

Antitrust Issues in Mergers & Acquisitions

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Syllabus

- 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.)
- Critical antitrust issues
 - Document management
 - Antitrust risk assessment
 - Merger notification (US and abroad)
 - Risk shifting
 - Gun jumping and information exchange

Why are the antitrust laws concerned with mergers?

- *Assumption:* The more competitors there are, the better for the consumer
 - *Concern:* Mergers among competitors reduce the number of competitors in the market. Fewer competitors results in higher prices and *consumer overcharge*.
- *Assumption:* The more ways-to-market there are, the better for the consumer
 - *Concern:* Mergers between manufacturers and distributors may exclude competing manufacturers from bringing products to market (= *immediate effect*). Once the excluded manufacturer goes out of business, consumers are vulnerable to being overcharged (= *ultimate effect*).

Coordinated and unilateral effects

- Coordinated effects: After the merger, collusion among the remaining competitors to raise prices is more likely than before.
 - *Ask: “Imagine that today the VPs of Sales of companies A, B, C, and D get together and try to set up a cartel. Would that work? Now imagine the same thing after A merges with D. Would it work? Would it be easier?”*
- Unilateral effects: After the merger, the combined company will be able to profitably raise prices all by itself.
 - *Ask: “If you controlled the price for both product A and product B, could you raise prices for your product A in a way that you can’t today? How about for their product B?”*

Antitrust risk assessment in a (very small) nutshell

- **Where's the value in the deal?**
 - Expanding output, lower costs, enter new markets (good)
 - Eliminating a competitor (bad)
- **What will the customers say?**
 - Excited about new products and better service (good)
 - Concerned because they lose their (only) alternative (bad)
- **What will happen to price?**
 - Quality-adjusted price will drop (good)
 - Increased “pricing flexibility” (bad)

Challenge risk, based on FTC data

Competitors	Enforced/Closed	Risk of challenge
2 to 1	68/5	Very high
3 to 2	84/23	High
4 to 3	22/20	Medium
5 to 4	1/10	Low

The presence of hot documents and/or strong customer complaints move the 4 to 3 category from medium to high risk.

“Other” Markets (excluding grocery, oil, chemicals, pharmaceuticals)
FTC Merger Challenges Data, Fiscal Year 1999-2003. (Table 4.6.)

Identifying the “antitrust moments”

	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 “bad” documents	Antitrust risk assessment		Information exchange	Risk allocation, document retention	HSR, Gun jumping, information exchange		

Avoid creating “bad” documents

- Firms and their advisors often use terms with a specific antitrust meaning (e.g., competitor, market, leverage, entry) and inflammatory language (e.g., kill, crush, dominate, war and sports metaphors) in internal documents
- Firms tend to 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 high market concentration
- What’s good from an investors point of view (e.g., high barriers to entry) is often cause for concern from an antitrust point of view
- Many of those documents must be submitted to the FTC/DOJ with the HSR filing (Item 4(c) documents)
- Therefore: Get involved *early in the process*

Avoid misunderstandings

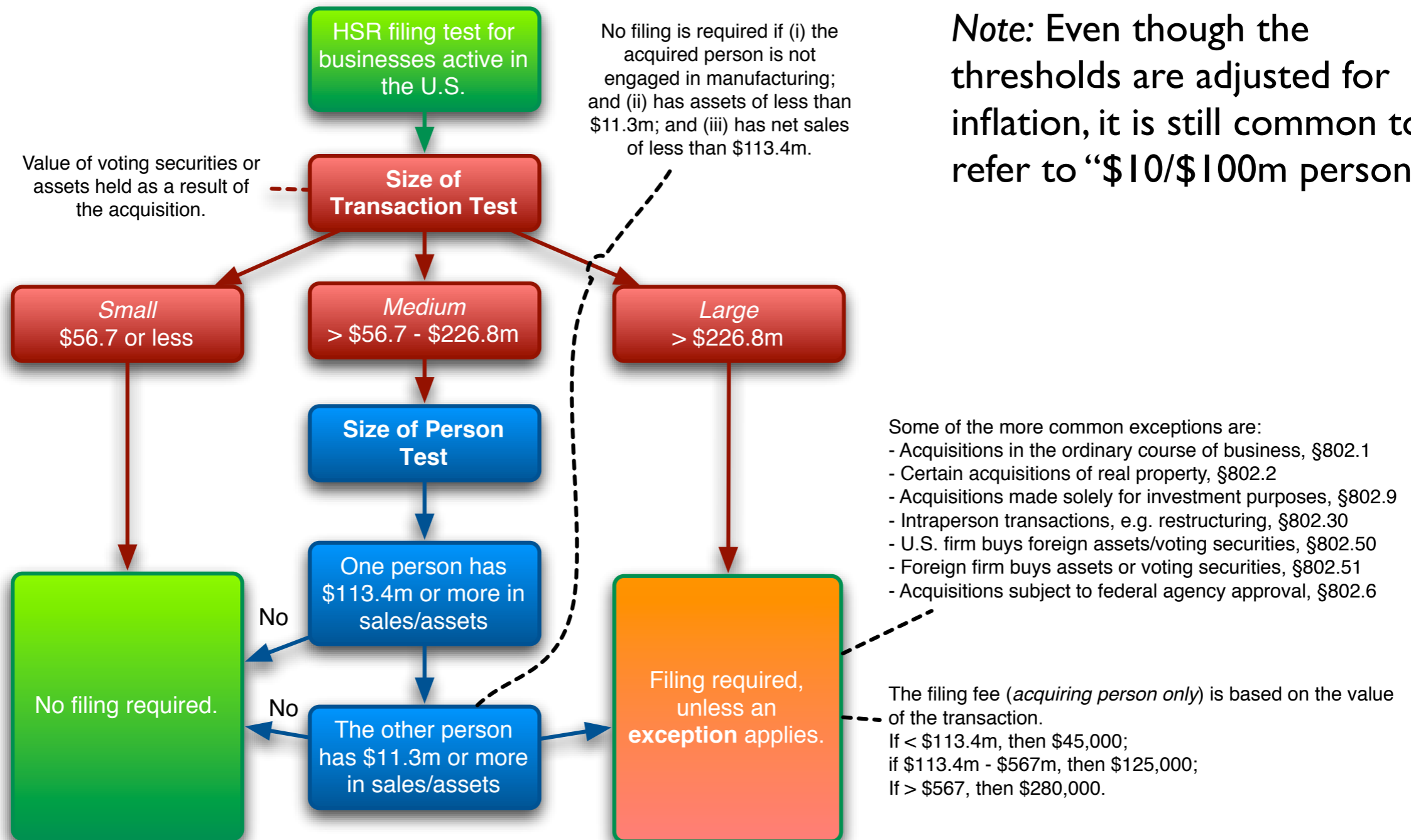
Ambiguous	Clear
We will pick up big share in the green widget market	We will expand capacity and grow our presence in widgets
We have an 85% market share in purple inverted widgets	We have a significant presence in purple inverted widgets (85%), though we compete with the green and blue ones too.
If we do this deal, we'll be able to leverage the customers better	If we do this deal, we will have more/better product to sell into our overall customer base.
"We dominate this market." "After the merger, we will dominate the market for purple inverted widgets."	"We are a leading supplier." "This deal will expand our market presence and enhance our ability to compete."
"With this deal we will kill (crush, annihilate, cripple, maim, nuke, etc.) Competitor X."	This deal will give us the products we need to beat the competition.

Antitrust risk allocation in merger agreements

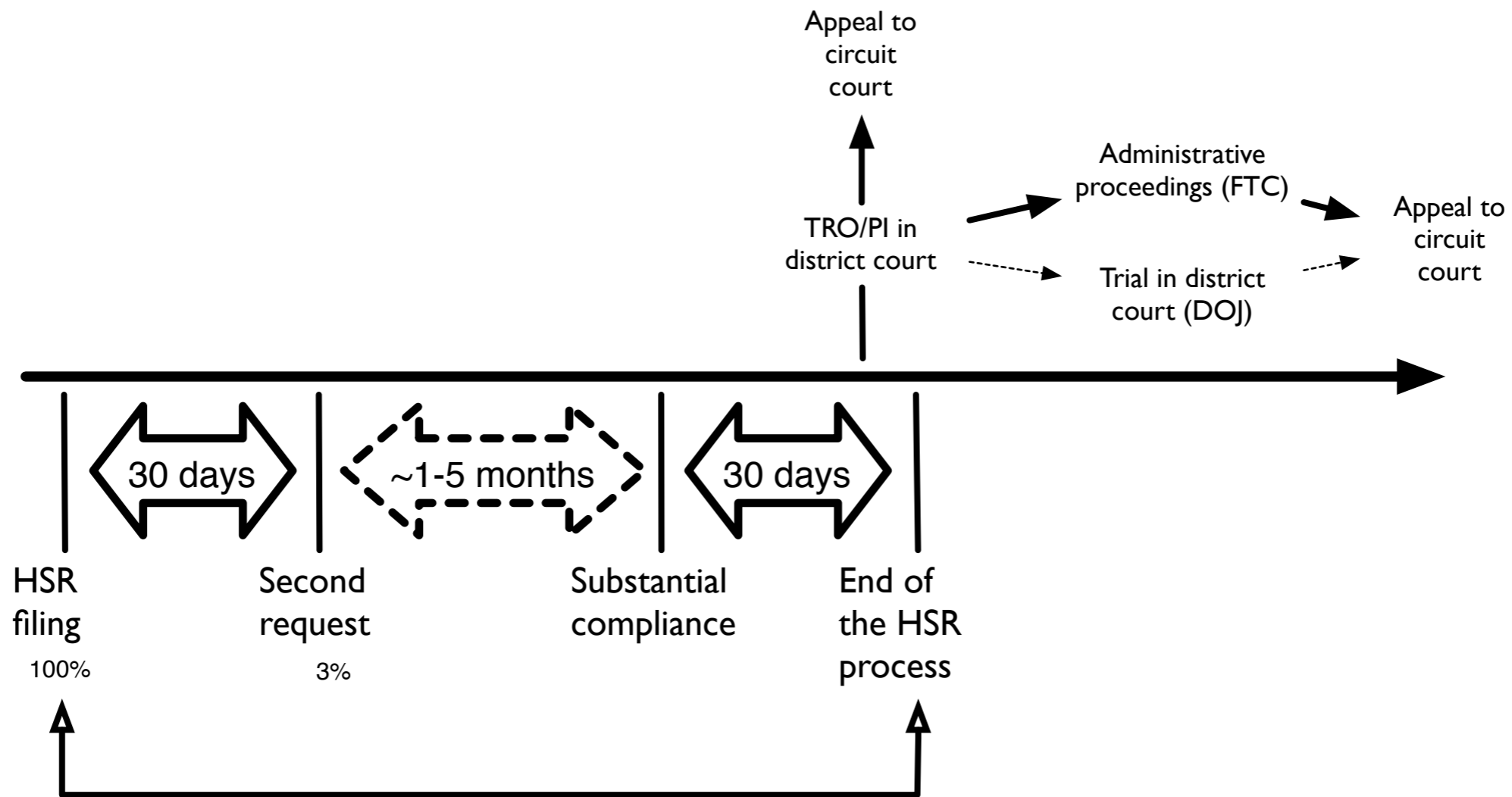
- Antitrust risks include delay, divestitures, injunction, costs, employee defection as a result of a government challenge
- **Seller's objective:** *To get the consideration, no matter what*
- **Buyer's objective:** *To get full value for the purchase price*

Common seller wish list	Common buyer wish list	Common compromise
Buyer to pay full purchase price, even if buyer has to divest the assets acquired or its present operations ("hell and high water clause")	No divestiture requirement. Buyer may walk if the government issues a second request, challenges the transaction, or requires divestitures.	Enumerated list of buyer divestitures. (Problem: Signals low hanging fruits to the government.)
Secure buyer commitment by way of "reverse break-up fee", if the deal can't be consummated because of antitrust problems	"No shop" provision imposed on seller. Secure seller commitment through break-up fee.	A buyer breakup fee is a common substitute for enumerated divestitures.
Buyer to use "best efforts." (Including divestitures)	Buyer to use "commercially reasonable efforts" (Excluding divestitures)	Both parties to use "reasonable best efforts." (Vague, uncertainty on both sides)

HSR filing requirements



The (normal) pre-merger notification process



Waiting Period

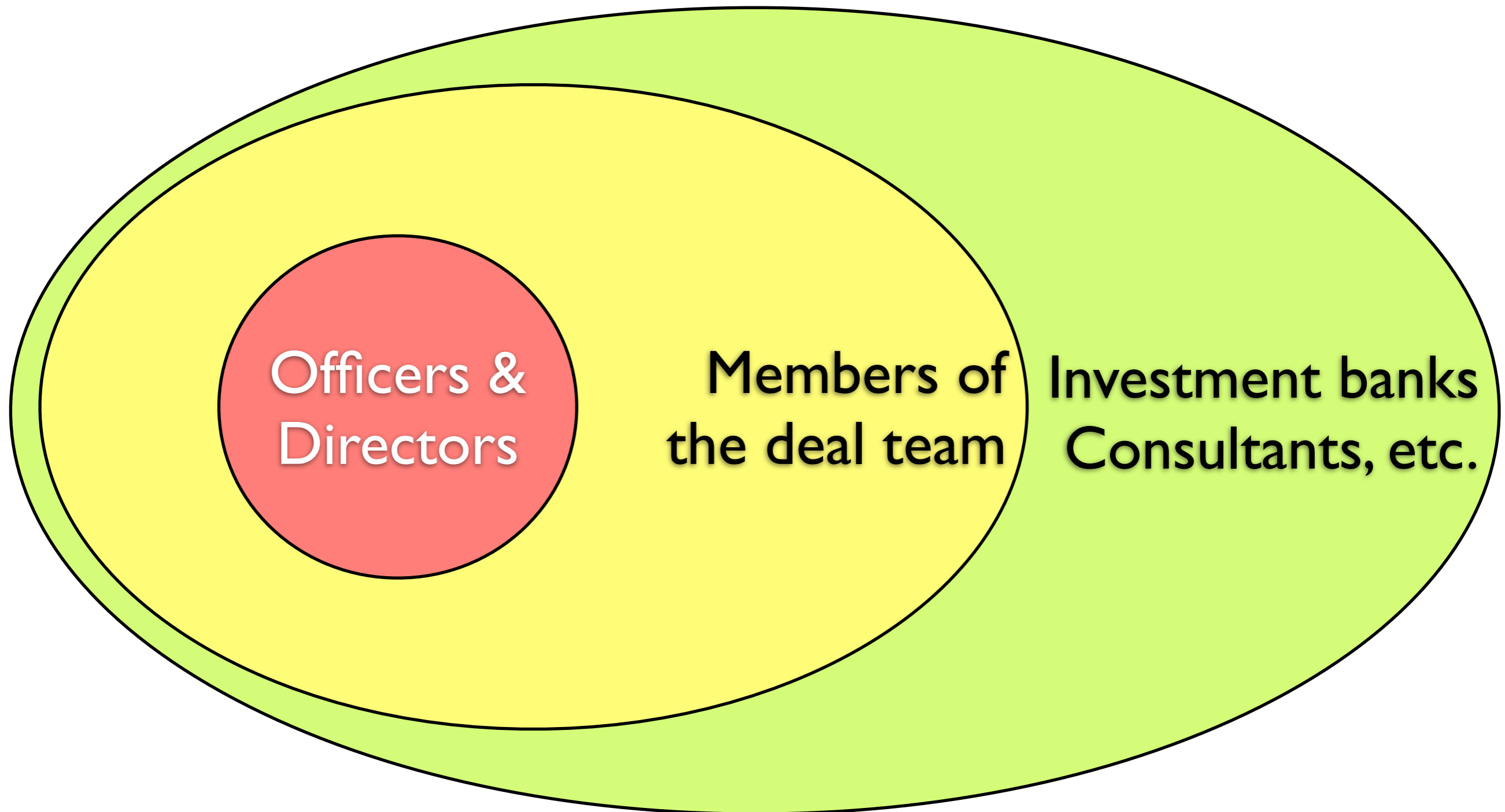
- (1) Consummation prohibited before termination or expiration of the waiting period.
- (2) The agencies may terminate the waiting period at any time after the filing.

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)

Locating 4(c) documents from the inside out



Multi-jurisdictional filings

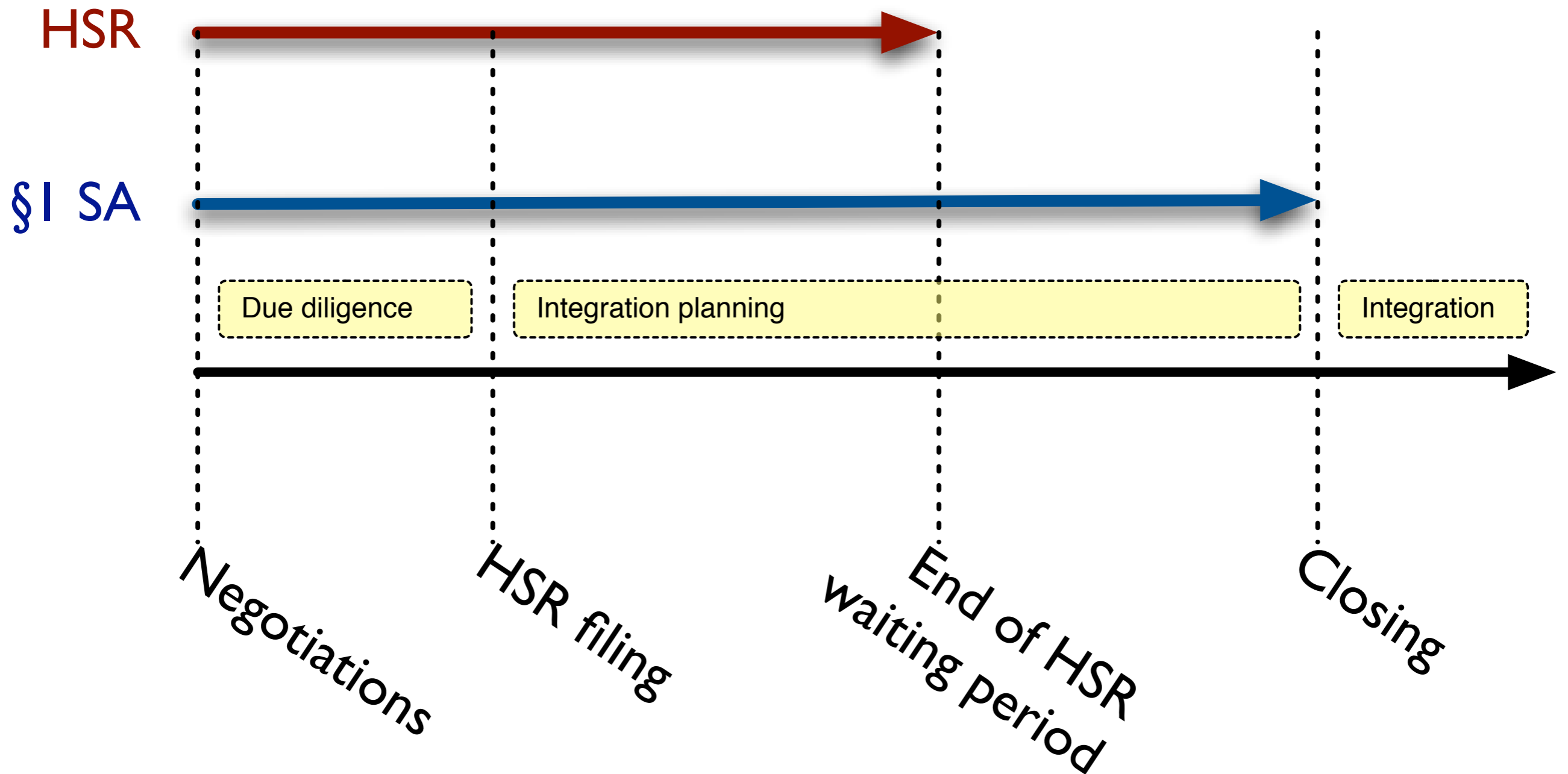
- Over 100 jurisdictions have merger control regimes
 - Some filings are voluntary, others mandatory
- Different **triggers**
 - Revenue, assets
 - Market shares
- Different **timing**
 - Signing, pre-closing, post-closing
- Different **effects**
 - Waiting period
 - Affirmative clearance
- Best practices
 - **Jurisdictional analysis** by way of elimination
 - **Master timeline** from global counsel with weekly status updates
 - **Substantive briefing memo** from global counsel for all local counsel
 - **One company point person** at the company for foreign agency contact
 - **Documentation** for future filings/requests
 - **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

Blumenthal, The Rhetoric of Gun Jumping (2005)

HSR and §1 both apply to large horizontal mergers



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.*)

Blumenthal, The Rhetoric of Gun Jumping (2005)

Gun jumping: Examples

- *Assuming operational control* of the target by the buyer violates §1 and §7A
 - Target refers customers to buyer
 - Buyer has veto rights over target's day-to-day operations
 - Target and buyer agree to “slow roll” customer negotiations until after the closing

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

Blumenthal, The Rhetoric of Gun Jumping (2005)

Conclusion

- Watch out for (properly defined) *horizontal overlaps*
- Key *antitrust moments* include: strategic decision to buy/sell, contract negotiation, due diligence, notification, agency investigation, integration, litigation
- Avoid creating “bad” 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)