



# Collaborate, Consolidate or Die?

Corporate Development and  
Antitrust Enforcement in a  
Global Economic Crisis

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This program will begin shortly. The slides and a link to a recording of the webinar will be distributed to attendees after the event.

## The Global Economic Crisis

“The worst economic crisis since the Depression”

- The Economist

“Unemployment rate at 26-year high”

- The Wall Street Journal

“Consumer confidence at lowest level on record”

- The Conference Board

“U.S. economy expected to contract in 2009”

- International Monetary Fund

## The Impact on U.S. Industry

“The current economic crisis has drastically ***decreased demand*** in numerous industries, resulting in excess capacity, idled factories, and widespread layoffs”

- Bloomberg News

“Manufacturing output at ***lowest level*** since 1948”

- U.S. Federal Reserve

“Industrial capacity utilization at ***record low***”

- U.S. Federal Reserve

## Today's Focus

- What are the business strategies to address the current predicament?
- How can companies increase efficiency and reduce cost?
- What can we expect from the antitrust agencies in this new administration?

## Potential Business Strategies

- Collaborations with competitors
  - Can generate efficiencies
  - Without the capital outlay or other costs of an outright acquisition
- These can take many shapes, including
  - R&D Joint Venture
  - Outsourcing/Cross-Supply Agreements
  - Teaming on Particular Projects
  - Production Joint Venture
  - Asset Swaps
  - All-in Joint Venture

- Potential Pro-competitive Benefits
  - Increasing asset utilization
  - Reducing production costs
  - Generating economies of scale or scope
  - Combining complementary technologies or know-how
  - Enabling new investments
- But competitor collaborations can also raise significant antitrust risks

## The Obama Administration on Antitrust

We will “reinvigorate antitrust enforcement.”

- President Obama

“Competition laws need to be implemented at least as strictly during a time of economic crisis as they are otherwise.”

- Tom Rosch, FTC Commissioner

“It is time for the Antitrust Division to step forward again... we cannot sit on the sidelines any longer.”

- Christine Varney, AAG Antitrust Division

## Case Study: Automotive JV

“The economic recession and financial crisis have had a 'devastating' effect on the U.S. automotive industry”

- July 2008: Auto sales plunge to lowest level in a decade
- Oct. 2008: Credit markets freeze, eliminating auto financing
- Jan. 2009: GM/Ford report combined \$45B annual loss
- May 2009: Chrysler closes plants, files for Chapter 11 protection
- May 2009: GM/Chrysler terminate thousands of dealerships
- June 2009: GM closes 14 assembly plants, files for bankruptcy
- July 2009: GM/Chrysler bankruptcies reverberate throughout the automotive supply chain



## Hypothetical: LampCo, Inc.

- LampCo is a manufacturer of automotive headlights
- Business Environment: Demand has fallen, and customers continue to press for price reductions
  - LampCo needs to cut costs
  - But also needs to invest in R&D to develop technology to comply with environmental regulations
- Competitive Environment: LampCo's three primary competitors are facing similar difficulties
  - Each competitor has approximately 25% of the overall automotive lamp market in the U.S.

## Strategy: R&D Joint Venture

- Competitors collaborate on research and development
- Combine research and development
- Combine complementary assets, technologies or know-how
- Statutory protection if legitimate and notified
- Antitrust risks
  - Limiting innovation competition
  - Spillover effects

- R&D JV for LampCo:
  - How big is too big?
  - How strong is evidence of benefits of collaboration?
  - What is impact on incentives to innovate, i.e., are there enough other innovators to spur rivalry?
  - What firewalls or other measures are needed to avoid spillover?

## Strategy: Production Joint Venture

- Competitors combine manufacturing; parties still compete in sale of jointly-produced products.
- Production JVs can reduce costs/risks and are efficiency-enhancing.
- Antitrust issues:
  - Agreements regarding output?
  - Nature of transfer pricing?
  - Information flow?

- Production JV for LampCo:
  - Keeps 4 competitors pricing independently
  - Achieves production efficiencies
- DOJ/FTC reaction:
  - Will test extent of demonstrable efficiencies
  - Will analyze impact on competition outside JV
  - Will test customer reactions (need strategy)

## Strategy: Asset Swap

- Solve mutual capacity issues across two plants/product lines
- Antitrust Issues:
  - On-going supply arrangements lead to post-closing communications – opportunities for coordination
  - If swap leads to exit, both competitive effects and appearance of agreement not to compete arise

## Strategy: All-in Joint Venture

- Integrates all aspects of a line of business (manufacturing, distribution, marketing and sales)
- Antitrust issue: just like as in a merger, will the collaboration harm actual or potential competition?
- Antitrust Analysis – “Merger Plus”
  - Competitive Effects: Market structure + nature of competition
  - Pro-competitive benefits
  - Customer reaction

- All-In JV For LampCo:
  - Creates one supplier with 50% share
  - Market structure: New competitor is 2x next closest
  - But creates greatest efficiency/cost savings
  - And auto companies are “power buyers”
- DOJ/FTC reaction:
  - Initial skepticism
  - Economic analysis of deal-specific efficiencies
  - Customer and competitor reactions
  - Documents
  - Defenses



- Defenses
  - Failing company/division
  - Exiting assets
  - *General Dynamics*
- Ultimate balancing of efficiencies vs. anticompetitive effects
  - Competition analysis, not social policy
  - Consider short vs. long-term effects

- Anticipating strategic responses from competitors
  - Silent/neutral position anticipating gain from increased importance to buyers
  - Competitor challenge to collaboration
    - DOJ/FTC/State AGs
    - Political (Federal/State/Local)

## Making The Initial Contact

- Competitor communications can raise significant antitrust issues
  - Limit the participants to senior executives or unaffiliated third parties, e.g., bankers/consultants
  - Limit the scope of initial discussions to determining interest, not exchanging information
  - Consider potential benefits/risks of an NDA
  - Consult with legal counsel before initiating contact

## The Due Diligence Process

- The antitrust agencies recognize that due diligence is a necessary and important means of assessing value

“[M]erging firms have a legitimate interest in engaging in certain forms of coordination that would not be expected except in the merger context .... due diligence necessarily will involve exchanges of information at levels of detail that would not normally occur among independent firms”

- William Blumenthal, FTC General Counsel

- While it is proper, certain limitations should be observed
- Exchanges of competitively-sensitive information among competitors can raise concerns regarding possible conspiracy/collusion

## Due Diligence Considerations

- The scope of competitive issues in the deal
  - *Greater overlaps means more information is likely competitively sensitive*
- The competitive sensitivity of the information
  - *High level financials vs. customer-specific pricing*
- The timing of the information exchange
  - *Concern is “too much too soon”*
- The dissemination of the information
  - *Corporate development vs. marketing personnel*
- The further use of that information
  - *Always comply with confidentiality protocols*

## Due Diligence Considerations

- Apply a “reasonableness standard”
- Ask the key questions, e.g.,
  - *Why do you need that level of detail?*
  - *Why do people in the business need to see it?*
- Consider having a third party collect, screen, and assess competitively-sensitive information prior to its distribution
- Antitrust should not be a barrier to legitimate due diligence

## The Integration Planning Process

- Synergies are the key to realizing deal value, and accelerated integration can significantly increase those returns
- The antitrust authorities have recognized the value of integration planning:

“Transition planning is needed to enable the merging firms to integrate their businesses effectively and rapidly after consummation, thereby allowing for the realization of available efficiencies”

- William Blumenthal, FTC General Counsel

## Integration Planning (cont.)

- Establish integration planning protocols
  - Clean room, parlor room, or both
- Understand limits on joint customer communications/meetings
- Appreciate difference between “gun jumping” and “pre-closing coordination” of activities



## Integration Planning (cont.)

- However, there are significant antitrust constraints:
  - Collusion
  - “Gun Jumping”
- But proper planning for post-merger integration is not illegal
- Several options exist to ensure compliance, e.g.,
  - Clean Rooms
  - Parlor Rooms

## Post-Closing – Need on-going antitrust compliance

- Firewall training/monitoring
- Justifications remain valid
- Efficiencies being realized
- Antitrust attack can come at any time!

## About The Authors



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Mr. Smith's practice involves assisting clients in analyzing and implementing the full range of mergers, acquisitions, joint ventures, and other transactions.

Mr. Smith was recently recognized by *The Best Lawyers In America 2009* and was named to the 2009 Washington, D.C. "Super Lawyer" list. He is recommended by every significant publication ranking antitrust lawyers, including *Chambers USA: America's Leading Business Lawyers*, *Chambers Global: The World's Leading Business Lawyers*, *Legal Media Group's Expert Guide to Competition and Antitrust Lawyers*, and the *Global Competition Review's GCR 100*.



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Mr. Lipstein was recognized as a leading lawyer by *Chambers USA 2008*, has been named by his peers for more than 10 consecutive years as one of *The Best Lawyers in America* in the area of International Trade and Finance Law, and was featured in the 2004 and 2006 *Guide to the World's Leading Competition and Antitrust Lawyers*.

## Relevant Statutes

- Sherman Act Section 1, 15 U.S.C. § 1: “Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal.”
- Sherman Act Section 2, 15 U.S.C. § 2: “Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any person or persons, to monopolize any part of the trade or commerce ... shall be deemed guilty of a felony.”

## Relevant Statutes (cont.)

- Clayton Act Section 7, 15 U.S.C. § 15: “No person engaged in commerce or in any activity affecting commerce shall acquire, directly or indirectly, the whole or any part of the stock ... of another person ... the effect of such acquisition may be substantially to lessen competition, or tend to create a monopoly.”
- National Cooperative Research and Production Act, 15 U.S.C. §§ 4301-4305, is designed to promote innovation, facilitate trade, and strengthen competition by providing for a rule of reason analysis of joint ventures and standards development organizations while engaged in a standards development activity.

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