



# **Surviving Antitrust Scrutiny of Non-HSR Reportable Transactions**

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# Topic Overview: Risk Assessment and Clearance Strategies

- Merger enforcement of non-reportable transactions
- Assessing the Risk of Government Detection
- Strategic Options for Obtaining Merger Clearance
- Timing Strategies in Merger Investigations
- Strategies for Avoiding an Investigation

- Agency challenges to non-reportable transactions are increasing year over year
- From 2009 to 2013, the DOJ's Antitrust Division initiated 73 preliminary inquiries into non-HSR reportable transactions, which represented about 20% of all merger investigations.
  - 25 percent of these investigations resulted in a challenge.
- Between 2009 and 2012, the FTC challenged nine consummated transactions, or about 20% of all challenges.

- Assess both substantive antitrust risk and likelihood of detection
- Potential Red Flags:
  - Trade press reports of the merger
  - Industries subject to prior antitrust enforcement efforts
  - Complaining third parties
  - Involvement of foreign competition authorities
  - A regional transaction with high local impact on consumers or involving a niche market
  - Industries that are particularly consumer-sensitive

- Industries in the Agencies' Cross-hairs
  - Healthcare
  - Pharmaceuticals
  - Energy
  - Financial services
  - E-commerce
- Pharmaceutical mergers are the most likely to be investigated. In fiscal years 1996 to 2011, the FTC reviewed 122 horizontal pharmaceutical mergers and sought relief in 119 (see *FTC: Horizontal Merger Investigation Data Report (Jan. 2013)*)

- Third-party Complaints

Transacting parties' customers, competitors, suppliers and other third parties may complain. The FTC and DOJ attribute varying weight to third-party complaints depending on:

- The factual support underlying the complaint
- The third party's role in the market
- Whether the complaint alleges harm to competition in the market

- Complaining Customers
  - Between fiscal years 1996 and 2011, the FTC received strong customer complaints in 114 mergers (see *FTC: Horizontal Merger Investigation Data Report (Jan. 2013)*). The FTC ultimately took enforcement action against 111, or 97%. By contrast, in 122 deals without strong customer complaints, the FTC only took action against 53, or 43%.
- As a practical matter, the investigating agency will have more difficulty making a case if customers are unconcerned about the transaction.
  - Complaining customers are important, but by no means guarantee a successful merger challenge.

- Complaining Competitors
  - Most impactful in highly concentrated industries with long-term or exclusive customer contracts, where the transaction may foreclose the competitor from certain key customers or enough customers to prevent it from competing.
  - The FTC and DOJ also heed competitor complaints in vertical transactions where the competitor does business with the upstream or downstream party and raises concerns of being:
    - Cut off from supply or distribution
    - Harmed by post-acquisition information sharing between the parties of the competitor's competitively-sensitive data

- Involvement of Foreign Competition Authorities
  - Communication and cooperation among national competition enforcement authorities is now routine, even though the FTC and DOJ need the parties' permission to share confidential information with their foreign counterparts.
  - The antitrust agencies can learn about the issues under investigation overseas through:
    - official channels of cooperation
    - complaining parties
    - the media

- Healthcare is local and regional in nature, and frequently involves acquisition of physician practices.
- These transactions generally do not involve price tags that are high enough for mandatory HSR filings.
- Yet, they still attract scrutiny, in part because the mergers represent high stakes for the welfare of local consumers.

- 2011 merger challenged by the FTC over concern about competition in a six-county market in Georgia that would have given the hospital an 85% market share in the relevant market.
- The parties argued an exemption under the “state action doctrine.”
- In 2013, the Supreme Court ruled against the parties and said that in order for the exemption to apply, a state statute must “clearly articulate an affirmative state policy to displace competition with a regulatory alternative.”
- The FTC recently rejected a proposed settlement and returned the matter to administrative litigation.

- 2012 merger between St. Luke's, a hospital, and Saltzer, a doctor group.
- The FTC challenged the merger on horizontal grounds, arguing the deal would foreclose competition in adult primary care in an Idaho county, with little prospect of new entry, and increased ability to negotiate favorable contracts.
- The parties consummated the deal in 2012, but more than 2 years later, the U.S. Dist. Ct. for the District of Idaho ordered St. Luke's to fully divest Saltzer.

- 2010 acquisition challenged by the FTC on the basis that the transaction would lead to higher prices and lower quality of clinical laboratory testing services sold to physician groups.
- The 9<sup>th</sup> Circuit Court of Appeals upheld a district court's denial of a preliminary injunction, finding that the FTC's alleged relevant market was too narrow, and that Westcliff was in an unstable financial position.
- The FTC subsequently withdrew its challenge.

# Strategic Options for Obtaining Merger Clearance

- Fingers Crossed Strategy
  - Used if the apparent risk of both competitive harm and detection is low
  - Decision to proceed with the transaction without incurring the costs of a merger analysis or preparing for a merger investigation
  - Advisable if there appear to be multiple competitive alternatives in the market and a limited risk of third-party, particularly customer, complaints

# Strategic Options for Obtaining Merger Clearance

- Wait-and-see Strategy
  - Used when the deal poses some competitive issues, but those issues can be explained away with factual support
  - Best for deals where there is some indication that customers might complain or there is some risk of government detection

# Strategic Options for Obtaining Merger Clearance

- Voluntary Access Strategy
  - Used when risk of investigation is high
  - Parties direct counsel to contact antitrust agencies to alert them to the transaction before closing
  - Minimizes the huge downside and expense of potentially having to defend and unwind a consummated transaction
  - Advisable when:
    - At least one of the parties was the subject of criminal antitrust investigation
    - FTC or DOJ investigated either party's last acquisition in the industry
    - Customers are complaining and have already contacted, or have threatened to contact, the Agencies

- Fix-it-first Strategy
  - If reasons exist for contacting the agencies before closing the deal, consider whether there is a quick end to any merger investigation by agreeing to a merger remedy upfront, typically a divestiture.
  - Recommended if the divestiture eliminates the agency's competitive concerns and there is a likely buyer for the divested business. This is especially true if the government believes it has a compelling case to stop the transaction.

# Timing Strategies in Non-HSR Reportable Merger Investigations

- Closing the Deal
  - In an unconsummated transaction, the parties' central point of leverage is that the antitrust agencies must be able to obtain injunctive relief from a court to prevent the transaction from closing.
  - If the agency is not likely to obtain an injunction, the buyer may decide to close the deal, as long as it has assumed all the legal risk associated with obtaining merger clearance under the purchase or merger agreement.
  - If the parties agreed to share the merger clearance risk, the decision to close will involve a business negotiation between the parties and a litigation risk assessment.

# Timing Strategies in Non-HSR Reportable Merger Investigations

- Exploring Settlement before Closing
  - If the litigation risk assessment is unclear or unfavorable, there is little downside to engaging the investigating agency in settlement discussions.
    - Timing agreements
    - “Hold separate” agreements

# Timing Strategies in Non-HSR Reportable Merger Investigations

- If the agency believes its litigation risk assessment is favorable, settlement discussions are unlikely to be fruitful unless there is a credible threat the parties will close the deal.
- Once a deal is closed and the parties' assets are integrated, the antitrust agencies bear a heavier burden of persuading a judge to unwind.
- Factors that may force settlement even if the agency has a strong case:
  - A looming bankruptcy for the seller
    - “Failing firm” defense
  - Effective political pressure

# Timing Strategies in Non-HSR Reportable Merger Investigations

- Entering a Timing Agreement for Settlement Negotiations
  - Timing agreements are often entered into at the outset of a merger review as a means to both:
    - Reduce discovery burdens
    - Narrow the scope of the inquiry to focus on dispositive issues
  - Often include deadlines for document production, submission of white papers and expert reports to the agency, and for an agency decision on whether to challenge the deal
  - In non-reportable deals, the reviewing agency may have less incentive to enter an agreement that imposes timing constraints on its investigation that do not apply outside the HSR context
  - If a transaction has already closed, timing agreements are even more difficult to obtain
  - Alternative: agreement to provide the agency a short notice period before closing

# Timing Strategies in Non-HSR Reportable Merger Investigations

- Closing with a Competitive Fix
  - If the agency rejects the remedy and decides to challenge the merger, its burden is increased as it must prove the potential competitive harm of both:
    - The original transaction
    - The proposed fix
  - The agencies have lost a few high-profile merger cases when they were forced to litigate the fix (see *FTC v. Arch Coal, Inc.*, 329 F. Supp. 2d 109 (D.D.C. 2004))

- Minimizing the Risk of Customer Complaints

Transaction must be effectively communicated and sold to the parties' customers. Announcement should highlight any procompetitive justifications, including:

- Efficiencies
- Ability to buy complimentary products from a single supplier
- Preserving a:
  - failing competitor
  - product offering

Sales representatives should address any customers concerns. The seller's customers should be assured that:

- Any existing contracts will be assumed and fulfilled
- The seller's products will continue to be available
- It will be business as usual post-transaction
- Tip: Talk to broader audience than the purchasing agent

- Avoiding Gun-jumping
  - Exercise vigilance in the period between signing and closing to ensure that the buyer does not improperly assume control over the seller's business before closing
  - While the parties may jointly undertake certain integration planning activities before closing, such as planning for integration of back-office technology and employee benefits programs, the parties' sales forces and R&D operations must continue to operate independently
  - Buyer should not:
    - exercise any control over the seller's pricing, bids or contract negotiations
    - Generally attend customer meetings with seller in this interim period

- Avoiding the Creation of Bad Documents
  - Before signing, when the seller is marketing itself for sale and the buyer is considering the purchase
  - In the interim period between signing and closing
- Between 1996 and 2011, the FTC discovered “hot” documents in 28 proposed mergers and took enforcement action against 25 of them (89%) (see *FTC Horizontal Merger Investigation Data Report (Jan. 2013)*)
- Hot documents can include references to increased prices post-merger or references to the target as the only, or only meaningful, competitor

## Bazaarvoice internal documents quoted in DOJ Complaint (filed Jan. 10, 2013):

- Co-founder noted that acquisition of PowerReviews would “[e]liminat[e] [Bazaarvoice’s] primary competitor” and provide “relief from [] price erosion”
- CEO wrote acquisition of PowerReviews was an opportunity to “tak[e] out [Bazaarvoice’s] only competitor, who . . . suppress[ed] [Bazaarvoice] price points [] by as much as 15% . . . .”
- Former CFO projected that, as a result of the transaction, Bazaarvoice would have “no meaningful direct competitor,” thereby reducing “pricing dilution”
- Memo to Board recommended acquisition because it would “block[] entry by competitors” and “ensure Bazaarvoice’s retail business [was] protected from direct competition and premature price erosion”

- N.D. Cal. decision following trial (Jan. 8, 2014) held
  - Bazaarvoice had acquired its “closest and only serious competitor” and violated Section 7 of the Clayton Act
  - Relied heavily on premerger “hot documents” reflecting the close competition between the merged parties and the anticompetitive deal rationale
  - “[w]hile Bazaarvoice fought against every material argument of the government, its defenses were often undermined by pre-acquisition statements from its and PowerReviews executives”

- Avoiding Anticompetitive Behavior Post-Acquisition
  - Particularly in non-reportable transactions where the FTC and DOJ have not had a first look at the deal and vetted it through the HSR process, the buyer's behavior post-consummation is critical
- For the two years after closing, the buyer should:
  - Avoid raising prices (most likely action to cause customer complaints)
  - Take steps to avoid otherwise upsetting customers
    - gradually, rather than immediately, phasing out any product offerings the buyer wishes to eliminate
    - honoring the seller's customer contracts and not trying to force the seller's customers to immediately switch from the seller's to the buyer's product offerings

# ***FTC and State of Minnesota v. Lundbeck, Inc. (8th Cir. Aug. 19, 2011)***



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- In August 2005, Lundbeck acquired from Merck the exclusive worldwide rights to Indocin IV (drug used to treat heart condition in premature babies) and soon thereafter raised its price from \$78 to \$1,500 per three-vial course of treatment
- Lundbeck acquired NeoProfen from Abbott in January 2006, and when the drug was approved by FDA, Lundbeck set its price at \$1,450 for a three-vial package, about three times the price that Abbott had forecast
- FTC Chairman Jon Leibowitz stated Lundbeck’s “profiteering on the backs of critically ill premature babies is not only immoral, it is illegal”
  - FTC ultimately lost in district court and on appeal because courts concluded that drugs at issue were not in the same market as prescribing physicians would not switch products based on cost

- American Bar Association, Antitrust Section, Fall Forum, Washington, DC, November 6, 2014
- Speaker: Jim Tierney, head of DOJ's Networks and Technology section
  - In the past 4 years, DOJ has opened 73 investigations into non-reportable transactions, including both consummated and non-consummated deals
  - If you think your deal might raise competition concerns:
    - “Don’t close”
    - “If you decide to close, don’t scramble the assets.”
  - Parties contacted by DOJ about consummated transactions, should take steps to preserve and hold separate acquired assets.

