

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, including
 - Antitrust risk assessment
 - Merger notification (US and abroad)
 - Contract drafting
 - Gun jumping and information exchange

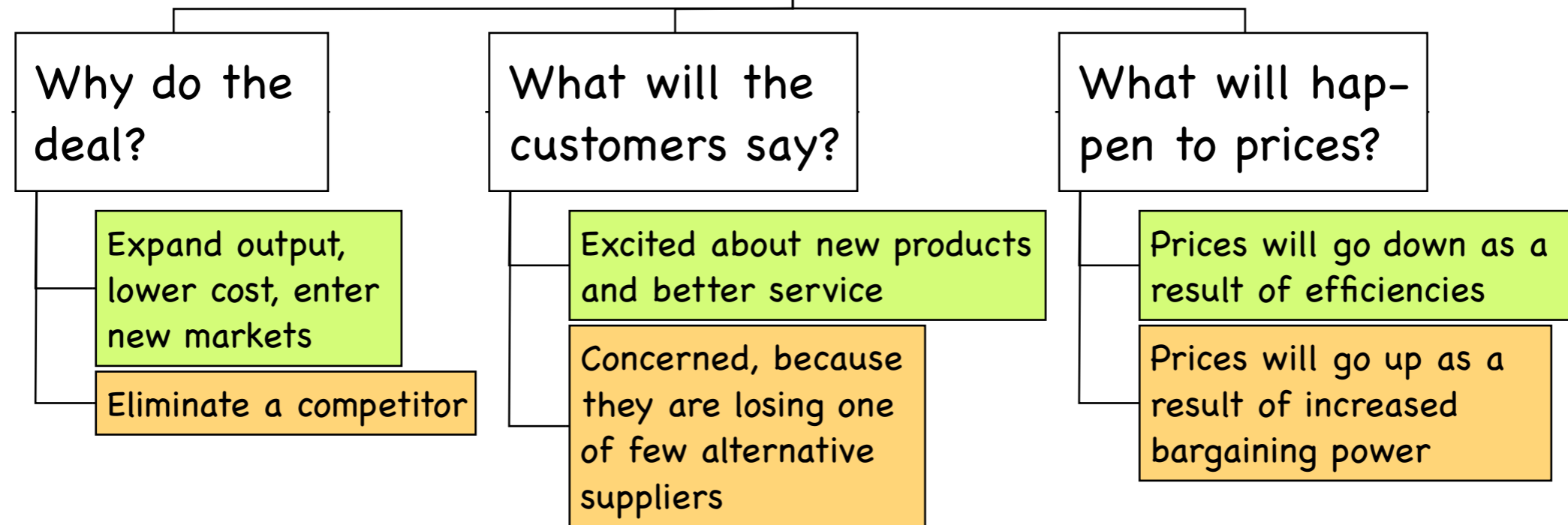
Coordinated effects

- Concern: “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

- Concern: “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?”
- Is the target the “next best substitute?”

Antitrust assessment in a nutshell



Challenge risk, based on FTC data

Competitors	Enforced/ Closed	Risk
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		

Here's 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."

Avoid creating bad 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 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.
"We dominate this market."	"We are a leading supplier."
"With this deal we will kill (crush, annihilate, nuke, etc.) Competitor X."	This deal will give us the products we need to beat the competition.

Risk allocation clauses in merger agreements

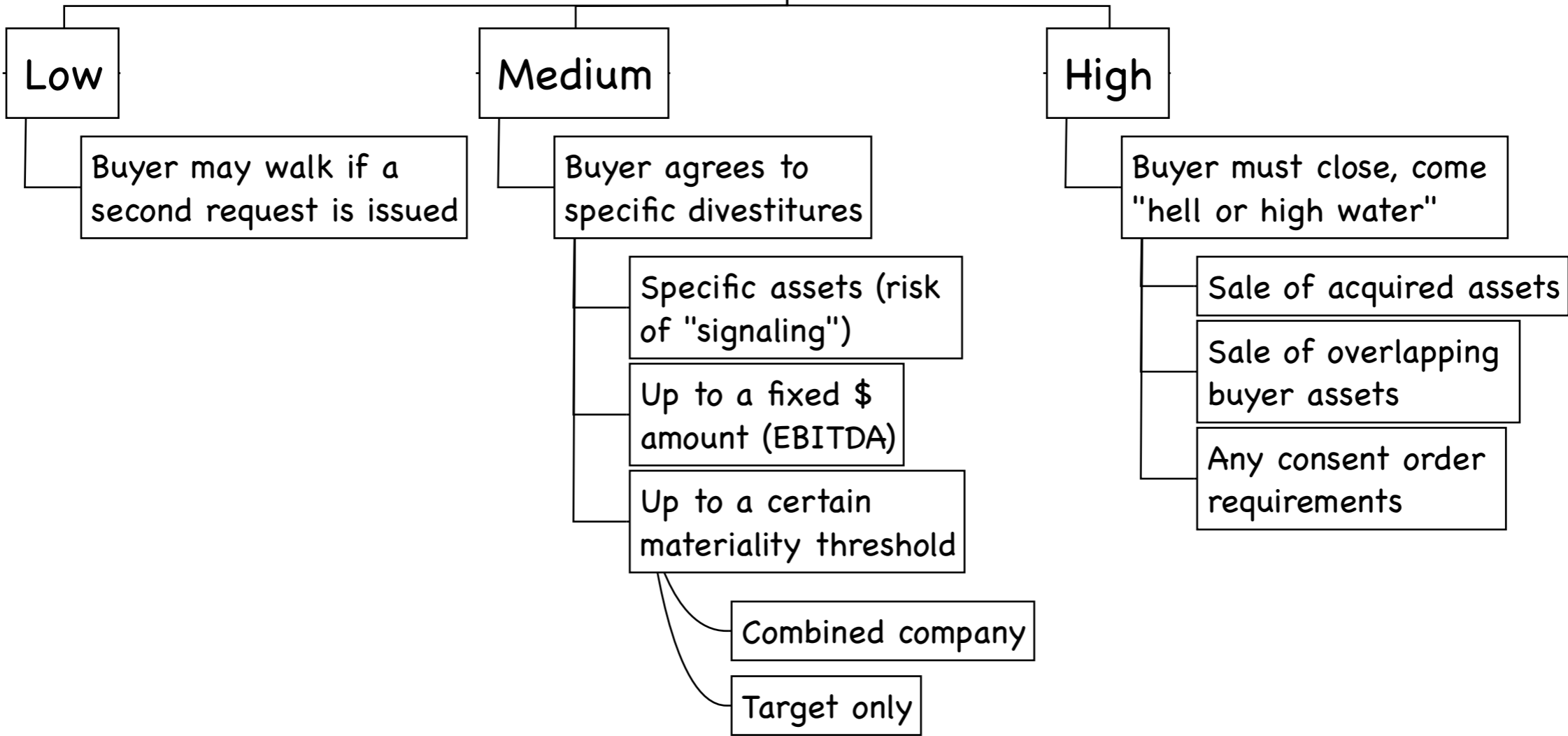
The parties should reach **express agreement** on the following points:

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

"Best efforts" and intentional uncertainty

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

Levels of buyer commitment



Common termination events

Merger agreements commonly provide for “termination events,” with or without (escalating) termination fees

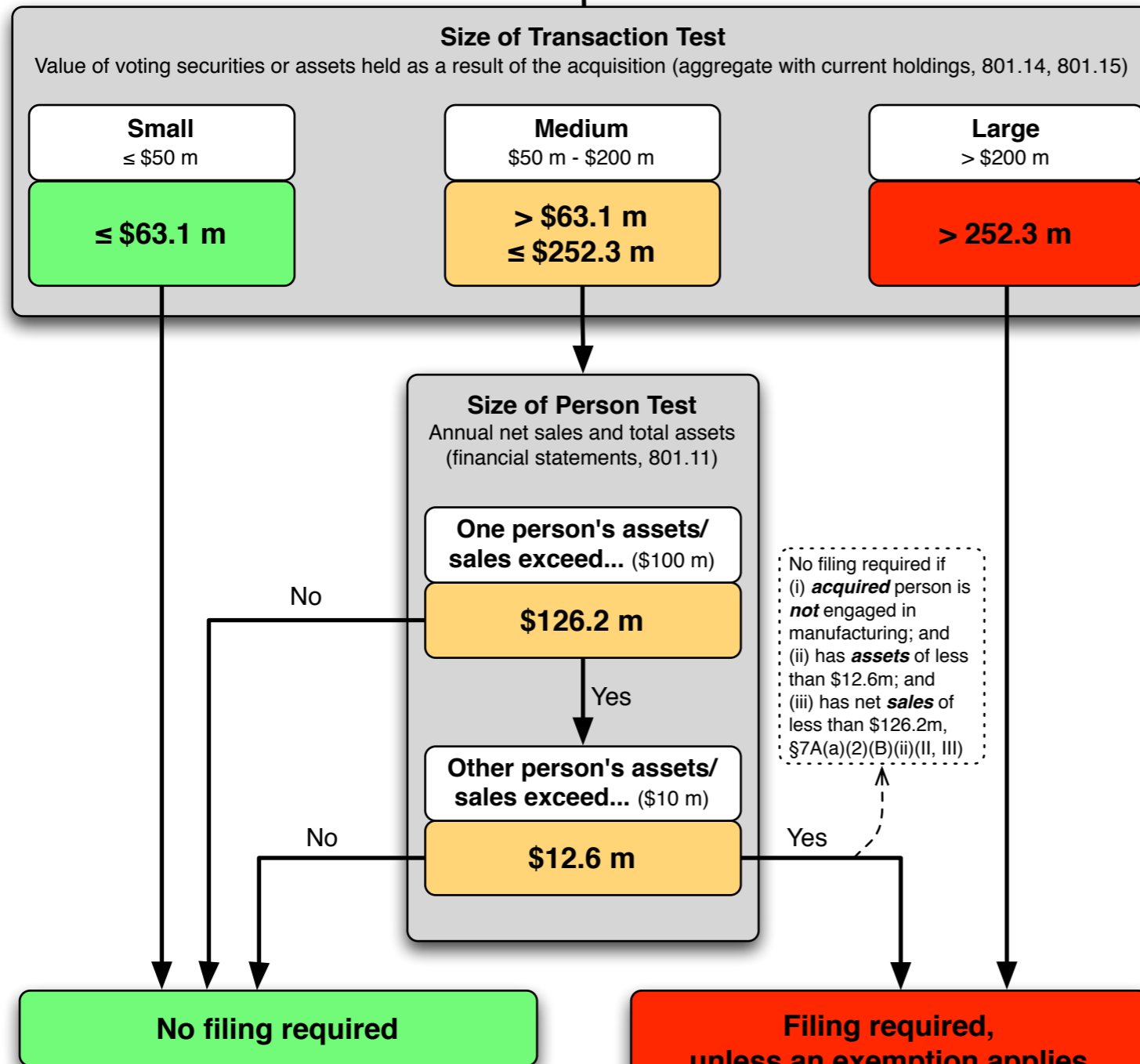
- Issuance of second request
- Agencies (decide to) bring a lawsuit
- Court issues preliminary injunction
- Outside date (usually 6 to 9 months)
- Final, non-appealable court order (years)

2008 adjusted
Thresholds

HSR Reportability Thresholds

§7A(a)(2)

New 2008 HSR Thresholds
(see separate Handout)



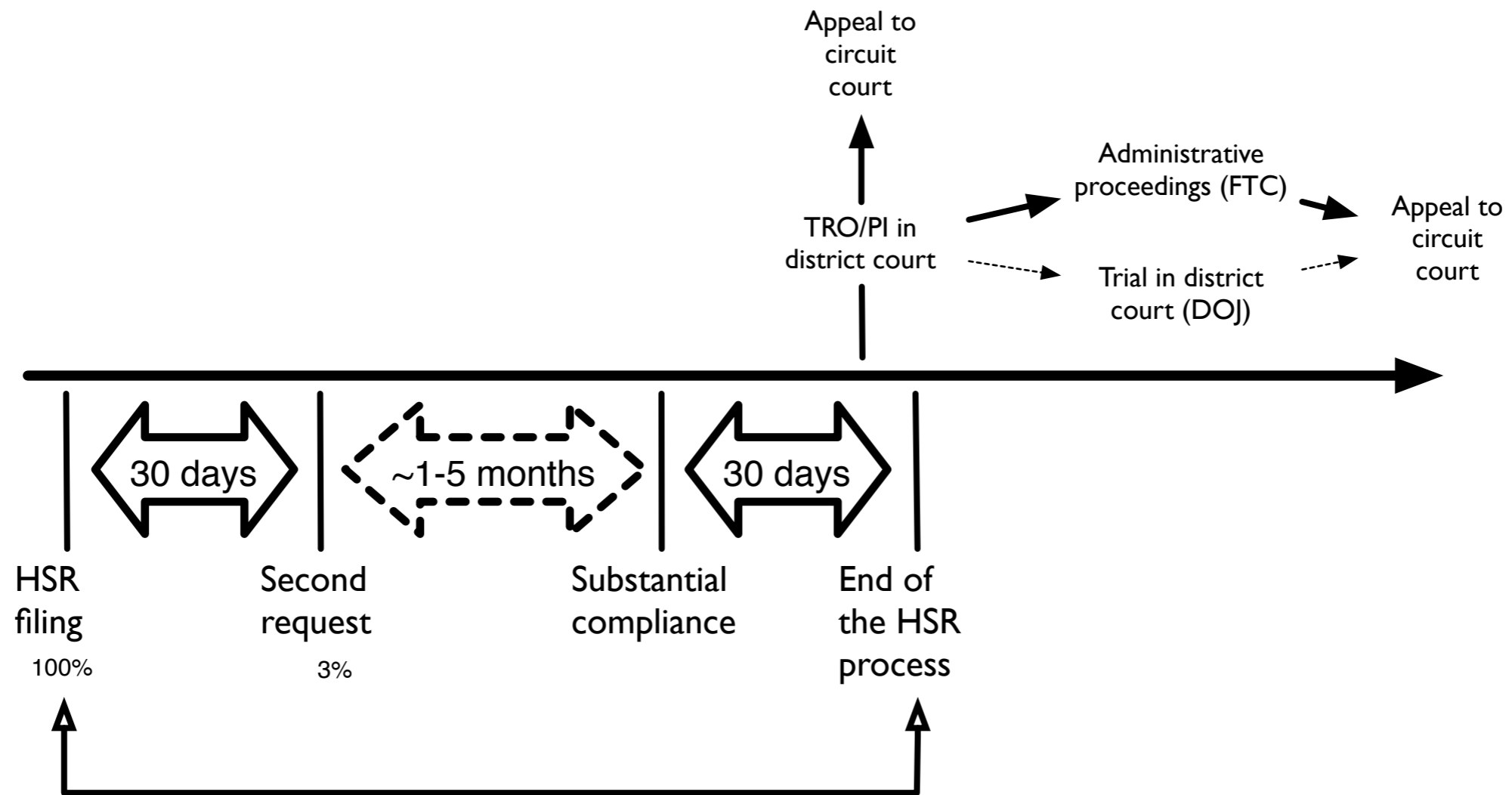
Some common exemptions:

- Ordinary course of business acquisitions, 802.1, §7A(c)(1)
- Certain acquisitions of real property, 802.2, 802.5
- Acquisitions solely for investment purposes, 802.9, 802.64
- Intraperson transfers, restructuring, 802.30
- Foreign assets, if U.S. sales below threshold, 802.50
- Voting securities of foreign issuer without U.S. nexus, 802.51
- Acquisitions subject to U.S. agency approval, 802.6

Size of Transaction	Filing Fee (acquiring person only)
< \$126.2 m (\$100 m)	\$45,000
< \$630.8 m (\$500 m)	\$125,000
≥ \$630.8 m (\$500 m)	\$280,000

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

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

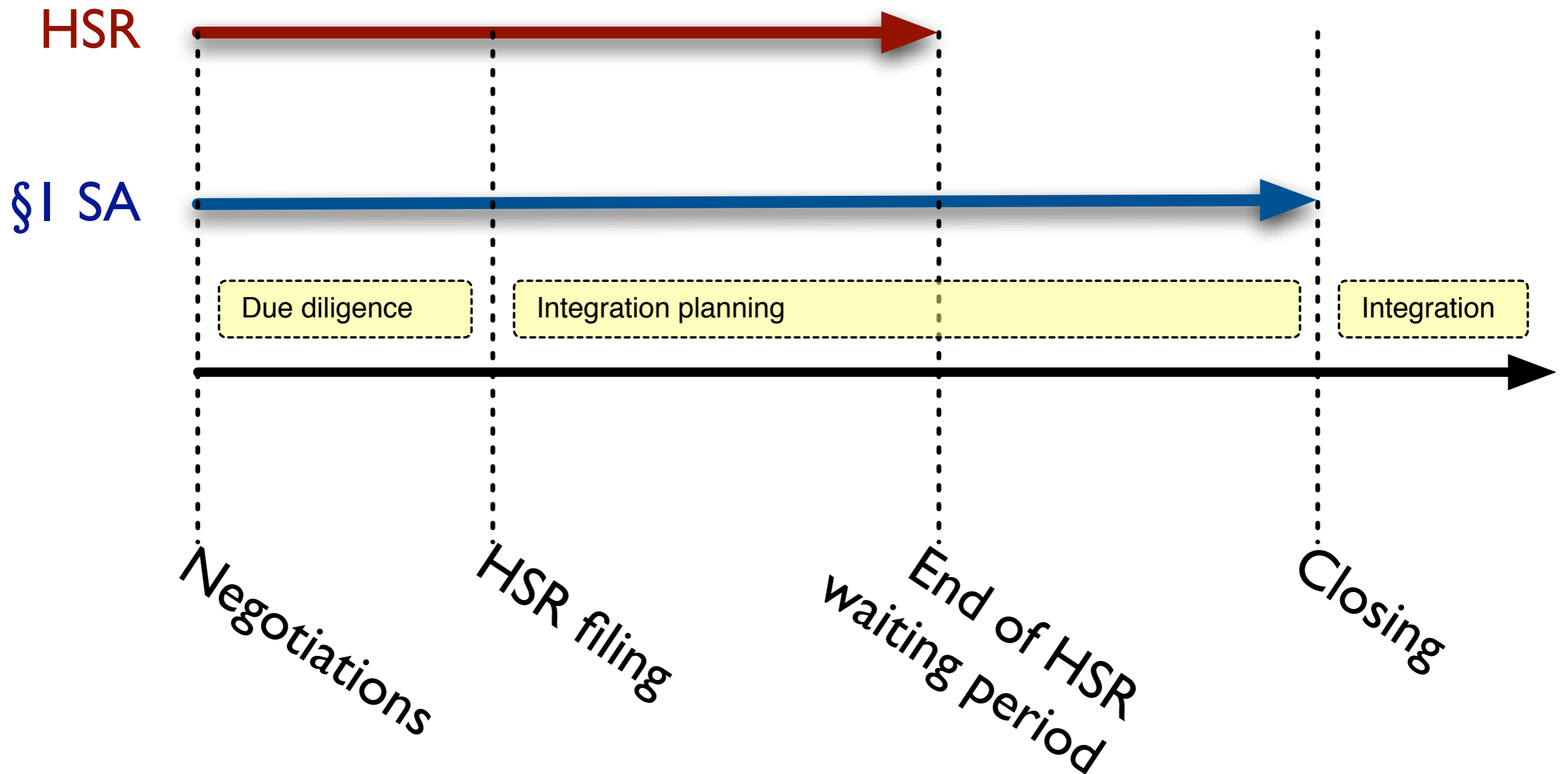
Multi-jurisdictional filings

- 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

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 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

Conclusion

- Watch out for (properly defined) horizontal overlaps
- 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)