CLASS 3A SLIDES

Unit 2. Predicting Antitrust Enforcement Challenges

The First Client Meeting

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Setup

It is September 2016. Nicholas Howley, the CEO of TransDigm, is considering making an acquisition of the SCHROTH commercial airlines safety restraint business. He is asking you for a preliminary antitrust risk analysis of this deal. You know no facts, but Mr. Howley is happy to answer your questions at the meeting. He is also skeptical that the deal presents any material antitrust risk.

Before the meeting: Learn what you can

1. Look at the websites of both companies
   - Learn about their businesses
   - Try to determine whether there are any product overlaps
2. Search the Internet and newspaper archives using "TransDigm and SCHROTH" as the search request

Assume that you find from this research that—

- *The deal involves a horizontal overlap in safety restraints for commercial airlines*
- *TransDigm is the dominant firm in the business*
- *SCHROTH is a new entrant with a small share*
- *There are few if any other firms in the business*

But no other meaningful information

Aside: Some notes on privilege

- Attorney-client privilege
  - *Rule*: The attorney-client privilege applies to—
    1. A communication
       - Includes verbal exchanges, written correspondence, emails, or any other form of communication
       - The communication may be from the lawyer to the client, from the client to the lawyer, or both
    2. Between an attorney and a client
       - May also encompass agents of either who help facilitate the legal representation
    3. Made in confidence
       - That is, there is an expectation of privacy at the time of the communication, and the communication is not intended to be disclosed to third parties
    4. For the purpose of seeking, obtaining, or providing legal assistance
       - Includes communications from the client containing responses to questions posed by the lawyer

Aside: Some notes on privilege

- Attorney-client privilege
  - *Rule*: The violation of any of these four elements negates the privilege and subjects the communication to discovery
  - *Rule*: The attorney-client privilege shields *communications* from discovery; it does not shield *facts*
    - *Exception*: Facts learned from an attorney through an attorney-client communication
      - Disclosing the facts necessarily discloses the content of the privileged communication

Aside: Some notes on privilege

- The work product doctrine
  - *Ordinary work product*:[1] A party may not discover—
    1. documents and tangible things
    2. that are prepared in anticipation of litigation or for trial
    3. by or for another party or its representative
    4. UNLESS the party shows that it—
       a. has substantial need for the materials to prepare its case and
       b. cannot, without undue hardship, obtain their substantial equivalent by other means

[1] Fed. R. Civ. P. 23(b)(3)(A). Rule 23(b)(3)(A) encapsulates the federal ordinary work product doctrine.

Aside: Some notes on privilege

- The work product doctrine
  - *Attorney opinion work product*:[1] The exception does not apply to materials that disclose "the mental impressions, conclusions, opinions, or legal theories of a party's attorney or other representative concerning the litigation"
    - NB: If only a portion of otherwise discoverable material contains attorney opinion work product, the protected attorney opinion work product should be redacted and the rest of the material produced

[1] Fed. R. Civ. P. 23(b)(3)(B).

Aside: Some notes on privilege

- The work product doctrine
  - *Rule*: Although the work product doctrine applies only to documents and tangible things, the protection cannot be pierced by inquiring into the content of a protected document[1]
    - Facts discovered in the course of an investigation by an attorney or her agent are at most ordinary work product and subject to discovery only upon a proper showing of hardship

[1] *See, e.g.,* Order re Petition to Limit or Quash Subpoenas Ad Testificandum Dated April 24, 2009, File No. 091-0064 (July 21, 2009) (in the FTC's investigation of Thoratec Corp.'s pending acquisition of HeartWare International).

Aside: Some notes on privilege

- The work product doctrine
  - Public policy behind the work product doctrine
    - *Promote adversarial litigation*: Allows attorneys to prepare for litigation without fear that their strategy, theories, mental impressions, or research will be exposed to their adversaries
    - *Preserves the integrity of the legal process*: Ensuring that attorneys can candidly evaluate and prepare their cases without concern that their work will be revealed
    - *Prevents unfair advantage*: Avoids situations where one party can free-ride off the investigatory and preparatory work of another attorney
  - Work product in investigations
    - Although the work product doctrines do not automatically apply to all investigations, they do apply if the investigation provides reasonable grounds for anticipating litigation
    - *The practice*: Almost all merger investigations by the FTC or DOJ provide reasonable grounds for anticipating litigation and hence triggering work product protections

Aside: Some notes on privilege

- The problem
  - Merging parties would like to share and coordinate their initial analysis and defense of the transaction
  - BUT ordinarily doing so would violate the attorney-client confidentiality requirement, negate any attorney-client privilege, and subject the communications to discovery by a second request, CID, or subpoena in an agency investigation or litigation

The solution: *The "common interest" privilege provides an exception to the confidentiality requirement and retains the attorney-client privilege for communications among parties with a common legal interest*

Aside: Some notes on privilege

- The "common interest" privilege
  - *Rule*: When the communication involves—
    - The sharing of privileged information
    - Among parties with a common legal interest

    the communication remains protected by the attorney-client privilege
  - *Rule*: Apart from this exception, all parties must continue to satisfy the elements of the attorney-client privilege for shared communications to preserve the privilege
  - *History*:
    - The common interest privilege originated as the "joint defense" privilege
    - But the courts expanded it to include communications outside of the context of litigation

Aside: Some notes on privilege

- The “common interest” privilege
  - *Agency practice*: Recognizes communications among merging parties to share and coordinate their analysis and defense of the transaction, including the sharing of--
    - Antitrust *analyses* of the transaction in the course of negotiations
    - Antitrust analyses of the transaction during the investigation
    - Strategies to defend the transaction generally
    - Strategies to settle the investigation of the transaction through a consent decree or “fix it first” restructuring

Aside: Some notes on privilege

- The "common interest" privilege
  - *Query*: Do differences in commercial objectives defeat the common interest privilege in negotiating risk-shifting provisions (e.g., the cap on a divestiture commitment)?
    - Although both parties share the common legal interest in defending the transaction against an antitrust challenge—
      - The seller wants the deal to close regardless of the cost to the buyer of any divestiture, while
      - The buyer wants the deal to close if and only if the costs of divestiture are not so high that they destroy the attractiveness of the transaction
    - As far as I am aware, this situation has not been addressed by a court
  - *Practice hint*:
    - The parties should frame their negotiations to be over what risk-shifting provisions are reasonably necessary to defend the merger and avoid discussing any business reasons for a divergence in views
    - This makes the discussions—that is, the putatively protected communications—to be about differences in the proper approach to the legal strategy, not commercial differences

Goals of the meeting

1. *Teach* the client the operational test for Section 7 illegality
2. *Ask* the client the most important factual questions
3. *Communicate* your view of the antitrust risk in a way that the client understands
4. *Provide* any strategic advice as to how the client might minimize antitrust risk

We will go through each goal in detail

Teach the client the operational test

- Important to begin the meeting with the operational test
  1. Unless the client understands the test, they will not be persuaded by your advice
     - The client will not be persuaded unless they can replicate your analysis and reproduce your conclusion
  2. If the client understands the test, they are more likely to give complete and meaningful answers your factual questions
  3. If the client knows the test, they can continue to think after they leave the meeting about what other facts may be relevant and follow up with you to sharpen the risk analysis
  4. The client *needs* to know the operational test as they move forward with the transaction to understand the antitrust implications of—
     - What they write in their documents
     - What they say to the press and to customers
     - What they say in meetings with the investigating agency

Teach the client the operational test

- Start with Clayton Act § 7
  - Governing merger antitrust statute
  - Other statutes may apply, but they will not be more restrictive than Section 7
  - Section 7 prohibits transactions that "may substantially lessen competition"
- But what does this mean *operationally*?
  - A transaction "may substantially lessen competition" when it is likely to harm an identifiable group of customers by—
    1. Increasing prices
    2. Reducing market output
    3. Reducing product or service quality
    4. Reducing the rate of technological innovation or product improvement
    5. [Maybe] reducing product variety

Clients can grasp the operational test immediately

Teach the client the operational test

- Tell the client how the investigating agency is going to find the facts about the likely competitive effect
  - HSR reportability and merger review process
    - Time to ask questions to find out if the deal is likely to be reportable
  - The investigating agency will—
    1. Entertain a presentation from the parties on the deal
    2. Interview—and perhaps later depose under oath—you and other relevant employees in both companies
    3. Obtain massive amounts of the documents and data from both companies
    4. Interview customers and competitors (and maybe obtain documents and data from them)
    5. Analyze win-loss records of the companies in bidding for projects
    6. Use economists to assist in analyzing the likely competitive effects of the transaction

Teach the client the operational test

- Bottom line
  - The agency's conclusion on the likely effect on customers will determine the outcome of the investigation
    - NB: Having the truth on the merger's side will not necessarily win the day
    - It is the *agency's conclusion*, not necessarily the truth, that counts
  - The best defense is a good offense
    - Can we argue that the deal is a "win-win" for the merging parties *and* the customers?
    - Companies do not do deals out of the goodness of their heart—*they do deals to make money*
    - Do we have a story consistent with the business model for the transaction, the documents and other company evidence, and the likely customer responses in staff interviews that the deal will be good for customers?

Best story*: The transaction will enable the combined company to make money by reducing costs and by making better products faster to the benefit of our shareholders and our customers*

Ask the client questions

1. What is the deal rationale?
   - How will TransDigm make money from the transaction?
   - Are there any documents on the business rationale?
     - If so, what do they say? Do they support the business rationale? Or refute it?
   - What are the implications of the business model for customers?
2. What will the company documents say about competition between the two companies?
3. Who are the customers and what will they say to the agency when interviewed?
4. Do we have a sales pitch that we can give the customers that the deal will be good for them?
   - Will they accept it?

Communicate the antitrust risk

- *Answer the client's question*: Based on what you learned in the meeting, what is the antitrust risk presented by the deal?
  - It is not sufficient for you to form a view as to the antitrust risk
  - You must meaningfully communicate the nature of this risk to the client so that the client can make informed business decisions
    - If the client does not understand your advice, they cannot act on it
    - If the client is not persuaded that your advice is correct, they will not act on it
- Best explained in terms of—
  - Substantive risk
  - Inquiry risk
  - Remedies risk

So what would you tell Mr. Howley about each of these risks in a TransDigm/SCHROTH deal?

Provide any strategic advice

1. Emphasize the need for a compelling sales pitch for the deal to customers of *both* companies
   - Offer to help the relevant business people develop this pitch and advise on when and how to roll it out
   - Note that it is the customers of the target company that are typically the most difficult to persuade
     - Will eventually need to work with the target company as to how best to persuade its customers
2. Emphasize the need for care in drafting documents
   - "Bad" documents alone can kill a deal
     - Avoid creating documents that suggest—implicitly as well as explicitly—that the deal could harm customers
     - Some documents are "bad" because they were carelessly phrased or factually incorrect, not because they speak the truth—These can also kill a deal
   - If there is one, include the procompetitive business rationale for the deal in as many documents as possible

Provide any strategic advice

3. Consider whether the deal can be structured to make it non-HSR reportable to minimize inquiry risk

Final thoughts

1. Caution the client that this advice is only preliminary and depends on what the client has told you in the meeting
2. Note that more work should be done
   - Would like to send the client a *preliminary information request* for easily obtainable documents and data
   - When confidentiality considerations permit, would like to set up a *meeting with knowledgeable employees* to develop the facts and the arguments further
3. Tell the client that all documents created at the request of counsel should have the following prominent legend:

   PRIVILEGED AND CONFIDENTIAL
   Prepared at the request of counsel

   - Whenever possible, make this legend *machine readable*

Do NOT forget this!!!

Final thoughts

4. Note that at some point in the process we will need to bring the target company onboard
   - The target's evidence and customer outreach program will be equally if not more critical to the outcome of any merger review
   - Note that we should be able to work with the target company under the "common interest" privilege
5. The target, unless incompetently advised, is likely to recognize the antitrust risk in the transaction
   - Should expect that the target will attempt to negotiate some provisions in the purchase agreement to—
     - Decrease the risk of a deal failure, *and*
     - Compensate the target for risk that cannot be eliminated

Will examine in Class 8