement to distinguish that party from the "buyer," which is the acquirer of assets that are divested.

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The Proposed Divestiture

• **Anticompetitive horizontal mergers are most often remedied by a divestiture; a proposal to divest one party's demonstrably autonomous, on-going business unit will usually expedite settlement.**

The Commission and the staff analyze proposed or consummated mergers between competitors to determine whether they will cause or have caused anticompetitive effects in violation of Section 7 of the Clayton Act. If staff determines that anticompetitive effects are likely, it will discuss with the parties what it has learned and what it believes an acceptable remedy must include to maintain or restore competition in the markets affected by the merger. A negotiated settlement is intended to achieve that remedy while allowing the parties to proceed with the merger's non-problematic portions.

The parties must decide whether they wish to engage in settlement discussions with the staff. On the Commission's side, the discussions will involve the Commission's Bureau of Competition (including the Compliance Division) and the Bureau of Economics. On the parties' side, the discussion should include not only outside counsel if the parties are so represented, but in-house representatives as well, including lawyers and operations people.

Although the parties and the staff negotiate a proposed settlement and finalize terms, the Commission ultimately determines whether the proposal is acceptable. It does so by a majority vote of the Commissioners after they review the materials that staff prepares and forwards to them. If the Commission concludes that a proposed settlement will remedy the merger's anticompetitive effects, it will likely accept that settlement and not seek to prevent the proposed merger or unwind the consummated merger.

The Commission and the staff review most mergers prior to consummation, but they also review consummated deals. The legal analysis of a proposed transaction does not differ significantly from the legal analysis of a consummated deal; however, remedying a consummated deal poses different issues. The Commission's objective in all cases is to eliminate, to the extent possible, the anticompetitive effects that will result or have resulted from the merger, which most often requires divestiture. In a consummated deal, the parties have already acquired assets and have often integrated them. If the acquired assets are well integrated, crafting an effective divestiture to eliminate the anticompetitive effects may be problematic,[5] but it nonetheless may be necessary to undo the illegal effects of the merger.[6]

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[5] The difficulty of "unscrambling of the eggs" led Congress to enact the Hart-Scott-Rodino Act in 1976 and authorize the antitrust enforcement agencies to implement the Premerger Notification Program in 1978. Hart-Scott-Rodino Antitrust Improvements Act of 1976, 15 U.S.C.§ 18a; Premerger Notification Rules, 16 C.F.R. § 800 *et seq.*

[6] For instance, in one consummated case in which the respondent had fully integrated
(continued...)

Most merger cases involve horizontal mergers, and the Commission prefers structural relief in the form of a divestiture to remedy the anticompetitive effects of an unlawful horizontal merger. Non-structural, or conduct, relief may also be required in aid of a required divestiture to remedy those effects. Such additional relief may include supply agreements, employee obligations, confidentiality protections, and other provisions necessary to support a successful divestiture. Conduct relief also may be required to remedy the anticompetitive effects of a vertical merger. Such conduct relief may include a requirement to erect firewalls to protect confidential information or a requirement not to favor certain entities.

The staff is most likely to accept the parties' offer to divest an autonomous, on-going business unit that comprises at least one party's entire business in the relevant market. Such a remedy will most immediately eliminate the competitive problems created by the merger by preserving or re-creating the competitive status quo, and it entails the least amount of risk. It also requires the Commission and the staff to make the fewest assumptions about the market and its participants and about the viability and competitiveness of the proposed divestiture.

The parties should be prepared to show that the business unit contains all components necessary to operate autonomously, that it has operated autonomously, that it is segregable from the parent, and that the unit's buyer will be able to maintain or restore competition almost immediately. The business people should be prepared to explain the unit's business operations and to provide relevant financial information and separate financial documents. As discussed below, a proposal short of that requires the staff to ask additional questions and conduct further analysis; as a result, completing negotiations will likely take more time.

The staff will examine a proposed divestiture to determine whether it includes all of the unit's components. These components generally include:

- manufacturing and other facilities
- access to key inputs and other supply
- access to markets for ancillary outputs
- research and development capability
- intellectual property, whether owned or licensed
- technology, including know-how and trade secrets as well as information technology

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[6](...continued)
acquired assets, the Commission required the respondent to reorganize the company into two separate, stand-alone divisions, and divest one of them. *In the matter of Chicago Bridge & Iron*, FTC Docket No. 9300, *aff'd Chicago Bridge & Iron Company v. Federal Trade Commission*, 534 F.3d 410 (5th Cir. 2008), available at http://www.ftc.gov/os/adjpro/d9300/index.shtm. The Commission also recently ordered divestiture in a consummated merger after the administrative law judge determined that the merger resulted in anticompetitive price increases. *In the matter of Polypore International, Inc.*, FTC Docket No. 9327 (Dec. 13, 2010), *available at* http://www.ftc.gov/os/adjpro/d9327/index.shtm. Respondents have appealed the Commission's order to the Eleventh Circuit. http://www.ftc.gov/os/caselist/0810131/index.shtm.

- identification of and access to personnel
- marketing and distribution capabilities
- supply, service, and customer relationships
- capital resources
- anything else necessary to compete effectively in the relevant market

The proposed package may also include business components relating to markets outside the relevant geographic or product market, if such components are necessary to assure that the buyer retains the same efficiencies that the respondent had. For example, when the product is marketed and distributed with other products, the assets to be divested may include assets relating to these other products in order to remain efficient. Similarly, if vertical integration is an important competitive element, it may be necessary to include assets at more than one level of the industry.

- **If the proposed package of assets does not comprise a separate business unit that has operated autonomously in the past, the staff is unlikely to recommend that the Commission accept such a proposal until the parties show that the package includes all necessary components, or that those components are otherwise available to a prospective buyer.**

If the parties seek to exclude any of these components, they must explain why the components are not included and what a buyer would use instead. The parties must also explain how the buyer will be able to integrate the divested components into its own operations to operate competitively. The parties' operational employees tend to be the most knowledgeable about these issues. Suppliers, customers, competitors, and other possible buyers may also provide instructive evidence; the parties should be prepared to make such evidence available if necessary or direct the staff to where it can be obtained.

A blanket assertion by the parties that certain components – for example, the research and development unit – are not necessary will generally not be persuasive. The parties should provide evidence that the carve out will not undermine the buyer's viability or competitiveness. For instance, an explanation that any buyer acceptable to the Commission will have its own research and development unit may be persuasive if the parties provide evidence to support the explanation. The parties may also demonstrate that manufacturing facilities need not be divested if they can show that appropriate third-party contract manufacturing is readily and competitively available. The parties must show that such arrangements are common, are readily available, and will not disadvantage the buyer. Providing evidence that competitors use such arrangements and that customers will purchase the contract-manufactured finished product may expedite negotiations.

If the parties propose to assemble all necessary components by combining assets that have never been combined in the past (*e.g.*, combining one party's assets with some of the other party's assets, rather than including all of one party's assets), the parties must show that the proposed divestiture will enable the buyer to maintain or restore competition in the market. For example, in the grocery retailing market, the parties might provide detailed analysis of each supermarket that the parties propose to divest to show that the proposed divestiture would

maintain or restore competition in the market. If, however, the parties have proposed divesting lower performing, higher operating cost, older, less conveniently located supermarkets, they will have difficulty persuading the staff to accept such a package. The Bureau is willing to examine any proposal, but it will always require sufficient evidence to conclude that the proposed divestiture will maintain or restore competition and will require sufficient time to analyze the evidence. In general, a "mix and match" proposal tends to slow the negotiations down, requiring a more fact-specific, detailed, and time-consuming evaluation of each asset.

- **The Commission will typically require an up-front buyer if the parties seek to divest assets comprising less than an autonomous, on-going business or if the to-be-divested assets are susceptible to deterioration pending divestiture.**

If the parties propose to divest more limited assets, the staff will typically consider such a package only if the proposed order specifies an "up-front buyer"; that is, the parties must identify an acceptable buyer and then negotiate, finalize, and execute the purchase agreement and all ancillary agreements with that buyer before staff forwards the proposed order to the Commission. The staff will carefully review both the buyer and the agreement before making its recommendation. The proposed order will specifically identify the buyer and require divestiture to that buyer pursuant to the reviewed agreement; the agreement will be attached as a confidential exhibit and incorporated into the order. The divestiture to the named up-front buyer must be completed immediately after the Commission accepts the proposed order. By requiring an up-front buyer, the staff seeks to minimize the risks that there will not be an acceptable buyer for such limited assets or that the buyer of the limited assets will not be able to maintain or restore competition.

Divestiture to an up-front buyer also minimizes the possibility that the assets and competition will diminish pending divestiture, which causes immediate competitive harm. The staff's experience has shown that some assets, such as supermarkets, tend to deteriorate pending divestiture; such deterioration harms competition and may make it more difficult for the buyer to maintain or restore competition. In these situations, the Commission has required up-front buyers. The staff remains willing, however, to consider on a case-by-case basis whether certain protections (such as orders to hold separate or maintain assets, crown jewels, and monitors, all discussed below) can eliminate the need for an up-front buyer.

An order that specifies an up-front buyer typically requires that the parties divest the assets to the up-front buyer quickly and pursuant to the agreement attached to the order. In fact, the parties may consummate the up-front deal before the public comment period on the proposed order ends and the order becomes final. To assure that the Commission can reject the up-front buyer if it determines to do so after the public comment period, the Commission typically requires a rescission clause in the purchase agreement. (As of December 2011, the Commission has never required rescission of such an agreement.) In most cases with an up-front buyer, the order states that, if the parties fail to divest to the up-front buyer pursuant to the up-front agreement in a timely manner, the Commission may appoint a trustee to divest the same assets or a "crown jewel" package of assets.

If staff is likely to require an up-front buyer, the parties should begin negotiations with an acceptable buyer as soon as they understand the scope of the assets that they must divest. Involving the staff as early as possible may expedite approval, although the staff will not be directly involved in the actual negotiations. The staff will, however, provide guidance, suggestions, and requirements about the provisions that should or should not appear in the final purchase agreement. For example, some non-compete, non-solicit, or royalty clauses may not be acceptable.

The parties will likely negotiate the proposed order with the staff while they are negotiating the purchase agreement with the proposed up-front buyer. The staff will not disclose to the buyer details of the negotiations between the staff and the parties. The parties should be aware, however, that the staff will discuss relevant issues with the buyer, especially those concerning the assets to be divested. The staff may also discuss these issues with others who might be knowledgeable about the market and be able to evaluate the proposed divestiture, such as other competitors, customers, suppliers, and employees. The process, therefore, will be an iterative one; as the staff learns more about the market and competition, it may require changes to the asset package, the proposed decision and order, or the purchase agreement.

The parties should finalize the purchase agreement and all ancillary agreements expeditiously. The staff will review the purchase agreement carefully, including all ancillary agreements, to assure that they convey all required assets and that they are consistent with the proposed order. (See discussion on the Divestiture Agreement below.)

By contrast, an order that requires what is referred to as a "post-order buyer" requires the parties to divest certain assets within a certain time period after the Commission has considered the proposed order "to a buyer that receives the prior approval of the Commission and in a manner that receives the prior approval of the Commission." Thus, a post-order buyer and the relevant agreements are typically neither identified nor reviewed before the Commission issues a final order; they are instead negotiated, finalized, and then reviewed some months later.

- **If the parties propose to divest primarily intellectual property or other limited assets, then the Commission will typically require an up-front buyer.**

The staff and the Commission may consider a divestiture of primarily intellectual property or other limited assets; however, the parties must persuade the staff and the Commission that such a divestiture will achieve the remedial purposes of the order. To show that such a divestiture will address the competitive concerns, the parties must show that there is an acceptable buyer that can enter the market by acquiring the intellectual property or other limited assets, is willing to make the acquisition, and has the necessary incentives to compete in the market. In all likelihood, staff will recommend accepting such a proposal only with an up-front buyer.

If the assets are primarily intellectual property, the parties must show that the buyer will acquire all intellectual property necessary to maintain or restore competition in the relevant market and will have access to all relevant and necessary rights. The parties should be prepared

to convey all rights necessary so that the buyer can develop, produce, use, distribute, and sell the relevant product in the relevant geographic market. (See discussion below relating to obtaining necessary third-party consents and approvals.) If the buyer cannot produce the product immediately, the staff may require that the parties supply product to the buyer temporarily until the buyer can produce the product itself. The parties should be prepared to enter into a supply agreement – reviewed by the staff – that will enable the buyer to compete effectively immediately. (See discussion below relating to such agreements.) The parties may be required to provide technical assistance to the buyer when, for example, the relevant product involves highly sophisticated or complex technologies. On the other hand, technical assistance alone may not be sufficient when, for example, access to key employees is critical to effective competition. The parties should then be prepared to assure the transfer of those key employees. (See discussion below relating to such steps.)

Supply agreements and technical assistance may, however, create what the staff refers to as "continuing entanglements." The staff seeks to avoid these because competitive issues may arise and complex monitoring may be required. In addition, the more a proposed buyer requires these provisions, the more difficult it may be to persuade the staff that such a divestiture would remedy the Commission's competitive concerns. When they cannot be avoided, staff will seek to minimize the length of the agreements and may require independent monitoring.

In some cases, the buyer's ability and incentive to develop the relevant product may be affected by whether it also has the right to develop other products or sell outside the relevant geographic markets. The staff may thus require that the divestiture include the right to use the intellectual property to develop products outside the relevant product market, or the right to use the intellectual property outside the relevant geographic market. The divestiture may also require exclusive, rather than co-exclusive or non-exclusive, rights to certain technology. The staff has found that access to patent lawyers and others knowledgeable about the transfer and use of intellectual property in the industry and access to the scientists or other professionals involved in the development and use of the intellectual property often expedite negotiations.

In some cases, parties propose to license necessary intellectual property instead of divesting it. This occurs often when the parties assert that they need to use the intellectual property in the research, development, or production of other products outside the relevant product market or in other locations outside of the relevant geographic market. If the parties seek to transfer only limited rights to the intellectual property, they should be prepared to show that such limitations will not adversely affect the buyer's ability to compete effectively. Licensing intellectual property rights instead of divesting the intellectual property may not be sufficient if it limits how the buyer can use the intellectual property and adversely affects the buyer's long-term viability; in such cases, the staff may require that the parties divest the intellectual property but agree that the parties can license back rights to the divested intellectual property. If the parties anticipate that they will require continued access to intellectual property that may be the subject of a proposed divestiture, they should raise that issue as early as possible.

An Acceptable Buyer

• **To be acceptable, a buyer must be competitively and financially viable; a proposed buyer that does not satisfy these tests will be rejected, and the parties will be required to propose an acceptable one.**

Whether the buyer is post-order or up-front, it must be one that can maintain or restore competition in the relevant market after acquiring the divested assets. The staff will therefore evaluate a proposed buyer to determine whether it has (1) the financial capability and incentives to acquire and operate the assets, and (2) the competitive ability to maintain or restore competition in the market.

The staff will be prepared to discuss with the parties an acceptable buyer's characteristics. It is, however, the responsibility of the parties to propose the buyer, and, as discussed below, the parties must show that the buyer is acceptable. Proposing a buyer that does not clearly satisfy the necessary criteria will delay approval.

The staff generally has no preference as to the method the parties use to select an acceptable buyer. Some parties prepare an offering memorandum (sometimes with the help of an investment bank) and solicit bids. Some parties approach individual firms that they believe may be acceptable buyers. Another possibility is an auction process. Auction processes have the advantage of excluding the parties from the selection of the proposed bidders or buyer; on the other hand, there is no guarantee that the Commission will approve the winning bidder (the high bidder may be, for example, an incumbent that raises independent competitive concerns or a financial investor that lacks the expertise to succeed, notwithstanding its high bid). The staff is not opposed to an auction as long as it can be completed within the required time period, although parties have typically been reluctant to use auctions because of the additional time involved. In the first instance, however, the parties select the search method. Should the parties have any questions about the method they intend to use, they should consult staff as soon as possible.

The staff will evaluate a proposed buyer very carefully to determine whether the buyer is financially and competitively viable. The parties should thus evaluate and select a proposed buyer with these criteria in mind. The proposed buyer's financial condition should be thoroughly scrutinized by reviewing balance sheets and other financial data to determine whether the buyer has the necessary financial resources. To protect the buyer's competitively sensitive information, the parties should have counsel or some other third party, rather than their own business people, conduct the review. The staff's review of a buyer will be broader than the parties might conduct if they were considering selling significant assets in a deal not ordered by the Commission; in a Commission-ordered divestiture, the parties must demonstrate not only that the proposed buyer has the financial ability to close on the proposed transaction, but also that it has both the financial ability and economic incentive to maintain or restore competition in the relevant market.

The parties and the buyer should determine whether any financial information raises concerns and, if so, notify staff as soon as possible. Such information would include, for example, significant debt due soon, other recent acquisitions that may implicate the buyer's financial position, or imminent adverse financial announcements. The parties should inform the buyer that the staff will be requesting financial information directly from the buyer; obviously, it is in the parties' interest to obtain the buyer's cooperation.

All orders require divestiture "at no minimum price." The Commission does not typically evaluate the proposed purchase price, but an offer to pay a price that is less than the break-up value of the assets may raise concerns about the buyer's incentives to compete and its commitment to the market. The Commission will not approve a divestiture to a buyer that intends to re-sell the assets for their break-up value.

The parties should ascertain whether the buyer will need financing. If the buyer will need financing, the parties should assure that the buyer is making those arrangements. The parties should inform the buyer that the staff may wish to interview the entity providing the financing. If the ability to obtain financing becomes an issue, decreasing the purchase price may be an option; seller financing, in all likelihood, is not. A buyer that requires seller financing because it cannot otherwise obtain financing may not be financially sound. In some cases in which the buyer's ability to obtain financing was in doubt the parties agreed to a limited, up-front payment followed by subsequent payments over time; however, the staff will not accept such an arrangement if the subsequent payments are tied to the assets' future performance, such as royalty payments or other performance-based payments. Such an arrangement may skew incentives and will likely require sharing competitively sensitive information. The requirement that the divestiture be "absolute" prohibits other continuing relationships between the parties and the buyer, such as, for example, lease arrangements or security interests retained by the parties.

The buyer must have the experience, commitment, and incentives necessary to achieve the order's remedial objective. These attributes can be shown, for example, by the buyer's participation in related product markets or adjacent geographic markets, involvement in up-stream or down-stream markets, past attempts to enter the market (depending on why those attempts were not successful), or previous expressions of interest in the market. The buyer should not currently be a significant market participant or already be pursuing significant entry on its own. A fringe competitor may be acceptable. If any components of an independent business have been omitted from the assets to be divested, the parties should be prepared to show that the buyer has the necessary components or access to them. The parties should inform the buyer that it will need to develop its business plans to present to the staff (not to the parties, of course). The business plans should be thorough enough to persuade the staff that the proposed buyer has sufficient experience to compete in the market, that it has done adequate due diligence, that it knows what is needed to compete in the market, and that it is committed to the market. The parties should ensure that the buyer understands this obligation and is prepared to cooperate with the staff.

The staff will independently evaluate the proposed buyer, interviewing, as necessary, buyer representatives, customers, suppliers, competitors, other possible buyers, and any other

individuals that may provide relevant information. As indicated above, the staff will also ask the buyer to submit competitively relevant information, including financial information. The parties should ensure that the proposed buyer will respond quickly and supply the requested information.

The Divestiture Agreement

• **Whether up-front or post-order, the staff will review the divestiture agreement carefully to determine that it conveys all assets required to be divested and contains no provisions inconsistent with the terms of the Commission's order or with the order's remedial objectives.**

The Bureau and the Commission will review and evaluate the purchase agreement, including all appendices, exhibits, and schedules, and all ancillary agreements that the parties and the buyer have negotiated, whether the divestiture is required up-front or post-order. The parties are responsible for transferring to the buyer all assets required to be divested and otherwise complying with the Commission's order; however, the staff makes every effort to assure that the divestiture agreement transfers to the buyer all assets required to be divested and achieves the order's remedial objectives. In addition to questioning the parties and the proposed buyer, the staff may question suppliers, competitors, or customers about the operation, effectiveness, or necessity of certain provisions.

Staff will discuss term sheets as soon as they are created, and the parties may expedite the matter by giving the staff a draft divestiture agreement as soon as one has been negotiated. The earlier the staff is able to begin its evaluation, the more quickly the matter can be resolved. If the staff has questions, it will raise them with the appropriate party. When necessary, the staff will suggest that the parties revise the agreement. Regardless of whether the parties submit a final, executed agreement or a draft of an agreement, the staff will review the agreement carefully and thoroughly and request changes that it believes are warranted and appropriate. Submitting only the final, executed agreement to the staff does not mean that the staff is less likely to request changes than if the parties had submitted drafts to the staff. In fact, it is the staff's experience that submitting drafts (ready for execution, but before execution) expedites the process. Obviously, the more quickly the parties address staff's concerns, the sooner the matter will be resolved. Involving the in-house people who negotiated or are negotiating the agreement, the transaction lawyers who drafted or are drafting the agreement, as well as the in-house personnel who will have to comply with the agreement, will also expedite the matter. Occasionally, transaction lawyers observe that the staff is raising issues about provisions that the lawyers describe as "boilerplate." The competition goals of the Commission are different, however, from the goals of a typical transaction; therefore, otherwise standard provisions, such as non-compete clauses and performance-based payments (*e.g.*, royalties), while acceptable in a typical transaction, may be unacceptable in a divestiture.

The staff will review the divestiture agreement to determine if the agreement transfers all assets required to be divested and is otherwise consistent with the order. Language mirroring the

order language typically provides the necessary assurances that the agreement includes all assets required to be divested. The parties sometimes intend to list all of the assets to be divested in an attached schedule; some insist that they cannot prepare such a list until right before closing. But before it recommends that the Commission accept the proposal, the staff must be assured that the agreement includes all assets. A blank schedule does not provide those assurances. In other cases, the parties have agreed to provide transitional services to the buyer, but they intend to work out the details later. If the order requires such services, the parties and the buyer must finalize the transitional services agreement and the staff must review it before the staff can conclude that the parties have satisfied their order obligation. Even if the order does not require the provision of such services, however, any agreement to do so may raise significant competitive concerns and, accordingly, the parties and the buyer must finalize the agreement and the staff must review it before the staff can make its recommendation. Similar concerns may arise about any incomplete schedules, exhibits, appendices, or agreements. The staff will be unable to recommend that the Commission accept such a proposal until all have been completed.

If the order imposes additional obligations, the staff will review the divestiture agreement to assure that all such additional obligations are satisfied. For example, if the order requires the parties to convey an exclusive license, conveying only a non-exclusive license will not be acceptable. A one-year supply agreement tied to one manufacturing plant would be inconsistent with an order provision that requires the parties to supply the buyer from a different plant. If the parties are required to provide transitional services to the buyer, the divestiture agreement should also provide "firewalls" if providing such services might disclose competitively sensitive information.

The staff evaluates all provisions mindful that this is an agreement between two firms who will be competitors. The staff often reminds the parties that a Commission-ordered divestiture is not the same as a conventional transaction. In the more typical, consensual, arm's-length transaction, the parties are neutral as to the buyer's success in the market; in a divestiture, the merging parties may prefer that the buyer *not* be robustly competitive. The Commission must protect against that preference.

- **In evaluating the terms of the divestiture agreement, the staff will rely primarily on information obtained from the buyer; however, the staff remains aware that the buyer's incentives may not always be consistent with the Commission's objectives.**

As discussed, the staff will thoroughly and carefully review the divestiture agreement. Staff will request information from the buyer and others, and will discuss the agreement with the buyer's legal and operational personnel, among others. The buyer's information is extremely important. But even though the buyer has reviewed the agreement and has agreed to its terms, staff may nonetheless question provisions that the buyer has accepted. The Commission cannot rely solely on the buyer's incentives to achieve the objectives of its order because the buyer's incentives may not necessarily coincide with the Commission's objective.

The Commission's objective is to remedy the merger's likely anticompetitive effects and to maintain or restore competition in the relevant market. The buyer's incentive is to generate an

adequate return on its investment, not necessarily to maintain or restore competition. As a result, the buyer may want provisions, such as a long-term non-solicit clause or a long-term supply agreement, that create perverse competitive incentives. Merely because the buyer agreed to a certain provision may not be sufficient justification for the provision. Past experience has shown that some buyers may agree to certain undesirable provisions that later undermine the buyer's effectiveness in the market. Therefore, even if agreed to by the buyer, objectionable provisions will be accepted only with further supporting evidence.

- **The merging parties must obtain all required third-party consents and approvals before the Bureau recommends that the Commission approve a proposed divestiture.**

In many cases, third parties must consent to or approve the transfer of certain assets. If such consents or approvals are necessary, then staff may require that the parties obtain all such third-party consents and approvals before the staff recommends that the Commission accept the proposed divestiture. For example, if a lease is included in the assets to be divested but the landlord's approval is required to transfer the lease, the parties must obtain that approval before the staff will recommend that the Commission accept the proposed divestiture. If the parties must transfer supply or customer contracts and they cannot do so without the supplier's or the customer's consent, the parties must obtain these consents before the staff recommends accepting the proposed divestiture. Transferring licensed intellectual property often requires the original licensor's consent, or assets to be divested may be subject to rights of first refusal. The parties should plan to deal with these rights before the staff recommends that the Commission accept the proposal.

Waiting until the last minute to begin obtaining these consents and approvals may delay negotiations. Further delay may occur if the third parties require compensation before granting the necessary approvals and consents. For example, a customer may not want its contract with the parties transferred to a buyer with whom the customer has had no past dealings, and that customer may insist on some protection (in the form of money or otherwise). The staff recognizes that pre-existing leases, licenses, and the like, can, in the context of a pending merger and divestiture negotiations, transform reasonable third-party approval rights into tools for extracting arguably excessive concessions. The staff will work with the parties, whenever possible, to explore how these conflicts may be minimized consistent with the need to obtain an effective remedy. Letting the staff know as soon as the parties are aware that such consents and approvals will be required can save time in the long run. The staff will work with the parties to resolve these issues. For example, the Commission has included provisions that allow for the substitution of equivalent assets when necessary, subject to the Commission's approval. The parties must show that the particular assets are not critical to the business's success, that substitute assets exist and can be transferred, and that transfer of substitute assets will enable the buyer to be as competitive as the parties had been.

The parties should raise these concerns and issues as early as possible to enable the staff to address them beforehand. After the order becomes final the parties must divest the assets described in the order, and it will be too late to renegotiate the order's terms. If the parties fail to complete the required divestiture by the order's deadline because the parties have not obtained

necessary third-party consents, the parties will have violated the order. The Commission can then appoint a divestiture trustee to divest the assets, making all arrangements necessary to do so. The Commission may also seek civil penalties and other relief for failure to divest on time. A final order may be modified pursuant to Rule 2.51 of the Commission's Rules of Practice, but the parties will have a heavy burden to show a modification is warranted.[7]

Additional Order Provisions

• **In some cases, the buyer may need additional, short-term assistance from the merging parties, particularly when less than the entire business of one party is being divested**.

Divestiture of an autonomous, on-going business (including all of the components of a business, as discussed above) to a viable buyer will, in the majority of cases, immediately create a competitor comparable to the competitor that would have been or was lost after the merger. Divestiture of less than an autonomous, on-going business will not create that result until the buyer can fill in the gaps; in some cases, the merging parties may be required to provide short-term transitional assistance to the buyer to fill in these gaps temporarily.

For example, when the staff agrees that the merging parties need not divest manufacturing or production capability, the staff may require that the parties assure a supply of product to the buyer until the buyer can manufacture or obtain the product itself. The parties can offer to supply the product themselves, but the staff will examine the offer to assure that it is temporary and that the buyer is not at a competitive disadvantage, for example by having to reveal competitively sensitive information or being locked in to a non-competitive price. Before the staff can recommend that the Commission approve the proposed order, the parties and the buyer must finalize the supply agreement so that the staff has an opportunity to review the agreement to ensure that adequate safeguards exist. For instance, the parties may have to sell the product to the buyer at some measure of variable cost. The parties must be prepared to provide safeguards for the buyer if the production facility or line stops, and also to ensure that competitively sensitive information is protected.

If the parties are required to divest patents, technology, and know-how, they also may be required to provide technical assistance until the buyer if fully familiar with the patents, technology, and know-how. If certain employees are key to the use of the technology or know-how, the parties may be required to encourage those key employees to transfer to the buyer, for example by providing financial and other incentives to those key employees to accept the buyer's employment offer. If reputation (which cannot be transferred) is a critical component of effective competition, the parties must ensure that the buyer is not at a competitive disadvantage because it lacks the reputation the parties have. The parties may be required to persuade customers to switch to the buyer and then remain with the buyer for some transitional period

[7] *See* 2.51 of the Commission's Rules of Practice, 16 C.F. R § 2.51.

while the buyer establishes its own reputation. These are intended as short-term, temporary obligations to establish the buyer as a viable competitor; the parties would have already demonstrated that the proposed buyer is one that is likely to be able to establish its own reputation in the market over the long term.

- **If the Commission's order imposes obligations requiring a continuing relationship between the respondent and the buyer, the Commission may appoint an independent third party to monitor the parties' compliance with their obligations under the Commission's order.**

When the parties have proposed divestiture of less than an autonomous, on-going business, the parties often need to provide additional assistance to the buyer. If that assistance perpetuates a relationship between the parties and the buyer, or imposes complex or highly technical obligations on the parties, the staff will recommend that the Commission appoint an independent third party to monitor compliance with the Commission's order. These monitors are typically from the industry or have consulted to the industry so that they have appropriate expertise and know-how, and they have no financial or other tie with the parties or the buyer. They serve as the "eyes and ears" of the Commission and the staff. The obligation of the monitor is to the Commission; however, the parties will be responsible for compensating the monitor.

Often, the parties recommend the monitor, including the category of monitor referred to as "hold separate trustee" or "hold separate monitor" (see discussion below). The most effective monitors have been those who established a positive working relationship with the parties as well as with the buyer. For that reason, the first candidates that the staff considers typically are those the parties suggest. The parties can expedite the matter if – when it appears that appointment of a monitor is likely – they have investigated possibilities early and have provided names to the staff. The staff has rejected candidates the parties have suggested when there appear to be conflicts resulting from stock ownership or pension benefits. In some cases (typically when expertise of a highly technical nature is required), the staff has rejected candidates who do not have the requisite expertise.

If a monitor is required, the staff will insist that the monitor be named in the order, or at least agreed to before the staff forwards its recommendation to the Commission. Ideally at that point, the parties and the monitor will have already finalized and executed an agreement. The staff must review and evaluate this agreement as well, and the staff will be available to review an agreement as soon as the parties have drafted one. Some previous monitor agreements are available on the Commission's web site and might guide the parties; however, as staff points out consistently: each case turns on its own facts, and therefore unique provisions in the applicable monitor's agreement may be required. The staff will ensure that the agreement gives the monitor all the authority necessary to satisfy his or her responsibilities and that the agreement does not limit the ability of the monitor to do so.

Order to Hold Separate or Maintain Assets

- **If there is concern about interim competitive harm or diminution in the competitive strength of the assets to be divested pending divestiture, staff will require an additional order that requires the parties to hold separate the assets to be divested. Even if an order to hold separate is not necessary, the parties will be required to maintain the assets to be divested pending divestiture.**

Some settlements raise the concern that competition may be harmed pending divestiture of the to-be-divested assets. In such cases, the staff and the Commission will usually require a separate order requiring the parties to hold separate at least those assets that the parties are required to divest. In some cases, the hold separate may cover assets beyond those required to be divested for viability or confidentiality purposes, or for other reasons. If the parties have provided and will continue to provide any necessary services to the held separate assets, the order to hold separate must address those services. The hold separate order also will impose obligations to protect the confidential information of the held separate assets.

Even if no hold separate order is required, staff will typically require an order to maintain the assets pending divestiture, to ensure no diminution in competitive strength of the to-be-divested assets pending divestiture. This may be true even if there is an up-front buyer, depending on the amount of time the parties will control the assets to be divested. If an order to hold separate is required, it will also include asset maintenance provisions.

The order to hold separate or maintain assets is not subject to a comment period and therefore becomes final upon service on the parties. If additional immediate obligations are necessary, the order to hold separate will include such obligations. For example, if the Commission seeks to impose obligations on the parties in connection with employees, the transfer of confidential information, or other similar conduct, the Commission will include these obligations in the order to hold separate or maintain assets. Because even the order to hold separate does not become final until some time period after the parties execute the agreement containing consent order, the agreement typically includes a paragraph in which the parties "agree to comply with the proposed Decision and Order and the Order to Hold Separate and Maintain Assets from the date they execute this Consent Agreement."

The order to hold separate or maintain assets may include benchmarks by which the parties' conduct can be measured. For example, the order to hold separate or maintain assets may require the parties to maintain certain levels of capital spending. The order will require that the parties submit (or identify previously submitted) plans that describe previously anticipated or planned levels of spending, benchmarks by which the Commission and the monitor can determine whether the parties are maintaining those levels. The staff prefers plans that the parties have previously prepared and approved in the ordinary course of business.

The order to hold separate or maintain assets may require that the parties offer incentives to employees to ensure that the employees (1) remain with the held separate business until it is divested and (2) accept offers of employment from the buyer if maintaining the workforce is important. The parties should be prepared to discuss with the staff the necessity of maintaining that particular workforce and what incentives will be required to maintain the workforce.

- **The order to hold separate or maintain assets will include the appointment of an independent third party to oversee the operations of the held separate business or monitor the parties' compliance with the order.**

An order to hold separate or maintain assets will also authorize the Commission to appoint an independent third party to oversee the held separate business or monitor the parties' compliance with the order. In an order to maintain assets, the independent third party will have functions similar to those of the monitor discussed above; he or she will be the "eyes and ears" of the Commission and its staff, raising issues with the staff as they arise. In an order to hold separate, the independent third party has somewhat more extensive obligations; he or she will monitor compliance, but will also oversee the operation of the held separate business. The staff has described the functions of that individual by analogizing to a chairman of the board.

The parties can expedite the matter if they anticipate this need and begin their own search for an appropriate monitor as early as possible. The staff will have to review the individual's qualifications and the agreement between the monitor and the parties, which may slow down the process. Acceptable monitors are those with substantive experience in the market and no financial or other ties to any of the parties involved. The Commission has appointed individuals with varied backgrounds to serve as monitors, including retired executives, consultants, and lawyers with particular regulatory experience. The staff will be available to discuss the characteristics of an acceptable monitor.

Divestiture Applications

- **In cases requiring a post-order divestiture, the respondent has the burden of showing that the proposed divestiture meets the order's specific requirements and satisfies the order's remedial purposes.**

In virtually all of the Commission's orders that require a post-order divestiture, the respondent is ordered to divest certain assets within a certain time period "to a buyer that receives the prior approval of the Commission and in a manner that receives the prior approval of the Commission." The Commission must thus approve both the buyer of the assets and the manner of the proposed divestiture, *i.e.*, the purchase and sale contract and all related agreements. It is the respondent's burden to show that the proposed divestiture – both the buyer and the manner – meets the order's specific requirements and satisfies its remedial purposes.[8]

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[8] *See Dr Pepper/Seven-Up Companies Inc. v. FTC*, 991 F.2d 859, 863 (D.C. Cir. 1993) (in a proceeding in which a respondent sought prior approval of a proposed divestiture pursuant to Rule 2.41(f) of the Commission's rules, the court upheld the Commission's rejection of the proposed buyer, agreeing that respondent had the burden of proof to demonstrate that its request should be granted), published at:

(continued...)

• **The respondent must include in its application all information and documents sufficient to satisfy its burden and should ensure that the buyer will cooperate with the staff's requests for information and documents.**

To obtain the necessary approvals of a post-order buyer, the respondent must file an application with the Commission requesting approval of the proposed divestiture pursuant to Rule 2.41(f) of the Commission's Rules of Practice.[9] There is no required format for the application, but it must contain facts sufficient to satisfy the respondent's burden. The application should include a final purchase and sale agreement and all related agreements with full details concerning financing and security provisions, if any, and all related documents. Specifically, the application should, at a minimum, include:

(1) the buyer's name and address;
(2) a description of the buyer's business;
(3) its most recent annual report, Form 10-K, Form 10-Q, and financial statements (which should be submitted directly from the buyer to the Commission if it is not publicly available);
(4) the names of its officers and directors;
(5) an accounting of sales and other transactions, if any, during the previous year, between the proposed buyer and the respondent;
(6) all documents that discuss the divestiture;
(7) a business plan or other documentation (which should be submitted directly from the buyer to the Commission and not to the respondent) showing how the buyer will use the acquired assets and be an effective competitor; and
(8) a complete description of the proposed divestiture and an analysis of how the divestiture would maintain or restore competition in the relevant market and achieve the remedial purposes of the order.

To the extent the above information (in addition to the business plan) is confidential to the buyer, the respondent should arrange for the buyer to submit that information directly to the staff. Once filed, applications for divestiture are placed on the public record for a thirty-day public comment period, with the exception of information and documents (or parts thereof) for which the submitter has requested confidential treatment.

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[8](...continued)
http://openjurist.org/991/f2d/859/dr-pepperseven-up-companies-inc-v-federal-trade-commission

[9] 16 C.F.R. § 2.41(f). Regardless of the size of the required divestiture, it is exempt from the reporting and waiting requirements of the HSR Act, 16 C.F.R. § 802.70, *available at* http://ecfr.gpoaccess.gov/cgi/t/text/text-idx?c=ecfr&sid=17a163536d70f643032f1c22c3266612&rgn=div5&view=text&node=16:1.0.1.8.85&idno=16#16:1.0.1.8.85.0.46.27.

The staff will usually need to obtain additional confidential information directly from the buyer. To facilitate the staff's review of its application, therefore, the respondent should include with the application the names of appropriate individuals to contact at the buyer for information relevant to the staff's analysis of the divestiture. The respondent should arrange for the proposed buyer to provide this information, and any further information required by the staff, as soon as possible.

- **The respondent's application should include a representation that the proposed divestiture conveys all assets required to be divested, including obtaining all necessary consents and approvals.**

To complete the application for approval of a proposed divestiture, the respondent should include a representation that the proposed divestiture agreement conveys all assets that the order requires to be divested and, to the extent third-party consents and approvals are required prior to conveying any of the assets, the application should include a representation that all have been obtained.

- **Failure to consummate the required divestiture within the time limit set forth in the Commission's order violates the Commission's order.**

If the respondent is required to divest assets within a specified time period, it must complete the transaction within that time period. Filing for approval within that time period will not satisfy the parties' obligation; the divestiture must be consummated in time. Failure to complete the divestiture within the time period is a violation of the Commission's order. The failure to comply is a continuing violation, cured only by complete divestiture. Failure to comply thus exposes the respondent to the possibility of civil penalties of up to $16,000 per day, until the respondent effectuates the required divestiture, as well as other relief.[10]

In most of the Commission's orders requiring divestiture, the Commission is authorized to appoint a trustee to divest the assets required to be divested if the respondent fails to divest within the time period required. If the staff has concerns about the respondent's ability to divest

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[10] *See* Section 5(*l*) of the Federal Trade Commission Act, 15 U.S.C. § 45(*l*), and the parallel provision in the Clayton Act, 15 U.S.C. § 21(l). *See United States v. Papercraft Corp.*, 540 F.2d 131 (3d Cir. 1976); *United States v. Beatrice Foods Co.*, 344 F. Supp. 104 (D. Minn. 1972); *see, e.g., FTC v. Red Apple Companies, Inc., et al.*, No. 97 Civ 0157 (S.D.N.Y. Jan. 23, 1997) (consent judgment ordering $600,000 civil penalty for failure to timely divest); *United States v. Louisiana-Pacific Corp.*, 554 F. Supp. 504 (D. Or. 1982) ($4 million civil penalty for failure to divest), *rev'd on other grounds,* 754 F.2d 1445 (9th Cir. 1985), *penalty reinstated*, 1990-2 Trade Cas. (CCH) ¶ 69,166 (D. Or. 1990), *aff'd,* 967 F.2d 1372 (9th Cir. 1992); *United States v. Boston Scientific Corp.*, 253 F. Supp. 2d 85, 98 (D. Mass. 2003) (Commission awarded over $7 million for Boston Scientific's violations); *In re* Aspen Technology, Inc., Docket No. D-9310 (August 2009)(Commission settlement included re-opening original Order and adding further obligations to remedy the effects of Aspen Technology's violation).

the assets on time and there will not be an up-front buyer, the staff may recommend that the Commission accept the proposed package but require divestiture, by a trustee, of alternative assets, referred to as the "crown jewel," if the respondent fails to comply with the original divestiture in a timely manner. A crown jewel may include assets in addition to the ones included in the original divestiture or it may be different assets such as the assets of the other party to the merger. In any case, it comprises assets that the staff has concluded will be more readily divested because, for example, the pool of acceptable buyers is larger. Appointing a trustee is within the discretion of the Commission. For example, if the respondent has not divested the required assets in a timely manner but is close to completing negotiations, the Commission may delay appointing a trustee to allow the respondent time to complete the negotiations. Whether or not the Commission appoints a trustee does not alter the fact that the respondent's failure to divest in a timely manner violates the order, and in either case the Commission may seek civil penalties and other relief.

Timing

- **The parties should raise any concerns or complexities as early as possible and consider alternatives that may expedite the matter.**

The staff is unable to predict how long any particular negotiation will take; however, in the staff's experience, the time involved to negotiate a particular consent agreement is directly related to the proposed remedy's scope and complexity. Analyzing a proposal to divest an autonomous, on-going business unit to a viable and competitive buyer will, in most instances, be relatively simple, and in all likelihood the process will be completed quickly. As the assets that the parties offer to divest become more limited or more complex, the staff will need more time to evaluate the proposal, and the parties will need more time to finalize an up-front transaction, if required. The more issues that arise with the proposed buyer, the more time the staff will need to evaluate the buyer. As the parties present additional and different proposals that the staff must analyze, the staff will need more time to complete the additional analyses. Thus, if time is of the essence, the parties should consider an offer to divest more or different assets to facilitate the staff's analysis and possibly to eliminate the need for an up-front buyer.

If an up-front buyer is required, the more quickly the parties and an acceptable buyer complete negotiations, the faster the case will be resolved. The parties may expedite the investigation if they make business executives available early (and perhaps often), respond fully and expeditiously to the staff's information requests, submit possible monitors' names as soon as possible, begin obtaining third-party approvals as soon as possible, and prepare to implement an order to hold separate or maintain assets as soon as possible. Attending to even seemingly small details, such as having the appropriate executive available to execute the required agreement, will expedite the process.

Parties often have timing concerns. Varied factors – some under the parties' control and some not – may affect timing. Sometimes, financing arrangements may terminate at a specific point. Other times, the target company may have the right to terminate the agreement

unilaterally if certain timing requirements are not satisfied. The passage of time alone often affects the value of the transaction. The staff understands these possibilities and is prepared to consider them if at all possible. The time needed to complete the negotiations, however, primarily depends on the proposed divestiture's scope and complexity; thus, if timing is an issue, the parties may have to balance their timing needs against their desire to structure the divestiture in a particular way.

The parties should understand the Commission's internal procedures and schedules as they plan. When the negotiations are completed and all terms have been agreed to, the parties will execute an "agreement containing consent order(s)," which will include all the terms required by the Commission's rules,[11] and other necessary representations; it will also include the agreed-to decision and order (and order to hold separate or maintain assets, if required) and a draft of the proposed complaint. If a corporate respondent, the Commission requires the president or chief executive officer to sign the agreement containing consent order on behalf of the corporation. After the negotiations are complete and the agreement containing consent order executed, the staff will complete its recommendation memorandum to the Commission and forward the entire package to management of the Bureau of Competition and the Bureau of Economics for review.

After approval by management, the package will then be forwarded to the Commission for its review. The Commission generally reserves two weeks to decide the matter, although it may require additional time depending on the case's complexity or other circumstances, and it can sometimes act more quickly if circumstances require. The Commission may request additional information from the staff; if responses from the parties are necessary, the staff will inform the parties. The Commission decides the matter by majority vote. If the Commission votes to accept the proposal, the Commission will issue a press release and place the documents on the public record for a thirty-day comment period. The documents include the agreement containing consent order(s), the draft complaint, the proposed decision and order, the order to hold separate or maintain assets if required, and the analysis to aid public comment. If the Commission does not accept the proposal, it may instruct the staff to obtain additional relief, it may vote to challenge the transaction, or it may take no action and close the investigation.

If the consent package includes an order to hold separate or maintain assets that the Commission accepts, those orders will be served immediately on the parties, along with the complaint, and they will become final upon service.[12] Acceptance of the proposed consent does

[11] Rule 2.32 of the Commission's Rules of Practice, 16 C.F.R. § 2.32.

[12] Rule 2.34(b) of the Commission's Rules of Practice, 16 C.F.R. § 2.34(b).

not constitute final approval of the decision and order, "but it serves as the basis for further actions leading to final disposition of the matter."[13]

The parties may generally consummate the underlying merger when the Commission accepts the consent agreement and places it on the public record; if subject to the provisions of the Hart-Scott-Rodino Act,[14] early termination is then granted with respect to any then-existing waiting periods. The decision and order, however, will not become final until after expiration of the thirty-day comment period. If the Commission receives no comments, it will usually approve the order quickly; the order will become final upon service on the parties. If the Commission receives comments, the staff will evaluate them and make any appropriate recommendations. In all cases, the Commission may determine to make the order final as first accepted, renegotiate its terms with the parties and take such action as may be appropriate, determine not to make the order final and to close the underlying investigation, or reject settlement and challenge the merger.[15] Once the order becomes final, it may be modified only according to the Commission's Rules of Practice.

The timing requirements for approval of a post-order divestiture are similar to those described above. The parties file an application for approval as required by the Commission's Rules of Practice.[16] Once the parties file their application, it is placed on the public record for a thirty-day comment period. During the comment period, the staff will review the materials filed and evaluate the buyer and the divestiture agreement. It will arrange to interview any third parties from whom information is required. It will not, however, complete its recommendation until the comment period expires and all issues have been resolved. If the Commission receives no comments and the staff has obtained the information it needs and has resolved its issues, the staff will forward its recommendation to its management quickly. If the Commission receives comments, the staff will review them and prepare the appropriate recommendation. Following management review, the recommendations will be forwarded to the Commission. The Commission usually reserves two weeks to make its decision. If the Commission approves the proposed divestiture, it will notify the parties and the buyer, which can then consummate the divestiture. The parties may not consummate the divestiture without the Commission's approval.

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[13] Rule 2.34(a) of the Commission's Rules of Practice, 16 C.F.R. § 2.34(a).

[14] 15 U.S.C. §18a.

[15] The great majority of proposed settlements have become final orders without any modification. We are not aware of any instance in which the Commission has rejected a settlement after the comment period and then brought a challenge.

[16] Rule 2.41(f) of the Commission's Rule of Practice, 16 C.F.R. § 2.41(f).

The staff is willing to work with the parties with respect to their timing needs; however, the parties must raise these needs as early as possible and with as much factual support as possible. The parties must also remember that the staff's objective is to recommend to the Commission a proposed settlement that, if accepted, will maintain or restore competition in the relevant market; it will take into account the timing considerations of the parties to the extent it can do so without compromising those objectives.

Attachment H

2000 WL 739461 (F.T.C.)

Federal Trade Commission (F.T.C.)
(Guide/Report)

THE EVOLVING APPROACH TO MERGER REMEDIES

May 2000

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Probably no single issue currently is receiving as much attention as the topic of relief in merger cases. The question of whether there is a remedy to an anticompetitive merger and what that remedy should be is perhaps the single most intriguing and complex issue faced by the Bureau of Competition of the Federal Trade Commission.

In this article, we seek to provide an overview of how the Bureau of Competition approaches the issue of merger enforcement and remedy. We begin by outlining the important responsibilities of an enforcement agency in fashioning relief. We then discuss how the FTC's approach toward merger remedies has evolved over the past two decades. After that, we describe several cases in which the Bureau of Competition chose not to accept various remedies proposed by parties to a merger. These examples illustrate why certain forms of relief, both structural and non-structural, may be inadequate to resolve certain types of competitive problems. We close with a series of difficult and important questions regarding merger remedies.

the merger wave: new challenges

The merger wave continues at a rapid and breathtaking pace. Each week there are announcements of new mergers, many of which appear to restructure industries or create firms of a size that was unimagined a few years ago. A recent article characterized the merger wave as "a frenzy of merger madness, capping a dramatic wave of global corporate consolidation that has been gaining momentum through much of the decade." [1] In terms of simple numbers, reported Hart-Scott-Rodino transactions have tripled since 1991, from 1,529 to 4,642 in fiscal year 1999. More important, the total value of these mergers has increased eleven-fold during this period, from $169 billion to over $1.9 trillion. The pace in the first six months of fiscal year 2000 promises another record year, with transactions averaging over 20 percent more than last year.

Of course, the vast majority of mergers are procompetitive or competitively neutral. Some mergers bring together firms in complementary relationships, or involve markets that appear to be converging. That is why at both the FTC and the Justice Department only a small handful, less that 3 percent a year receive some type of in-depth investigation. At the FTC, the vast majority (over 60 percent) of these investigations result in enforcement actions. In fiscal year 1999 there were thirty merger enforcement actions. So far in fiscal year 2000 there have been ten enforcement actions.

There are several aspects to the ever-intensifying merger wave that directly impact the issue of merger remedies. The problem of designing and securing effective relief is an increasingly complex and challenging problem. Why is that? The primary reason is that mergers are increasingly strategic in nature. Many of the investigated mergers are motivated by strategic concerns, such as the desire to become dominant in a market. Unlike the mergers of the 1980s, which were frequently motivated primarily by financial concerns, today's mergers are based on a desire to strengthen competitive position. Thus, they are more likely to involve substantial horizontal overlaps, some of which are much larger than those the FTC dealt with in the past. Replacing a competitor with 30 percent of the market is far more daunting than replacing one with a 5 percent market share. Moreover, as each merger occurs the number of remaining firms diminishes and,

in turn, so does the pool of potential acquirers of divested assets. Often, when presented with problems of substantial relief and few remaining competitors, the parties propose putting the FTC in a regulatory position, monitoring remedies short of a clean divestiture.

***2** There are other factors that increase the challenge of remedy. The sheer size of the mergers and the number of markets involved is far greater than the past. Since technology and information are assuming primacy as driving forces in the economy, relief often must include these assets. But crafting relief for intangible assets can create tough challenges. Some transactions are in regulated or newly deregulated industries where the antitrust agencies must determine whether to rely on regulation to protect competition.

Finally, as described below, the Bureau of Competition recently completed an important study of the divestiture process. The Bureau has learned from the success and failure of remedies in the past, and approaches merger remedies with a renewed sense of humility and caution. Unlike other agencies which possess expertise in a specific industry, the FTC has general jurisdiction. We are not experts in any particular industry. Therefore, we have increasingly recognized the need for more thorough examination and care before any particular remedy is adopted. [2]

the range of remedial options -- how do we choose?

There are a variety of approaches to curing anticompetitive mergers. First and foremost, the agencies may simply decide that no remedy, short of blocking the transaction, will fully resolve the competitive concerns. Second, the agencies may decide that the resolution of competitive concerns will require the divestiture of an entire ongoing business and related assets. Third, they might conclude that some form of partial divestiture incorporating various aspects of a business would be acceptable, because it could facilitate the entry or expansion of a replacement competitor. Fourth, a merger might be resolved through contractual arrangements, such as the licensing of intellectual property or perhaps a supply agreement. Fifth, the agencies may decide to use some form of behavioral relief such as a non-discrimination provision. Some mergers can be resolved with a combination of these forms of relief.

The Commission has broad discretion in deciding whether any one of these possible remedies is acceptable in a particular case, so long as the remedy will cure the competitive problem. [3] So how does it decide which approach is most suitable for a given case?

The foremost obligation of antitrust enforcers is to make sure that a merger does not reduce competition to any significant extent. As Justice Brennan recognized over forty years ago in *DuPont:* "The key to the whole question of an antitrust remedy is of course the discovery of measures effective to preserve competition." [4] Consumers should benefit from the same degree of competition after a merger as before a merger. Thus, our first objective is to determine which remedies will effectively and fully preserve competition.

A second objective is to select a remedy that will preserve competition with as much certainty as possible. The risk of inadequate relief, or the burden of untimely relief, should not be borne by consumers.

***3** The third objective is to preserve the efficiency-enhancing potential of a merger, to the extent that is possible without compromising our obligation to preserve competition. If there are two remedial options, both equally effective (based on experience) and both equally likely to achieve their objective, but with different implications for preserving cognizable merger efficiencies, we should choose the one that is more likely to preserve efficiencies. They must be effective *based on experience*--theory alone may not be enough for the risk of a failed remedy to be shifted to consumers.

Our approach to remedies evolves, as does our approach to merger enforcement generally. We learn from each case what works and what doesn't work. Our past actions provide guidance, but there are no absolute rules. We evaluate remedies

based on the facts in each individual case. We also go back and evaluate our remedy process, as described below, to see if expectations are borne out and the remedies are effective.

We should also keep in mind what our objectives do not include. The FTC is not a market regulator. Apart from enforcing the prohibitions that are contained in the antitrust laws, our job is not to regulate or prescribe the market behavior of firms. That is a function of the competitive process. Nor are we industrial planners. Our obligation is straightforward and simple--make sure that the post-merger world is every bit as competitive as the one that existed before the merger. Of course, nothing in the real world is ever that simple. Tradeoffs and judgment calls need to be made.

is there a preferred merger remedy?

One way to assess the FTC's approach to merger remedies is to determine whether there is some benchmark or preferred remedy it should be trying to achieve. Generally, there is. In most cases divestiture is the preferred remedy. As Justice Brennan stated in *DuPont*: "Divestiture has been called the most important of antitrust remedies. It is simple, relatively easy to administer, and sure. It should be in the forefront of a court's mind when a violation of § 7 has been found." [5] Many courts have followed that guidance for the past several decades, as have the enforcement agencies.

The facts in *DuPont* illustrate why divestiture is preferable. The parties had proposed various forms of behavioral relief (e.g., barring DuPont from influencing the selection of GM officers or directors and prohibiting preferential trade relationships) in favor of divestiture. The Court found that enforcing such a decree likely would be cumbersome and time-consuming, that framing an injunction to address all forms of anticompetitive conduct would be impossible, and that policing the order "would probably involve the courts and the Government in regulation of private business affairs more deeply than administration of a simple order of divestiture." [6]

Of course, saying that divestiture is the preferred remedy somewhat begs the question: Divestiture of what? The entire acquired entity? A complete, ongoing business? A partial divestiture of assets that might provide the basis for starting a business? In markets where technology is a key to success, is a divestiture of "soft" assets such as intellectual property sufficient, or is a broader asset package, even an ongoing business, needed to ensure successful entry? The Supreme Court's characterization of divestiture in *DuPont* as "simple, relatively easy to administer, and sure" applies most clearly to a clean separation of two ongoing businesses--essentially, undoing the merger or acquisition. That is what was ordered in *DuPont*, where the Court stated that "complete divestiture is peculiarly appropriate in cases of stock acquisitions which violate § 7." [7] *DuPont* was a post-acquisition case, of course. Today, thanks to Hart-Scott-Rodino, we more typically look at the remedy issue in the premerger context, and the lesson of *DuPont* would be to prevent the two businesses from combining in the first place.

***4** One issue that arises where the divested facility produces several products is whether divestiture of the entire facility is necessary. Occasionally, parties argue that they should be able to retain those portions of a facility that produce products which do not raise competitive concerns. This argument will not carry the day where those other portions of the facility are necessary to ensure the viability of the divested entity. For example, in *Olin Corporation*, which involved a chemical plant that manufactured certain swimming pool sanitizers, the respondents sought to exclude from the Commission's order part of the plant that manufactured cyanuric acid. The Commission rejected that request because there was no evidence that the part of the plant that manufactured the swimming pool sanitizers could operate independently. Thus, the Commission concluded that divestiture of the entire facility was necessary "to give its acquirer a real chance at competitive success." [8]

The teaching of *DuPont* and *Olin* is that it is clearly within the Commission's power to require divestiture of a greater set of assets than those which participate in the overlap markets in order to effectively replace competition. Often the buyers of the divested assets will need other ancillary assets in order to effectively restore competition. Sometimes without these

ancillary assets the buyer will not be able to replicate the economies of scale or scope of the firm that has been acquired. In other cases, these additional assets will be necessary to give the buyer both the incentive and ability to fully restore competition.

This principle was applied in both of the recent oil mega-mergers, Exxon/Mobil and BP/ARCO. In Exxon/Mobil, there was a direct overlap in California between the two firms in oil refining, but a far less significant overlap downstream (in gas stations). The FTC required divestiture not only of Exxon's refinery, but also of all of Exxon's downstream assets. The Commission required a "clean sweep" of all assets in order to assure the buyer had the same level of economies of scale and scope that Exxon possessed prior to the merger. A vertically integrated refinery would be a far more significant competitive force.

Similarly, in BP/ARCO, there were significant competitive overlaps in the production, sale, and delivery of Alaska North Slope crude oil. The parties entered into a separate agreement with the State of Alaska which would have combined various assets of BP and ARCO. This mix-and-match approach at best only partially cured the direct overlaps, but failed to create a firm with the efficiencies possessed by ARCO. The Commission rejected the proposed consent and sought to enjoin the merger. Ultimately, after extensive negotiations the parties agreed to the divestiture of all of ARCO's complete, free-standing Alaska businesses, including oil and gas interests, tankers, pipeline interests, exploration data, and selected long-term supply agreements. Again, a clean sweep approach was necessary to provide the acquirer of the assets (Phillips) with ability to fully restore competition.

***5** When we depart from the kind of divestiture remedy the Court spoke about in *DuPont*, it is not always clear that divestiture is "simple, relatively easy to administer, and sure"--at least not retrospectively. That is the lesson of the Bureau's divestiture study. But first let us explain how our policy to merger remedies has evolved.

the government's approach to merger remedies over the years

The government's position towards remedy has evolved over the past several decades. Prior to enactment of Hart-Scott-Rodino, the government typically was faced with seeking to remedy a merger several years after it had been consummated. That was a daunting, almost always hopeless, task because the assets had been intermingled and the acquired firm typically dissolved. Usually there was relatively little left to divest, at least little that resembled the acquired entity. Sometimes the agencies would require the merged firm to scrabble together various plants and other assets into something that vaguely resembled the acquired entity before the merger. Most often these divestitures were nothing more than "pyrrhic victories." [9] *DuPont* was an easier case, since it involved a partial stock acquisition and it was not difficult (apart from tax considerations) to spin off the acquired stock.

With the enactment of the Hart-Scott-Rodino Act and its mandatory waiting period before merger consummation, the agencies became able to enjoin a merger before the assets were scrambled. That placed the agencies and the merging firms on equal footing in terms of finding the appropriate resolution to a problematic merger.

The agencies' initial response to Hart-Scott-Rodino was to almost always seek a preliminary injunction. Sometimes the agencies would seek to enjoin the entire merger even when the amount of overlap was relatively small. That policy began to change in the early 1980s, when the agencies were more willing to allow firms to restructure transactions to avoid competitive problems ("fix-it-first"), or to engage in partial divestitures. In some cases, such as the Alcan/Arco joint venture, or the GM/Toyota joint venture, the agencies were even willing to resolve their concerns solely on certain forms of behavioral relief. [10]

During the mid 1980s, there was a shift back toward litigation and away from settlement, at least at the FTC. From 1986 to 1988, for example, of the thirty merger enforcement actions authorized by the Commission, only seven, or 23 percent, were settled prior to litigation with some form of divestiture or behavioral relief. In the vast majority of enforcement

actions the Commission chose to litigate. Typically that resulted in the parties' dropping the transaction. In the cases that were litigated, the FTC often prevailed and the merger was preliminarily enjoined.

During the late 1980s and early 1990s, the FTC began to take a more flexible view of merger relief. While divestiture of a plant or facility was typically the most common remedy, the Commission increasingly considered a variety of alternative solutions to competitive problems. In a number of cases, the Commission was willing to accept licensing arrangements (which might eventually result in partial structural relief), supply agreements, and certain forms of behavioral relief, such as firewalls and nondiscrimination provisions. A number of these cases involved high-technology markets in which licensing was used to convey intellectual property rights to bring a new entrant into the market. We had come a long way from *DuPont*. Not surprisingly, this broader remedy policy resulted in a greater number of settlements and far fewer litigated cases.

***6** When Bill Baer and George Cary arrived at the Bureau of Competition in 1995, they wanted to take a fresh look at the question of merger remedies. There had been a perception, both in the private bar and within the FTC staff, that some merger relief orders had not worked as well as expected. As part of the Baer-Cary initiative, the Bureau of Competition and Bureau of Economics staffs were directed to study what happened as a result of a number of merger consent orders issued from 1990 through 1994.

the ftc divestiture study

Issued in August 1999, the study ("Divestiture Report") has both reinforced some of our approaches to remedies and caused us to rethink others.[11] The Divestiture Report provided new insight into the divestiture process, and understanding its lessons is vital for all merger lawyers. It found that in the majority of cases the acquirer of the divested assets was able to enter the market. An important detail, however, was that the likelihood of successful entry was much higher if an ongoing business was divested. A divestiture of selected assets to facilitate entry was significantly more problematic. The Divestiture Report also observed that a number of factors can complicate the divestiture process and lessen the likelihood of success, unless they are adequately dealt with. For example, respondents have incentives to offer a divestiture package that is too narrow, to propose a weak buyer, and to engage in strategic behavior to impede the success of the buyer; and even if they don't affirmatively try to impede the buyer, respondents normally don't have incentives to assist or cooperate with the buyer during the transition phase.

One particular problem identified by the Divestiture Report was continuing relationships between the seller and buyer of divested assets after divestiture, such as a supply arrangement or technical assistance requirement, which may increase the buyer's vulnerability to the seller's behavior. Of the nineteen divestitures where a seller had a continuing relationship with the buyer of the assets, in six cases the ongoing relationship was so detrimental that the buyer could not operate effectively, and in seven cases the ongoing relationship was competitively harmful. Yet those ongoing relationships may be critical to the buyer's success, particularly if less than a separate complete business is divested.

Another significant finding was that buyers sometimes--too often, in fact-- have a serious informational disadvantage. They may not fully know what assets they need to succeed in the business, or whether the assets offered by respondents are up to the task. That finding came as somewhat of a surprise, since it was generally assumed that purchasers of divested assets would be informed buyers who could protect their own interests. That assumption isn't necessarily valid when much of the key information is principally held by the respondent. Unfortunately, we face the same informational disadvantage. While we try to learn as much as we can about the industries and businesses we investigate, we don't presume to know how to operate the business. The Divestiture Report also revealed that buyers may not have the same objectives as the Commission, so the remedial purposes of the order may not be met.

***7** Finally, divestitures that include technology transfers present serious difficulties and challenges. They bring together many of the problems already mentioned--respondent's incentive to limit the asset package, the buyer's informational

disadvantage, the buyer's reliance on the respondent for technical assistance and transfer of know-how, and the respondent's incentives to engage in strategic behavior. Another difficulty, because technology transfers often involve the divestiture of less than an ongoing business, is that the buyer may be at the bottom of the learning curve and thus starts with a disadvantage.

So it became increasingly evident from a relative early stage of that study that we needed to rethink and modify our approach to merger remedies. If fact, the Bureau of Competition began to incorporate many of those lessons into its remedy approach while the study was still being completed. In 1996, the Bureau adopted several reforms based on initial findings of the Divestiture Report:

• More frequent use of up-front buyers;

• Shorter divestiture periods, to minimize the risk of interim harm and dissipation of asset value. The divestiture periods were shortened from twelve months to typically three or four months;

• Increased use of full or structural relief. The closer the divestiture package is to an ongoing business--better yet, if it is an ongoing business-- the greater the likelihood that competition will in fact be restored;

• The use of interim trustees, especially where technology transfers are involved.

The value of up-front buyers and short divestiture periods is illustrated by the Schnucks supermarket case, where the consent order did not require an up-front buyer. Schnucks Markets acquired its chief competitor in St. Louis, Missouri, and the Commission required the divestiture of twenty-four stores within twelve months. But before the stores could be acquired Schnucks failed to maintain them properly, resulting in a relatively unattractive set of assets. [12] The Commission filed a civil penalty action, and Schnucks agreed to pay a $3 million civil penalty and divest two additional stores. [13] While that was a substantial penalty, we cannot rely on civil penalty actions alone to ensure that respondents do it right. Obviously, the prospect of substantial civil penalties did not deter Schnucks from engaging in strategic behavior, and it may simply have been an investment or cost of doing business to preserve market power. Moreover, by the time we can bring a civil penalty action, the damage to the market will have already been done. So we have to make sure up front that the remedy really will work.

Up-front buyers are probably the most vital tool in assuring a successful divestiture. It enables us to better determine (a) whether a proposed package of assets that is not a stand-alone business is viable in the real world, (b) whether there is a buyer for the proposed divestiture assets, and (c) the likelihood that the proposed buyer will restore the competition that otherwise would be lost through the merger. This last factor is receiving careful scrutiny. The FTC seeks to assure not only that the buyer will successfully enter, but also that it can restore competition fully.

***8** Up-front buyers are now used in over 60 percent of the cases in which there is some form of non-behavioral relief. There might have been an impression that the up-front buyer policy is reserved for cases where assets may waste quickly, such as supermarkets. That is not the case. The Commission has used up-front buyers in pharmaceutical cases, in other health care products, industrial products such as refractories, acrylic polymers, lead smelters, industrial power sources, and consumer products. (See the appendix for a representative list of cases and markets.) In many cases where the parties have identified an up-front buyer at the beginning of the investigation, the Commission has been able to resolve its concerns and enter a proposed consent order in less than sixty days after the investigation began. The message is straightforward: parties must consider and be able to identify an up-front buyer as part of the merger planning process.

recent application of remedy reforms

The application of remedy reforms over the past few years, especially the greater focus on effective structural relief, has led to claims that the FTC has raised the bar for resolving merger concerns. That characterization is not entirely accurate. We have always insisted on the kind and quantum of relief necessary to protect competition. We evaluate what it takes to preserve or restore competition, based on our experience and the evidence. But as our experience with divestitures grows, so does our understanding of what it takes to successfully remedy the potential anticompetitive effects of a proposed merger. We are more willing today to consider non-litigated resolutions to merger concerns, but that is no more a lowering of the bar than the recent reconsideration of merger remedies has resulted in a raising of the bar.

In reality, the vast number of mergers raising competitive problems are resolved through consent orders that include a wide variety of approaches to relief. In most cases, structural relief involving divestiture of an ongoing business is required. In many cases, a partial divestiture is appropriate, often because it is clear that the acquiring firm has sufficient assets to replicate the efficiencies of the acquired firm and fully restore competition. In other cases, even more refined relief, such as behavioral relief or licensing arrangements, may be used. Again, cases of more limited relief will require a careful assessment of whether the relief can fully restore competition.

One illustration of the Commission's flexible approach is its evaluation of the merger between Ciba and Sandoz. Although divestiture is the "preferred remedy," that does not mean it will be invariably used, especially where it might diminish procompetitive aspects of a merger. This can be a tough issue, particularly in high-technology markets where research and development rights and scientists work together on a number of projects. In the Ciba/Sandoz merger, the Commission chose licensing over divestiture because of the problems of separating ongoing R&D projects. [14] Commissioner Azcuenaga dissented as to the licensing aspect of this order, noting that divestiture would cure the anticompetitive problem in a "simple, complete, and easily reviewable" manner. While divestiture is certainly an easier remedy to impose and monitor, it may not always be the most effective way of restoring competition. Because licensing is more flexible and can more easily be tailored to unusual fact situations, it may be the preferred remedy in innovation cases where divestiture could interrupt potentially successful research efforts. In this case, the majority of the Commission determined that the gene therapy research efforts, which contained a number of joint efforts with third parties, would be too difficult to disentangle from the merging firms, and would thus "not only ... hamper efficiency but also could be less effective in restoring competition if it led to coordinated interaction or left the divested business at the mercy of the merged firm." [15]

***9** Another consideration to keep in mind is that many mergers are taking place in a changing market environment. As noted earlier, many mergers we review are large and complex, they involve strategic combinations of businesses, and they may involve new forms of competition. Complex cases are difficult to resolve, and we must be careful that the remedy we accept really will do the job. Not surprisingly, parties are presenting the Commission with proposed orders that are increasingly complex and regulatory. As Chairman Pitofsky has observed, our recent experience is that parties are often presenting "proposals that are so extensive and complex that it is impossible to predict with any confidence that competition will be restored and consumer welfare protected." [16]

That said, our approach to merger remedies may affect the resolution of particular cases. Compared to the practice in the late 1980s and early 1990s, we are somewhat more careful in the use of non-structural and partial structural relief. During the mid and later 1990s, the Commission was faced with a number of cases in which the parties proposed relief short of divestiture that was simply insufficient to remedy the competitive problem. The nature of the competitive problem has a lot to do with whether there is an acceptable fix. Some of the mergers during the last few years presented new competitive issues that were not easy to fix, short of blocking the merger. Others posed particularly complex issues of relief. Here are some examples of these types of situations.

partial divestiture of the overlapping assets

Often the competitive problems from a merger can be resolved through the divestiture of some assets in overlapping markets. This is frequently the approach in retail markets where we require divestiture of all the stores in markets where there are overlaps and significant levels of concentration. For example, in Exxon/Mobil we required the divestiture of all gasoline stations from Virginia to Maine to ensure that there was no increase in concentration in northeastern gasoline retail markets. This "clean sweep" approach resolved the competitive concerns in those markets.

Drug wholesalers

Sometimes, such an approach will not be sufficient, especially where competition is not solely local. For example, in the drug wholesalers cases, *FTC v. Cardinal Health, Inc.* and *FTC v. McKesson Corp.*,[17] the FTC challenged two mergers of the four largest drug wholesalers. As anyone who followed the trial knows, the court explored every opportunity with the parties to find a settlement that could permit the proposed mergers to go forward. The parties suggested that a divestiture of several drug wholesale distribution centers in the Northwest, where there were clear overlaps, would be sufficient to restore competition. As the FTC told the court, that divestiture would have been severely inadequate because, in the FTC's view, customers demanded firms that could provide national service and divestiture of a handful of distribution centers could not compensate for the loss of two national competitors that would have resulted from the proposed transactions. The court found that regional firms did not offer the same level of competitive restraint as the national firms. Thus, the proposed settlement was appropriately rejected and the court issued a preliminary injunction.

Rite Aid/Revco

***10** Rite Aid's proposed 1995 acquisition of Revco would have resulted in a single pharmacy chain of over 5,000 stores. In thirty MSAs in twelve Midwestern states, the firm would have had over a 35 percent market share, and in most of these markets it would have been more than twice as large as its closet rival. Rite Aid proposed to divest some stores where there was an immediate geographic overlap. Had we been concerned only about those retail overlaps, we might have been able to reach a satisfactory resolution. In previous cases where the relevant market was viewed as direct retail sales to consumers, the Commission had agreed to accept divestitures in towns where the firms had immediate overlaps.

Although that remedy might have been satisfactory in the past it was not in this case because the markets had evolved. The competitive problem was not simply the elimination of competition in direct retail sales to consumers but also in a parallel market, the provision of network pharmacy services to pharmaceutical benefit managers ("PBMs") and other managed care providers. These firms use networks of pharmacies to deliver pharmaceutical benefits to consumers. From the perspective of these PBMs it was necessary to form a network of pharmacies in geographically diverse locations. Rite Aid and Revco were direct competitors in providing PBMs with a suitable network, and they often competed to be the "anchor" of the managed care network.

The nature of the competitive concern complicated the remedy issue; it was more difficult to make the divestitures necessary to replace a network than it was to eliminate some local overlaps through the divestiture of a few stores. The proposed divestitures offered by Rite Aid would have eliminated the direct local overlaps, but were simply insufficient for an acquirer of those assets to fully restore competition in this managed care market. Ultimately, the Commission refused the proposed divestiture and authorized staff to seek an injunction. Rite Aid dropped the acquisition, and Revco was acquired by CVS, which currently competes aggressively with Rite Aid in the markets where competitive concerns were raised.

Mediq/UHS

Mediq and UHS are the two largest firms in the country that rent durable, movable medical equipment--such as respiratory devices, infusion devices, and monitoring devices--to hospitals on an "as-needed," short-term basis. Much of the contracting for durable medical equipment is done on a national basis, and hospital chains and group purchasing

arrangements require a national network for this equipment. Mediq Inc.'s proposed acquisition of Universal Hospital Services ("UHS") in 1997 would have given Mediq a near monopoly in the national market, and a near monopoly in numerous local geographic markets as well. Competitive concerns were heightened because earlier acquisitions by Mediq had led to higher prices.

In an attempt to forestall litigation, the parties presented a purported "fix-it-first" solution involving Medical Specialties, a firm in the business of renting infusion pumps to home healthcare customers. The parties proposed to sell rental equipment to Medical Specialties and provide it with an option to lease several facilities. Our assessment--and that of customers--was that Medical Specialties would not have been an adequate replacement for UHS. The new firm would have had a substantially smaller inventory than UHS, which itself was considerably smaller than Mediq. Customers--particularly national ones, like hospital buying groups--testified that Medical Specialties would not have the amount and breadth of equipment necessary to replace UHS. Moreover, much of the business that Medical Specialties claimed it needed in order to compete successfully in the hospital rental market was under long-term exclusive contracts with UHS and MEDIQ.

***11** The Commission found the proposed relief inadequate and authorized the staff to seek a preliminary injunction. [18] The defendants attempted to short-circuit the litigation by asking Judge Sporkin to approve the proposed settlement, but the judge was unwilling to second-guess the FTC. On the eve of the preliminary injunction hearing, the parties dropped the proposed acquisition. [19]

behavioral relief

Of course, behavioral relief is typically a less satisfactory solution than structural relief, since it often involves some sort of ongoing regulation. But that does not mean that it is never used. In appropriate cases, the Commission has used behavioral relief such as firewalls and nondiscrimination provisions, particularly to remedy vertical concerns. For example, in the Time Warner/ Turner transaction, the Commission approved the merger based on a wide variety of behavioral rules. In other cases, a behavioral approach may be inadequate. [20]

Questar/Kern River

The proposed Questar/Kern River transaction in 1995 involved a situation in which a monopolist sought to acquire a 50 percent ownership interest in a firm that was on the verge of entering its market. Questar was the only transporter of natural gas to the Salt Lake City area, and Kern River Transmission Corp. had a gas pipeline that ran past Salt Lake to points further west. Kern River, which was jointly owned by Tenneco and Williams, planned to build a lateral pipeline to serve Salt Lake customers as well. The focus of the case was on transportation service to industrial customers, which could bypass the local utility and purchase gas directly from suppliers and pay separately to have it transported to their facility. Kern River had begun to solicit customers and was already having an effect on the market. Because of Kern River's marketing efforts, Questar sought and obtained a tariff to lower its rates to certain industrial customers, to persuade them not to switch to Kern River. Questar then sought to acquire Tenneco's 50 percent interest in Kern River, with the other 50 percent to be retained by the Williams Companies. The transaction obviously raised concerns because it would eliminate the current price effect of Kern River's presence in the market and prevent future competition and the erosion of Questar's monopoly.

Questar proposed what was in effect a competitive rules joint venture in which it would be permitted to have a 50 percent interest in the Kern River pipeline but Williams would have a large degree of independence on its decisions where to enter. There were several problems with the proposal. First, the agreement undermined Questar's incentives to discount on its own pipeline since it had a 50 percent interest in its only competitor. Questar's 50 percent interest in Kern River would have diminished its incentives to engage in unfettered competition with Kern River; even if Questar lost a bid, it would still

have a big share of the business through its interest in Kern River, so it was less likely to bid aggressively. Second, Kern River shipped all the way to California, and the remedy would not diminish Questar's incentives or ability to direct Kern River's capacity away from Salt Lake City. Third, although the "competitive rules" had a "capital forcing" mechanism in which Williams theoretically could have secured Questar's commitment for capital expansion projects, it was unclear this mechanism could work. The Bureau rejected the remedy as inadequate and too regulatory. The Commission authorized a preliminary injunction action, and Questar abandoned the transaction. [21] Ultimately, Tenneco sold its share of the pipeline to Williams, which competes aggressively with Questar today.

Barnes & Noble/Ingram

***12** Barnes & Noble's 1999 attempt to buy Ingram Book Group raised a different set of issues. Barnes and Noble is the largest book retailer, and Ingram is the largest wholesaler of books in the United States. Thus, it was largely a vertical transaction. [22]

The transaction raised concerns principally under the "raising rivals cost" theory. The Bureau was concerned that the acquisition of an important upstream supplier such as Ingram might enable Barnes & Noble to raise the costs of its bookselling rivals, such as independent book retailers or Internet retailers, by foreclosing access to Ingram's books and services or denying access on competitive terms. The rivals would be less able to compete, and Barnes & Noble could increase its profits at the retail level or prevent its profits from being eroded as a result of competition from new business forms such as Internet retailing. We were concerned that the combined Barnes & Noble/Ingram could do that in a number of ways, including strategies short of an outright refusal to sell to the non-Barnes & Noble bookstores. For example, Barnes & Noble/Ingram could choose to (1) sell to non-Barnes & Noble bookstores at higher prices, (2) slow down book shipments to rivals, (3) restrict access to hot titles, (4) restrict access to Ingram's extended inventory or back list, or (5) price services higher or discontinue or reduce these services.

The parties did not present a complete settlement proposal, which makes a discussion of remedies hypothetical. There were reasons to be skeptical that the deal could have been fixed. The nature of the competitive problem would have made it very difficult to address from a remedy standpoint. Structural relief would seem to require the creation of a substitute for Ingram, but that didn't seem to be a realistic possibility. The only remedy that might have addressed the situation is a set of behavioral rules--essentially, a set of non-discrimination or "fair dealing" provisions. But those kinds of rules can be problematic. They are susceptible to evasion and difficult to monitor, particularly in a transactional setting where discrimination could be exercised in subtle ways on several different variables. While the Commission has on occasion accepted some forms of behavioral relief in mergers, those approaches may not have worked in this context. Recall the Supreme Court's admonition in *DuPont* that "the public interest should not in this case be required to depend upon the often cumbersome and time-consuming injunctive remedy" to enforce behavioral rules. [23]

Another concern about the merger was that Barnes & Noble could use Ingram to obtain competitively sensitive information about its bookselling rivals. Independent booksellers raised concerns about two types of information they provide to Ingram in the course of their supplier-customer relationship: the financial information they supply to obtain credit, and the titles and quantities of books they purchase from Ingram. Barnes & Noble might use this information for such purposes as targeting promising store locations, identifying competitors' weaknesses, and reaping the fruits of others' marketing efforts. Whether or not the fears were realistic, the fact that they were out there could have had its own dampening effect on competition. For example, independents may have less incentive to develop a market for special interest books if they believe Barnes & Noble would simply free-ride on their efforts, or might have returned their usage of Ingram and been forced to rely on other higher cost book wholesalers.

***13** This concern has been addressed in other cases by obtaining a remedy commonly called a "firewall." Could a firewall work effectively in this case? Most of the cases in which a firewall has been used are situations, such as defense

mergers, where there is a regulator which can identify violations of the firewall.[24] Even if a firewall could address the information access problem, there was the discriminatory access problem discussed earlier. In the end, we did not have to decide these remedy issues--there was no proposal on the table--but it would have been difficult to find a satisfactory solution. The parties chose to abandon the transaction following press reports that Bureau staff would recommend a preliminary injunction.[25]

divestiture of an ongoing business

Divestiture of an entire business will usually resolve the FTC's competitive concerns, since there will be some evidence that the business unit has operated effectively and efficiently. But that will not always be the case, as illustrated by the review of the Ahold/Pathmark merger.

Ahold/Pathmark

Last year, Ahold, the fourth largest supermarket in the United States with over 1,000 supermarkets in fifteen states, attempted to acquire Pathmark stores, a regional supermarket chain of 135 stores in metropolitan New York, Philadelphia, and New Jersey. The acquisition was valued at approximately $1.75 billion. Unlike most of the supermarket mergers the Commission had reviewed over the past several years, this deal involved a much more dramatic and clear geographic overlap. Previous supermarket mergers were resolved through consent agreements primarily because the acquisitions enabled the acquiring firm to gain entry into new markets that did not pose competitive problems, and the limited overlap areas that in fact did present competitive problems were resolved through divestitures. The competitive concerns raised by the Ahold/Pathmark transaction were much more serious. Ahold was acquiring a supermarket chain that competed head-to-head with Edwards, a chain that Ahold already operated in the same geographic areas. This was not a geographic extension merger, but rather the elimination of a direct competitor.

The parties' initial proposal of relatively modest divestitures of individual stores in various overlap markets did not meet the standards of recent consent orders in the industry. Based on our concerns from prior supermarket mergers, we typically require divestiture of a single chain's stores to an up-front buyer to resolve competitive concerns. In almost all cases, we require a “zero delta” approach. That is, we require divestiture of a sufficient number of stores to maintain competition at the pre-merger level.

The parties eventually proposed to divest all of the Edwards stores. While that would eliminate the competitive overlap at least nominally--i.e., zero delta--a serious question remained whether a suitable purchaser existed that would fully restore competition. Edwards was a strong rival to Pathmark to no small degree because it was funded by a much larger parent organization, Ahold. Many efficiencies of being part of Ahold would have been lost if Edwards was divested to a smaller rival. Our assessment was that divesting the entire Edwards chain still might not be sufficient to adequately restore competition because another firm might not be able to provide the level of support necessary to keep this same level of rivalry.

***14** We insisted on a high probability of success in the Ahold/Pathmark matter because there is some sense that many of the divestitures in our supermarket merger orders do not succeed. In retail markets, a chain's assets consist of far more than just the individual stores and the fixtures inside (assets that clearly can be divested). Customer and supplier relationships are critical assets that cannot be conveyed in a divestiture. Thus, even where large numbers of stores have been divested, if the stores are not an entire ongoing business, frequently they do not succeed.

mix-and-match approach

Sometimes parties will offer to divest a combination of assets selected from both of the merging firms. This mix-and-match approach requires a more careful review by the agencies than the divestiture of a single firm's business, because

the agencies must determine whether the mixed assets can function effectively as an ongoing business. The agencies also must determine whether the mixed assets will be capable of producing comparable efficiencies and economies of scale and scope as the acquired firm. Merging parties must recognize that this type of evaluation will delay the merger review process, and take that into account in their merger planning. The Commission has accepted a mix-and-match approach in some cases, such as the Albertsons/American Stores merger, where the divestiture included stores from both firms. [26] In other cases, such as BP/ARCO, a mix-and-match approach was rejected because the proposed divestiture could not have replicated the competitive significance of the acquired firm.

Federal-Mogul/T&N plc

The merger between Federal-Mogul and T&N plc [27] is an example of why a mix-and-match approach may not work. Both firms were leading producers of a wide range of automotive parts in Europe and the United States, and the merged firm would have accounted for 80 percent of sales in the worldwide market for thin-wall bearings used in car, truck, and heavy equipment engines. The merger was investigated by multiple jurisdictions. Rather than offering to divest an ongoing business unit, the parties initially proposed to divest a package of assets from both Federal-Mogul and T&N, in both Europe and the United States; they even presented an up-front buyer. Upon close examination, this offer, while substantial, was found wanting. The divestiture package included some of the parties' least efficient production facilities. More important, they offered insufficient research and development assets. We concluded that the up-front buyer's ability to maintain competition in the United States with these assets was questionable at best. We ultimately obtained the divestiture of T&N's entire thin-wall bearings business, which consisted of the assets and plants that T&N used to make thin-wall bearings, as well as the assets, including intellectual property, that T&N used to develop and design new bearings to meet the bearings needs of engines that OEMs will develop in the future. The assets were ultimately divested to the Dana Corporation.

ongoing relationships between merged firm and acquirer of the divested assets

***15** Many of our consents require ongoing relationships between the merged firm and the acquirer of the divested assets. Often ongoing relationships will be required, especially in pharmaceutical cases, where the acquirer has to undertake a regulatory approval process and may need an interim source of supply during that period. Although the Divestiture Report observes that these relationships can be problematic, often they are successful. The Abbott/Alza merger illustrates where ongoing relationships may raise concerns.

Abbott/ALZA

Many of the FTC's recent enforcement actions have involved pharmaceutical markets. Last fall, it reviewed the proposed acquisition of ALZA Corporation by Abbott Laboratories. The investigation revealed that the proposed merger would lead to serious anticompetitive effects in the market for palliative hormone drug treatment for advanced prostate cancer. At the time of the proposed merger, Abbott already had an 80 percent market share in a two-firm market. ALZA was not yet in the market but was poised to enter within a relatively short period of time, and the investigation confirmed that ALZA would provide vigorous competition when it entered. ALZA was planning to enter with an innovative delivery mechanism providing longer drug deliveries for patients.

Over the course of the investigation the parties presented several settlement proposals that involved selling various assets related to Viadur, ALZA's product, which was still in development, to another pharmaceutical company. The staff had serious concerns about competition being restored based on this arrangement for several reasons. First, the completion and commercial scale-up of Viadur would depend upon the research and development know-how associated with individuals from throughout ALZA's organization for several years as Viadur and its manufacturing processes are optimized and made most efficient. Ascertaining the necessary ALZA individuals was impossible before the product or process variables are known. Second, the acquiring party was a pharmaceutical company that was not in the business

of developing innovative drug delivery systems the way ALZA is; the potential acquirer had experience transferring technology associated with ongoing pharmaceutical businesses, not those still in development. Third, the acquirer would have taken several years to be approved by the FDA at its own facility after trying to replicate facilities and processes of Abbott/ALZA's that are not yet even in place, and would have been dependent upon Abbott/ALZA's supplying the product for several years after it completed the development and commercial scale-up process. With Abbott controlling 80 percent of the market, and having such a critical role in the success of any buyer of the assets, it was uncertain whether any divestiture could effectively work. In addition, the length of the supply contract, which would have had to be more than two years, posed significant competitive concerns.

***16** An alternative upon which the acquisition might have been approved would have been for Abbott to divest its own cancer product. That could have resulted in something that resembled the pre-acquisition state of the market. Because this was not a viable option for Abbott, the transaction was terminated by the parties.

potential competition mergers

Increasingly, the elimination of potential competition is a concern in mergers, especially in telecommunications, energy, and grocery markets. In many cases, where the scope of potential competition is relatively modest, divestiture may be sufficient relief. For example, competitive concerns in several supermarket mergers have been resolved through the divestiture of various land sites that were purchased in order to enter new markets. In other cases, where the scope of potential competition is far more substantial, divestiture may be inadequate as illustrated by the Staples/Office Depot merger.

Staples/Office Depot

Staples' proposed acquisition of Office Depot in 1997 involved the two largest office supply superstore chains in the United States. In many geographic markets, the merger would have resulted in a monopoly, and at most there was only one other superstore competitor, Office Max. The parties sharply disputed that office supply superstores were a relevant market, but suffice it to say that the district court ultimately agreed with us. As with the Rite Aid/Revco merger, the parties offered to divest stores in local markets where they had direct overlaps; they proposed a divestiture of sixty-three stores, primarily in merger to monopoly markets.

There were two problems with the proposed solution. First, it did not address a significant potential competition issue. Both Staples and Office Depot had been rapidly expanding into each others' geographic markets where they did not already have a store. The evidence in the case clearly showed that prices were lower in markets where there were two competing superstores, rather than a single superstore, and lower still in markets where there were three superstore competitors. The merger would have eliminated the likelihood of lower prices as Staples and Office Depot continued to invade the other's backyard, and the proposed divestitures did nothing to cure that.

The second problem with the parties' proposed remedy was that the most likely purchaser of the divested stores probably was Office Max, which was already in the market and could provide a basis for achieving reasonable scale economies. But a divestiture to Office Max would result in a duopoly in the overlap markets. It was clearly better to have three competitors than two. Consequently, the Commission rejected the proposed divestitures [28] and sought a preliminary injunction, which the court granted. [29]

The enforcement action has clearly led to substantial benefits to consumers. Both Staples and Office Depot have expanded at a rapid rate, and within three years after the merger was abandoned each firm has surpassed the size that the merged Staples/Office Depot would have achieved. Both firms are competing aggressively, invading each other's markets and driving prices down to levels not even seen before the merger was proposed. Both firms compete aggressively on the Internet, where Office Depot is the clear leader.

coordinated interaction

***17** As markets are becoming more concentrated, there are increasing concerns over mergers that may enhance the ability of firms to engage in coordinated interaction. Almost invariably these mergers are resolved through significant divestitures, typically of ongoing businesses. But where there is no acquirer with the incentives and ability to fully restore competition, even a substantial divestiture may be insufficient.

DuPont/ICI

DuPont's proposed acquisition of the Tioxide division of Imperial Chemical Industries in 1998 was structured in a way that sought to avoid antitrust problems, but in our view it fell short of a satisfactory solution. DuPont was the leading supplier both in the United States and the world of titanium dioxide ("TiO2") pigments, which are used in paints, plastics, paper, inks, and other products to provide whiteness, enhance brightness, and improve opacity. ICI was the second-largest supplier in the world, with plants located both in the United States and abroad. The deal was structured so that DuPont would acquire ICI's TiO2 facilities outside North America, and NL Industries, another competitor, would acquire ICI's TiO2 assets in the United States.

The DuPont/ICI transaction therefore avoided a production overlap in North America. But it did not avoid a *competitive* overlap, because ICI also was a significant importer of TiO2 into the United States, especially for use in plastics and architectural coatings. In fact, imports accounted for a majority of ICI's sales to North American customers. ICI was also developing new sulfate-based TiO2 products to compete with DuPont's chloride-based products. Consequently, the acquisition would still give DuPont control over a very substantial percentage of the supply of TiO2 for North American customers. Our concern was that the elimination of an important import competitor like ICI could facilitate or increase the likelihood of coordinated behavior. [30]

DuPont tried to address our concerns by proposing a supplemental basket of other arrangements: It would exclude from its acquisition one of ICI's European plants, which instead would be acquired by NL Industries; DuPont would supply TiO2 products to NL for two years; DuPont would not compete against NL for North American customers by sourcing them from plants acquired from ICI; and DuPont would divest ICI's North American customer lists, current contracts, and customer information. There were several problems with these proposals--the plant that DuPont proposed not to acquire was a relatively minor supplier to North America, and the non-competition agreement would be an oddity for an antitrust order--but the most critical deficiency was that the proposal did not address the elimination of a competitor that stood in the way of coordinated behavior. The parties abandoned the transaction in January 1999.

an observation about these actions

Occasionally, some people question whether mergers should be challenged in court, because they expect that once a firm is "on the block" its days are numbered and it will inevitably cease to be a competitive force. That observation is not supported by the cases discussed in this article. In the ten cases in which the FTC authorized an injunction action, in only one case--Rite Aid/Revco--did the target of the acquisition cease to be an independent competitor. [31] In none of the other cases, have any of the firms exited from the market--they continue to be direct competitors.

going forward

***18** Having described in detail which proposed remedies the Bureau did not find acceptable in some recent cases, let us describe the basic contours of the Bureau's approach to remedies:

• The divestiture of an ongoing business is strongly preferred over more limited forms of divestiture;

• The use of up-front buyers is critical in making sure that a divestiture package is adequate;

• We appropriately have a healthy dose of skepticism about proposals that seek to "mix and match" assets from the two firms;

• Often we won't have sufficient expertise to determine how the divestiture of specific assets will work, and so we will need the assistance of interim trustees; interim trustees will also play a vital role in making sure the acquirer can seek and secure necessary regulatory approvals; and

• Other forms of relief, such as hold separate orders, will also play an important role.

We welcome your views on these or any other issues involving merger remedies.

Endnotes:

Footnotes

1 Sandra Sugawara, *Merger Wave Accelerated in '99; Economy, Internet Driving Acquisitions,* Wash. Post, Dec. 31, 1999, at E01.

2 For a more elaborate discussion of many of these factors, see Robert Pitofsky, *The Nature and Limits of Restructuring in Merger Review*, Prepared Remarks before Cutting Edge Antitrust Conference (Feb. 17, 2000).

3 FTC v. Ruberoid Co., 343 U.S. 470, 473 (1952). Courts have long and consistently held that the Commission's authority to enforce Section 7 includes the ability to condition approval of a merger on the parties' divestiture of certain assets or interests, either by negotiating a consent decree or through litigation. *See, e.g.*, Lieberman v. FTC, 771 F.2d 32, 34 (2d Cir. 1985); Yamaha Motor Co. v. FTC, 657 F.2d 971, 984-85 (8th Cir. 1981), *cert. denied*, 456 U.S. 915 (1982); United States v. Beatrice Foods Co., 493 F.2d 1259, 1273 (8th Cir. 1974), *cert. denied*, 420 U.S. 961 (1975).

4 United States v. E.I. du Pont de Nemours & Co., 366 U.S. 316, 326 (1961).

5 366 U.S. at 330-31. *See also* California v. American Stores Co., 495 U.S. 271, 285 (1990) (divestiture is "the remedy best suited to redress the ills of an anticompetitive merger"); Ford Motor Co. v. United States, 405 U.S. 562, 573 (1972) (divestiture is "particularly appropriate" in merger cases).

6 366 U.S. at 334.

7 *Id.* at 330.

8 113 F.T.C. 400, 619 (1991), *aff'd*, Olin Corp. v. FTC, 986 F.2d 1295 (9th Cir. 1993), *cert. denied*, 510 S. Ct. 1110 (1994).

9 *See* K. Elzinga, *The Antimerger Laws: Pyrrhic Victories?*, 12 J.L. & Econ. 43, 65 (1969).

10 General Motors Corp., 103 F.T.C. 374 (1984

11 Federal Trade Comm'n, *A Study of the Commission's Divestiture Process* (1999), *available at* www.ftc.gov/os/1999/9908/index.htm#6.

12 Schnucks was required to divest 24 supermarkets in the St. Louis area as a result of its 1995 acquisition of National Food Markets and was subject to an asset maintenance agreement pending divestiture. As soon as it closed on the National Foods acquisition, it began treating the divested stores as second class citizens. It closed departments, failed to keep others adequately stocked and staffed, unlisted store phone numbers, and referred customers to Schnucks stores that were not being divested. During the year it had to sell the stores, the sales for those stores declined approximately 35%.
For further discussion of the Schnucks case and other supermarket mergers, see David A. Balto, *Supermarket Merger Enforcement*, Antitrust Rep., Aug. 1999, at 2.

13 FTC v. Schnucks Markets, Inc., Civ. No. 01830 (E.D. Mo., filed Sept. 5, 1997).

14 Novartis AG, C-3725 (Apr. 8, 1997) (consent order) (Commissioner Azcuenaga concurring in part and dissenting in part).

15 Statement of Chairman Pitofsky and Commissioners Steiger, Starek, and Varney at 2.

16 Robert Pitofsky, *The Nature and Limits of Restructuring in Merger Review*, Prepared Remarks before Cutting Edge Antitrust Conference (Feb. 17, 2000).

17 12 F. Supp. 2d 34 (D.D.C. 1998).

18 *See* FTC v. Mediq, Inc., Civ.Act. No. 97-1916 (D.D.C. Aug. 22, 1997).

19 FTC Press Release, *Mediq Informs FTC That It Will Abandon Merger With UHS in Face Of Challenge*, Sept. 22, 1997.

20 For a discussion of remedies in vertical merger cases, see Richard G. Parker & David A. Balto, *The Merger Wave: Trends in Merger Enforcement and Litigation*, 55 Bus. Law. 351 (1999).

21 Questar Corp./Kern River Gas Transmission Co., FTC File No. 961 0001 (preliminary injunction action authorized, Dec. 27, 1995); FTC v. Questar Corp., No. 2:95CV 1137S (D. Utah 1995) (transaction abandoned).

22 Although the firms stood principally in a vertical relationship, the transaction also had horizontal implications. At the horizontal level, there were two competitive concerns. First, Barnes & Noble, which had its own distribution centers, could compete directly with Ingram by wholesaling to other bookstores. In fact, Barnes & Noble had announced publicly that it was considering providing wholesale services to other book retailers. Second, Ingram wanted to retain Barnes & Noble as a customer and so offered competitive prices, expanded its range of titles, and improved service. All of Ingram's customers, including independent bookstores, were beneficiaries of this competition, and there were concerns that the acquisition would have eliminated that stimulus to competition.

23 366 U.S. at 333-34.

24 *E.g.,* Martin Marietta Corp., FTC Dkt. No. C-3500, 117 F.T.C. 1039 (1994); Eli Lilly & Co., FTC Dkt. No. C-3594, 120 F.T.C. 243 (1995).

25 *See, e.g.*, Stephen Labaton, *Staff of FTC Is Said to Oppose Barnes & Noble Bid to Wholesaler*, N.Y. Times, June 1, 1999, at A1, C9; Patrick M. Reilly & John R. Wilke, *FTC Staff to Fight Barnes & Noble Bid for Wholesaler*, Wall St. J., June 1, 1999, at B16.

26 For a description of the Albertsons--American Stores merger and the mix and match approach, see Balto *supra* note 12.

27 Federal Mogul Corp., No. C-3836 (Dec. 9, 1998).

28 FTC Press Release, *FTC Rejects Proposed Settlement in Staples/Office Depot Merger*, Apr. 4, 1997.

29 FTC v. Staples, Inc., 970 F. Supp. 1066 (D.D.C. 1997).

30 The investigation revealed that ICI had a unique incentive to import substantial quantities of TiO2 into North America, because of the configuration of its extensive European facilities. ICI in fact had demonstrated a commitment to supply U.S. customers during peak demand periods, and it had been attracting increasing sales. Given its incentive to import, ICI was a potential disruptive force in any scheme to coordinate output or prices in North America. By removing that threat, it could become much easier for DuPont and remaining suppliers to engage in coordinated behavior. Concerns about coordinated behavior were sharpened by the presence of a number of factors that generally facilitate collusion--e.g., inelastic demand and substantial information flows between competitors. Firms had considerable knowledge of their competitors' capacity, pricing, and sales to individual U.S. customers. Thus, firms were capable of monitoring pricing and output and detecting cheating. In addition, DuPont already played a strong price leadership role in the industry, with other firms taking their cues from DuPont. The elimination of ICI's import competition could only strengthen that role. Those concerns were heightened by evidence that North America's price declines during slack demand periods already were shallower relative to other regions. FTC staff also were concerned that with a more commanding position wordwide, DuPont would have increased incentives to close some of the capacity acquired from ICI to demonstrate its resolve to promote higher prices and encourage investment restraint by other suppliers.

31 Revco was acquired by another firm.

2000 WL 739461 (F.T.C.)

End of Document

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I hereby certify that on November 20, 2018, I filed the foregoing document electronically using the FTC's E-Filing System, which will send notification of such filing to:

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I certify that the electronic copy sent to the Secretary of the Commission is a true and correct copy of the paper original and that I possess a paper original of the signed document that is available for review by the parties and the adjudicator.

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