DIVESTITURE, DISGORGEMENT, AND THE DOUGHBOY DISPUTE: RECENT DEVELOPMENTS IN MERGER REMEDIES

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Although recent economic conditions have led to a downturn in merger activity, merger enforcement remains vibrant in the U.S and around the world. In the U.S., through the first six months of its fiscal 2002, the Federal Trade Commission (“FTC”) took enforcement measures in seventeen proposed mergers and authorized the filing of three federal complaints seeking to block proposed mergers.¹ If anything, the numbers understate the continued importance of merger enforcement, as the size, value, and complexity of mergers continue to reach new heights.

Enforcement in merger cases is motivated by the desire to preserve competition in the relevant market. Yet there is no sure-fire way to reach that goal. Developing effective remedies in merger cases is a highly fact-specific exercise, and the enforcement agencies have crafted numerous strategies in response. This article addresses recent developments in the U.S. and E.U. enforcement authorities’ approach to merger remedies. In the U.S., two issues have emerged: (1) the continued debate over how to ensure that the merging firms’ divestiture of assets will be sufficient to protect competition in the relevant market; and (2) the emerging debate over the wisdom of requiring the merged parties to disgorge profits acquired during the period of

wrongful gain. In the E.U., the Commission issued a recent notice setting forth its guidelines on
the divestiture process. The notice suggests a growing convergence in the antitrust enforcers’
approach to merger remedies and an increasing willingness to adopt flexible remedial measures.

I. SUFFICIENCY OF DIVESTITURE: THE DIVESTITURE STUDY AND THE
PILLSBURY DOUGHBOY

Section 7 of the Clayton Act prohibits mergers which have the likely effect of
substantially lessening competition or tending to create a monopoly in the relevant market.
Subject to certain exemptions, the Hart-Scott-Rodino Act (“HSR Act”) requires merging parties
to file notification with the FTC and the Antitrust Division of the Department of Justice (“DOJ”)
 prior to the closing of the transaction. The agencies have thirty days to investigate the merger
and, if their competitive concerns are not resolved, the agencies may issue a “second request” for
significant additional information. The waiting period is then extended until thirty days after
substantial compliance with the second request, at which time the parties are allowed to proceed
with the deal unless the government takes steps to block the transaction.

Often, the agencies’ competitive concerns can be resolved through negotiation and
agreement on a consent decree that requires the merging parties to sell certain business lines or
assets to a party who can suitably replace the competition lost by the merger.\(^2\) The content of
consent decrees varies according to the facts of the case, but several requirements are common to
most divestiture orders.\(^3\) First, the divestiture must be “absolute,” meaning that the merging

\(^2\) In certain circumstances, divestiture of voting securities may be required.

parties cut all ties to the divested businesses or assets and have no on-going financial interest in
the buyer’s success. In some cases, however, continuing arrangements (such as supply contracts
or technical support) may be necessary to ensure the competitive viability of the divested assets.
Additionally, consent decrees often contain provisions for naming a trustee to oversee the sale of
the assets, if the assets are not divested within a certain time. Also, the parties are typically
required to operate the assets to be divested independently from the remainder of the business.
The objective is to “hold separate” the assets, preserve their viability pending divestiture, and
prevent competitive harm in the interim.

Innovative twists on traditional merger remedies have become increasingly popular in
recent years.4 When the agencies are concerned about an asset package’s ability to attract an
acceptable buyer, the parties are now likely to be required to identify an “up front” buyer for the
package of divested assets. An up-front buyer is less commonly required when the divested
assets constitute a stand-alone business. The agencies are also using “crown jewel” provisions
that require the divestiture of additional highly-marketable assets if the merging firms fail to
divest the original asset package as required by the consent decree. Finally, the agencies have
recently decreased the time available for parties to divest the assets, now requiring divestitures to
occur within three to six months of the consent order. The FTC has stated that, under the one
year period previously given to parties, divestiture often occurred at the end of the period, after
the assets had deteriorated.5

4 See Casey R. Triggs, Back to the Future: FTC Merger Remedies after the Pillsbury
‘Doughboy Deadlock’, Clayton Act Newsletter (ABA Section of Antitrust Law), Winter 2002, at

5 See FTC Staff, Frequently Asked Questions About Merger Consent Order Provisions at
The lingering question is whether these or other remedial measures adequately preserve competition in the relevant market. In 1999, the FTC issued a study of its divestiture process that sought to determine how well buyers of divested assets fared as viable competitors and whether divestiture orders lived up to the FTC’s remedial goals.\(^6\) The Divestiture Study reached several significant conclusions:

- Three-quarters of the divestitures analyzed in the Divestiture Study were found to be successful at maintaining competition in the relevant market, meaning that the approved buyer acquired the assets, began operations, and was operating in the relevant market within a reasonable period.\(^7\)

- As common sense might suggest, divestitures of on-going businesses succeeded more frequently than divestitures of selected assets.\(^8\)

- The buyer’s continuing relationship with the merged firms following the purchase of the divested assets increases the vulnerability of buyers, but may be necessary for some buyers to succeed.

- Smaller firms have succeeded at least at the same rate as larger firms. The buyer’s knowledge and experience in the business is more relevant than its size.\(^9\)

- Difficulties in divestitures include respondents divesting assets to weak buyers and otherwise diminishing the viability of the assets acquired by the buyer. Buyers were found to often lack sufficient information about the divested assets, and many buyers perceived a lack of bargaining power in securing divested assets for sale.


\(^7\) Id. at 10.

\(^8\) Id. at 12.

\(^9\) Id. at 14.
These principles were put to the test in the FTC’s recent consideration of enforcement action against General Mills Inc.’s proposed acquisition of The Pillsbury Co. from Diageo plc. In that matter, both the parties and the FTC agreed that the proposed deal created potential anticompetitive consequences in several overlap product categories. As a result, General Mills offered to divest Pillsbury’s baking mixes, ready-to-spread frosting products, flour products, pancake mixes, and potato mixes to an up-front buyer, International Multifoods Corp. (“IMC”). General Mills also offered a number of other commitments intended to minimize the competitive risk of the transaction, including guaranteeing up to $200 million in long-term debt of IMC to finance the purchase, converting a state-of-the-art plant to produce Pillsbury products and turning it over to IMC, and licensing to IMC the use of Pillsbury trademarks, including the well-known “Pillsbury Doughboy,” in a “brand split” that would enable both IMC and General Mills to use the trademark.

After a fifteen-month investigation, the FTC was faced with the question of whether the sale of the proposed asset package to IMC would be sufficient to preserve competition. With Chairman Muris recused, in October 2001 the FTC split on a 2-2 vote on whether to direct the staff to draft a proposed consent decree manifesting those terms, and also on a separate vote whether to authorize the staff to seek a preliminary injunction to block the merger. The deadlock meant that the FTC would take no action at this time—neither a consent decree nor a preliminary injunction would be sought in this case.

The Commissioners’ statements regarding their votes belie significant differences in their approach to merger remedies. Commissioners Swindle and Leary voted in favor of the consent
decree and against the preliminary injunction.\textsuperscript{10} In their view, the deal was largely competitively benign and the parties had taken sufficient measures to preserve competition. Although they would have “strongly preferred” that the parties’ commitments be embodied in a formal FTC order, they acknowledged that they would have to rely in good faith that the parties would honor the spirit of their promises.

By contrast, Commissioner Anthony was “profoundly disappointed” that the FTC would not challenge the merger, particularly because “the parties proposed an aberrant trademark license to split a corporate name and other trademarks between two competitors, one of which would have been built and financed from the ground up.”\textsuperscript{11} As a result of the transaction, both IMC and General Mills will be direct competitors who must share a powerful trademark, the Pillsbury Doughboy. Commissioner Anthony was also troubled by the “cobbled-together nature of the assets and personnel that IMC would acquire,” noting that the Divestiture Study confirmed that divestitures of on-going businesses were more likely to restore competition going forward.

Commissioner Thompson also was concerned about the trademark agreement dividing the Pillsbury Doughboy among competitors. Commissioner Thompson added, “[n]o less important, however, is the issue of how IMC would be situated in the market post-divestiture;

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specifically, whether the package of assets to be divested, the transition plans, and available financial support would permit IMC to rise to the heights once occupied by Pillsbury.\footnote{12}{Statement of Commissioner Mozelle W. Thompson, General Mills Inc./Diageo plc/The Pillsbury Co., File No. 011-0213, available at http://www.ftc.gov/os/2001/10/gmstmtthomp.htm.}

Despite the differences in the Commissioners’ views on the Doughboy debate, it is unlikely that this case indicates a significant shift in the FTC’s approach to merger remedies. Ultimately, the General Mills matter may amount to a fundamental disagreement based on the unique facts of the case.\footnote{13}{See Triggs, supra note 4, at 18.} Indeed, subsequent cases have indicated that the FTC will continue to guard vigilantly against the risks presented by partial divestiture orders, and that no substantial policy shift has occurred. In Nestle/Ralston Purina, for example, the FTC accepted a consent order that required a divestiture to an up-front buyer, with the added stringent requirement that the buyer (an investment firm) must seek prior approval from the FTC if it seeks to resell the acquired brands within five years.\footnote{14}{See Nestle Holdings, Inc./Ralston Purina Co., Docket No. C-4028 (Feb. 4, 2002), available at http://www.ftc.gov/os/2002/02/nestledo.pdf.}

II. DISGORGEMENT AND THE HEARST CASE

In December 2001, the FTC announced a proposed settlement with Hearst Corporation to resolve charges that Hearst unlawfully acquired Medi-Span, Inc. The settlement required Hearst to divest the Medi-Span business and pay $19 million as disgorgement of unlawful profits. This was an unprecedented step for the agency. Although disgorgement is commonly used in consumer protection cases, the FTC has very rarely sought disgorgement of unlawful profits in
antitrust cases,\textsuperscript{15} and prior to Hearst the FTC had never done so in the merger context. This section briefly looks at the question of disgorgement in merger cases and the controversy that has followed the FTC’s action in Hearst.

The Hearst case brought forth allegations of particularly egregious conduct. The target, Medi-Span, maintained a database used by doctors, pharmacies, and hospitals to obtain information about drug prices, drug effects, drug interactions, and eligibility for drugs under certain payment plans. The only other widely-used database is owned by First DataBank, a subsidiary of Hearst. In December 1997, Hearst and Medi-Span filed pre-merger notifications that Hearst intended to acquire the Medi-Span business. The acquisition was completed in January 1998, following the expiration of the 30-day HSR waiting period.

Following dramatic price increases and consumer complaints, the FTC launched an investigation in December 1999. Through compulsory process the FTC obtained from Hearst several high-level corporate documents that evaluated the Medi-Span acquisition and its effect on competition. Those documents were not disclosed in Hearst’s pre-merger filing, as required by HSR rules. As a result, the FTC sued in federal court in April 2001, claiming that the parties failed to disclose documents as required by the HSR Act and that the acquisition itself created an illegal monopoly in the sale of integratable drug information databases.

The November 2001 settlement with the FTC required divestiture of the Medi-Span business and disgorgement of $19 million. The settlement was approved by the FTC over Commissioner Leary’s dissent from the part of the order requiring disgorgement. Although

Commissioner Leary refused to say that disgorgement was never appropriate, he believed that here disgorgement was “unnecessary, if not affirmatively harmful,” because in this case the disgorged profits would be used to offset existing private damages claims.\textsuperscript{16} Commissioner Swindle also observed that the “months-long pursuit of disgorgement has yielded a monetary recovery that adds no real value to the private remedy.”\textsuperscript{17}

The Hearst case raises important questions about when it is appropriate for the agencies to seek disgorgement of profits in merger cases. Although the Hearst case presented extraordinary and extreme facts, parties should be aware that the FTC may require disgorgement of profits—particularly when the agencies did not have a full and fair opportunity to review the merger before consummation, either because of violations of the HSR rules (like the nondisclosure of responsive documents in Hearst) or because the transaction is not required to be reported under the HSR Act.

To get a better understanding of the issues, the FTC sought public comments on the factors it should consider in applying disgorgement remedies. Extensive comments were filed by several parties, including the Section of Antitrust Law of the American Bar Association, the leading antitrust bar organization.\textsuperscript{18} These and other comments raise several important, unanswered questions about the future of disgorgement remedies in the merger context:

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\textsuperscript{18} The Section’s Comments, filed on March 11, 2002, are available at http://www.abanet.org/antitrust/disgorge.pdf.
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• In light of the availability of private treble damages actions, does disgorgement risk imposing duplicative liabilities upon defendants? Because defendants could be forced to disgorge illegitimate profits as well as compensate consumers for their damages, are defendants being subjected to multiple liability for the same injury?

• How can the ill-gotten gains to be disgorged be distinguished from gains due to procompetitive efficiencies generated by the merger?

• Is disgorgement appropriate for violations of the HSR Act’s pre-merger notification requirements, even though such violations have no effect on competition and do not necessarily lead to the consummation of a transaction that will have anticompetitive effects?

• Should disgorged profits be distributed to indirect purchasers, who may be prohibited from sharing in the private right of action in federal court?

These issues, and many others, will need to be fully resolved before divestiture can become a regular feature of U.S. merger remedies—if it ever will. Yet the FTC’s willingness to explore this new avenue is an important step of which all interested parties and practitioners should be aware.

III. MERGER REMEDIES IN THE E.U.

Merger review before the European Commission (“Commission”) is governed by Council Regulation (EEC) 4064/89 (“Merger Regulation”), which became effective in 1990 and was substantially amended effective March 1998. The Merger Regulation prohibits the creation or strengthening of a dominant position that could significantly impede competition in the common market. The provision applies to mergers that affect trade within the European Community and satisfy the Merger Regulation’s recently-amended turnover thresholds. Proposed deals or concentrations must be notified by submitting a Form CO to the Commission’s Merger Task Force not more than one week after the earliest of the conclusion of the agreement, the announcement of the public bid, or the acquisition of a controlling interest.
The Commission reviews merger filings in two stages. In Phase I, the Commission reviews the initial Form CO submitted by the merging parties. The Form CO requires a significant amount of information about the parties and the proposed transaction—more than what is required under the premerger notification requirements of the HSR Act in the U.S. The Commission must make a decision to initiate a full proceeding within one month of receiving the filing (or within six weeks if a member state indicates that it believes that the transaction will have an effect on a distinct market within that state). Phase II involves a more thorough investigation of the proposed transaction to determine if the concentration is compatible with the common market. This portion of the investigation may (and often does) last up to four months and typically requires responding to numerous requests for information and gathering and analyzing a substantial amount of data.

The Merger Regulation authorizes the Commission to declare a concentration compatible with the common market after the parties’ modification of the deal. However, much like the U.S. enforcement authorities, the Commission has grappled with the difficulty of designing remedies for mergers that threaten to harm competition. Its policy on remedies has been transformed significantly in recent years and has clearly been influenced by the conclusions reached in the FTC’s Divestiture Study. While divestiture remains a common solution to merger problems, the Commission has increasingly required many of the same commitments extracted by U.S. authorities, such as favoring divestitures of on-going businesses, requiring crown jewel provisions and/or up-front buyers, and setting shorter divestiture periods.19

To clarify its analytical approach to merger remedies, the Commission recently issued substantive and procedural guidelines in its notice on remedies (“Notice”). The Notice is comparable to the guidelines issued by U.S. antitrust authorities. It is a significant step toward the Commission’s goal of implementing a transparent, cohesive, and predictable regulatory scheme for merger remedies—a goal confirmed by the establishment in April 2001 of a unit within the Merger Task Force dedicated to advising on the acceptability and implementation of merger remedies.

**General Principles**

While acknowledging that each transaction must be assessed on an individual basis, the Notice establishes several general principles governing its approach to remedies. First, the Notice articulates the Commission’s preference for structural remedies (such as the sale of a subsidiary) over behavior remedies, which may not be suitable to ensure the competitiveness of the market structure. The remedy must be able to restore effective competition in the common market on a permanent basis. Furthermore, the remedy must be capable of being implemented effectively within a short period of time, and without additional monitoring or oversight by the Commission. The commitment must therefore contain specific details and procedures

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21 See id. ¶ 9.

22 See id. ¶ 6.

23 See id. ¶ 10 n.10 (“Only in exceptional circumstances will the Commission consider commitments which require further monitoring.”).
regarding their implementation to permit the Commission to evaluate it fully.\footnote{See id. ¶ 46.}

\textbf{Divestiture Issues}

Although the Notice recognizes that certain circumstances may warrant terminating exclusive agreements or requiring access to infrastructure or key technology,\footnote{See id. ¶¶ 27-28.} the remedy of preference is divestiture. The primary concern with divestiture is making sure that the divested assets, when in the hands of a suitable purchaser, can compete with the merged entity on a lasting basis. Typically, a viable business is an existing one that can operate on a stand-alone basis, without maintaining ties to the merging parties.\footnote{See id. ¶ 14.} The Commission may require divestiture of a business of the acquiring firm, particularly in hostile bid situations where there is more limited knowledge of the business to be acquired.\footnote{See id. ¶ 16.}

The Commission may also require a divestiture of activities in related markets in which there are no competitive concerns, if this is the only possible way of creating or enhancing an effective competitor in the affected markets.\footnote{See id. ¶ 17.} This occurred in \textit{TotalFina/Elf Acquitaine},\footnote{Case No. COMP/M.1628, Commission Decision of Feb. 9, 2000.} in which the parties’ initial proposal to sell portions of their assets in the liquid petroleum gas industry was deemed neither adequate nor precise enough to allay all serious doubts about the transaction. The Commission subsequently required the divestiture of a full subsidiary, in its approval of the merger in February 2000.
In certain circumstances, the Commission’s recent practice has been to require “crown jewel” divestiture provisions. Like the provisions imposed by U.S. enforcers, crown jewel provisions require that, if the sale of the preferred divestiture asset does not occur by a specific deadline, the Commission will require the divestiture of a more valuable asset or group of assets. The Notice explains that alternative divestiture commitments (such as crown jewel provisions) may be required if the implementation of the parties’ preferred divestiture option is uncertain or difficult, due to such factors as third-party pre-emption rights or other uncertainties as to the transferability of key contracts, intellectual property rights, or employees. While alternative divestitures were accepted by the Commission prior to the adoption of the Notice, post-Notice cases requiring crown jewel provisions include Industri Kapital/Dyno and Nestle/Ralston Purina.

**Suitability of Purchaser**

As condition for approval, the Commission will require the parties to transfer the viable business to a suitable purchaser within a specific deadline. The Commission’s criteria for determining the suitability of a purchaser requires the buyer to be “a viable existing or potential competitor, independent of and unconnected to the parties, possessing the financial resources, proven expertise and having the incentive to maintain and develop the divested business as an

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30 See Notice ¶ 22.

31 See de Matteis, supra note 19, at 25.


34 See Notice ¶ 19.
active competitive force in competition with the parties.” This provision can greatly impact the parties’ efforts to obtain clearance, for in TotalFina/Elf Acquitaine the Commission initially rejected a proposed list of purchasers for the divested assets on the grounds that the buyers would not have the necessary incentive to maintain sufficient competition in the market.

If the viability of the divestiture package depends largely on the identity of the purchaser, the Commission will require the parties to enter into a binding agreement with an “up front buyer” approved by the Commission, prior to completing the notified transaction. This practice is similar to the approach taken by U.S. enforcers. In Bosch/Rexroth, the Commission found that, if Bosch had divested the business to a weak buyer, over time it could have won back lost market share. The Commission decided that the deal could not proceed until a suitable up-front buyer had been found. An up-front buyer was also recently required in The Post Office/TGP/SPPL.

**When Should Commitments Be Offered?**

The parties may offer commitments to modify a proposed concentration during either phase of the Commission’s investigation. Article 6(1)(c) of the Merger Regulation requires that remedies offered in Phase I must be sufficient to clearly rule out serious doubts regarding the concentration’s compatibility with the common market. As a result, during this phase the Commission will only accept commitments when the competition problem is “so straightforward

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35 Id. ¶ 49.

36 Id. ¶ 20.


and the remedies so clear-cut that it is not necessary to enter into an in-depth investigation.”

Proposed commitments filed within three weeks of the notification will extend the deadline for the Commission’s decision from one month to six weeks.

When commitments are offered at an early stage of Phase II proceedings, the Commission must take a clearance decision once its serious doubts regarding the deal have been removed. Once the investigation has progressed to an in-depth stage, when the Commission has reached a preliminary finding in a Statement of Objections that the merger will create competitive problems, the commitments must eliminate the creation or strengthening of a dominant position. Under the Merger Regulation, parties may propose commitments up to three months after the initiation of proceedings.

The Commission has increased its emphasis on the parties submitting proposed remedies in a timely fashion. In a recent speech, Commissioner Mario Monti explained, “I always recommend to merging companies, particularly in complex cases, to start discussing remedies at the earliest possible stage.” Indeed, the Commission is willing discuss remedies on an informal basis in the pre-notification phase. Yet, as noted in a recent Green Paper reviewing the Merger Regulation, many parties wait until the last day of the period for submitting proposed remedies.

\[39\] Notice ¶ 11 n.11.
\[40\] Id. ¶ 11.
\[41\] Id.
commitments, in part because of time constraints imposed by other portions of the merger review process.\textsuperscript{43} The delay effectively leaves the Commission with little time for consultation with Member States and interested third parties about the proposed commitments. The Green Paper thus recommends a “stop the clock” provision that, upon consent of the parties and the Commission, would allow a short extension of time for the parties to submit and the Commission to review proposed commitments.\textsuperscript{44} Such a provision might help alleviate the time crunch that too often occurs when commitments are not proposed until the in-depth Phase II investigation is well underway.

\textbf{Additional Remedial Obligations}

The Commission may place several additional requirements on parties to ensure the viability of the divested business. Those obligations may include appointing a “hold separate” trustee, who can make sure that the merging entity fulfills its duty to maintain the economic viability and competitiveness of the divested assets until they are sold.\textsuperscript{45} The Commission may also appoint a “divestiture” trustee, who is responsible for overseeing the search for a purchaser for the divested assets and who may be given a mandate to dispose of the divested assets at any


\textsuperscript{44} \textit{Id.} ¶¶ 212-221.

\textsuperscript{45} \textit{Notice} ¶¶ 50-52.
price, within a specific deadline and subject to the Commission’s approval.\textsuperscript{46} The divestiture
trustee may be the same entity as the hold separate trustee.\textsuperscript{47}

\textbf{IV. CONCLUSION}

Antitrust enforcers on both sides of the Atlantic continue to struggle with difficulties in
crafting equitable and effective remedies for mergers that create competitive problems. Faced
with similar issues, the enforcement authorities’ approach is increasingly converging.
Enforcement authorities now recognize that narrowly-tailored, properly-applied mechanisms
(such as crown jewel provisions, up front buyers, and hold separate arrangements) can protect
competition in threatened markets while allowing beneficial mergers to go forward.

\footnotesize\textsuperscript{46} \textit{Id.} ¶¶ 53-54.

\footnotesize\textsuperscript{47} \textit{Id.} ¶ 55.