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# Unit 3. The DOJ/FTC Merger Review Process

## CLASS SLIDES

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# Premerger Notification

# HSR Act

## ■ Hart-Scott-Rodino Act<sup>1</sup>

- 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

<sup>1</sup> Clayton Act § 7A, 15 U.S.C. § 18a.

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# 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

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# 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 reportability
  - 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”<sup>1</sup>
- 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

<sup>1</sup> 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 as having obtained a beneficial interest in Company B and hence to have acquired Company B for HSR Act purposes.



# Prima facie reportability<sup>1</sup>

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	
	<i>Acquiring person</i>	<i>Acquired person</i>
	\$180.0 million (in total assets or annual net sales)	\$18.0 million (in total assets or annual net sales of a person engaged in manufacturing)
	and	
	\$180.0 million (in total assets or annual net sales)	\$18.0 million (in total assets of a person not engaged in manufacturing)
	and	
	<i>Or</i>	
	\$18.0 million (in total assets or annual net sales)	\$180.0 million (in total assets or annual net sales)
	and	
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.

<sup>1</sup> 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

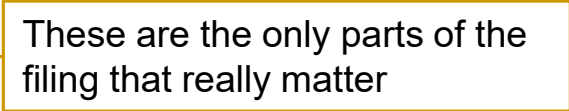
# Notification thresholds

- 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 <sup>1</sup>
\$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

<sup>1</sup> See Revised Jurisdictional Thresholds for Section 7A of the Clayton Act, 84 Fed. Reg. 7370 (Mar. 4, 2019) (effective Apr. 3, 2019).

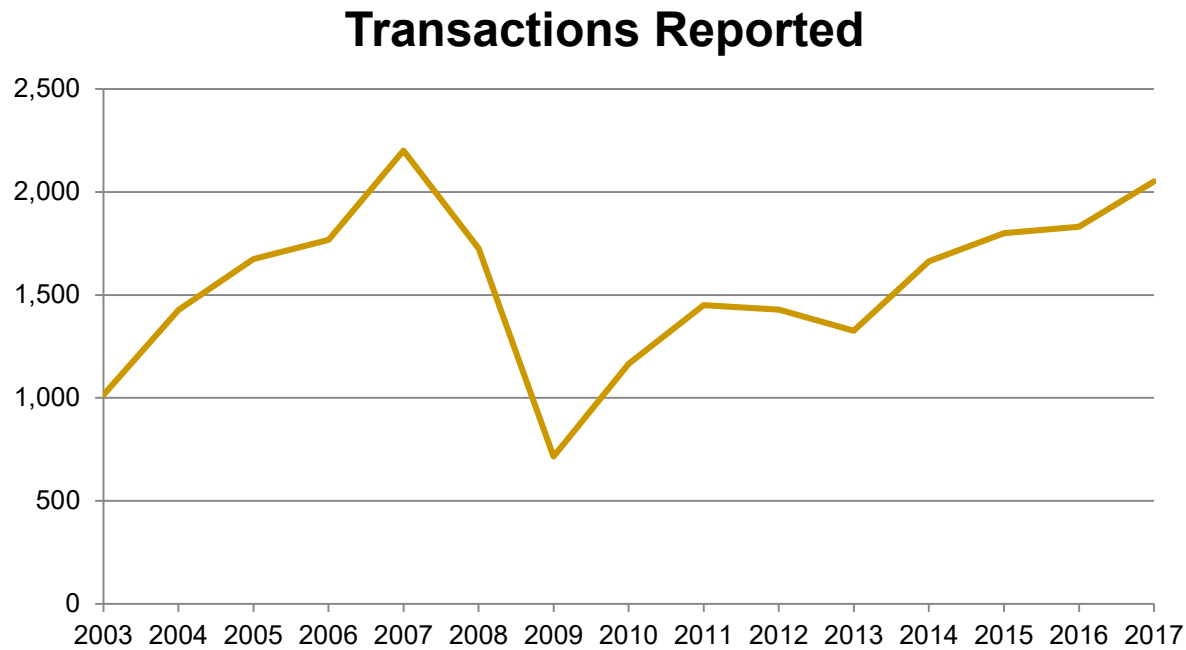
# HSR Act filing

- 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
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# 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<sup>1</sup>

- Recall that the HSR regulations provide that a person holds (acquires) voting securities or assets when it has a “beneficial interest” in them<sup>2</sup>

## ■ 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<sup>3</sup>
- Also can put the violator on the radar screen of the agencies for future acquisitions

<sup>1</sup> 15 U.S.C. § 18a(a).

<sup>2</sup> 16 C.F.R. § 801.1(c).

<sup>3</sup> 84 Fed. Reg. 3980 (Feb. 14, 2019) (increasing civil penalty from \$41,484 per day to \$42,530 per day effective February 14, 2019, pursuant 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

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# Initial Waiting Period Investigations

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# Preliminaries

- Parties must file their respective HSR forms with both the DOJ and the FTC
  - Separate forms are required for each reporting person
- FTC Premerger Notification Office review
  - Only for technical compliance on form—no review of substance
  - Allocated to DOJ or FTC for review through agency “clearance” process
  - Responsible agency assigns to litigating section for substantive review

# “Clearance”

- DOJ and FTC decide which, if either, of the agencies will do the investigation (“clearance”)
  - “Liaison agreement” between DOJ and FTC prevents duplicative investigations
    - If neither DOJ nor FTC want to open a preliminary investigation—PNO grants early termination of the waiting period
    - If DOJ or FTC (but not both) want to open a preliminary investigation—Requesting agency gets clearance to open investigation
    - If both DOJ and FTC want to open a preliminary investigation—Agencies negotiate to allocate the investigation based on prior experience with the industry or the merging parties (and which agency got the last contested clearance)
  - Process can be fraught with strategic behavior by agencies
  - In extreme cases, “clearance battles” can last until the last day of the initial waiting period
  - Efforts to reform “clearance” process by allocating specific industries to specific agency have failed miserably
    - Neither agencies nor their respective congressional oversight committees want to relinquish jurisdiction over any type of merger

# Initial contact by investigating staff

- Usually occurs 7-10 days after filing
- Three purposes
  1. Inform parties of the investigation and introduce the investigating staff
  2. Request that the parties provide certain information to the staff on a voluntary basis—
    - Most recent strategic, marketing and business plans
    - Internal and external market research reports for last 3 years
    - Product lists and product descriptions
    - (Perhaps) competitor lists and estimates of market shares
    - Customer lists of the firm's top 10-20 customers (including a contact name and telephone number)<sup>1</sup>
  3. Invite the parties to make a presentation to the staff on the competitive merits of the transaction

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<sup>1</sup> The agencies do not ask for customer lists in transactions involving consumer goods sold at retail.



# Initial merits presentation

- Critical to do completely, coherently, and quickly
  - Often a large “first mover” advantage in being the first to give the staff a systematic way to think about the transaction
  - Well-prepared business people are the best to present
    - Agencies not impressed with “testifying” lawyers—especially outside counsel
  - Need to anticipate and answer staff questions
  - Need to clear and compelling
    - Cannot win on an argument that the staff does not understand or finds ill-supported
  - Need to anticipate and be consistent with what the staff is likely to hear from customers
    - Staff is strongly biased to accepting customer view in the event of an inconsistency
  - Need to do quickly
    - By the time of the initial call from the investigating staff, one-third of the initial waiting period will be over

The best presentations anticipate all of the issues the staff will raise, provide answers that are supported by company documents and consistent with customer perceptions, and have all of the facts right. Ideally, the rest of the investigation needs to do no more than defend the analysis of the first presentation.

# Initial merits presentation

- Ideal structure (when the facts fit)
  1. Provide an overview of the parties and the transaction
    - Identify other jurisdictions in which the transaction is reportable
    - Provide an overview of the industry (if the staff is not familiar with the industry)
  2. Explain the business model driving the transaction
    - Essential to give a compelling reason for doing the deal that is not anticompetitive
    - The deal is procompetitive—a win-win for the company and the customers
    - Identify the customers benefits implied by the business model
  3. Explain why market conditions would not allow the transaction to be anticompetitive in any event
    - “We could not raise price even if we wanted. Customers have alternatives to which they can turn to protect themselves in the event we try to raise price or otherwise harm them.”
    - Alternatives can be other current suppliers, firms in related lines of business that can expand their product lines, new entrants, or customer self supply (vertical integration)

# Customer interviews by staff

- Occupies the bulk of the remaining time in the initial investigation
- Customer views are given great weight
  - *Theory*: The purpose of the antitrust laws is to protect customers from competitive harm, and sophisticated customers should have a good idea of whether they will be competitively harmed by the transaction under review
  - Staff will attempt to call all of the contracts on the customer lists provided by the merging companies in response to the initial voluntary request
  - Staff often will accept customer complaints uncritically but question customer support
  - Customer reactions may differ depending on the position of the contact person
    - The CEO may take a broader and more nuanced view of the transaction than a procurement manager

# Competitor interviews by staff

- Competitor conclusions are given little weight
  - *Theory*: Anticompetitive transactions are likely to benefit competitors, so competitor complaints are more likely the result of concerns about procompetitive efficiencies than anticompetitive effect
  - But competitor interviews can be useful in understanding more about the industry
    - Complaining competitors are often willing to spend considerable time educating the staff
    - Customers usually just want the staff to go away unless they strongly oppose the deal

# End of the initial waiting period

## ■ Three options for the agency

1. Close the investigation
2. Issue a second request

### ■ Most important factors—

- ❑ Incriminating company documents
- ❑ Significant customer complaints
- ❑ Four or less competitors postmerger for horizontal transactions (5→ 4 deals)
- ❑ Merging parties are uniquely close competitors to one another (“unilateral effects”)
- ❑ Merger eliminates a “maverick”
- ❑ Elimination of a probable and significant potential entrant into a highly concentrated market
- ❑ Obvious significant foreclosure possibilities (for vertical transactions)

NB: Any one of these factors can be sufficient to trigger a second request investigation

### ■ A second request must be authorized—

- ❑ By the assistant attorney general (typically delegated to a deputy assistant attorney general)
- ❑ By the Federal Trade Commission (typically delegated to the chairman or a commissioner)

## 3. Convince the parties to “pull and refile” their HSR forms to restart the initial waiting period

- Typically used when the initial investigation to date indicates no problem but requires a short additional time to complete customer interviews
- The agency usually grants early termination in the middle of the second initial waiting period

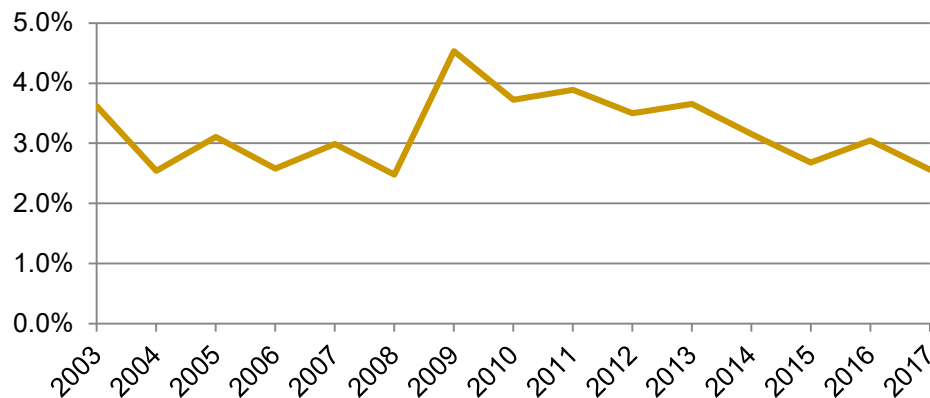
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# Second Request Investigations

# The second request

- HSR Act authorizes investigating agency to issue one request for additional information and documentary material (a “second request”) during the initial waiting period to each reporting party
- Issuance of a second request extends waiting period until—
  - All parties comply with their respective second requests, and
  - Observe a final waiting period (usually 30 days) following compliance
    - 10 days for all cash tender offers

**Percentage of Eligible Transactions Receiving Second Requests**



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

# Second request investigations

- **Second request**
  - **Blunderbuss request**
    - If you can only ask once, ask for everything
    - DOJ and FTC each have “model” second requests, but typically customized with additional specifications
  - **Typically takes 6-16 weeks to comply**
    - Often covers 60-120 custodians
      - Agencies are making meaningful efforts to reduce this number—target 30-35
    - Interrogatories, including:
      - Detailed sales data (CRM database)
      - Bid and win/loss data
      - Requirements for entry into the marketplace
      - Rationale for deal
    - Document requests, including:
      - Business, strategic and marketing plans
      - Pricing documents
      - Product and R&D plans
      - Documents addressing competition or competitors
      - Customer files and customer call reports
    - Covers e-mail and other electronic documents
    - Non-English language documents must be translated into English



# Second request investigations

- Depositions of business representatives of parties
  - Often 3-5 employees for each party
    - Often senior person knowledgeable about U.S. sales and competition for U.S. customers
    - Can include sales representatives for key accounts
    - R&D directors (if R&D is important to defense)
  - In Washington
  - Can be compelled
    - Civil Investigative Demand (CID) by the DOJ
    - Subpoena by the FTC
  - Transcribed and under oath
  - Typically each lasts 6-8 hours
- Documents and testimony from customers and competitors
  - Testimony will be memorialized in a sworn affidavit
- Expert economic analysis
  - By experts retained by the parties
  - By agency experts
    - Or, in investigations where litigation is foreseeable, by outside experts retained by agency

# Final waiting period

## ■ Timing

- Begins when all parties have submitted proper second request responses
- Ends 30 calendar days later
  - 10 days in a cash tender offer
- Parties often voluntarily “extend” the final period<sup>1</sup>
  - Provides additional time for agency to complete investigation
  - Usually better than being sued!
  - May be necessary to complete meetings
  - May be necessary if a consent decree is being negotiated

## ■ “Timing agreements”

- Agencies like to negotiate “extensions” early in a second request investigations so that they know how much time they have before the deal can close
- Typically will accept 60 days beyond the normal expiration of the waiting period
  - 30 days for the staff (making a total of 60 for the staff after second request compliance)
  - 30 days for the front office
- Technically a contract, but real effect is more of an estoppel

<sup>1</sup> Surprisingly, many members of the bar believe that you can voluntarily extend the waiting period. The FTC’s position, however, is that the waiting period is set by statute and cannot be extended by agreement, although the parties can commit by contract not to close the transaction before a certain time. This has significant implications for “gun-jumping” violations, which cannot occur after the waiting period has ended.

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# Merger Review Outcomes

# The final arguments

- Formal meetings at the end of the investigation

	DOJ	FTC
1	Investigating staff	Investigating staff
2	Section Chief & staff	Assistant Director & staff
3	Deputy Assistant Attorneys General (legal and economics)	Directors meeting (Bureau of Competition/ Bureau of Economics)
4	Assistant Attorney General	Five FTC Commissioners (meet individually)

- Numerous informal meetings can occur up the chain at the end of the investigation
- *Critical question:* How much of its analysis will the investigating staff disclose to the parties?

# Possible outcomes in DOJ/FTC reviews

## Close investigation

- Waiting period terminates at the end of the investigation with the agency taking no enforcement action, or
- Agency grants early termination prior to normal expiration

## Litigate

- DOJ: Seeks preliminary and permanent injunctive relief in federal district court
- FTC: Seeks preliminary injunctive relief in federal district court  
Seeks permanent injunctive relief in administrative trial

## Settle w/consent decree

- Typical resolution for problematic mergers
- DOJ: Consent decree entered by federal district court
- FTC: Consent order entered by FTC in administrative proceeding

## Parties terminate transaction

- Parties will not settle at the agency's ask and will not litigate, or
- Agency concludes that no settlement will resolve the agency's concerns and the parties will not litigate
  - Examples: AT&T/T-Mobile, NASDAQ/NYSE Euronext

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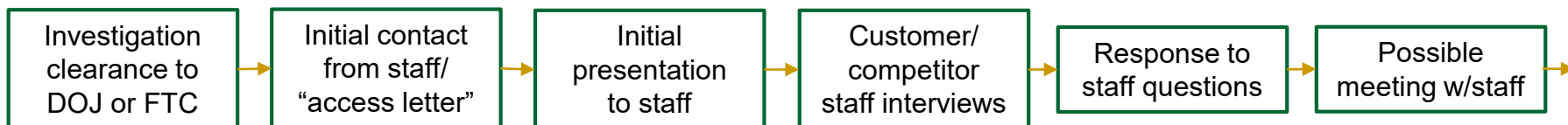
# The HSR Review Process: A Summary

# The HSR review process

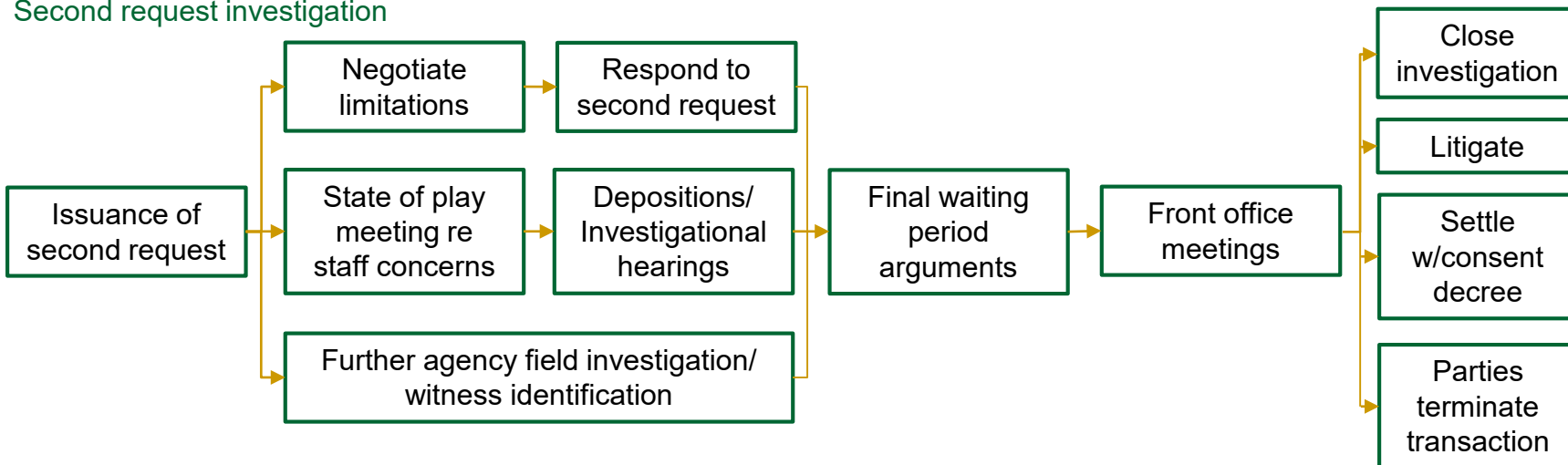
## Prefiling/filing



## Initial investigation

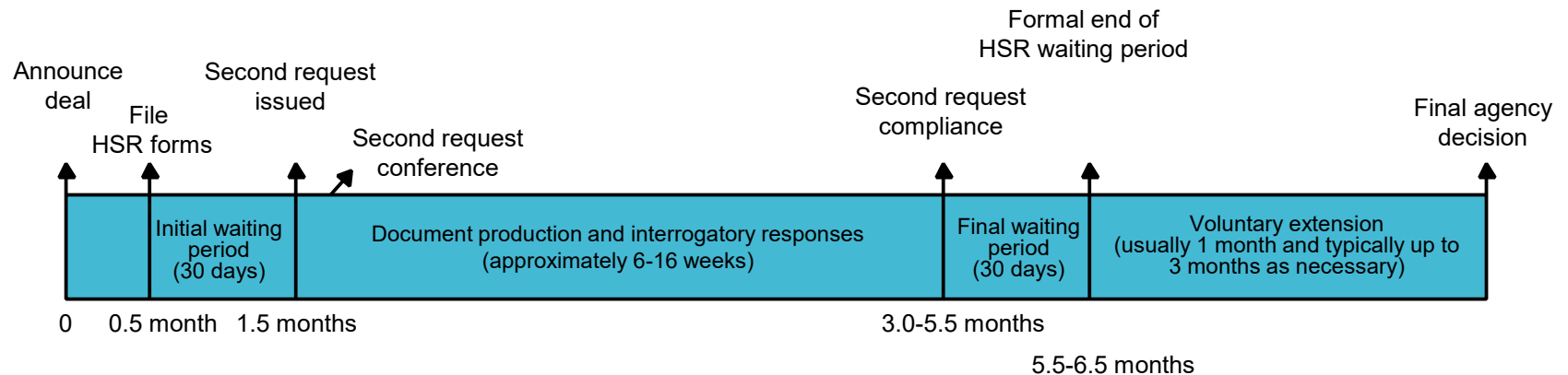


## Second request investigation



# The HSR Act review process

## ■ Typical domestic transaction



- |                  |  |  |  |
|------------------|--|--|--|
| Customer rollout | <ul style="list-style-type: none"> <li>- First telephone call (voluntary request)</li> <li>- First presentation</li> <li>- Follow-up meetings</li> <li>- First DOJ/FTC customer interviews</li> <li>- First DOJ/FTC competitor interviews</li> <li>- Filings in other jurisdictions</li> </ul> | <ul style="list-style-type: none"> <li>- Second request conference</li> <li>- Collect and review documents</li> <li>- Prepare interrogatory responses</li> <li>- Depositions of employees</li> <li>- Additional meetings</li> <li>- Follow-up DOJ/FTC customer interviews and affidavits</li> <li>- Follow-up DOJ/FTC competitor interviews</li> </ul> | <ul style="list-style-type: none"> <li>- Final meetings with staff</li> <li>- Meetings with senior staff</li> <li>- Negotiate consent decree (if necessary)</li> </ul> |
|------------------|--|--|--|