

# Antitrust Issues in Mergers & Acquisitions

Hanno F. Kaiser

Latham & Watkins LLP  
Benjamin N. Cardozo School of Law



Boston  
2007

# 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*

# Lessons from *FTC v. Whole Foods*

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

# Avoid misunderstandings

| Ambiguous  | Clear  |
|--|--|
| We will pick up big share in the green widget <b>market</b>  | We will expand capacity and grow our presence in widgets   |
| We have an 85% <b>market share</b> 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 <b>leverage</b> the customers better                                      | If we do this deal, we will have more/better product to sell into our overall customer base.                         |
| "We <b>dominate</b> 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 <b>kill</b> (crush, annihilate, cripple, maim, nuke, etc.) Competitor X."              | This deal will give us the products we need to beat the competition.   |

# Risk allocation clauses in merger agreements

The parties should reach **express agreement** on the following points:

- Cooperation (before and during the investigation)
- Commitment (“best efforts”)
- Divestiture
- Break-up fees and termination
- Costs

# “Best efforts” and intentional uncertainty

|  | <b>Commercially reasonable efforts</b> | <b>Reasonable best efforts</b> | <b>Best efforts</b> |
|--|--|--------------------------------|---------------------|
| Substantial compliance with second request | yes                                    | yes                            | yes                 |
| Preliminary injunction litigation          | probably                               | probably                       | yes                 |
| Divestitures                               | no                                     | probably not                   | yes                 |

# Levels of buyer commitment

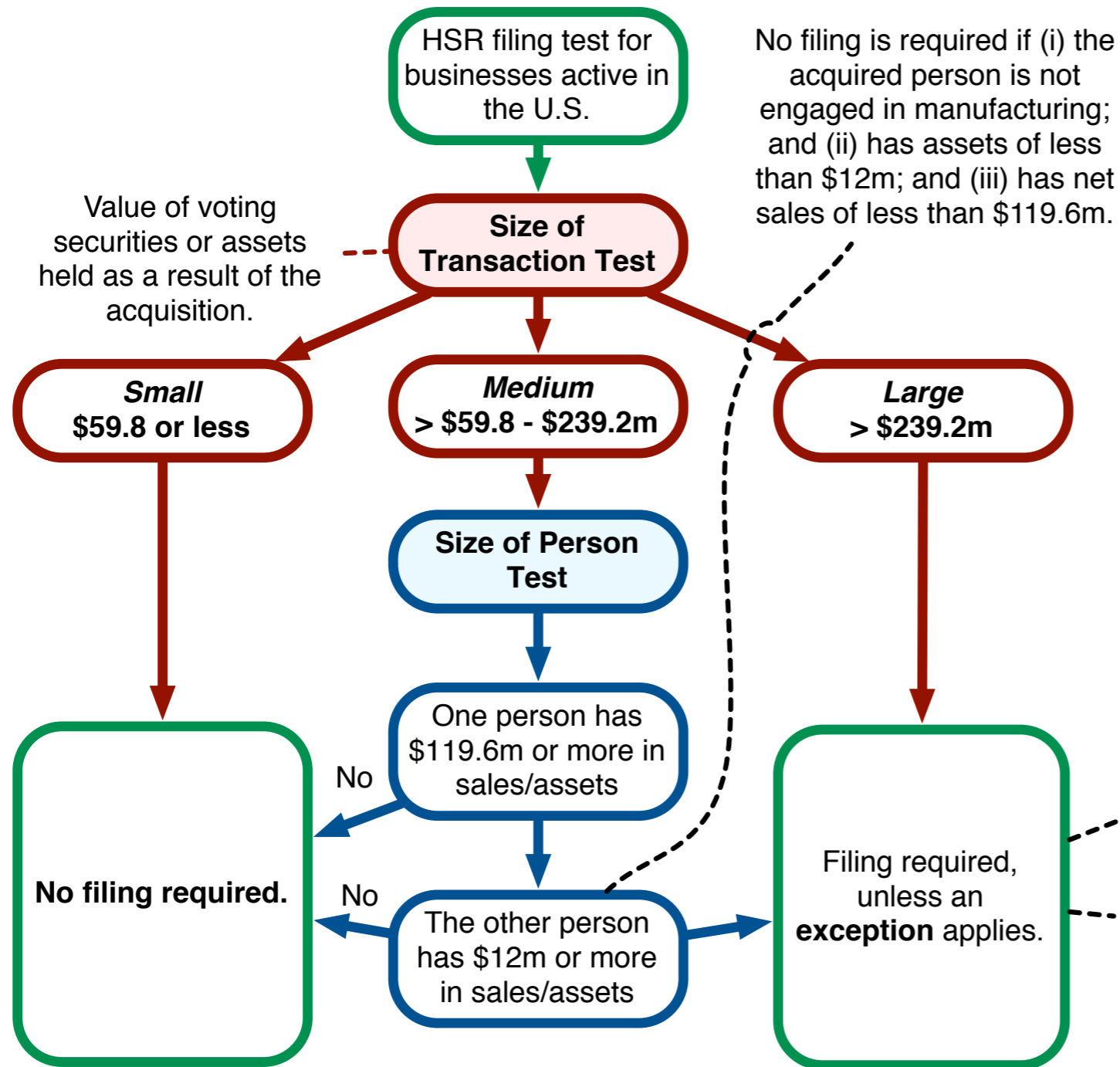
| Low  | Medium  | High   |
|--|---|--|
| Buyer may walk if a second request is issued | <p>Divestiture required:</p> <ul style="list-style-type: none"><li>• Of specific assets (risk of “signaling”)</li><li>• Up to a fixed dollar amount (EBITA)</li><li>• Up to a materiality threshold<ul style="list-style-type: none"><li>• Target only</li><li>• Combined company</li></ul></li></ul> | Buyer must close “come hell or high water” and divest all assets required to achieve that goal |

# 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)

# HSR filing requirements



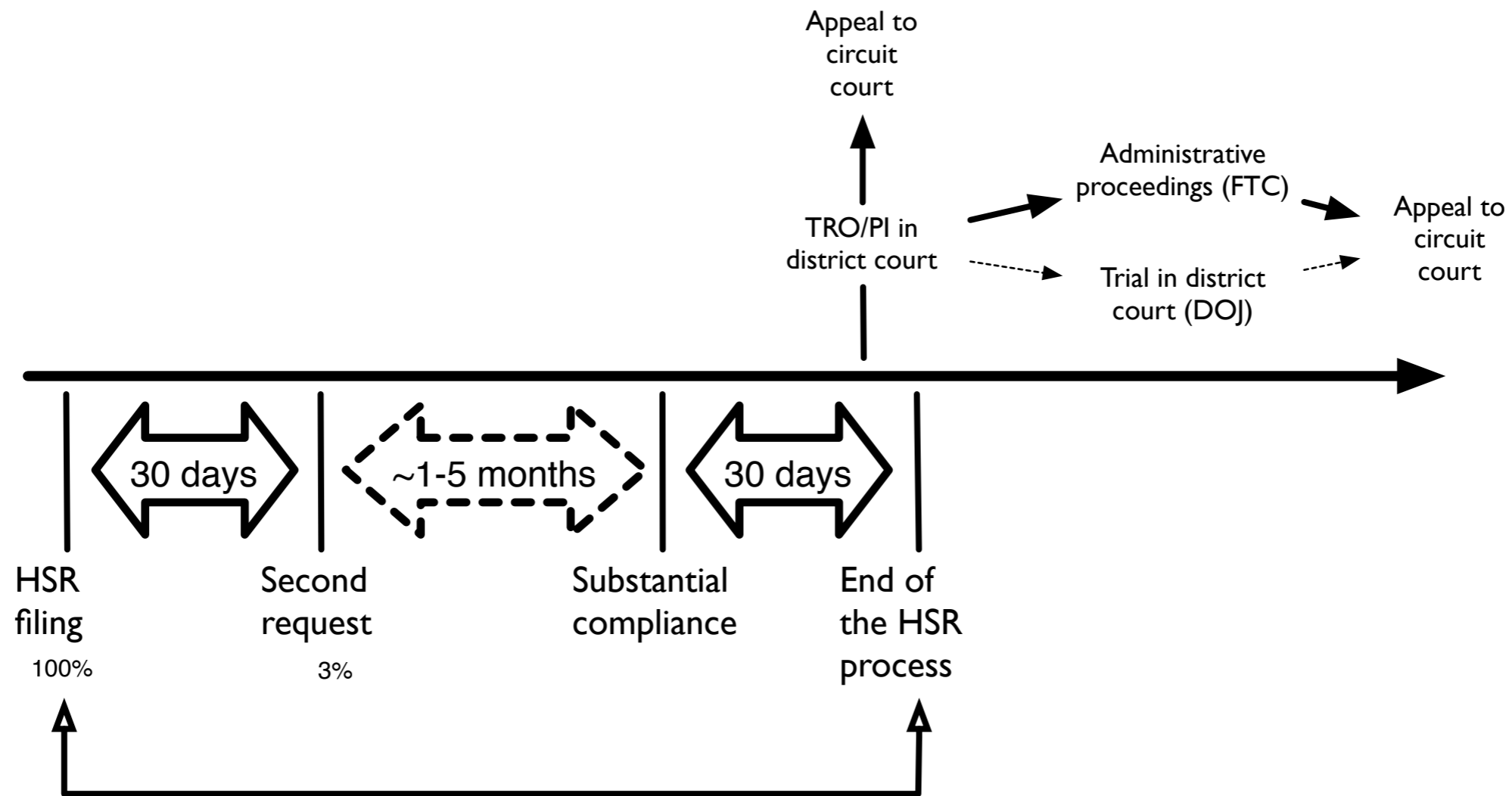
*Note:* Even though the thresholds are adjusted for inflation, it is still common to refer to “\$10/\$100m persons.”

- Some of the more common exceptions are:
- Acquisitions in the ordinary course of business, §802.1
  - Certain acquisitions of real property, §802.2
  - Acquisitions made solely for investment purposes, §802.9
  - Intraperson transactions, e.g. restructuring, §802.30
  - U.S. firm buys foreign assets/voting securities, §802.50
  - Foreign firm buys assets or voting securities, §802.51
  - Acquisitions subject to federal agency approval, §802.6

The filing fee (*acquiring person only*) is based on the value of the transaction.

- If <math>< 119.6</math>, then \$45,000;
- if <math>119.6 - 597.9</math>, then \$125,000;
- If > \$597.9, then \$280,000.

# The (normal) Pre-Merger Notification Process



## Waiting Period

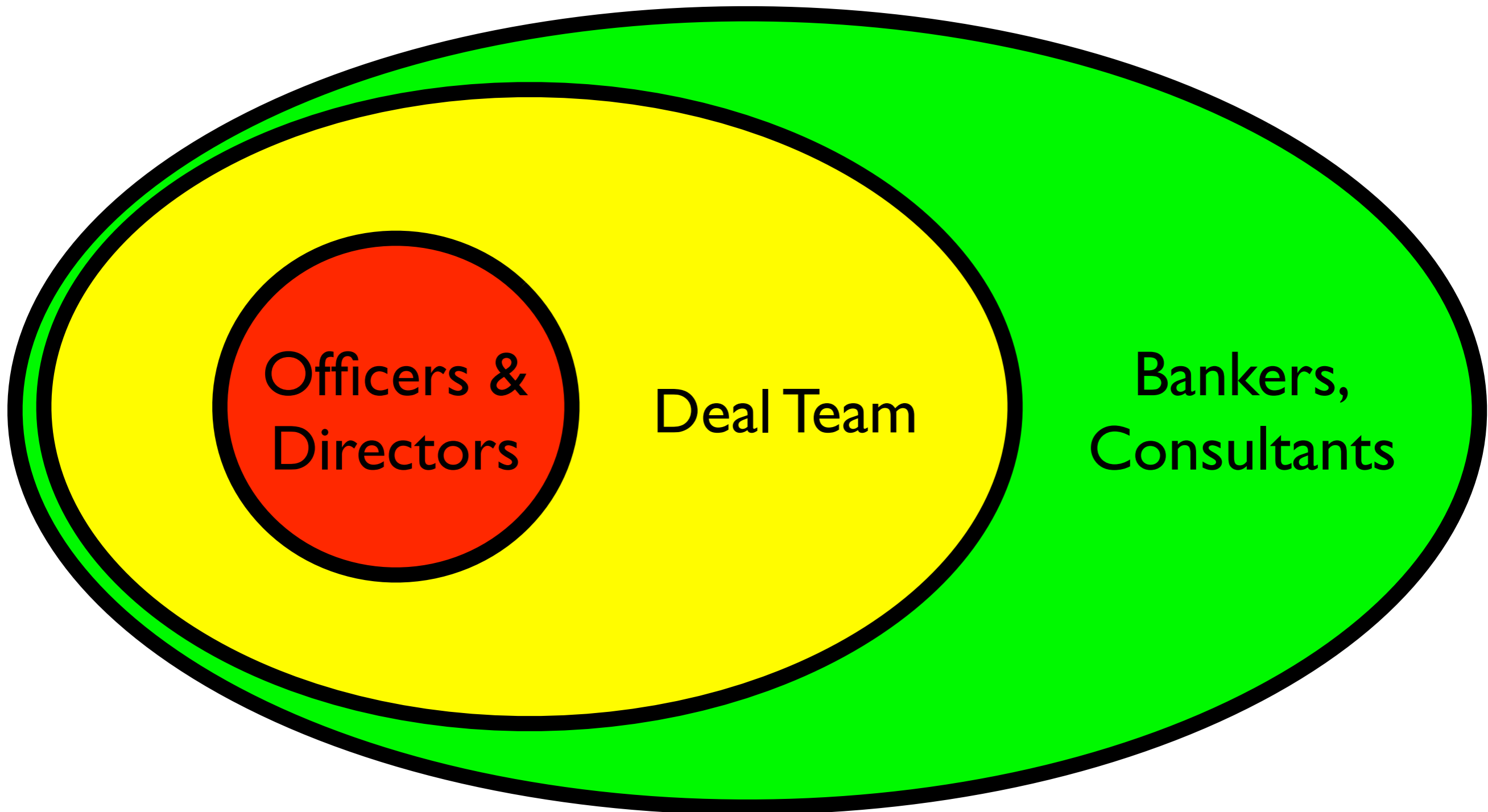
- (1) Consummation prohibited before termination or expiration of the waiting period.
- (2) The agencies may terminate the waiting period at any time after the filing.

# 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

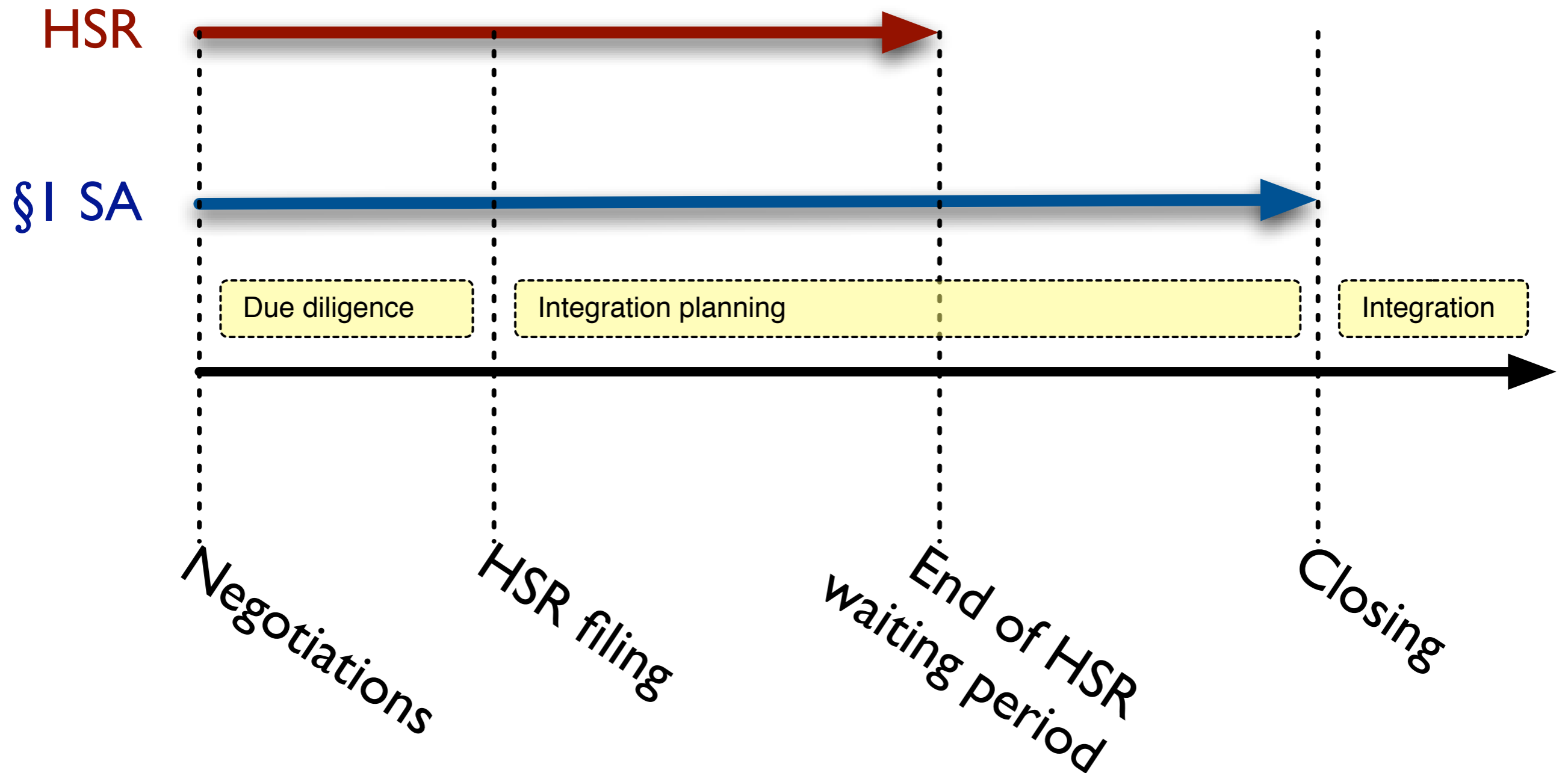
- Over 100 jurisdictions have merger control regimes
  - Some filings are voluntary, others mandatory
- Different **triggers**
  - Revenue, assets
  - Market shares
- Different **timing**
  - Signing, pre-closing, post-closing
- Different **effects**
  - Waiting period
  - Affirmative clearance
- Best 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)

**Thanks!**

hanno.kaiser@lw.com