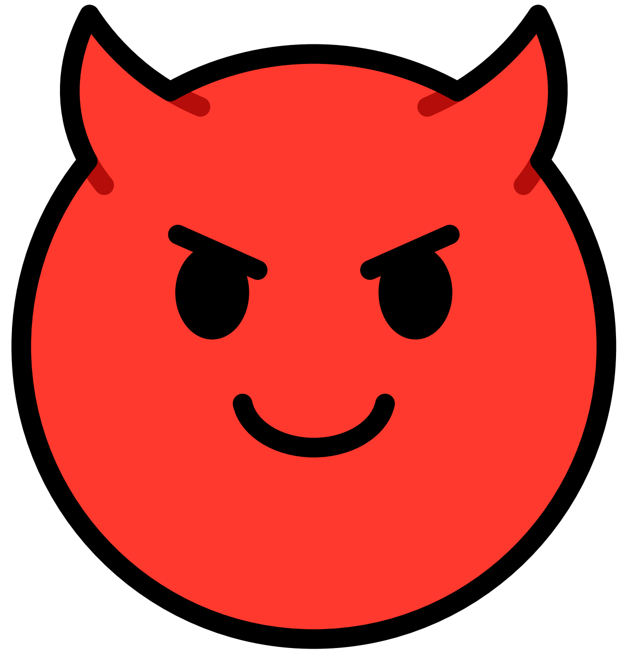

BY JONATHAN JACOBSON[1]

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THE FTC'S PRIOR APPROVAL MISCHIEF

By Jonathan Jacobson

Sometimes, the appropriate remedy in a merger case will involve a requirement for prior agency approval of later transactions by the buyer in the market in issue. From 1995 through 2022, the Federal Trade Commission's policy was to assess on a case-by-case basis whether prior approval was actually needed. That changed in 2022, when the FTC adopted a requirement for prior approval in all cases and extended the requirement to adjacent markets. This paper explains why the new policy is misguided and traces the history of the *Coca-Cola/Dr Pepper* transaction that led to the now-abandoned 1995 policy. There, after the merger was abandoned and the case found moot by the D.C. Circuit, the FTC nevertheless insisted on litigating the moot case through a long trial and appeals. Coke could not settle because a one-sided prior approval requirement would effectively cede all future acquisitions to Pepsi. And Dr Pepper had found new owners in what is now *Keurig/Dr Pepper/Snapple/7-Up*. The 2022 policy is another example of the current FTC's hostility to all mergers.

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It is no secret that the Federal Trade Commission, as currently constituted, dislikes almost all mergers and acquisitions. To that end, it has proposed the most aggressive *Merger Guidelines* in the past 55 years and a revised Hart-Scott-Rodino pre-merger notification form that, if it ever is allowed to go into effect, would require massive expenditures of time and money to complete. This paper is about a related third FTC initiative: the October 2021 *Statement of The Commission on Use of Prior Approval Provisions in Merger Orders*[2] and, in particular, the *Coca-Cola/Dr Pepper* case that provided the sound reasons underlying the 1995 policy that the current Commission majority has now repudiated.

I. CURRENT PRIOR APPROVAL POLICY

In 1995, the FTC adopted a policy that, in merger case settlements, provisions calling for prior FTC approval of future transactions would not be required automatically but instead would be required on a case-by-case basis, primarily where there was some credible risk that the acquiring firm would seek a similar or unreportable merger in the near future.[3] On July 21, 2021, by a 3-2 vote, the Commission repealed this policy[4] and on October 29, 2021, a 2-2 Commission adopted the new policy.[5] The central features of the revised policy can be summarized briefly:

- The FTC will "routinely require merging parties subject to a Commission order to obtain prior approval from the FTC before closing *any* future transaction affecting each relevant market for which a violation was alleged."
- These provisions will be effective for a minimum of ten years.
- The FTC may impose "stronger relief" by imposing prior approval provisions that cover "product and geographic markets beyond just the relevant product and geographic markets affected by the merger."
- *Buyers* of divested assets will have "to agree to a prior approval for any future sale of the assets they acquire in divestiture orders," again "for a minimum of ten years."[6]

The FTC added this comment: "The Commission is less likely to pursue a prior approval provision against merging parties that abandon their transaction prior to certifying substantial compliance with the Second Request (or in the case of a non-HSR reportable deal, with any applicable Civil Investigative Demand or Subpoena *Duces Tecum*)." Under the pre-1995 policy, the FTC would seek prior approval of an abandoned deal only after being required to file a complaint in federal court.

As Commissioners Phillips and Wilson explained, these provisions go well beyond the prior approval policy that was in force before 1995.[7] Standard FTC policy then required prior approval provisions in merger consent orders, but the provisions were limited to deals in the same relevant market, and ten years was a maximum, not a minimum – and would be invoked only after a federal district court complaint was filed. There was also nothing about requiring buyers to submit to any prior approval requirement.

So why was the pre-1995 policy changed? And does the reasoning in 1995 have relevance to the economy today? A visit to the Coke/Dr Pepper saga from the 1980s and 1990s provides some answers.

II. *COCA-COLA/DR PEPPER*

On January 25, 1986, PepsiCo announced that it was acquiring 7-Up. At the time, Coca-Cola management had wanted to acquire Dr Pepper, but the company's terrific in-house competition counsel, Jim Koelemay, had advised that any such acquisition would be challenged by the FTC.

2 https://www.ftc.gov/legal-library/browse/statement-commission-use-prior-approval-provisions-merger-orders.

3 https://www.ftc.gov/system/files/documents/public_statements/410471/frnpriorapproval.pdf.

4 See Remarks of Chair Lina M. Khan Regarding the Proposed Rescission of the 1995 Policy Statement Concerning Prior Approval and Prior Notice Provisions (July 21, 2021), https://www.ftc.gov/system/files/documents/public_statements/1592338/lk_remarks_for_1995_rescission_-_final_-_1230pm.pdf.

5 At the time the new policy was adopted, former FTC Commissioner Chopra had already moved to become the Director of the Consumer Financial Protection Bureau but was said to have cast his vote before leaving. Commissioners Phillips and Wilson dissented, in the course of which they dubbed this a "zombie" vote. Dissenting Statement of Commissioners Christine S. Wilson and Noah Joshua Phillips Regarding the Statement of the Commission on Use of Prior Approval Provisions in Merger Orders (Oct. 29, 2021), at https://bit.ly/3QYggCD.

6 https://www.ftc.gov/legal-library/browse/statement-commission-use-prior-approval-provisions-merger-orders.

7 Dissenting Statement of Commissioners Wilson and Phillips, *supra* note 4.

So when Pepsi's announcement was made, Coke's senior management asked whether Pepsi just had better lawyers (!) and (more seriously) determined that, if Pepsi could do it, so would Coke. On February 21, 1986, Coca-Cola announced that it would buy Dr Pepper.

The two announcements made a big splash. Royal Crown sought a preliminary injunction against both deals in a Georgia district court, but the motion was quickly denied as there could be no irreparable harm from a transaction at the beginning of FTC review. The parties sought to persuade the Commission that deals would increase market output and benefit consumers, but the FTC was having none of it and voted in June 1986 to challenge both transactions. Pepsi, true to form, abandoned its proposed merger before any complaint could be filed.[8] Coke did not.

The Commission voted out a complaint on June 24, 1986, and the parties proceeded to trial in the District of Columbia in delightful July DC weather before Judge Gerhart Gesell. Judge Gesell was the legendary advocate who, among many other accomplishments in private practice, won the *duPont/Cellophane* case in the Supreme Court. But he was no shill for defendants in antitrust cases, with his basic 1960s antitrust outlook. As we would soon learn.

Trial. Trial lasted two weeks. My job was to prepare our economists (Will Baumol and Bill Lynk) and depose the FTC's (Larry White). The legendary Gordon Spivack argued the case and handled the witnesses at trial. The evidence was essentially undisputed that the acquisition would increase the share of the leading firm in carbonated soft drinks, which was found to be the relevant market and highly concentrated. But it was also undisputed that Coke lacked single-firm market power in any geographic market, that there were significant efficiencies as Dr Pepper was predominantly sold by Coke bottlers, and that the acquisition would increase market output. Judge Gesell was unfazed. On July 31, he issued an opinion enjoining the merger.[9]

Appeal. Coca-Cola quickly appealed. But just as I finished our appeal brief, Dr Pepper pulled the plug on the deal[10] and soon afterwards was sold to the Hicks & Haas investment firm. (Dr Pepper is now part of the Keurig/Dr Pepper-7-Up/Snapple group.) The case had become moot as a result of the sale, and we revised our appeal to argue that Judge Gesell's ruling should be vacated as a result. FTC staff opposed our motion, but the Court of Appeals agreed and vacated the ruling.[11] The D.C. Circuit panel on the case included Robert Bork and Douglas Ginsburg. We were left to wonder what the outcome of a merits appeal would have been.

Administrative proceedings. Back at the FTC under Part III, the case was still moot and Coca-Cola argued that further proceedings would "not be in the public interest" (the FTC standard whether to pursue a case) as a result. Ultimately, Complaint Counsel and the ALJ agreed and recommended dismissal of the case. But the Commission, by a 2-1 vote (Chairman Oliver dissenting), found otherwise, saying: "We are not persuaded that subsequent events have eliminated the need for some form of prior approval relief if a violation of law is established. Notwithstanding Respondent's arguments to the contrary, continuation of this proceeding is therefore in the public interest."[12] So the case was sent back to determine whether the acquisition in fact was unlawful and, if so, to enter a 10-year prior approval order for any proposed acquisition in the carbonated soft drink industry.

Most companies in this context submit to prior approval orders and settle. That was not an option for Coke. Prior approval would put Coke in a position where, if an asset or company came up for sale, Pepsi could buy it (subject of course to the HSR process), but Coke could not – at least without a long review by FTC staff and the consent of a then-hostile FTC. The owners of the asset would obviously prefer Pepsi in that context, and Coca-Cola would be at a serious disadvantage in this famously competitive business. So a moot case went to trial solely because of the prior approval threat.

The case was tried over several weeks before the ALJ, the first time in memory that a genuinely moot case went to trial – and this one was a major resource commitment from both sides. ALJ Parker ultimately concluded that the merger violated Clayton Act § 7 and FTC Act § 5. He declined, however, to enter a prior approval order, finding it unnecessary and contrary to the public interest.

Both Coke and Complaint Counsel appealed to the full Commission, which unsurprisingly affirmed the merits ruling in a 3-0 vote and ordered a 10-year prior approval requirement. The order provided that, without the Commission's prior approval, Coca-Cola could not acquire

8 In the *Sun-Drop* case in North Carolina, where RC bottlers were suing both Coke and Pepsi bottlers, Pepsi settled two days before trial. In the *Harmar* case in east Texas state court, where again RC bottlers were suing, Pepsi again settled on the eve of trial.

9 *FTC v. Coca-Cola Co.*, 641 F. Supp. 1128 (D.D.C. 1986), *vacated as moot*, 829 F.2d 191 (D.C. Cir. 1987).

10 Dr Pepper Halts Plan to Merge with Coca-Cola (Aug. 6, 1986), at https://www.latimes.com/archives/la-xpm-1986-08-06-fi-1607-story.html.

11 *FTC v. Coca-Cola Co.*, 829 F.2d 191, 1987 U.S. App. LEXIS 17849 (D.C. Cir. 1987).

12 *Coca-Cola Co.*, Dkt. 9207, 1988 WL 490206 (FTC Aug. 9, 1988).

anyone "engaged in the manufacture and sale in the United States of branded concentrate or branded syrup . . . or engaged in the franchising or licensing of any brand, name, or trademark used in the United States in connection with the production, marketing, or sale of branded concentrate, branded syrup, or branded carbonated soft drinks."[13] Prior approval was not required for tiny acquisitions; for those there was a prior notice requirement.

Appeal and resolution. Coca-Cola appealed once again to the D.C. Circuit. The arguments on the merits were largely the same, but the disparity between the treatment of Pepsi (who after all started the whole mess) and Coke was an additional point. While the appeal was pending, President Clinton appointed Robert Pitofsky to be the Chairman of the FTC. Pitofsky was firmly committed to aggressive antitrust enforcement. But he disagreed with the Commission's prior approval policy, and so there was room for a settlement.

On May 18, 1995, a little over a month after Pitofsky became FTC Chairman, the case settled. Coke withdrew its appeal and the Commission entered a modified order under which: "Coca-Cola [was] required to notify the FTC and the Department of Justice before acquiring more than $15 million in assets or voting securities from an entity worth more than $10 million," i.e. a prior notice provision. Prior approval was no longer required except that Coke would have to seek prior approval if it sought to acquire Dr Pepper again. A final order to that effect was entered May 25, 1995.[14] The vote was 3-0.

Revised prior approval policy. The Commission explained its reasoning in jettisoning the prior policy:

- *Preventing facially anticompetitive deals*. Too many deals that should have died in the boardroom get proposed because merging parties are willing to take the risk that they can 'get their deal done' with minimal divestitures. Acquisitive firms in particular are too willing to roll the dice on an anticompetitive deal because there are few downsides (from their perspective) to their long-term strategy that contemplates other acquisitions down the road. . . .

- *Preserving Commission resources*. Challenging anticompetitive mergers—through litigation or settlement—is a resource intensive enterprise that puts pressure on the Commission's limited staff and budget. Where the Commission has expended those resources to understand the competitive dynamics and market structure of a particular market, the Commission should not have to incur additional costs by either (1) re-reviewing the same transaction on numerous occasions or (2) reviewing a similar transaction by one of the merging parties in the same market. . . . Conducting merger review after a petition for prior approval would allow the Commission to husband its scarce resources without the brinksmanship we encounter during HSR reviews.

- *Detecting anticompetitive deals below the HSR reporting thresholds*. Incorporating prior approval provisions in Commission orders reduces the risk that the Commission will not learn of harmful mergers that do not trigger federal antitrust reporting requirements. . . . Absent these provisions, the Commission often learns about these deals without sufficient time to investigate and, if necessary, block the transaction.[15]

Apart from ignoring the significant burden that prior approval can put on companies, and the competitive disadvantage it can place on firms (such as Coca-Cola faced), these explanations just do not hold up. Transactions under HSR thresholds is the strongest argument, but a prior *notice* requirement would alleviate any such concern; even without prior notice, most transactions worth pursuing will be announced publicly and, if the deal really is problematic, affected parties can complain. The "prevent facially anticompetitive deals" excuse is even worse. If the Commission is doing its job, it will block such transactions through the normal HSR process. And "preserving Commission resources" has it backwards. Prior approval requires the Commission to investigate *every* proposed transaction, not just those that pose some competitive risk. That can require more resources, not less, than relying on the normal HSR process.

The dissenting statement from then-Commissioners Phillips and Wilson identified a number of other problems with the policy change. Significantly, as they explained, FTC review of transactions under prior approval petitions takes much much longer than HSR reviews for the simple reason that there is a statutory clock on HSR deals but not for prior approval petitions. The divestiture buyer remedy is especially problematic in this context. When assets are being sold off, either because of FTC litigation or otherwise, buyers subject to a prior approval remedy will be at a major disadvantage because of the lengthy time it will take to gain prior approval. Divestitures are almost always difficult. But this requirement will make them even more so by chasing potential buyers away. Buyers in bankruptcy subject to prior approval will be left out almost entirely

13 *Coca-Cola Co.*, 117 F.T.C. 795, 1994 WL 16011006 (June 13, 1994).

14 *Coca-Cola Co.*, 119 F.T.C. 724 (1995).

15 Statement of the Commission, *supra* note 1.

because the bankruptcy timeline is necessarily short and the prior approval process necessarily long. Sellers in bankruptcy will be disadvantaged because a sale cannot be approved until the FTC has weighed in.

Further, as the dissenters explained:

> [T]he majority seems to relish the prospect of controlling the clock, stating that "[c]onducting merger review after a petition for prior approval would allow the Commission to husband its scarce resources without the brinksmanship we encounter during HSR reviews." Particularly given the torrent of prior approval deal notifications the agency will receive once this policy is up and running, we anticipate lengthy delays in deal review. A lengthy investigation can be a death knell for many deals as financing runs out, suppliers and customers hesitate to do business with the merging parties whose futures remain uncertain, and the parties hemorrhage employees in the face of uncertainty. For the majority, though, this is a feature, not a bug.[16]

III. CONCLUSION

Mergers and acquisitions can harm competition. That is one of the major reasons why we have the Sherman, Clayton, and FTC Acts to begin with. And some deals are really bad (whether they harm competition or not). AOL/Time Warner is an example. But they can also provide huge benefits to the economy. Take Google's 2006 acquisition of YouTube, where YouTube was on a path to go out of business had Google not acquired it and then enhanced its offering with better monetization and many improved, consumer-friendly features. Presumably, even the FTC would agree that the combination of Keurig, Dr Pepper, 7-Up, and Snapple was procompetitive as well. There are too many others to mention. By acquiring firms that allow for the creation of a new product, provide enhanced features for existing products, or that sharply reduce costs, mergers can allow competition and innovation to thrive. Putting roadblocks in the way of virtually every merger can only harm the economy.

16 Dissenting Statement of Commissioners Wilson and Phillips, *supra* note 4.

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