CLASS 3 SLIDES

For September 10, 2019

Unit 3

Merger Antitrust Law

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PREDICTING MERGER ANTITRUST LAW CHALLENGES: The Practice

Refresher: Anticompetitive effects

- Recall that the purpose of merger antitrust law is
  - to prevent the creation or facilitation of market power
  - to the likely harm of an identifiable group of customers through—
    - Increased prices
    - Reduced market output
    - Reduced product or service quality
    - Reduced rate of technological innovation or product improvement
    - [Maybe] reduced product variety

Basic structural tests for horizontal mergers

Reduction in Bidders/Competitors*

5 → 4	Usually clears if no bad documents and no material customer complaints
4 → 3	Usually challenged unless there are no bad documents and there is a strong procompetitive business rationale, some customer support, *and* minimal customer complaints
3 → 2	Almost always challenged unless there are no bad documents, and there is a compelling business rational that is strongly supported by customers and no material customer complaints
2 → 1	Always challenged

* Critically, these must be ***meaningful*** and ***effective alternatives*** from the perspective of the customer; "fringe" firms that customers do not regard as feasible alternatives do not count

Special Case #1:

Unilateral effects

Two firms that compete very closely with one another but much less with other firms in the market

Special Case #2:

Elimination of a maverick

Elimination of a firm that has been especially disruptive in the marketplace (a maverick)

Special Case #3:

Elimination of a potential entrant

In a high concentrated market, the acquisition by or of a firm that otherwise would have entered the market and thereby increased competition

Basic structural tests for horizontal mergers

- The chances of success *improve* if—
  - There are demonstrable powerful forces that constrain price increases or other anticompetitive behavior beyond the mere number of incumbent competitors
  - Major forces:
    1. *Entry, repositioning, or output expansion* by third-party competitors in response to anticompetitive behavior by the combined company
       - Requires low barriers to entry or repositioning
    2. *Powerful customers*, who can use their bargaining leverage to stop the combined firm from acting anticompetitively
       - Requires a detailed explanation of how the bargaining will work to constrain the combined firm
       - Defense on works firm-by-firm—Small firms without the requisite bargaining power can still be hurt
    3. *Efficiencies*, where the procompetitive pressure of the efficiencies outweighs the anticompetitive pressure of the increased market power
       - More on this below
       - Agencies very skeptical

Basic structural tests for horizontal mergers

- The chances of success *decrease* if—
  - If there are factors that facilitate the exercise of market power in the wake of the transaction
  - Major factors:
    - Close and unique competition between the merging parties ("unilateral effects")
    - Merging parties two of the largest firms in the market
    - The merger eliminates a "maverick"

Another basic distinction

- Truth v. evidence
  - The agencies (and the courts) deal in *evidence*
  - Having the truth but being unable to prove it will not win the day
  - The investigating staff also needs evidence to be able to prove its case to the agency decision makers and, if necessary, in litigation

So what are the sources of evidence?

Major sources of evidence

1. Ordinary course of business documents of the merging firms
2. Company documents submitted with the original HSR filing
3. Company responses to second requests in an HSR Act review
   - Includes responsive documents and responses to data and narrative interrogatories
4. Interviews/testimony/public statements of merging firm representatives
5. Interviews with knowledgeable customers
6. Interviews with competitors
7. Customer and competitor responses to DOJ Civil Investigative Demands (CIDs) or FTC subpoenas
8. Analysis of bidding or "win-loss" data
   - Including the ability of customers to play the merging firms off one another
9. "Natural" experiments
10. Expert economic analysis

Synergies/Efficiencies

Synergies/efficiencies

- Some definitions
  - *Synergies* (a business term)
    - Benefits to the company from the transaction that lower the combined firms' costs or increase its revenues
  - *Efficiencies*
    - The term used in antitrust analysis for synergies that benefit consumers

Efficiencies are relevant to the antitrust analysis only to the extent they are passed on or otherwise benefit to customers

Efficiencies

- Types of efficiencies enabled by the deal
  - Customer value-enhancing efficiencies
    - Making existing products better or cheaper, or
    - Creating new products or product improvement better, cheaper, or faster
  - Cost-saving efficiencies
    - Reductions in duplicative costs
    - Increases in the productive efficiency of the combined operation (e.g., through best practices, transfer of more efficient production technology)
  - Anticompetitive synergies
    - Eliminating competition on price, quality, service, or innovation and so increase profits (horizontal theory of anticompetitive harm)
    - Creating an incentive and ability to withhold important/ essential products or services used by competitors and so eliminate competition and increase price (vertical theory of anticompetitive harm)

Efficiencies

- Efficiencies play two roles in an antitrust merger analysis
  1. They provide an explanation why the acquiring firm is pursuing the deal (and probably paying a significant premium) that does not depend on price increases to customers or other anticompetitive effects
  2. In some cases, efficiencies can tip the agencies into not challenging the deal
     a. Where efficiencies exist *inside* a problematic market: A defense if efficiencies negate the anticompetitive effects that otherwise would likely occur
     b. Where efficiencies exist *outside* of the problematic market: Not cognizable as a legal defense but can appeal to prosecutorial discretion

Efficiencies

- To be credited by the investigating agency, synergies must be:
  1. Merger-specific
     - That is, they could not be obtained in the absence of the merger
  2. Verifiable by sufficient evidence
  3. Would completely and immediately be sufficient to offset any anticompetitive tendencies of the merger
  4. Not be the result of an anticompetitive effect of the transaction
- Agency view
  - Efficiencies were usually given very little weight by the end of the Obama administration
  - (Surprisingly), the same perspective has continued during the Trump administration

Structuring the Defense

Canonical structure of a complete defense

1. Describe the parties and the deal
2. Describe the deal rationale
   - Implicit (if not explicit) in the presentation is that customers will benefit and not be harmed by the transaction
   - That is, the profit-maximizing strategy for the combined firm is to shift the demand curve to the right and make money on increased volume, not increased prices
3. Explain that the market will not allow the deal to be anticompetitive
   - That is, customers have alternatives that they can use to protect themselves

Canonical structure of a complete defense

- Bottom line:

The best defense is a good offense:

The transaction is affirmatively procompetitive and *the market would not allow the deal to be anticompetitive even if the combined firm tried*

Homework Assignment for Class 2

The problem

The general counsel of TransDigm has asked you to begin a merger antitrust analysis of an acquisition by TransDigm of SCHROTH from Takata. The GC wants to start with a “quick and dirty” view of the problems that might arise in the United States. To this end, the GC will try to find the answers within the company to up to six questions. What six questions would you like to ask?

Instructor's answer

1. Business rationale
   - What is Transdigm's business rationale for making the acquisition (i.e., how will TransDigm make money by acquiring SCHROTH)?
2. Customer benefits
   - How, if at all, will customers benefit from the transaction?
3. Consumer complaints
   - Are any customers likely to complain about the transaction and, of so, what will they say?
4. Power to raise prices
   - In any product line, would TransDigm have the power to increase its profits (if it wanted) by raising prices, reducing product or service quality, reducing investment in innovation or product improvement, or cut off supplies to competitors following the acquisition?

Instructor's answer

5. Competitive overlaps
   - In what product lines do TransDigm and SCHROTH compete in the United States?
6. Other competitors
   - In each overlapping product line, are there significant other competitors to whom customers can turn to protect themselves in the event that TransDigm increases its price, reduces its product or service quality, or reduces investment in innovation or product improvement following the acquisition?

Questions from homework submissions

1. What are the relevant markets that will be affected by this acquisition?
2. How would you define the market (products/services and geography) for your products?
3. Will this acquisition substantially decrease competition in the relevant markets?
4. Does TransDigm have any current or potential competitors other than SCHROTH?
5. How big a player is TransDigm within the market?

Questions from homework submissions

6. For each product TransDigm's produces, please provide the names of all competitors and their respective market shares?
7. Will consumers be harmed by this acquisition by an increase in prices?
8. Do customers "play off" TransDigm and SCHROTH against each other to get better prices?
9. What would TransDigm's new market share in an already highly concentrated market be after the acquisition?

Questions from homework submissions

10. Would the acquisition decrease innovation of future technologies or would TransDigm remain motivated to innovate?
11. Will consumers benefit from or be harmed by differences in product quality after the acquisition?
12. Has TransDigm received any customer complaints about the transaction?
13. What documents do the merging parties have that might reveal the intent of the transaction?
14. Does TranDigm have any documents or has it made any public statements suggesting that postmerger it will raise prices, reduce production, or decrease R&D investment?

Unit 3.
The DOJ/FTC Merger Review Process

Merger Antitrust Law

Georgetown University Law Center
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Topics

- Premerger notification
- Initial waiting period investigations
- Second request investigations
- DOJ/FTC merger review outcomes

Premerger Notification

HSR Act

- Hart-Scott-Rodino Act[1]
  - Enacted in 1976 and implemented in 1978
  - Applies to large mergers, acquisitions and joint ventures
  - Imposes reporting and waiting period requirements
    - Preclosing reporting to both DOJ and FTC by each transacting party
    - Post-filing waiting period before parties can consummate transaction
  - Authorizes investigating agency to obtain additional information and documents from parties during waiting period through a "second request"
  - Designed to alert DOJ/FTC to pending transactions to permit them to investigate—and, if necessary, challenge—a transaction prior to closing
    - *Idea*: Much more effective and efficient to block or fix anticompetitive deal prior to closing than to try to remediate it after closing
  - Not jurisdictional: Agencies can review and challenge transactions—
    - Falling below reporting thresholds,
    - Exempt from HSR reporting requirements, *or*
    - "Cleared" in a HSR merger review—no immunity attaches to a transaction that has successfully gone through a HSR merger review

[1] Clayton Act § 7A, 15 U.S.C. § 18a.

HSR Act

- Basic materials
  - The HSR Act, 15 U.S.C. § 18a (also known as Section 7A of the Clayton Act)
  - The HSR Act implementing regulations
  - Formal FTC interpretations of the implementing regulations
  - Informal staff interpretations of the implementing regulations
  - The HSR reporting form and instructions

HSR Act

- Administration
  - The FTC Premerger Notification Office (PNO) is responsible for the procedural administration of the premerger notification program under the HSR Act
  - There is a “clearance process” to allocate HSR filings to the DOJ and FTC for substantive review (discussed below)
  - Once a filing has been “cleared” to an agency for review, the filing is sent to the appropriate investigating section for review, investigation, and possible challenge

Basic prohibition

- Section 7A(a)

> [N]o person shall acquire, directly or indirectly, any voting securities or assets of any other person, unless both persons (or in the case of a tender offer, the acquiring person) file notification . . . and the waiting period . . . has expired . . . .

- A reportable transaction is one that—
  - Involves the ***acquisition*** of ***voting securities*** or ***assets***
  - Satisfies the ***dollar thresholds*** for prima facie reportablility
  - Does not fall into one of the ***exemptions*** provided by the HSR Act or implemented by the HSR Rules
- Thresholds are adjusted annually for inflation

Acquisition of voting securities or assets

- The HSR Act applies only to acquisitions of voting securities or assets
- Voting securities
  - "[S]ecurities which at present or upon conversion entitle the owner or holder thereof to vote for the election of directors of the issuer"[1]
- Assets
  - No special definition
  - The acquisition of a 50%or greater ownership interest in a non-corporate entity (such as a partnership or LLC) is regarded as an acquisition of the entity's underlying assets
  - An exclusive license is regarded as an asset

[1] 16 C.F.R. § 801.1(f)(1)(i).

Acquisition of voting securities or assets

- Acquisition
  - Obtaining the “beneficial interest” in the underlying voting securities or assets
  - Does not require a formal transfer of legal title
    - *Example*: Company A has a signed purchase agreement to acquire the voting securities of Company B from its parent company. Although the transaction has not yet closed, Company A is influencing the operational management decisions of Company B. Given this influence, the agencies will view Company A has having obtaining a beneficial interest in Company B and hence to have acquired Company B for HSR Act purposes.

Prima facie reportability[1]

Size of transaction*	Prima Facie Reportability		
Up to and including $90.0 million	Not reportable		
Above $90.0 million up to and including $359.9 million	Reportable if : (1) satisfies the "size of person" test, and (2) no exemption applies		
	Size of person test		
	Acquiring person		*Acquired person*
	$180.0 million (in total assets or annual net sales)	and	$18.0 million (in total assets or annual net sales of a person engaged in manufacturing)
	Or		
	$180.0 million (in total assets or annual net sales)	and	$18.0 million (in total assets of a person not engaged in manufacturing)
	Or		
	$18.0 million (in total assets or annual net sales)	and	$180.0 million (in total assets or annual net sales)
In excess of $359.9 million	Reportable absent an exemption		

* Based on the value of voting securities and assets the acquiring person will hold as a result of the acquisition, including the value of any previously acquired voting securities.

[1] *See* Revised Jurisdictional Thresholds for Section 7A of the Clayton Act, 84 Fed. Reg. 7370 (Mar. 4, 2019) (effective Apr. 3, 2019).

Prima facie reportability

- Simple rule

> If the acquiring person will hold ***$90 million*** or more of the voting securities or assets of the acquired person, then the acquisition is likely reportable absent an exemption

  - A transaction that satisfies the dollar thresholds is called ***prima facie reportable***

Prima facie reportability

- Measuring thresholds
  - Measured against everything the acquiring person will hold as a result of the pending acquisition, not just the amount to be acquired in the pending transaction
- Asset acquisitions
  - Acquisition price + value of assumed liabilities
- Voting securities acquisitions
  - Acquisition price for voting securities to be acquired + value of voting securities already held
  - Note: Acquisitions of minority interests can be reportable
- Acquisitions of ownership interests in LLCs, partnerships and other noncorporate entities
  - Acquisition price for non-corporate interests to be acquired + value of interests *and* acquisition confers "control" of the entity
  - For HSR Act purposes, "control" is defined as the right to 50% or more of the entity's profits and/or 50% or more of the entity's assets upon dissolution

Selected exemptions

- Intraperson
  - Acquired and acquired person are the same
- Investment
  - Hold no more than 10% of target's outstanding voting securities
    - 15% for certain institutional Investors
  - Acquirer must have a purely passive investment intention
    - Any membership on the board of directors or other involvement in the management of the company (other than voting shares) voids exemption
- Convertible voting securities
  - Acquired securities have no present voting rights
- Acquisitions of non-U.S. assets
  - Must not generate sales in or into the U.S. of more than $90.0 million
- Acquisitions of non-U.S. voting securities by non-U.S. persons that either—
  - Do not confer control over the target, or
  - Do not involve assets in the U.S., or sales in or into the U.S., over $90.0 million

Notification thresholds

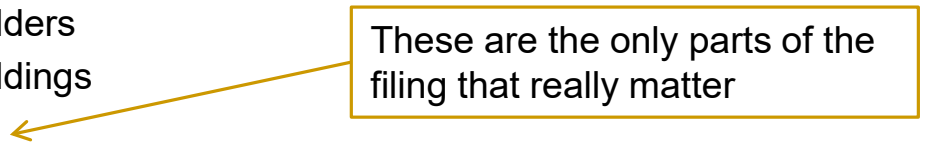
- An otherwise reportable transaction is not subject to the reporting and waiting period requirements of the HSR Act if—
  1. The reporting and waiting period requirements were satisfied within the last *five years* for a prior acquisition, *and*
  2. The pending acquisition will not cause the acquiring person to cross a notification threshold

Notification thresholds[1]
$90.0 million
$180.0 million
$899.8 million
25% of the voting securities if their value exceeds $1,687.80 million
50% of the voting securities if their value exceeds $84.4 million

[1] *See* Revised Jurisdictional Thresholds for Section 7A of the Clayton Act, 84 Fed. Reg. 7370 (Mar. 4, 2019) (effective Apr. 3, 2019).

HSR Act filing

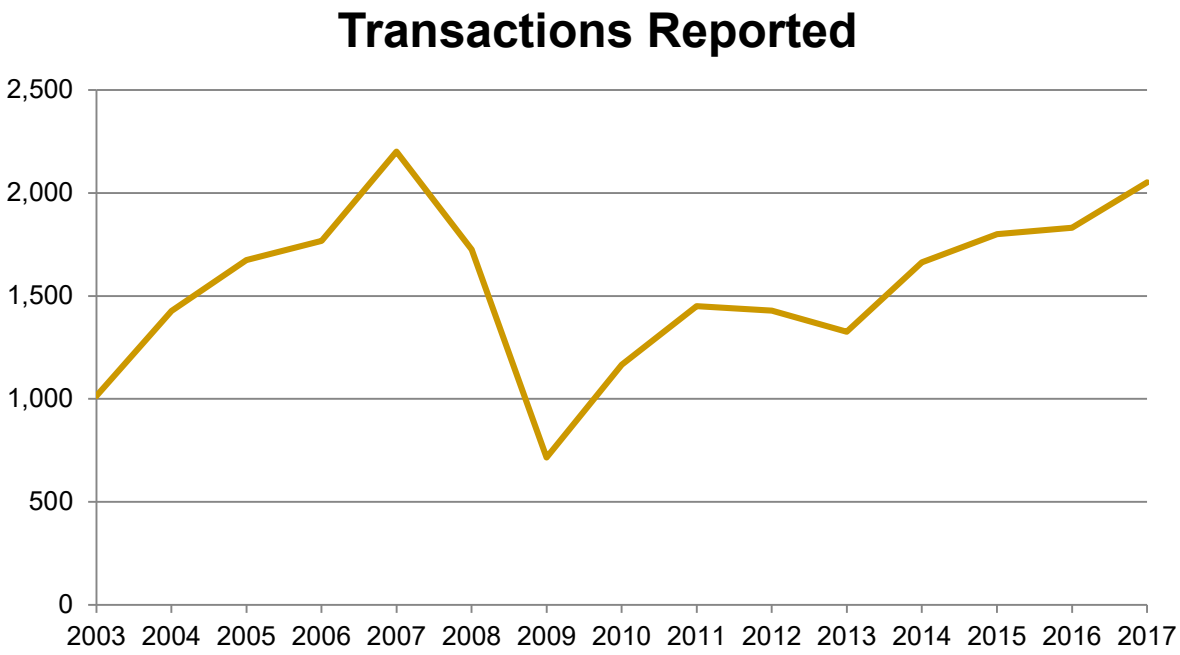
- Uses a prescribed form: Requires no—
  - Market definition
  - Calculation of market shares or market concentration statistics
  - Presentation of any antitrust analysis or defense
- Both the acquiring and acquired persons must submit their own filing
- Key information required:
  - Transaction documents (e.g., stock purchase agreement)
  - Annual reports and financial statements
  - Revenues by North American Industry Classification System (NAICS) codes
  - Corporate structure information
    - Majority-owned subsidiaries
    - Significant minority shareholders
    - Significant minority shareholdings
  - "4(c)" and "4(d)" documents



HSR Act filing

- 4(c) and 4(d) documents
  - 4(c) documents
    - Studies, surveys, analyses or reports
    - Prepared by or for officers or directors of the company (or any entities it controls)
    - That analyze the transaction
    - With respect to markets, market shares, competition, competitors, potential for sales growth, or expansion into product or geographic markets
  - 4(d) documents
    - Confidential Information Memoranda ("CIM")
    - Third party advisor documents
    - Synergy and efficiency documents
  - Failure to provide all 4(c) and 4(d) documents
    - Makes the HSR filing ineffective, so that the waiting period never started
      - Usually discovered by investigating agency in the document production in a second request
      - Agencies have required parties to refile and go through the entire process (including a second second request)
    - Also, civil penalties (fines) for closing a transaction without observing the applicable waiting period

HSR Act Notifications



Source: Fed. Trade Comm'n & U.S. Dept. of Justice, Hart-Scott-Rodino Annual Report Fiscal Year 2017, at App. A.

Statutory waiting periods

- General rule
  - Cannot close a reportable transaction until the waiting period is over
  - The duration of the waiting period is prescribed by the HSR Act
- Initial waiting period
  - 30 calendar days generally
  - 15 calendar days in the case of—
    - a cash tender offer, or
    - acquisitions under § 363(b) of bankruptcy code
- Extended waiting period
  - Waiting period extended by issuance of a second request in initial waiting period
  - Waiting period extends through—
    - Compliance by all parties with their respective second requests
    - PLUS 30 calendar days (10 calendar days in case of a cash tender offer)
- Investigating agency may grant *early termination* of a waiting period at any time

HSR Act violations

- HSR Act prohibition

> "[N]o person shall acquire, directly or indirectly, any voting securities or assets of any other person" in a reportable transaction without observing the filing and waiting period requirements[1]

  - Recall that the HSR regulations provide that a person holds (acquires) voting securities or assets when it has a "beneficial interest" in them[2]

- Two basic types of violations
  - Failure to file
  - Gun jumping

- Violations can be expensive
  - $42,530 per day for every day of the violation—Equals $15.9 million per year[3]
  - Also can put the violator on the radar screen of the agencies for future acquistions

[1] 15 U.S.C. § 18a(a).
[2] 16 C.F.R. § 801.1(c).
[3] 84 Fed. Reg. 3980 (Feb. 14, 2019) (increasing civil penalty from $41,484 per day to $42,530 per day effective February 14, 2019, purusuant to the Federal Civil Penalties Inflation Adjustment Act Improvements Act of 2015, Pub. L. No. 114–74, § 701, 129 Stat. 599 (2015) (requiring a catch-up CPI inflation adjustment from the date of the statute's enactment)).

Failure to file

- Violation
  - Failing to file an HSR report and observe the waiting period requirements in a reportable transaction
- Two scenarios
  1. Failure to file at all
     - Intentional failure to file
     - Inadvertent failure to file
     - Improper invocation of an exemption (usually the investment exception)
  2. Filing an insufficient report (e.g., a report that is incomplete because it does not contain all Item 4(c) and 4(d) documents)
- Prosecutorial discretion
  - Vigorous enforcement for intentional failures to file
  - "One-bite" rule for inadvertent failures to file
    - No enforcement action on first failure
    - Enforcement actions on subsequent failures
  - Filing of an insufficient report requires a corrective filing
    - Restarts the waiting period
  - Varies with culpability in invoking exemption

"Gun jumping"

- Violation
  - The FTC takes the position that a person has a beneficial interest in the voting securities or assets of the target company within the meaning of the HSR Act when the person can ***exercise a material degree of management influence*** on the current (preclosing) operations of the target
    - Especially decisions regarding how to compete in the marketplace
  - Exercising this influence prior to the end of the waiting period is called "gun jumping"
    - Violates the HSR Act, regardless of effect on competition, because, for HSR Act purposes, the acquiring company has acquired the target without observing the waiting period—subjects the acquiring company to a civil penalty of $42,530 per day (in 2019)
    - May also violate Section 1 of the Sherman Act if the influence creates an anticompetitive effect in the marketplace (e.g., the coordination of bids by merging competitors)
    - The acquiring person cannot violate the HSR Act after the waiting period has expired, but it can still violate the Sherman Act if the transaction has not closed