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Practical guide to the U.S. merger review process

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Abstract

There are important antitrust considerations at every stage of a transaction from inception to closing. The merger review process takes a different path for every transaction, requiring careful navigation by experienced practitioners. Involvement of antitrust counsel is often overlooked and can ultimately be quite costly.

D'importantes considérations sont à prendre en compte durant toutes les étapes d'une transaction, du début jusqu'à la signature. Chaque fusion a son propre chemin, ce qui requiert un pilotage attentif de la part de praticiens expérimentés. Le rôle de l'avocat en droit de la concurrence est souvent oublié et peut se révéler fort onéreux.

1. This paper provides a practical overview for corporate counsel involved in the U.S. merger review process. There is no doubt that to secure the best outcomes in U.S. merger reviews, involvement of experienced counsel throughout the transaction – from inception to closing – is critical. Mistakes made early in the process can severely impact the trajectory of regulatory review. While the U.S. system is considered relatively well-structured and transparent, there are many intricacies and potential pitfalls that require careful management. We discuss below key considerations for providing counsel at each of the stages of U.S. merger review, including pre-signing negotiation and due diligence, the HSR filing itself and the ensuing waiting period, a Second Request, and subsequent remedy negotiations and potential litigation.

I. The early stages of the transaction

2. During the early stages of a potential transaction, including during deal negotiations and due diligence, transaction parties often, unwittingly, take actions that interfere with the clearance of the transaction, and miss opportunities to improve the likelihood of success or the duration of regulatory review. The three most basic steps a firm can take to reduce HSR risk at this stage is to (i) avoid the creation of problem documents (and, conversely, aid the creation of helpful documents that accurately capture the market situation and the procompetitive drivers to a deal), (ii) take precautions against the exchange of competitively sensitive information in due diligence and (iii) implement safeguards for meetings between the companies.

3. *Avoiding Creation of Problem Documents*. All directors, management and other employees involved in the transaction should operate under the assumption that every email, presentation, memo and other document that they create about the transaction, or about the company's markets, market shares or competition, will be submitted to an antitrust agency during the review of the transaction. The United States, unlike most merger control regimes, requires a search and production of internal documents regarding the transaction to be produced with an HSR filing; and in an antitrust-sensitive deal, the U.S. antitrust agencies will often require an incredibly invasive and comprehensive production of documents regarding the markets in which the deal parties overlap. Bad documents are a major reason that the U.S. antitrust agencies challenge transactions. Documents created when the company is considering a transaction should not contain references to dominance, high market shares, barriers to entry, entrenched competitors, increased post-merger pricing power, stabilizing or disciplining pricing, removing a threat to the business by acquiring the target, or limiting customer choice. If markets or market shares must be discussed, they should be defined broadly to accurately include all competitive threats. Documents should not include terms like "kill", "crush" or "eliminate" with respect to competition, and should not include transaction models that predict price increases resulting from the combination of the businesses. All of this seems obvious, but it is astounding how frequently sophisticated firms fall into this trap. And in our experience, most documents that offend the above principles do not accurately depict market conditions, which makes the pain they cause to the parties all the more grave.

4. Documents can do good too, however. They present an opportunity to educate the agencies about the pro-competitive aspects of the deal rationale, and orient the agencies toward a more sympathetic view of the proposed transaction. Care taken to accurately describe the pro-competitive drivers of a deal in internal management

* This contribution was presented at the 2013 Competition Summit organized by Premier Cercle.

presentations and board briefing or approval documents provides valuable up-front support to the arguments the parties will make if and when the transaction generates antitrust scrutiny.

5. *Due Diligence Precautions*. The due diligence process is rife with antitrust traps. During due diligence, the laws prohibiting restriction of competition continue to apply. The parties would not ordinarily share competitively sensitive information or consult or coordinate with each other in conducting business or transacting with customers or suppliers. They may not take these actions during due diligence, or at any time before the transaction closes, including during integration planning. Information exchanges during due diligence should be confined to a formalized and counsel-approved process, with the subjects and recipients of the diligence limited by counsel to avoid highly sensitive information on topics like current and future pricing and sales and marketing strategies reaching the desks of the other party's management involved in day-to-day competitive decision-making. The prevailing rule should be that any information exchanged is limited to that actually required in order to conclude a deal (e.g., valuation) and is distributed in a manner that protects against anticompetitive uses or effects, which normally means controlling the scope, timing and form of the information exchanged and the group of individuals who have access to it. Normally these precautions should not impair the due diligence process, but cutting corners can easily and needlessly create risk and distract the U.S. antitrust agencies from focusing on the antitrust merits of the transaction.

6. *Safeguards for Meetings Between the Parties*. Whenever the members of the respective "deal teams" of the parties meet with each other to negotiate the terms of the transaction or to discuss other aspects of the transaction, the same concerns regarding exchanges of competitively sensitive information and coordination of conduct exist. Counsel should review and approve detailed written agendas of these meetings prior to their occurrence, and in many cases, particularly for meetings involving discussions of particularly sensitive topics like sales and marketing strategies or pricing, counsel attend the meetings in order to redirect any potentially problematic discussions.

II. The transaction agreement

7. The transaction agreement has several components that are relevant to the merger review process and require the careful consideration of counsel. A distinguishing characteristic of the U.S. merger control regime is that the U.S. agencies must succeed in court to block a deal. They have no approval authority; their investigation powers are focused on determining whether there are meaningful likely anticompetitive effects from the transaction that they can prove in court. This litigation "backstop" impacts nearly every decision taken in the course of a regulatory review. Litigation, however, is costly and presents risk for the agencies and parties alike, and is thus relatively rare. "Settlements" in the form of divestitures or other remedies, or abandonment of the transaction, are more common. The parties' and agencies' own perceptions of litigation risk also inform the leverage they each believe they have as a merger investigation intensifies. What the parties say in their own merger agreement that could impact litigation leverage can be important.

8. *Regulatory Efforts Provisions*. The regulatory efforts provisions set out what steps each party must take to obtain the required antitrust approvals. These efforts clauses range from a basic "commercially reasonable efforts" clause that requires a lesser level of effort to obtain approvals (potentially excluding divestitures of businesses or assets or conduct restriction agreements) to a "hell or high water" clause that requires a party to take any and all efforts to obtain antitrust approvals, often including litigation with the antitrust agency and any divestitures or conduct restrictions agreements. The efforts provisions serve to allocate the risk of merger clearance among the parties. While in a merger of equals, the parties likely have relatively similar incentives as to the level of efforts required, in transactions with clear acquirer-target relationships, the acquirer typically advocates for lesser efforts requirements, while the target presses for a robust efforts commitment to ensure that the deal closes.

9. Perhaps the most important consideration in this regard is that whatever the parties agreed on regulatory risk will be communicated to the agencies and can send strong signals about the parties' willingness to resist litigation to block the transaction. A "hell or high water" provision, for example, signals that the agency will likely have significant leverage in extracting a remedy, particularly if the merger agreement does not allow ample time for the parties to litigate (discussed below). It also tends to signal that the parties themselves think the transaction poses significant antitrust risk. There are normally several alternatives, dictated by deal dynamics, to reduce the impact of negative inferences that might be drawn from antitrust risk allocation provisions. One alternative is to allocate merger clearance risk through a "reverse break-up fee" to be paid by buyer to seller in the event that the regulatory review condition is not satisfied before a specified termination date. Parties would be well-advised to involve experienced antitrust counsel in the crafting and review of these provisions.

10. *Termination Provisions and Timing*. Closely tied to the regulatory efforts provisions are the termination provisions, which set out how long the parties have to close the deal after the transaction agreement is signed. Shorter termination periods place more pressure on the parties to quickly bring the merger review process to a conclusion, and may force a party to agree to a divestiture or conduct restriction in order to close the transaction before the termination date. Alternatively, a longer termination period allows the parties more time to work through any issues that an antitrust agency might raise and possibly even to litigate against the agency through completion before the termination date comes into play. Because the antitrust agency will have access to the transaction agreement during its review, a shorter duration termination period may give the agency additional confidence in pressing the parties for concessions in order to obtain clearance, since the parties might not have sufficient time for a full litigation.

11. *Conduct of Business Provisions*. Transaction agreements also typically include "conduct of business" covenants that limit how the parties may act during the period between signing and closing. Counsel must be careful to ensure that these covenants do not overly restrict the conduct of the parties before the deal closes, since the parties must continue to act as independent, arm's length competitors while the transaction is still pending. Certain conduct restrictions are accepted as necessary to ensure that neither party diminishes the value of its businesses or assets prior to closing, but this must be balanced with unnecessarily restricting strategic decisions of the parties and thereby unreasonably constraining competition.

III. The HSR filing and the 30-day waiting period

12. The parties begin the U.S. merger review process by filing Hart-Scott-Rodino ("HSR") notification forms with the Department of Justice ("DOJ") and Federal Trade Commission ("FTC") and paying the required filing fee.[1] The HSR form is a highly technical document that, unlike what is required in most other merger control regimes around the world, includes no substantive antitrust content. The parties need only submit minimal information about their revenues, shareholders and shareholdings, along with certain transaction-related documents that address competition, markets, entry and other antitrust-relevant points. The HSR form does not contain any analysis by the parties of market definition, closeness of competition between the parties, barriers to entry or any other competition-pertinent aspects of the transaction – in effect, the opposite extreme of a Form CO filed with the European Commission. The contents of the HSR submission, as well as the fact that the parties filed HSR forms at all, is kept confidential by the U.S. agencies.

13. There is no deadline under U.S. law for filing the HSR form, and the parties may in some cases delay filing their HSR forms for strategic reasons. For example, they may want to give themselves time to engage on substantive antitrust issues of the deal with the DOJ or FTC before the waiting period begins. Once both parties successfully file their HSR forms (subject to some exceptions for tender offers) a 30 calendar-day waiting period begins to run. The DOJ and FTC then work together through their internal "clearance process" to determine whether either agency will take a closer look at the transaction, and if so, which agency will conduct the review. The decision between DOJ and FTC review is typically based on historical expertise of the agencies in certain industries, but delays may result where the agencies both claim special expertise related to the industry in which the parties operate. The 30-day clock continues to run as this clearance process plays out.

14. In most cases, the parties request in their HSR forms that they be granted "early termination" of the 30-day waiting period. This means that if (i) neither agency decides to review the transaction or (ii) the DOJ or the FTC decides to review the transaction but it decides before the end of the 30 day period that it will not undertake an in-depth "Second Request" review, the parties may receive notice of "early termination" of the waiting period, allowing them to close the deal. While early termination is in most cases desirable, in transactions where the parties wish to keep the transaction entirely confidential, they might not request early termination because a grant of early termination is published on the public website of the FTC's Premerger Notification Office ("PNO"). In some cases, the reviewing agency may not grant early termination, but rather may simply allow the waiting period to expire, allowing the parties to close at the end of the 30 days.

15. During the 30-day waiting period, the DOJ or FTC may request voluntary information submissions from the parties to help advance its analysis of the competitive effects of the transaction. Typical requests include customer and supplier lists, business and strategic plans, industry reports and financial information. These requests may come in the form of a "voluntary access letter" or may be delivered more informally (by phone or email) as piecemeal requests. For transactions where the parties anticipate close scrutiny by the DOJ or FTC, they may invite the agency to provide an access letter very early in the process (even before filing the HSR forms) or they may submit information without an agency request in order to try to accelerate the agency's review and hopefully conclude it within the 30-day waiting period. The parties may also make presentations to the agency regarding potential antitrust concerns, and may involve economists to present economic arguments as to why the transaction does not raise antitrust issues. The DOJ and FTC are typically very receptive to such presentations and economist submissions. While the parties are submitting information, the agency is typically simultaneously reaching out to third parties, including the parties' customers, competitors and suppliers, about their views of the antitrust aspects of the transaction. Agency policy typically prohibits the agency's staff from revealing these contacts to the parties.

16. In transactions where the agency's review continues into the latter part of the waiting period, the parties have two options. First, they may withdraw their HSR forms and then re-file them (a "pull-and-refile"). A pull-and-refile restarts the 30-day clock and provides the agency more time to evaluate the transaction before it must move into the more in-depth, extended "Second Request" review phase (discussed below). Parties typically only choose a pull-and-refile where they believe that giving the agency an additional 30 days has a reasonable chance of leading to a clearance without a Second Request. Multiple pull-and-refiles are possible, but the parties are required to pay the HSR filing fee again for a subsequent pull-and-refile. Second, the parties may allow the waiting period to continue to run. They may choose this option for three reasons. First, agency staff may have communicated in some form that they have no concerns, or the parties perceive that agency staff do not have material concerns worthy of a Second Request. Second, where some concerns about the transaction have been communicated, the parties may seek to place pressure on the agency to make a decision whether

1 See Hart-Scott-Rodino Antitrust Improvements Act of 1976, 15 U.S.C. §18a, and the related Premerger Notification Rules at 16 C.F.R. Parts 801-803.

the possible antitrust concerns justify a Second Request. The issuance of a Second Request is normally the product of a thoughtful exercise that requires agency staff to prepare a memorandum to agency management and a decision by agency management. In short, agency staff must justify the decision to issue a Second Request and they could fail to convince agency management if they cannot articulate a sound rationale. Third, the parties may not believe that giving the agency an additional 30 days will allow them to avoid a Second Request – they are better off beginning the Second Request process without delaying another 30 days.

IV. The second request

17. The DOJ or FTC will issue a request for additional information and documentary material to each party where it decides that it needs a more in-depth review to reach a conclusion on potential antitrust concerns about the transaction. Compliance with a Second Request involves several months of collecting, reviewing and producing potentially hundreds of thousands of the parties' internal documents, as well as compiling extensive financial and market data. The expense involved in complying with a Second Request is very substantial, typically several million dollars, unless the parties find a way to address the agency's concerns without fully complying with the Second Request. The parties' counsel engage in extensive negotiations with the DOJ or FTC to attempt to narrow the document and information requirements, but even with those modifications, the compliance process remains very burdensome and costly.

18. While the parties are working to comply with their Second Requests, the agency may take the depositions of key management of the companies, and may also take the depositions of third parties including the parties' customers, competitors and suppliers. The DOJ and FTC also often serve document subpoenas on a wide range of relevant third parties. Key customers are often required to submit their internal documents and information about their commercial relationships with the parties.

19. The issuance of a Second Request stops the antitrust review clock. The clock only begins to run again once both parties have certified "substantial compliance" with the Second Request. At that point, a new 30-day waiting period begins. During this new waiting period, the parties and their counsel and economists often meet with the senior staff, economists and head office management at the DOJ or FTC to discuss the status of the agency's analysis of the deal. Often, the agency asks the parties to agree to a "timing agreement" that allows the agency additional time beyond the 30-day waiting period to consider the parties' Second Request submissions, review any additional advocacy from the parties, and reach a decision as to whether it will challenge the transaction.

V. The agency's decision

20. Depending on the agency's final analysis of the antitrust aspects of the transaction, it may either notify the parties that it is closing its investigation and allow the transaction to go forward, or it may indicate that it intends to challenge the transaction. If the agency indicates that it intends to challenge the transaction, the parties may consider offering remedies, such as asset or business divestitures, or conduct restriction agreements, to address the agency's antitrust concerns. Remedy negotiation is a lengthy, often multi-month process that requires extensive discussions between the parties and the agency, provision of information and documents to the agency to confirm that the remedy will sufficiently address its antitrust concerns, and negotiation of the contents of a remedy agreement. Note, however, that the U.S. process is flexible in this regard – remedy negotiation can happen at any stage – but it is typical not to offer remedies until the agency has identified and articulated serious concerns that can be supported in litigation, which normally happens late in the process, except in those circumstances where the antitrust issues are so obvious from the outset to warrant quick treatment. Alternatively, the parties may decide to abandon the transaction rather than offer a remedy. The parties may also choose to litigate against the agency to establish in federal court or before an administrative law judge that the transaction will not violate the U.S. antitrust laws.

VI. Litigation with the agency

21. The nature of litigation with the U.S. antitrust agencies depends greatly on which agency reviewed the transaction. Where the DOJ is the reviewing agency, it will file a complaint against the parties in federal court, frequently in the District of Columbia, to block the consummation of the transaction. On the other hand, if the FTC is the reviewing agency, agency staff will first seek a preliminary injunction from a federal court enjoining the parties from closing while they proceed under administrative procedure before an Administrative Law Judge and eventual review by the full Commission itself. Litigation in either case is lengthy and very expensive. Depending on the termination period provided in the transaction agreement, the parties may not have sufficient time to fully litigate the case and may be forced to reach a settlement before the case's conclusion.

* * *

22. The U.S. merger review process takes a different path for every transaction and involves several important tactical decisions along the way. Counsel must be closely involved throughout the lifetime of a transaction in order to be well-placed to make the decisions that result in the best outcomes. Involvement at the very earliest stages is often overlooked and ultimately quite costly. ■

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