Antitrust Issues in Mergers & Acquisitions

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Syllabus

- Key developments in 2009
- What are the substantive "*antitrust issues*" in an M&A transaction? (*What* to look for.)
- What are "antitrust *moments*" in the life of an M&A transaction? (*When* to look for it.)
- Important antitrust issues, including
  - Antitrust risk assessment
  - Merger notification (US and abroad)
  - Contract drafting
  - Gun jumping and information exchange

Key developments in 2009

FTC v. WholeFoods	Low FTC injunction standard; market definition; inframarginal customers
FTC v. CCC Holdings	Coordinated effects in intransparent market; no unilateral effects in 3-2 merger
FTC v. Thoratec	Future competition; strict requirements for proof of future output effects
FTC v. Ovation (Rosch/Leibowitz dissent)	Challenge based on changed incentives despite constant level of competition?
Omnicare v. United Health	Small teams, NDAs, data aggregation, mitigate gun jumping concerns

Coordinated effects

- Concern: After the merger, collusion among the remaining competitors to raise prices is more likely than before.
- Ask: “Will it be easier to expressly agree with the remaining firms on prices/business?”
- Ask: “Will it be easier to tacitly coordinate pricing/business with the remaining firms?”
  - Is the target a maverick or disruptor?
  - Is there a history of collusion in the industry?

Unilateral effects

- Concern: After the merger, the combined company will be able to profitably raise prices all by itself.
- Ask: “Will it be profitable to raise prices even without anyone else going along because everyone else is capacity constrained?”
- Ask: “Will it be profitable to raise prices for one of the two products even without anyone else going along because enough of the lost customers for product A will be recaptured by product B?”
  - Are products A and B the #1 and #2 choices for a significant group of customers?

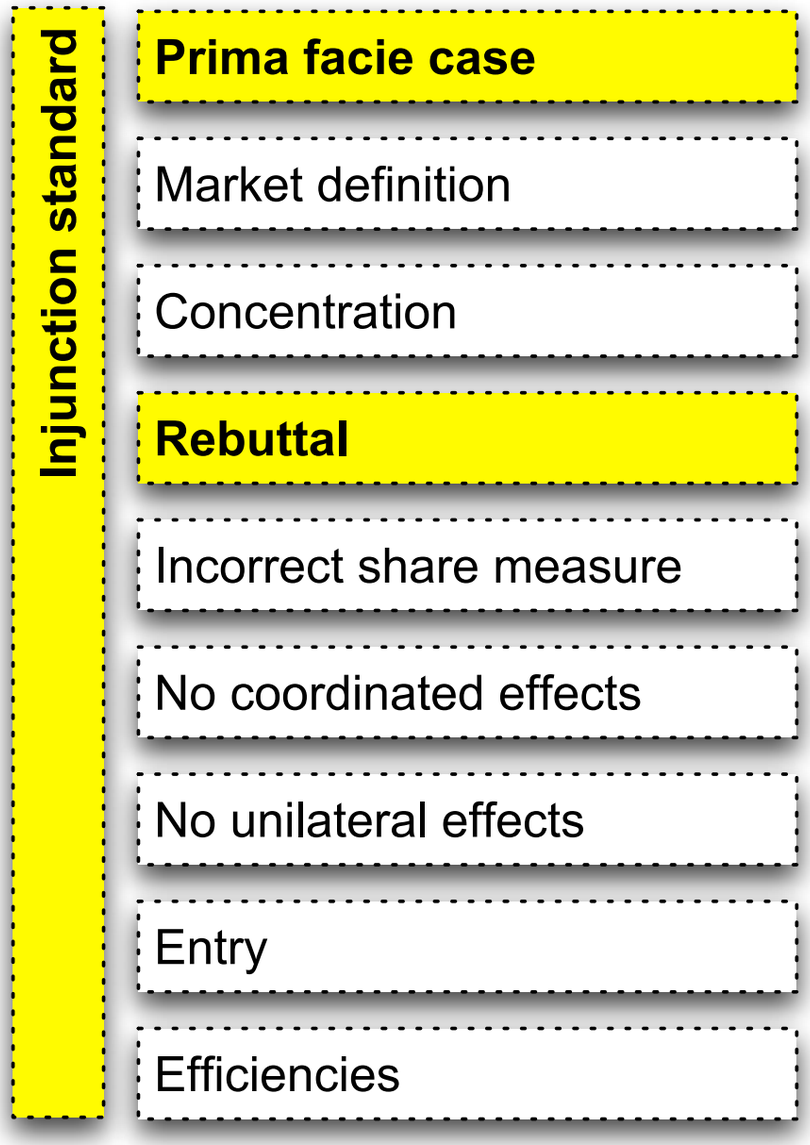
Antitrust risk assessment in a nutshell

- Why do the deal?
  - Take out a present or future competitor. Bad.
  - Sell more and better products to more customers more quickly and at a lower price. Good.
- What will the customers say?
  - Concerned, loss of an important supplier. Bad.
  - Excited about new products and better service. Good.
- What will happen to prices?
  - Rise. Bad.
  - Fall. Good.

Evidence for the antitrust risk assessment and beyond

- SEC filings; 10-Ks
- Internet; company websites; news; blogs
- Market studies (Gartner, Dataquest, etc.)
- Company documents evaluating the transaction (4c), including stand-alone and combined financial deal models
- Company documents discussing markets, market shares, competition, competitors (strategic plans, marketing plans, business plans)
- Company personnel interviews (sales, finance, R&D, corp dev.)
- Analyst reports
- Prior antitrust actions in the industry
- Win/loss CRM records
- Discount approvals
- Case law (courts, agencies, EU)
- Expert reports (industry, economic)
- Affidavits, open letters

Market definition and injunction standards



- The FTC has a much lower standard for a PI than DOJ
  - Preliminary injunction granted upon showing "serious, substantial" questions." *FTC v. Whole Foods Market*, Inc., 548 F.3d 1028, 1043 (D.C.Cir. 2009)
- 1960s-style Brown Shoe market definition is back with a vengeance
  - *FTC v. Whole Foods* (see above); *FTC v. CCC Holdings Inc.*, 605 F.Supp.2d 26 (D.D.C. 2009) rely extensively on *Brown Shoe v. U.S.*, 370 U.S. 294 (1962); practical indicia; documents, affidavits, etc.

Identifying the “antitrust moments” in the life of a deal

	Decision to sell (buy)	Solicitation of potential buyers (targets)	Negotiate letter of intent	Conduct due diligence	Negotiate and sign agreements	HSR process & integration planning	Closing	Integration
Management	X	X	X	X	X	X	X	X
Board of directors	X	X	X					
Investment bankers	X	X	X	X				
Lawyers			X	X	X	X	X	
Accountants				X	X		X	X
Business consultants	X					X		X
Key antitrust concerns	**Creation of misleading documents**	**Antitrust risk assessment**		**Information exchange**	**Risk allocation, document retention**	**HSR, Gun jumping, information exchange**		

Be mindful of the agencies as a "secondary audience" for documents

- Avoid terms with a specific antitrust meaning (e.g., competitor, market, leverage, entry) and inflammatory language (e.g., kill, crush, dominate, war and sports metaphors)
- Firms often define "markets" around a sub-set of *key customers* or *target customers*, even though their actual customer base might be much broader
  - Gives incorrect impression of narrow *relevant antitrust markets*
- Similarly, firms tend to focus on their *primary* competitors as proxies for competition in general
  - Gives incorrect impression of few firms and high market concentration
- Many firms (over-) emphasize investor selling points (e.g., high barriers to entry, highly optimistic stand-alone success projections), which often cause antitrust concerns
- Many of deal-related documents must be submitted to the FTC/DOJ with the HSR filing (Item 4(c) documents). The agencies often lack the proper context.
- Therefore: Get involved *early in the process*

Avoid misunderstandings

Ambiguous	**Clear**
“We will pick up big share in the green widget market”	“We will expand capacity and grow our presence in widgets”
“We will have an 85% widget market share.”	“We will have a significant presence in purple inverted widgets (85%), though we compete with green and blue ones too.”
"We will dominate this market."	"We will be a leading supplier."
“With this deal we will kill (crush, annihilate, nuke, etc.) Competitor X.”	“This deal will enable us to build the products that our customers really want.”

Real life example of a bad document

"Reasons to do this deal:

1. **Elimination of an acquisition opportunity for a conventional supermarket** — [Wild Oats] is the only existing company that has the brand and number of stores to be a meaningful springboard for another player to get into this space. Eliminating them means eliminating this threat forever, or almost forever.

2. **Elimination of a competitor** — they compete with us for sites, customers and Team Members.

Note: these two points add tremendous value that does not show up in any of the pro formas."

John Mackey, CEO of WholeFoods to the Board

Risk allocation clauses in merger agreements

The parties should reach express agreement on the following points:

- Cooperation (before and during the investigation)
  - No acquisitions that would increase antitrust concerns
  - Inform each other of government contacts; share submissions prior to filing; schedule joint government meetings and client interviews.
- Commitment ("best efforts")
- Divestitures
- Break-up fees and termination
- Costs

“Best efforts” and intentional uncertainty

	Commercially reasonable efforts	Reasonable best efforts	Best efforts
Substantial compliance with second request	yes	yes	yes
Preliminary injunction litigation	maybe	maybe	yes
Divestitures	no	probably not	yes

Note that the case law is often unclear and varies from state to state. The purpose of this chart is to flag an important issue but it cannot substitute for your own research.

Levels of commitment: common examples

- Low
  - Buyer or seller may walk if second request is issued
- Medium
  - Buyer must litigate and if need be (i) sell specific assets or (ii) up to a fixed amount (EBITDA) or (iii) up to a materiality threshold (target/combined company)
- High
  - Buyer must close “come hell or high water,” i.e., litigate and if need be sell overlapping assets and any other consent order requirements to consummate the acquisition

Common termination events

- Merger agreements commonly provide for "termination events," with or without (escalating) termination fees
- Issuance of second request
- Agencies (decide to) bring a lawsuit
- Court issues preliminary injunction
- Outside date (usually 6 to 9 months)
- Final, non-appealable court order (years)

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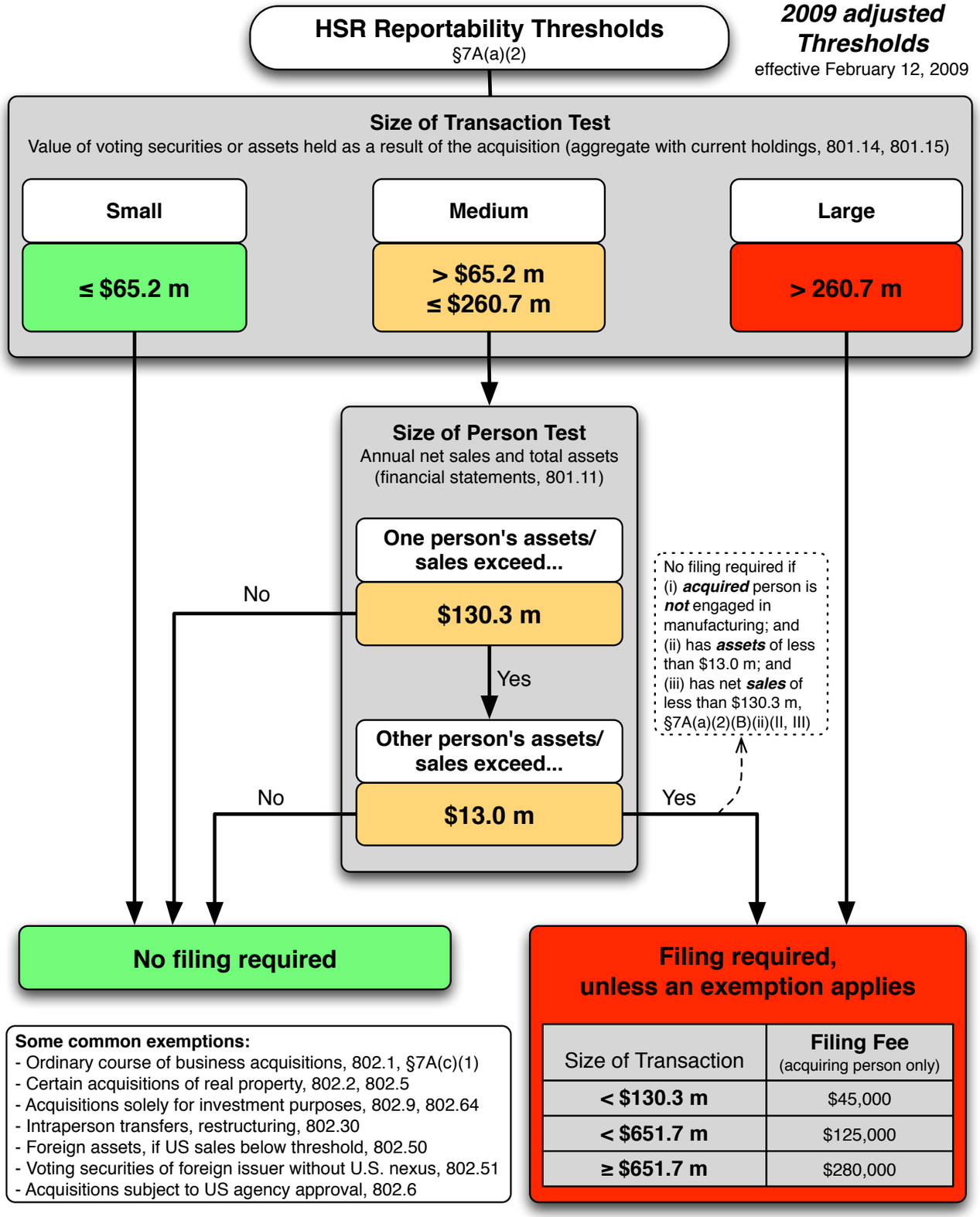
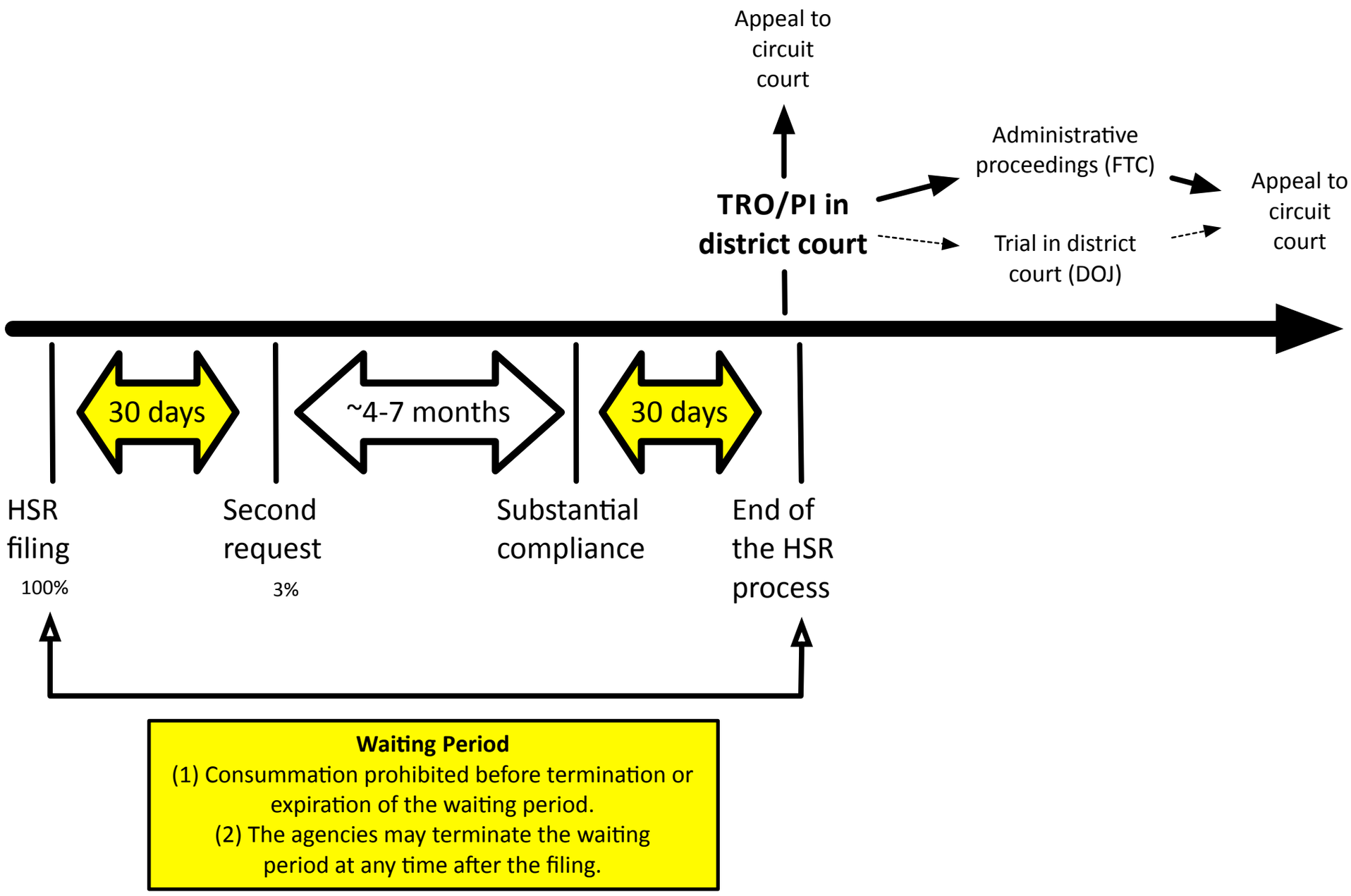


Sources: HSR Act (§7A Clayton Act,15 USC §18a), Coverage Rules and Exemption Rules (16 CFR Parts 801 and 802)

When is a transaction reportable?

Please see separate handout

The (normal) Pre-Merger Notification Process



Item 4(c) documents

- *Universe:* "All documents," including hardcopies, electronic documents, emails, voicemails at work and in home offices
- *Content:* Discussing markets, market shares, competition, competitors. Also expansion and potential for sales growth *of the combined company*
- *Custodians:* Prepared by or for (real) officers and directors
  - General presumption that what's in a D/O's files was prepared for him or her
- *Finals and final drafts only:* Earlier drafts don't qualify unless presented to the board of directors
- *Automatic 4(c)s:* Banker's books and offering memoranda
- *Common sources for 4(c)s:* D/O files, deal team, strategic development group, investment bankers, business consultants

Bruno, Mohr, Prager, Locating and Identifying Item 4(c) Documents, Antitrust (2002)

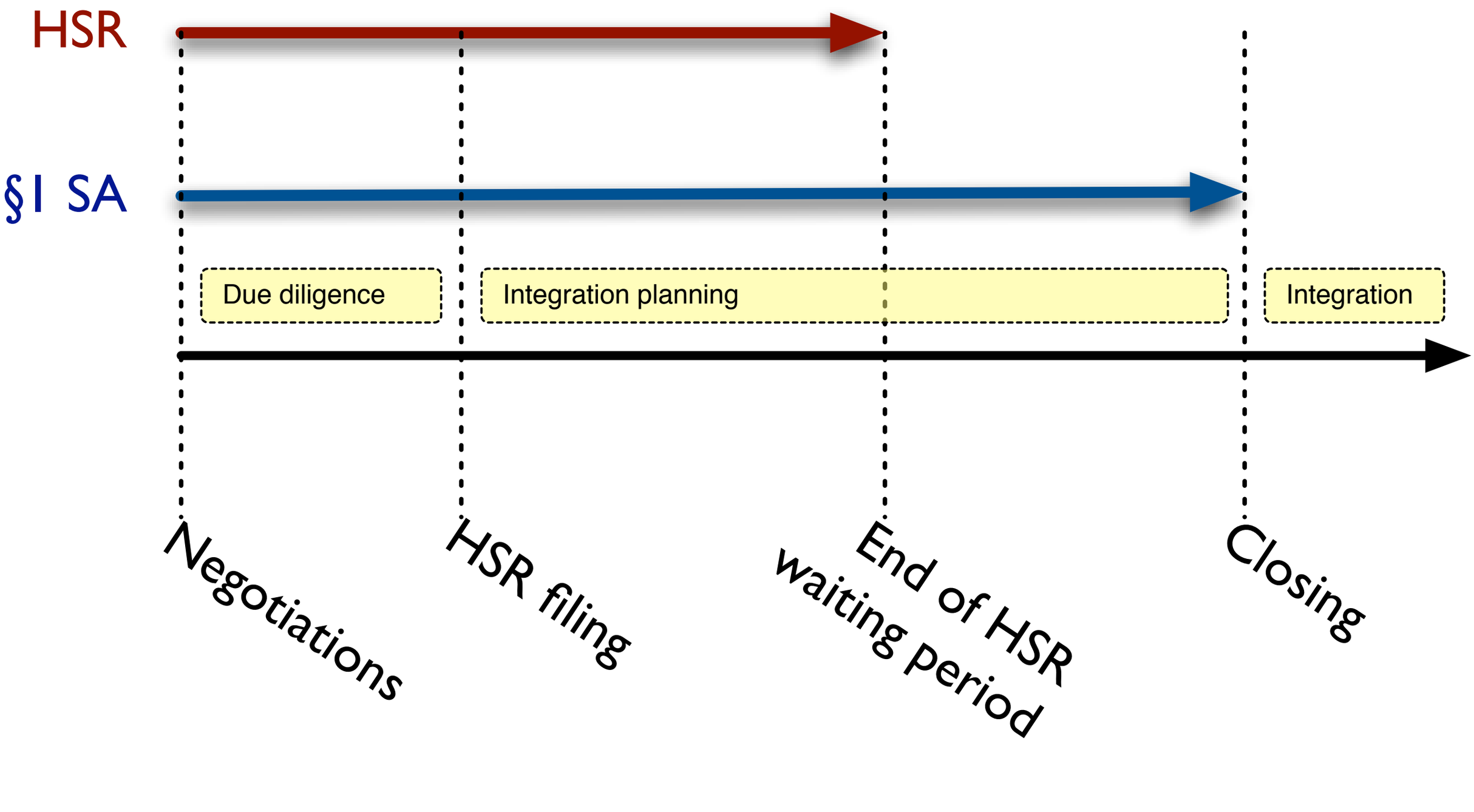
Multi-jurisdictional filings

- Over 100 jurisdictions have merger control regimes
  - Some filings are voluntary, others mandatory
- Different triggers, timing, effects
  - Revenue, assets, market shares
  - Signing, pre-closing, post-closing
  - Waiting period, affirmative clearance
- Best practices
  - Jurisdictional analysis by way of elimination
  - Substantive briefing memo from global counsel for all local counsel
  - Timing is critical

Pre-closing information exchange

- Practical necessity for due diligence (purchase price) and integration planning (post-merger operations and strategy)
- Problem: Knowledge of the other firm's sensitive information might inform unilateral pre-merger conduct and coordinated interaction ("spill over")
  - Legal standard: §1 rule of reason
- Solutions: Use of historic or aggregated information, separation of integration and operation teams, third-party clean rooms
  - Confirmed by *Omnicare v. United Health* (2009)

Large horizontal mergers: HSR and §1



Integration planning

- Joint planning *for competitive post-closing conduct* is permissible ("After the merger, the joint firm will drop supplier x.")
  - But watch out for spill-over effects
- Agreements on *competitive pre-closing conduct* are impermissible ("Let's each drop supplier x now.")
  - *Gun jumping:* §1 (per se) and §7A ("beneficial ownership")
- Bona fide *unilateral pre-closing conduct*, even with an eye towards the closing, is usually permissible
  ("I will drop supplier x now." *But preserve evidence of the decision's unilateral nature*.)

Gun jumping: Examples

- Assuming operational control of the target by the buyer before the closing violates §1 and §7A
  - Target refers customers to buyer
  - Buyer installs employees at the target
  - Buyer has veto rights over target's day-to-day operations, discounts
  - Target and buyer agree to "slow roll" customer negotiations until after the closing

U.S. v. Computer Associates (2002)
Blumenthal, The Rhetoric of Gun Jumping (2005)

Joint communications

- Jointly *selling the transaction* to shareholders, customers and suppliers is permissible
- Jointly *selling the merging firms' products* before closing is generally not permissible ("gun jumping")
- Examples
  - Joint press release, announcing the transaction = OK
  - Joint calls to top customers and suppliers to tout the benefits of the transaction = OK (unilateral calls are preferable)
  - Joint calls to sell products pre-closing = Impermissible

Conclusion

- Watch out for (properly defined) *horizontal overlaps*
- Avoid creating misleading documents
- Anticipate antitrust risks and address them in the merger agreement
- Avoid gun jumping and properly manage the necessary information exchange
- Start early with the merger notification(s)