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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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In re Applications of	)	
	)	
Sprint Corporation, Transferor	)	CC Docket No. 99-333
and	)	
MCI WorldCom, Inc., Transferee	)	
	)	
for Consent to Transfer Control	)	
of Corporations Holding Commission	)	
Licenses and Authorizations Pursuant	)	
to Sections 214 and 310(d) of the	)	
Communications Act and Parts 1,	)	
21, 24, 25, 63, 73, 78, 90, and 101	)	

Reply Comments of Communications Workers of America

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CWA[1] and other commentators have provided the Commission with overwhelming evidence to demonstrate that the proposed merger between MCI WorldCom and Sprint would result in irreparable harm to competition in long distance and Internet markets with no countervailing public interest benefits. The Commission received opposition comments from a wide and diverse cross section of consumer and industry groups representing residential consumers, small businesses, Internet users, state-based utility consumer advocates, minorities, senior citizens, religious organizations, persons with disabilities, labor, and competing local, long distance, and Internet carriers.[2] These commentators convincingly demonstrate that the proposed merger would create a long distance duopoly with the Big Two controlling 80 percent of the long distance market; result in one dominant Internet backbone carrier whose greater than 50 percent market share would give it the ability to disrupt the dynamic competition that is driving Internet growth;

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[1] *See* Comments of Communications Workers of America, *In re Applications of Sprint Corporation, Transferor and MCI WorldCom, Inc., Transferee for Consent to Transfer Control of Corporations Holding Commission Licenses and Authorizations Pursuant to Sections 214 and 310(d) of the Communications Act and Parts 1, 21, 24, 25, 63, 73, 78, 90, and 101*, CC Docket 99-333, Feb. 18, 2000 (CWA Comments).

[2] *See* Comments of National Consumers League; AFL-CIO; AARP; Alliance for Public Technology; Telecommunications Research and Action Center/Alliance for Small Business Advocacy/LB Price Communications, Inc./National Association of Commissions for Women/National Council of Churches in Christ USA/National Council of Senior Citizens/National Hispanic Council on Aging/Telesis Systems/United Homeowners Association; Comments of the Texas Office of Public Utility Counsel, Texas Sprint Cities, and Consumers Union-Southwest Regional Office; Comments of the Public Utility Law Project; Comment in Opposition/Petition to Deny of Inter City Press/Community on the Move/and the Inner City Press Public Interest Law Center; Comments of the Utility Reform Network (TURN)/Indiana Office of Utility Consumer Counsel, Maine Public Advocate/Maryland Office of People's Counsel/Missouri Public Counsel; Petition to Deny of Rainbow/PUSH Coalition/League of United Latin American Citizens/Greenlining Institute/Latino Issues Forum; Comments of California Small Business Roundtable/California Small Business Association/Utility Consumer Action Network; World Institute on Disability; Puerto Rican Chamber of Commerce of Illinois; Comments of Cable & Wireless, Inc; Opposition of SBC Communications, Inc.; Petition of AT&T Corp. To Deny Application; Comments of Eliot Spitzer, Attorney General of the State of New York; Comments of Global Crossing Telecommunications, Inc.; Petition of GTE Service Corporation and GTE Internetworking to Deny Application of Condition Merger on Fully Effective Internet Backbone Divestiture; Bell Atlantic Corporation's Petition to Condition Approval on Adequate Divestiture of Internet Backbone Assets; Comments of NEXTLINK Communications, Inc.; plus many letters from individual consumers and small businesses.

and provide no verifiable and demonstrable merger-related benefits, particularly for residential and small business consumers. Further, the proposed merger would essentially trap Sprint's primarily rural customers in its local exchanges into a continued spiral of company neglect (including service-affecting employment cuts and subsidization of other services from local services revenues).[3]

The Applicants have indicated their willingness to work with policymakers to address and resolve concerns regarding Sprint's Internet backbone business.[4] (The Applicants have not indicated their willingness to address the other public interest concerns raised by commentators, including anti-competitive problems in the long distance market.) However, Cable & Wireless as well as other commentators have provided the Commission with convincing evidence to demonstrate that a spin-off of Sprint's Internet backbone business would *not* resolve merger-related anti-competitive problems in the Internet backbone market.[5]

Commentators draw lessons from the failed divestiture of iMCI to Cable & Wireless, noting that Cable & Wireless' Internet market share dropped from iMCI's pre-divestiture 40 percent to Cable & Wireless' less than 10 percent market share today. The failure of the iMCI divestiture

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[3] *See* CWA Comments at 39-55.

[4] MCI WorldCom and Sprint, Supplemental Internet Submission, CC Docket No. 99-333 (Jan. 14, 2000), at 1 (Internet Submission).

[5] *See* Cable & Wireless Comments generally; CWA Comments at 28-39. *See also* Bell Atlantic Petition, AT&T Petition; SBC Opposition; Global Crossing Comments; GTE Petition; NEXTLINK Comments; Alliance for Public Technology Comments; Rainbow/PUSH *et al.* Petition.

demonstrates that it is not possible to achieve an effective Internet backbone spin-off when the Internet business assets and operations of the divested entity are integrated with the divesting carrier's other telecommunications businesses and operations; when the purchaser of the Internet assets remains dependent on the divesting carrier for network facilities and key technical and commercial information; and when the divesting entity has the ability to sabotage the divestiture by not transferring knowledgeable staff and essential contract information.[6]

Based on the evidence, many commentators therefore conclude that the only effective remedy in this instant proceeding to resolve Internet competition problems would require a divestiture of UUNET, MCI WorldCom's stand-alone Internet business and network facilities, with strong enforcement mechanisms in place.[7] CWA and other commentators propose an alternative that would resolve merger-related anti-competitive problems in long distance *and* Internet markets: a complete divestiture of Sprint's integrated Internet and telecommunications business and facilities.[8]

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[6] *See generally* Cable & Wireless Comments.

[7] *See* Cable & Wireless Comments at 23-47; Alliance for Public Technology Comments at 4; Bell Atlantic Petition at 7-8; NEXTLINK Comments at 11-12; Rainbow/PUSH *et al.* Comments at 25. AT&T notes that a simple divestiture of Sprint's backbone will not restore the *status quo ante,* AT&T Petition at 11-12. SBC states that the divestiture must be under rigid conditions and supervision, SBC Opposition at 43-45. Global Crossing states thedivestiture must be economically meaningful, Global Crossing Comments at 9-11. GTE states the divestiture must be one of a non-integrated system, GTE Petition at 12-14.

[8] CWA Comments at iii and 37-39; Alliance for Public Technology Comments at 4.

The Federal Trade Commission recently concluded a study of 35 divestiture orders with findings that are highly relevant to this instant proceeding.[9] (A copy of the FTC Divestiture Study is attached.) The FTC Divestiture Study concludes that divestitures of stand-alone businesses (such as UUNET) are far more likely to succeed than are divestitures of selected assets of organic businesses (such as Sprint's commingled Internet/telecommunications facilities and operations).[10] According to the FTC study, partial divestitures allow the divesting party to retain customers of its divested assets through coordinated marketing of its products. Further, partial divestitures make it less likely that the buyer of the divested assets will acquire the experienced staff and know-how necessary to operate as efficiently as the business eliminated by the merger.[11] According to the FTC, "[t]he difficulty in transferring knowledge is one reason why divestitures of on-going businesses succeeded more often than divestitures of selected assets. Where an entire business is divested with the personnel who operate it, the knowledge will pass as part of the transaction."[12] However, when a partial asset is divested, knowledgeable employees whose work and customers are integrated into other businesses are more likely to remain with the divesting entity.

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[9] Bureau of Competition of the Federal Trade Commission, *A Study of the Commission's Divestiture Process,* 1999 (available at http://www.ftc.gov/os/1999/9908/index.htm#6) (FTC Divestiture Study).

[10] *Id.* at 10.

[11] *Id.* at 3-4 and 10-11.

[12] *Id.* at 27-28.

This was the case in the failed iMCI divestiture; MCI transferred only a small fraction of the personnel necessary for Cable & Wireless to operate its newly acquired business; did not provide Cable & Wireless with customer contracts (until seven months after the divestiture); failed to provide database access, provisioning support, and other necessary documentation in support of the business; and failed to provide billing information and services.[13] Therefore, the iMCI business transferred to Cable & Wireless was a significantly weaker competitor as a stand-alone business than as an MCI operating unit.[14]

Moreover, the iMCI divestiture failed to meet another important FTC recommendation for successful divestitures. According to the FTC Divestiture Study, divestitures which involve "continuing relationships with respondents [e.g. divesting parties] post divestiture may increase the vulnerability of the buyers of divested assets."[15] Cable & Wireless remained dependent upon MCI WorldCom for network facilities as well as technical know-how and customer information, thus limiting its viability post divestiture. Any spin-off in this instant proceeding must not repeat this mistake.

[13] *Id.* at 35-40. Seventeen months after divestiture C&W still does not have contract information on 755 of its dedicated access customers.

[14] *Id.* at 40-41.

[15] *Id.* at 12.

As a consequence of the flawed divestiture, Cable & Wireless' market share tumbled from iMCI's pre-divestiture 40 percent to less than 10 percent today.[16]

Sprint recently announced plans to split off its Internet business into a separate business unit. According to Sprint, "in the event that we are asked to divest, this will help better identify what's involved and impacted by that move."[17] While publicly available information does not identify the details of the restructuring, the Commission should remain skeptical that the proposed restructuring will indeed result in a completely separate stand-alone Sprint Internet business. For example, will Sprint cancel and re-negotiate all its customer contracts to prevent commingling of Internet and other telecommunications service contracts and operations? Will Sprint completely separate out all its network facilities, data centers, network operations centers, accounting, billing, marketing, and customer care operations? Will Sprint customer service personnel cease all joint marketing and customer care of commingled Internet and other telecommunications services? Absent an independently verifiable affirmative answer to these and related questions, the Commission should not conclude that Sprint's internal restructuring has indeed created a stand-alone independent Internet network, customer base, and business comparable to UUNET's stand-alone Internet network, customer base, and business.

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[16] CWA Comments at 37. Data from Internet Submission Attachments 3 and 5 for C&W's current Internet market share and *Boardwatch* June 1997 for MCI's pre-divestiture market share.

[17] Sprint company spokesperson Deborah Trevino quoted in Denise Pappalardo, *Network World Fusion,* March 6, 2000 (available at http://www.nwfusion.com/news/2000/0306NWsprint.html?/nf).

"Fool me once, shame on you, fool me twice, shame on me." Having learned from the failed iMCI divestiture, the Commission has two choices. A full and complete divestiture of MCI WorldCom's stand alone UUNET Internet network and business (including its customer base and all employees) with strong enforcement mechanisms would resolve merger-related competition problems in the Internet market, but would fail to resolve anti-competition problems in the long distance market. A full and complete divestiture of Sprint's integrated long distance Internet backbone facilities and business (including all customers and employees), with strong enforcement mechanisms, would resolve merger-related competition problems in *both* long distance and Internet markets.

Absent an effective divestiture, the proposed merger will result in serious anti-competitive harm in long distance and Internet markets, with no countervailing public interest benefits, and the Commission should deny the Applicants' request.

Respectfully Submitted,

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Dated: March 20, 2000

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PUBLIC VERSION

A STUDY OF THE COMMISSION'S DIVESTITURE PROCESS

Prepared by the
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William J. Baer
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1999

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

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>
> **For the Bureau of Economics: Harold E. Saltzman, Deputy Assistant Director Charissa P. Wellford, and then Deputy Assistant Director R. Michael Black.**

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Executive Summary

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

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

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

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

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

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

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

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

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

- provided for the redivestiture of certain types of assets where the buyer fails to exploit them; and
- provided for the divestiture of additional assets by a divestiture trustee where the respondent has failed to fully divest assets within the time required by the order.

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I. Divestitures Since the HSR Act

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

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

A. Objectives of the HSR Act

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

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

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

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

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

(continued...)

Rogowsky's studies of merger orders issued prior to the HSR Act found that divestitures typically occurred more than five years after the anticompetitive merger transaction.[5] In such cases, a lawsuit successfully challenged the transaction and relief was ordered and obtained, but consumers and the market were damaged by the loss of competition until the remedy became fully effective. This interim competitive harm is likely to occur as a result of any unlawful transaction and therefore the public cannot be fully protected unless the transaction is prevented.

The legislative history also catalogs a second problem in its litany of difficulties in reestablishing competition after a merger of competing firms. Some mergers result in the destruction of productive resources: for example, a glass making furnace, if turned off because it was redundant in the merged entity, must be reconstructed before a divestiture remedy can be effective because the furnace immediately becomes inoperable as a result of cooling. Other mergers result in the firing of employees because their knowledge is duplicative. Once dispersed, these employees may be impossible to rehire, and important knowledge may be unavailable to any entity that buys the divested assets.

Even worse than the loss of particular elements of a business is the destruction of the organic nature of an ongoing business acquired in the merger. In some cases, this destruction can be readily identified as the loss of credentials as a "qualified" supplier to specific customers. In other cases, it is the loss that relates to the more general notion of customer acceptance and reputation or goodwill that is attached to an ongoing business. In still others, the terminated business may be impossible to reconstruct by a buyer of the divested assets if the business depended on complex operations that included evolved procedures that no one had specified. In such instances, even former employees may have failed to realize the significance of these procedures and could not help recreate them.[6]

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[4] (...continued)

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

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

[5] *See* note 3, *supra*.

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

The Congressional committees did not try to grapple with the difficulties posed by divestiture orders. Rather, their solution -- offered by the HSR Act -- was "to detect and prevent illegal mergers prior to consummation."[7] Thus, the Senate Report suggests that problems associated with divestiture -- interim competitive harm and reconstituting competition -- might disappear as a result of prior notice under the Act.

B. Implementation of the HSR Act

The HSR Act did not end the use of divestitures as antitrust remedies in merger cases; to the contrary, divestitures have continued to be the most common remedy in merger orders. These orders, however, differ from pre-HSR orders in several respects. Unlike their predecessors, Commission orders arising out of a merger reported pursuant to the HSR Act are almost always negotiated and entered prior to consummation of the reported merger. The requirement of premerger notification enables the antitrust agencies to insist that parties agree to remedies, including divestitures, before they permit the parties to consummate their transactions. And the agencies insist that divestitures be subject to their prior approval. Thus, for the large class of mergers subject to the HSR premerger notification requirements, the Act largely reversed the unfortunate history of merger enforcement in which the agencies had been unable to prevent or remedy anticompetitive mergers.

Furthermore, with experience, the agencies improved techniques to prevent the commingling of business operations that made pre-HSR divestitures so difficult. As Congress had noted, commingling operations creates problems. It sometimes destroys the possibility of future competition based on trade secrets or it can establish a basis of coordinated marketing that might not necessarily disappear with divestiture. Requirements that respondents divest assets quickly, and that they maintain viability of or hold separate the to-be-divested business address some of the remedial difficulties identified in Congressional hearings.

However, passage of the HSR Act did not eliminate entirely problems associated with commingling in merger cases. Divestiture orders typically require the sale of only a portion of the acquired or acquiring firm to a third party. Separating that set of assets, or portion of a firm, may be like separating the commingled assets in pre-HSR divestitures if the to-be-divested assets were never operated as a stand-alone business. These problems can be exacerbated when the to-be-divested assets are units of the acquiring firm rather than parts of the acquired firm. It is likely that the acquiring firm will retain competitively important information about the unit as a result of having operated it. Separating out portions of companies for divestiture may destroy the organic integrity of competing businesses that Congress sought to preserve when it passed the HSR Act. For example, the transfer of less than the entire business may result in the buyer of the divested assets having to requalify as a supplier, or the buyer may obtain full production assets but lack the experienced work staff and thus not obtain the know-how to operate as efficiently as

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[6] (...continued)
132 (1982).

[7] Senate Report at 65.

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

1. Early post-HSR divestiture policies at the FTC

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

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

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

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

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

payment of a $4 million civil penalty.[9] Overall, this was a dramatic success when compared with the federal antitrust merger enforcement efforts prior to the passage of the HSR Act.[10]

2. Divestiture orders in the mid-1980s

In addition to the 47 final orders that the Commission entered between 1979 and 1985, it also authorized 17 preliminary injunction actions to prevent consummation of proposed mergers.[11] As early as 1980, the Commission included a crown jewel provision in an order that transferred to a Commission-appointed divestiture trustee the right to sell the assets and allowed the trustee to add assets to make the package more saleable. With more experience, the Commission required the respondent:[12]

- to maintain the assets to preserve the viability of the divestiture package pending completion of the divestiture;
- to hold assets separate and to refrain from exercising any control over the acquired entity until the divestiture was complete;

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

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

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

[12] *See, e.g.*, *Texaco, Inc.*, FTC Docket No. C-3137, 104 F.T.C. 241 (1984) (Decision and Order); *Chevron Corp., et al.*, FTC Docket No. C-3147, 104 F.T.C. 597 (1984) (Decision and Order), *modified*, 105 F.T.C. 228 (1985) ; *L'Air Liquide, SA*, FTC Docket No. C-3216, 110 F.T.C. 19 (1987) (Decision and Order), *modified*, 111 F.T.C. 135 (1988), *further modified*, 117 F.T.C. 473 (1994), *set aside*, 121 F.T.C. 95 (1996); *Supermarket Development Corp.*, FTC Docket No. C-3224, 110 F.T.C. 369 (1988) (Decision and Order), *modified*, 117 F.T.C. 473 (1994), *further modified*, 130 F.T.C. 613 (1995).

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

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

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

3. Licensing remedies

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

C. Authorization of the Divestiture Study

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

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

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

previously available in the Commission's records have tracked divestitures only to the point that the Commission approved the contract and the assets were divested. There was no requirement that the person acquiring the assets report on its success with the assets, and there is little public data that allow calculating the impact of the divestitures on the markets affected by the mergers. As a result, most of the earliest efforts focused on identifying divestiture orders and the provisions included in those orders, and determining whether the divestitures occurred within the times required by the orders.

In 1995, the staff recommended that the Commission undertake a systematic study of the Commission's divestiture process that would expand the information obtained about Commission-ordered divestitures by, for the first time, questioning buyers of divested assets about the results of the divestiture process. The Study was undertaken in two parts: a pilot study undertaken to test the methodology, followed by an expanded study of divestitures from a selected time period.[15] The pilot study established that useful information could be obtained from a case study method, and the Commission then obtained authorization from the Office of Management and Budget to conduct the expanded study of divestitures.[16]

II. Findings from the Divestiture Study

A. Background of the Study

The Study covers divestiture orders entered from fiscal year 1990 through fiscal year 1994, and includes 35 orders in which the Commission required the divestiture of assets, including licensing of intellectual property. This time period was chosen because it is long

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[14] (...continued)
for dismissal, 849 F.2d 551 (11th Cir. 1988), *pet. for reh'g denied*, 858 F.2d 746 (11th Cir. 1988). In *Rhone-Poulenc S.A. et al.*, FTC Docket No. C-3287, 113 F.T.C. 329 (1990) (Decision and Order), Rhone-Poulenc was required to offer a license to any applicant, but no applicants came forward. In another case, the respondent failed to find an acceptable licensee as required by the order. *Institut Merieux S.A.*, FTC Docket No. C-3301, 113 F.T.C. 742 (1990) (Decision and Order), *modified*, 117 F.T.C. 473 (1994).

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

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

enough ago for effects to have been felt in the market, but recent enough for memories to be fresh. The Study included the fifty buyers to whom respondents divested assets pursuant to these orders. Staff interviewed 37 out of the fifty buyers. Staff interviewed an additional eight respondents and two third parties. One additional buyer and one additional respondent declined a request for an interview. Staff was not able to schedule interviews with the remaining buyers and respondents.

The orders included in the Study represent a broad sampling of industries and asset packages, including retailing, services, end-use goods, and various inputs. The orders in the Study required divestiture of a variety of packages of assets, ranging from virtually autonomous subsidiaries to non-exclusive licenses to particular patents and know-how. In addition, the buyers appear to have been just as varied, running the gamut from large international, multi-divisional firms to individual entrepreneurs seeking new business opportunities. The price paid for the assets range from one dollar to more than a hundred million dollars. And the success that the buyers had after acquiring the assets to be divested also varied widely, from firms that had an almost immediate impact by growing share, introducing new products, and lowering prices to firms that were never able to sell the first widget.

B. The Study supports the view that divestitures have been successful remedies for anticompetitive mergers

The Divestiture Study has produced three general findings: first, most divestitures appear to have created viable competitors in the market of concern to the Commission; second, respondents tend to look for marginally acceptable buyers and may engage in strategic conduct to impede the success of the buyer; and third, the Study has unexpectedly indicated that most buyers of divested assets do not have access to sufficient information to prevent mistakes in the course of their acquisitions. Evidence that most Commission-ordered divestitures have contributed to the maintenance or reestablishment of a competitor supports the usefulness of the Commission's divestiture remedies. Staff had assumed that respondents would seek marginal buyers and might engage in strategic conduct, but it had relied, in part, on the assistance of the buyers in defining the package of assets to be divested and the terms of the divestiture contract as a counterbalance to the respondents' conduct. Evidence of widespread mistakes by buyers of divested assets has, however, changed how the staff examines proposed divestiture orders and prospective buyers.

Even though the methodology of the Study is based on case studies, the interviews support some numerically based findings about divestitures. Those findings include: (1) three-quarters of the divestitures included in the Study succeeded to some degree; (2) divestitures involving on-going businesses tended to succeed more frequently than divestitures of selected assets; (3) continuing entanglements and relationships between buyer and respondent post-divestiture often presented unexpected problems for some buyers, increasing their vulnerability, but may have been critical to the success of other buyers; and (4) smaller firms succeed at least at the same rate as larger firms and, therefore, should not be presumed to be less competitive buyers than larger firms.

In addition to these numerically based findings, the case studies also illustrate why particular orders were or were not successful and what provisions in the orders or divestiture agreements helped or hurt the particular buyers. The case studies allow the staff to refine its identification of order and contract terms and buyer characteristics so as to increase the likelihood that a divestiture remedy will succeed.

1. Almost all required divestitures occurred

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

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

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

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

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