Class 1 slides

Unit 1: TransDigm/Takata

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TRANSDIGM GROUP INC.

SCHROTH

The Parties

Who was the buyer?

- TransDigmGroup Incorporated
  - Leading supplier of highly engineered airplane components
  - Delaware corporation
  - Headquarters: Cleveland, OH
  - Revenues (2016): $3.1 billion

Who was the buyer?

- TransDigm’s AmSafe subsidiary
  - World’s dominant supplier of restraint systems (seatbelts) used on commercial airplanes

  - Global revenues (2016): $198 million
  - Headquarters: Phoenix, AZ

Who was the seller?

- Takata Corporation
  - Global manufacturer of automotive safety systems and products for automakers worldwide
    - Also diversified into aviation systems
  - Headquartered in Japan
  - Production facilities on four continents
  - Manufacturer of the airbags subject to the massive recalls
    - U.S. recall of more than 42 million cars (Nov. 2014)
  - Bankruptcy
    - June 2017: Filed for bankruptcy protection in Japan
    - April 2018: Takata was acquired by Key Safety System

TAKATA

What was the seller going to sell?

- The SCHROTH passenger restraint systems business
  - Designs and manufactures proprietary, highly engineered, advanced safety systems for aviation, racing, and military ground vehicles throughout the world
  - History
    - Founded in 1946
    - Built the world's first seat-belt in 1954
    - Entered the aviation business in 1991
    - Acquired by Takata in 2012
  - Facilities in three locations
    - Arnsberg, Germany
    - Pompano Beach, Florida
    - Orlando, Florida
  - Operations
    - Employees: 260
    - Revenues (2016): $37 million
    - Profits: Don't know, but probably between $5 - $10 million annually

SCHROTH®
Safety Through Technology

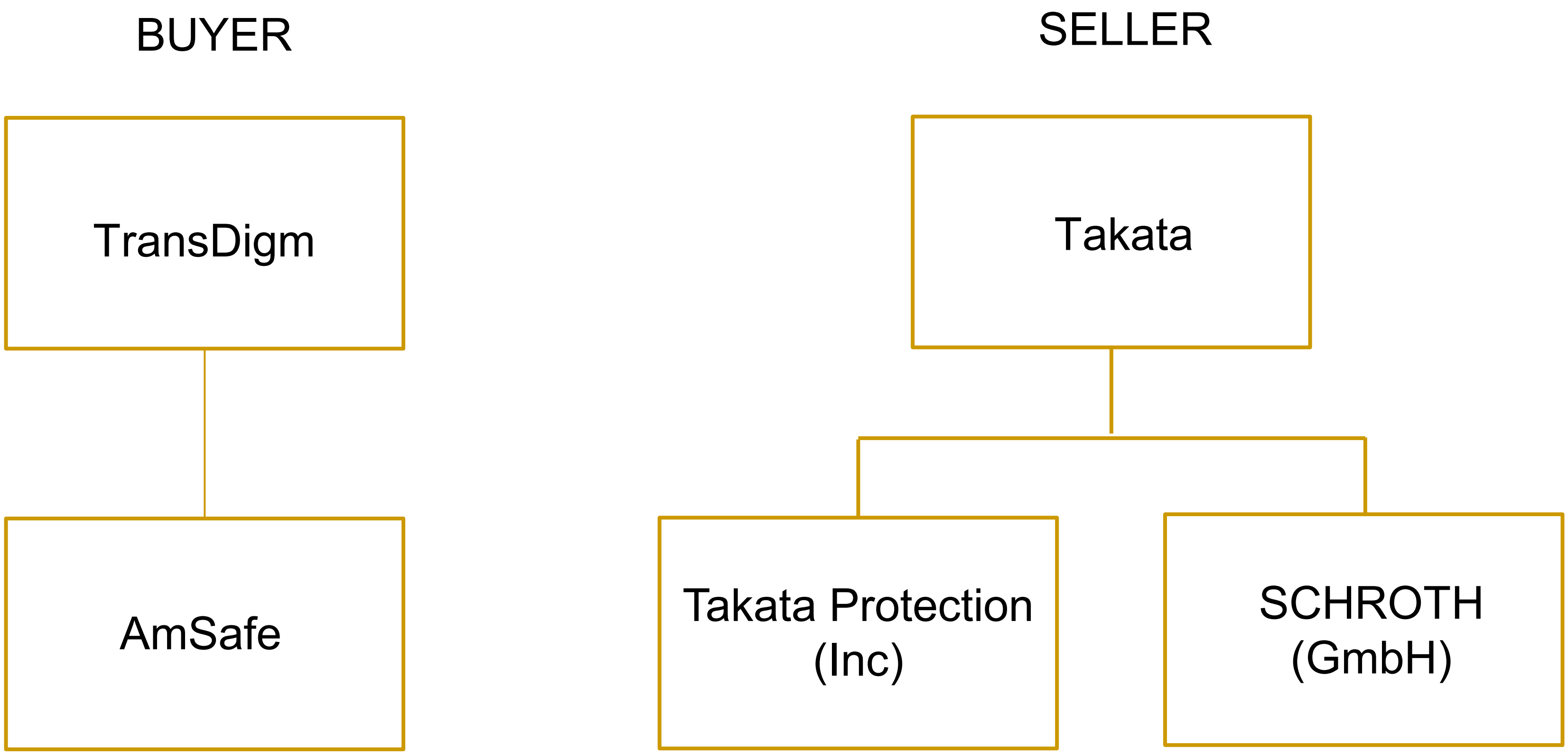
The Transaction

What was the transaction?

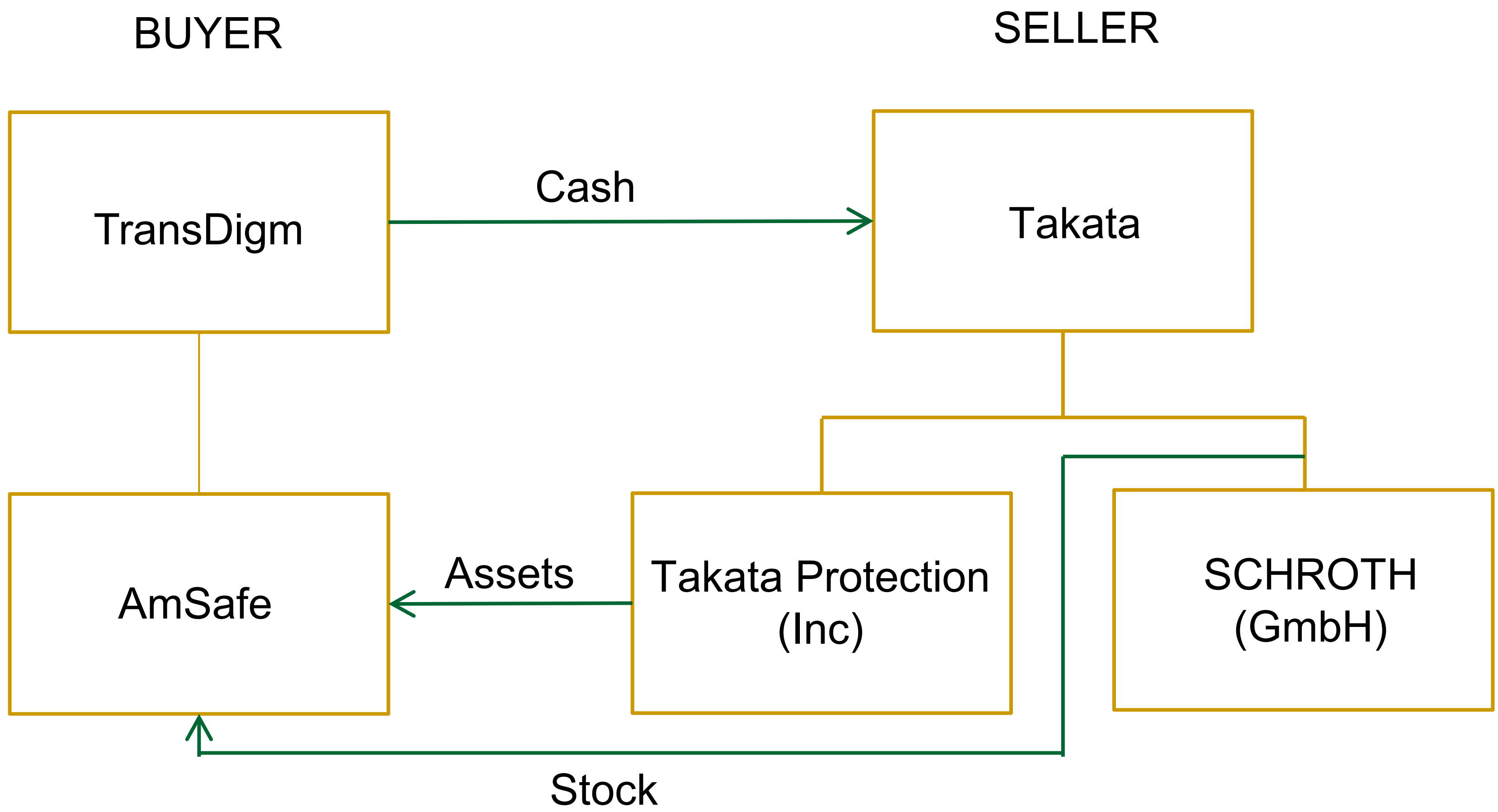
- TransDigm Group to acquire—
  1. Stock of SCHROTH Safety Products GmbH, *and*
  2. Assets of Takata Protection Systems, Inc.

  from Takata Corporation
- Purchase price: $90 million
- Transaction closed: February 22, 2017
  - Five years after being acquired by Takata

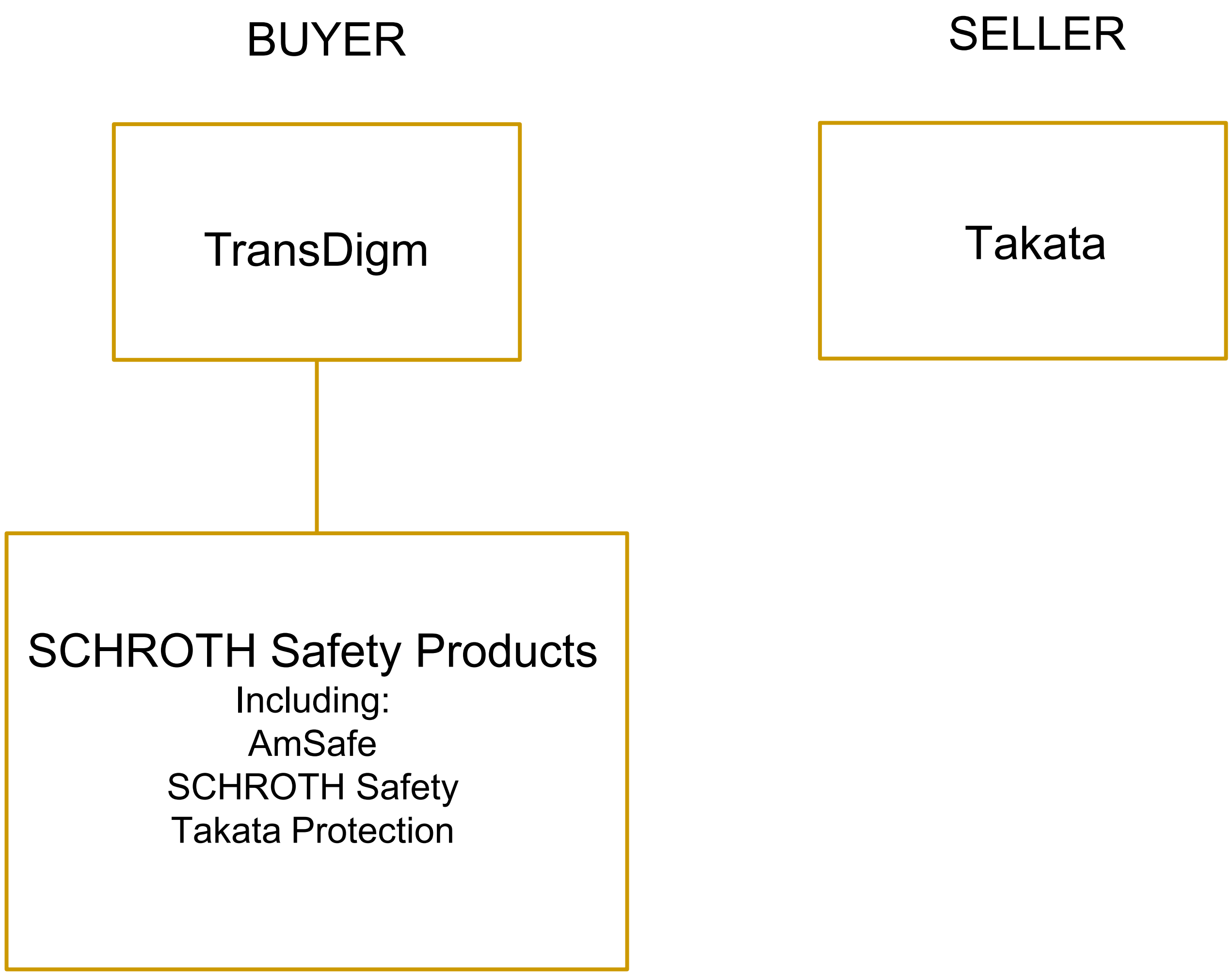
Summary of the deal structure: Before



Summary of the deal structure: Deal



Summary of the deal structure: After



Is this a horizontal transaction?

- Yes
- Horizontal transactions:
  - Combine two competitors
  - Sell *substitute* products

Firm 1 + Firm 2

- Vertical transactions:
  - Combine two firms at adjacent levels in the chain of manufacture and distribution
  - May be extended to two firms that sell *complementary* products

Firm 1
+
Firm 2

- Conglomerate transactions
  - Mergers that are neither horizontal nor vertical

Firm 1
+
Firm 2

The Business Rationale

Why did the parties do the transaction?

- TO MAKE MONEY

Parties do not do deals out of the goodness of their heart

Firms act with the goal of maximizing profit

To make money, the buyer must value the target at more than the target's going concern value

To make money, the seller must value the purchase price at more than the target's going concern value

- 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

How can buyers profit from a horizontal deal?

- Cost-saving efficiencies
  - Eliminate duplicative facilities
  - Consolidate corporate functions
  - Rationalize workforce
  - Run the business more efficiently
- Customer value-enhancing efficiencies
    - "Shift the demand curve to the right"
    - Improve the *customer value proposition*
  - Make existing products better or cheaper
  - Create new or improved products better, cheaper, or faster
  - Enhance customer service or support quality

These synergies are procompetitive *because they tend to improve consumer welfare*

How can buyers profit from a horizontal deal?

- Exploit customers
  - Increase prices by reducing competition on price, quality, or service
  - Reduce costs by degrading product quality, service, or other aspects of customer value
- Harm competitors (primarily vertical deals)
  - Gain the incentive and ability to withhold essential products or services from competitors, thereby weakening or excluding rivals and enabling higher prices

These synergies are anticompetitive *because they tend to harm consumer welfare*

Why did Takata buy SCHROTH in 2012?

- TO MAKE MONEY
- How?
  - Conglomerate transaction ("product extension" merger)
    - Saw AmSafe as essentially a monopolist
    - Only SCHROTH and one other company—both small—were in the market for restraint systems
    - Probably making significant profit margins
  - Takata thought it could capture more share and make more profits with SCHROTH than had SCHROTH's current owner
  - BUT Takata's strategy required some initial investment in—
    - Aggressive pricing
    - Innovation

    to gain reputation and market share

Why did TransDigm want to buy SCHROTH?

- TO MAKE MONEY
- How?
  - Horizontal transaction—would eliminate competition from an aggressive “new” competitor
    - Recall that SCHROTH, after being acquired by Takata in 2012, embarked on an ambitious plan to capture market share from TransDigm AmSafe (Compl. ¶ 3)
      - Competing on price
      - Investing in R&D
    - At the time of the signing of the acquisition agreement, SCHROTH was—
      - AmSafe’s closest overall competitor
      - AmSafe’s only meaningful competitor for certain types of restraint systems
    - TransDigm’s strategy—
      - Eliminate Schroth’s price competition and so stop competing on price
      - Eliminate innovation competition and reduce R&D costs
      - TransDigm also may have expected some cost-savings synergies

Why did Takata want to sell SCHROTH?

- TO MAKE MONEY
- How?
  - Purchase price more valuable than keeping the business
  - Why might that be the case?
    - SCHROTH needed to compete aggressively to attract customers from TransDigm:
      - Cost money to operate business and conduct R&D
      - Had to price aggressively
      - Probably not making much in profits
    - Had been at it for five years (Compl. ¶ 3)
    - May also have been an effort to obtain cash to stave off bankruptcy in light of the airbag litigations
      - Sale closed in February 2017, three months before Takata's bankruptcy filing

The Law

Statutes

- What federal antitrust statutes could apply to the TransDigm/SCHROTH transaction?
  - Clayton Act § 7
  - Sherman Act § 1
  - Sherman Act § 2
  - FTC Act § 5

Clayton Act § 7

- Provides the U.S. antitrust standard for mergers

> **No person** engaged in commerce or in any activity affecting commerce **shall acquire**, directly or indirectly, the whole or any part of the **stock** or other share capital and no person subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the **assets** of another person engaged also in commerce or in any activity affecting commerce, **where in any line of commerce** or in any activity affecting commerce **in any section of the country**, the **effect** of such acquisition **may be substantially to lessen competition, or to tend to create a monopoly**.[1]

- *Simple summary*: Prohibits transactions that—
  - "may substantially lessen competition or tend to create a monopoly"
  - "in any line of commerce" (product market)
  - "in any part of the country" (geographic market)

Called the *anticompetitive effects test*

Called the *relevant market*

[1] 15 U.S.C. § 18 (remainder of section omitted)

The Sherman Act

- Sherman Act § 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.[1]

- Sherman Act § 2

> Every person who shall **monopolize**, or **attempt to monopolize**, or **combine or conspire** with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony.[2]

[1] 15 U.S.C. § 1.
[2] *Id*. § 2.

The FTC Act

- FTC Act § 5

> **Unfair methods of competition** in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce, are hereby declared unlawful.[2]

- NB: Unlike other provisions, not included in the definition of "antitrust law" in Clayton Act § 1
  - This will be important when it comes to private actions

[1] 15 U.S.C. § 45(a)(1).

Section 7 is the binding constraint

- The Sherman Act and FTC Act, as applied to mergers, are either coextensive or less restrictive than Section 7 of the Clayton Act

*Section 7 provides the antitrust test for all mergers**

* There is arguably an exception for acquisitions of "nascent" competitors (where Section 2 *might* be more restrictive—we will be looking for a test case)

- Consequently:
  - Invocation of the Sherman Act or the FTC Act is usually superfluous
  - Plaintiffs—including the DOJ and FTC—typically allege only a Section 7 violation
    - BUT the FTC alleges that the *signing* of the merger agreement violates Section 5
- State antitrust law
  - Not preempted by federal law
  - But no state has enacted a statute stricter than Section 7

Section 7 and the Consumer Welfare Standard

Some history

- Until recently, modern antitrust law has focused on anticompetitive effects in downstream markets
  - *Downstream markets* are markets in which the firms of interest sell their products or services
  - *Upstream markets* are markets in which the firms of interest buy the inputs to manufacture their products or create their services

We will focus first on effects in downstream markets

Downstream anticompetitive effects

- How do the DOJ/FTC decide whether a merger is anticompetitive in a downstream market?
  - *Rule*: Modern antitrust law looks to the *consumer welfare standard* to determine whether a merger is likely to substantially lessen competition
  - *Rule*: A merger will have a Section 7 anticompetitive effect if, when compared to the "but for" world without the merger, the world with the merger is likely to harm to customers in the market through—
    - Increased prices
    - Reduced market output
    - Reduced product or service quality
    - Reduced rate of technological innovation or product improvement
    - [Maybe] reduced product variety[1]

These are called *anticompetitive effects*

A firm that has the power to produce or strengthen an anticompetitive effect is said to have *market power*

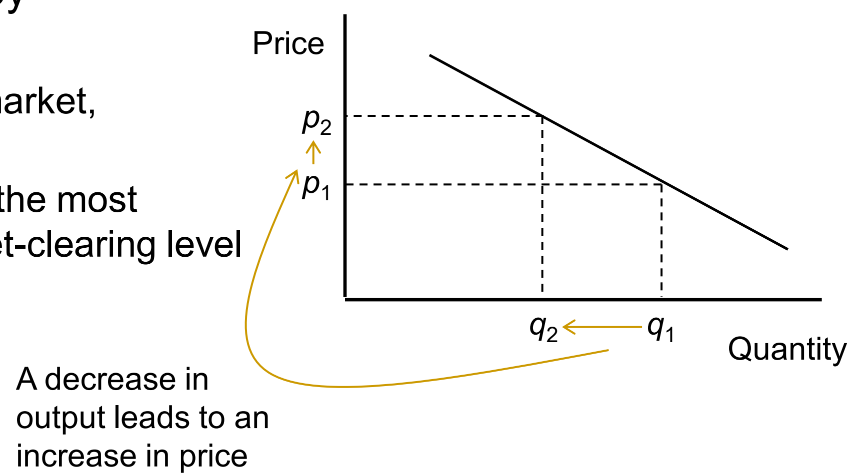
[1] Reduced product variety may or may not have an anticompetitive effect. It can lower costs and benefit consumers if the savings result in lower prices or better products. But it may harm consumers if it limits meaningful choices without offsetting gains. The impact depends on whether consumers are better or worse off after considering both.

Downstream anticompetitive effects

- The anticompetitive effects analysis is *forward looking*
  - Compares the postmerger outcomes with and without the deal
    - Does NOT compare premerger outcomes with postmerger outcomes
    - Requires the investigating agency and the courts to do a *predictive analysis*
      - In the most common situation where the merger has not yet been consummated, the agencies and the courts will have to predict future market outcomes in BOTH with world with the merger and the "but for" world without the merger
  - *Example*: Suppose a merger occurs in a market where prices are decreasing over time
    - The merger is anticompetitive if reduces how fast prices will decrease in the future compared to what would have happened in the "but for" world without the merger
    - The fact the postmerger prices will be lower than premerger prices is irrelevant to the Section 7 anticompetitive effects analysis
  - Can view potential competitors today as future competitors tomorrow

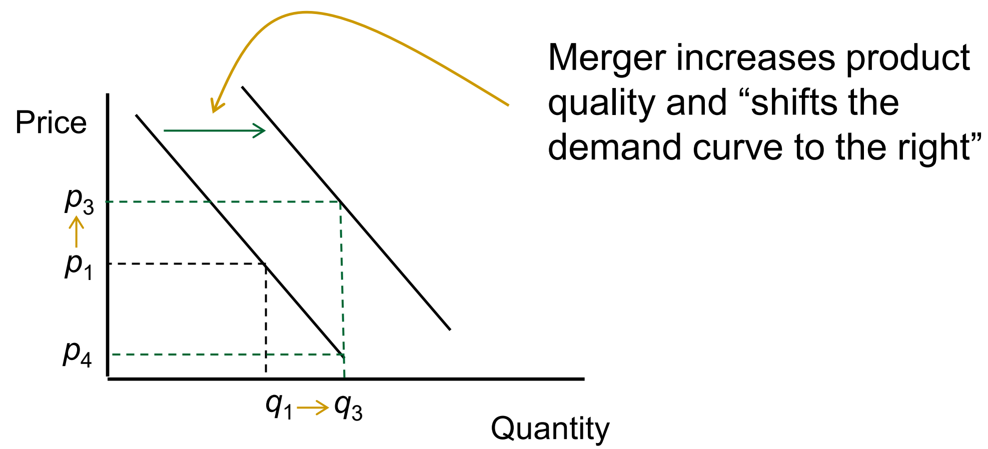
Downstream anticompetitive effects

- Some observations
  1. Prices are usually most easily observed and measurable dimension on which an anticompetitive effect can occur
  2. In competitive effect analysis, an output reduction is equivalent to a price increase
     - In standard economic theory, a firm facing a downward-sloping residual demand curve increases its price by—
       - decreasing output, which
       - creates an artificial scarcity in the market, resulting in
       - The customers valuing the product the most bidding up the price to a new market-clearing level



Downstream anticompetitive effects

- Some observations (cont.)
  3. Conversely, an output increase is (usually) treated as a price decrease
     - A merger that increases output is treated as decreasing "quality-adjusted" price even as it increases the nominal postmerger price
       - The revealed preferences of the customers in increases their unit purchases postmerger demonstrates that the merger increases consumer welfare
       - The difference $p_3 - p_4$ reflects the market's valuation of the product improvement



The conventional wisdom is that when a merger increase output, the merger is procompetitive regardless of the merger's effect on price

  4. Economic models exist to predict price and output effects from mergers that are widely used in merger antitrust analysis

Downstream anticompetitive effects

- Some observations
  5. Economic models to predict quality, rate and direction of technological innovation—
     - Have found little traction in the economics profession, *and*
     - Are not credited with any material probative value by the agencies or the courts

     The result is that merger antitrust analysis focuses primarily on the merger's effects on prices and output

     - It is not, as some critics maintain, that the consumer welfare standard focuses narrowly on price
       - The consumer welfare standard recognizes *all* dimensions on which consumers can be harmed
       - So evidence of anticompetitive harm on nonprice dimensions must come from admissions in the merging parties' documents or statements by executives—evidence that rarely exists (especially in well-counselled companies)

     The upshot is that the agencies rarely, if ever, have challenged a merger primarily on nonprice grounds

Downstream anticompetitive effects

- Four important rules
  1. Absent compelling evidence of significant customer harm on other dimensions, only ***price increases*** count
  2. The merger is anticompetitive if it is likely to result in a price increase or other competitive harm to ***any identifiable customer group***
  3. The agencies believe that ***no customer group is too small*** to deserve antitrust protection
  4. *Corollary*: ***No deal is too small*** not to be challenged

Upstream anticompetitive effects

- *Primary concern*: Reduced prices paid for inputs
  - Wages paid to labor is a central focus
- The history
  - Agencies traditionally focused on downstream customer harm, not supplier-side effects
  - Enforcement focus shifted in the late Obama and first Trump administrations
    - Agencies began exploring theories of harm in upstream (buying) markets, especially labor
    - The Biden administration embraced upstream theories as enforcement doctrine
      - Treated labor and supplier harms as Section 7 violations—even absent downstream harm
      - But it only brought one case
  - Trump 2.0 administration appears to accept upstream enforcement in principle
    - Though likely to apply it cautiously

Consumer welfare standard in practice

In each case, assumes compelling evidence of the effect

- Some operational implications
  - *Downstream effects*: If the merger—
    - Expands market output, the merger is (usually) procompetitive regardless of price effects
    - Reduces market output, the merger is anticompetitive
    - Results in a price increase for some or all customers and no price decrease for any customers, the merger is anticompetitive (unless output expands, usually because of a product or service quality increase)
    - Increases price for some customers but decreases it for others, then the merger is anticompetitive if the wealth transfer to producers from the price increase is greater than the wealth transfer to customers from the price decrease
    - Reduces product or service quality in the market as a whole or reduces the rate of innovation, the merger is anticompetitive
  - *Upstream effects*: If the merger—
    - Reduces input prices with little or no customer benefits, the agencies are likely to regard the merger as anticompetitive
    - Reduces input prices but passes on the savings to downstream customers, the agencies are unlikely to challenge
      - *Exception*: The supplier harms greatly outweigh the customer benefits

The DOJ Investigation

Timing

- Did the DOJ investigation start before or after consummation?
  - After
    - Transaction closed Feb. 22, 2017
    - Complaint filed ten months later on December 21, 2017
- Important distinction
  - Mergers challenged after closing (postconsummation mergers)
  - Merger challenged before closing (preconsummation mergers)

Why is this distinction important?

Timing

- Why didn't the DOJ investigate and challenge the transaction before closing?
  - Probably did not know about it, *or*
  - Was aware of the transaction but not aware of its likely effect on competition
- Didn't the HSR Act filings alert the DOJ to the transaction before closing?
  - No. Apparently not reportable under the Hart-Scott-Rodino Act[1]

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

Hart-Scott-Rodino Act

- Requires large mergers and acquisitions to—
  1. File a *premerger notification report* with the DOJ and FTC
  2. Observe a *statutorily prescribed waiting period* before closing the transaction
     a. *Initial waiting period*: 30 calendar days after filing (for most transactions)
     b. *Final waiting period*: 30 calendar days after all merging parties have responded to their respective second requests (for most transactions)

        NB: A *second request* is a subpoena-like document that—
        1. Contains document requests, narrative interrogatories, and data interrogatories
        2. Can only be issued during the initial waiting period
        3. Can only be issued once to each filing person
        4. Can easily take 4-10 months to respond

- Idea:
  - Much more effective and efficient to block or fix an anticompetitive deal before closing than to try to remediate it after closing

Hart-Scott-Rodino Act

- Why wasn't the TransDigm/SCHROTH transaction reported under the HSR Act?
  - The purchase price was $90 million in cash
  - The HSR threshold in 2017 was $80.8 million
    - In 2025, the threshold is $126.4 million

So the transaction was "prima facie reportable"

  - BUT there are exemptions—Two of which may have applied here to reduce the reportable amount to under the threshold:
    - Foreign stock exemption (for U.S. acquirers)
    - Foreign asset exemption

A transaction that is prima facie reportable where no exemption applies is called "reportable"

Hart-Scott-Rodino Act

- Not jurisdictional
- Agencies can review and challenge transactions that—
  1. Fall below reporting thresholds
  2. Are exempt from the HSR reporting requirements
  3. Have been "cleared" in an HSR merger review
     - "Clearance"—a commonly used term—is a misnomer
     - No immunity attaches to a transaction that has completed an HSR merger without agency enforcement act
       - Compare a merger investigation that is settled with a consent decree
       - A consent decree is entered as a final judgment in a litigation
         → Claim preclusion/res judicata applies

The fact that the TransDigm/Takata deal was not HSR reportable did not preclude the DOJ from investigating and challenging the transaction months or even years after closing

DOJ investigation

- How did the DOJ find out about this transaction?
  - Someone probably called the FTC and complained
  - Maybe Boeing complained
    - Largest U.S. passenger airline manufacturer
    - Isn't it the biggest beneficiary of SCHROTH's competition with AmSafe

    But why would Boeing wait until after the acquisition to complain?

  - Maybe it was a Tier 1 seat manufacturer supplier to Boeing (e.g., Safran, RECARO, Zodiac Aerospace, and Adient Aerospace)

    But why would they wait until after the acquisition to complain?

  - Maybe it was a disgruntled current or former TransDigm employee
  - But probably not a third-party competitor (WHY NOT?)

DOJ investigation

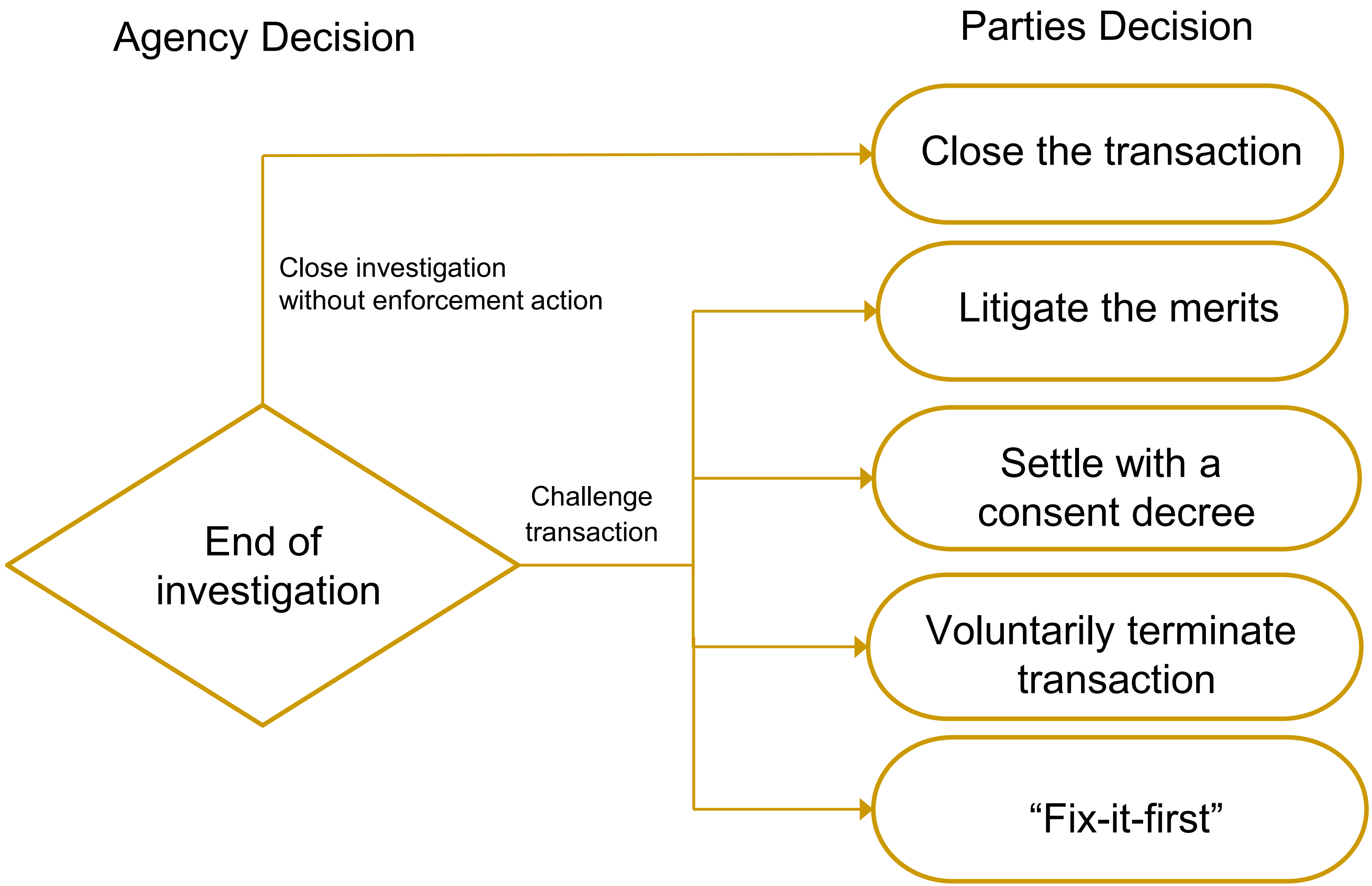
- What did the DOJ do after it learned about the transaction?
  - Opened an investigation

DOJ investigation

- How did the DOJ obtain testimony, documents, and data on which to base its antitrust analysis?
  - Typically would obtain from the parties pursuant to a *second request* under the HSR Act
    - BUT this transaction was not HSR reportable
  - But DOJ also has the power to issue *civil investigative demands* (CIDs)
    - Essentially precomplaint subpoenas
    - Can include document requests, narrative interrogatories, and data interrogatories
    - Is not quite compulsory process (i.e., not self-executing)
      - DOJ must first obtain a court order compelling compliance before sanctions can be imposed
    - May be issued any time during the course of an investigation
    - May be issued to both the merging parties and to third parties
    - Often ask for the same documents and data as a second request
    - Multiple CIDs may be issued in the course of an investigation to the same person

  NB: The FTC can also issue CIDs in antitrust investigations

What were the possible investigation outcomes?



What happened here?

- What did the DOJ do?
  1. Decided that TransDigm's acquisition of SCHROTH violated Section 7 of the Clayton Act, *and*
  2. Told TransDigm that absent an acceptable settlement, the DOJ would file a Section 7 complaint against TransDigm seeking divestiture of the SCHROTH business to a third party

If the FTC had investigated the acquisition, the procedure would have been different (but the outcome would have been the same)

What Was the Problem?

Anticompetitive Effects

- What were the anticompetitive effects of the acquisition alleged in the complaint?

All downstream

1. Increased prices
   - Prior to the acquisition, customers could and did "play off" the companies against each other to obtain better prices (Compl. ¶ 32)
   - Postmerger, the next closest competitor will not be as price-competitive with the combined firm as SCHROTH was to AmSafe
2. Reduced innovation
   - Companies also competed against each other through R&D to develop new and better products (Compl. ¶ 32)
   - Could save significant money by curtailing R&D activities postmerger
3. Significantly increased market concentration
   - Combined the only two significant players in the markets (Compl. ¶ 31)
   - Not really an anticompetitive effect under the prevailing consumer welfare interpretation
     - But the Supreme Court in the 1950s-1960s regarded it as the primary anticompetitive effect—included because of that precedent

Two-point lapbelts

1. Two-point lapbelts used on commercial airlines

- Only three competitors premerger (Compl. ¶ 24)
  1. AmSafe was by far the largest
  2. Small, privately held firm that had been in the market for years but had gained little share → little or no competitive significance
  3. SCHROTH, which entered the market with a new, innovative lightweight two-point lapbelt (“Airlite”), which it aggressively marketed to the major international airlines
- *Competitive effects implications*:
  - When three competitors are reduced to two, the remaining competitors are more likely to engage in oligopolistic coordination, which would result in a higher equilibrium market price and reduced rates of innovation
  - If the smallest firm is ignored → “Merger to monopoly” → higher prices

Three-point shoulder belts

2. Three-point shoulder belts used on commercial airlines

- Factual allegations
  1. Only two meaningful competitors premerger (Compl. ¶ 26)
  2. AmSafe was by far the largest
  3. “SCHROTH was aggressively seeking to grow its business at AmSafe’s expense”
  4. Probably means that SCHROTH had not achieved any significant sales yet, but that efforts to penetrate the market caused AmSafe to reduce prices
- *Competitive effects implications*:
  - “Merger to monopoly” → higher prices

Technical restraints

3. Technical restraints used on commercial airlines

- Only three significant suppliers premerger (Compl. ¶ 28)
  1. AmSafe (“leading supplier”)
  2. SCHROTH (“aggressively seeking to grow”)
  3. (Unnamed) international aerospace equipment manufacturer
- *Competitive effects implications*:
  - “3-to-2 merger,” resulting in higher equilibrium market prices

Inflatable restraint systems

4. Inflatable restraint systems used on commercial airplanes

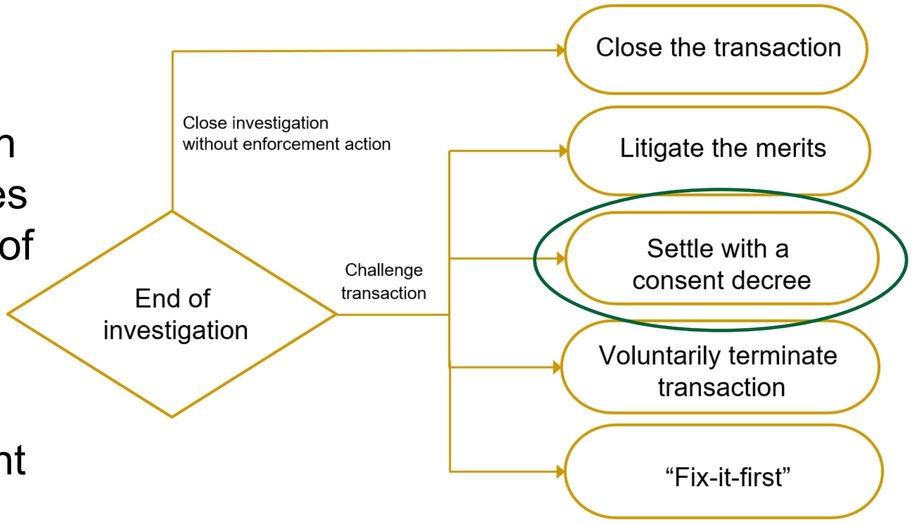
- Only two competitors premerger (Compl. ¶ 30)
  1. AmSafe (which developed technology—offers both inflatable lapbelts and structural mounted airbags)
  2. SCHROTH (offers only structural mounted airbags)
  3. "In recent years, SCHROTH had emerged as a strong competitor to AmSafe in the *development* of inflatable restraint technologies"
     - Only allegation of innovation competition—Not sales competition

Why did the DOJ include this claim?

What Did TransDigm Do?

What happened here?

- What did TransDigm do?
  - Agreed to divest SCHROTH pursuant to a consent decree
    - A consent decree in a DOJ challenge is a final judgment in a litigation that the court enters with the consent of the litigating parties rather than pursuant to a finding of a violation
    - To get the DOJ's agreement, TransDigm agreed to give the DOJ essentially the relief it sought from a litigation of the merits
      - In the past, the DOJ/FTC sometimes have been willing to settle for less than they could get from a successful litigation on the merits
      - Today, not so much



What did the consent settlement require?

- Divestiture of SCHROTH
  - Within 30 days after regulatory clearances or entry of the Hold-Separate Order, TransDigm must divest SCHROTH (including the Takata Protection assets) to—
    - Perusa Partners Fund 2 and SSP MEP Beteiligungs KG (an "upfront buyer") or
    - another buyer acceptable to DOJ

What did the consent settlement require?

- Divestiture
  - Observations
    1. Historically, the DOJ and FTC always require divestiture relief in horizontal merger cases
    2. The DOJ and FTC require that the divestiture buyer be capable of operating the divested business as an effective, standalone competitor immediately upon closing
        a. The divestiture buyer must acquire all assets—tangible and intangible—necessary to operate the business independently and competitively on a permanent basis
        b. The divestiture buyer must have the operational, managerial, technical, and financial capabilities to run the business without material assistance from the merged firm
        c. Any transition services from the seller must be strictly limited to short-term support (e.g., IT, payroll) and cannot be critical to competitive operations
        d. The divestiture must be structured so that the business remains a going concern with no interruption in production, customer relationships, or competitive presence

What did the consent settlement require?

- Divestiture
  - Observations (cont.)
    3. The agency must approve the divestiture buyer, the divestiture agreement, and any transition services agreements
       - The investigating agency will assess whether the buyer has the *ability* and *incentive* to operate the divestiture business with the same competitive force as did the divestiture seller premerger, including—
         a. the relevant industry experience and expertise
         b. the financial resources to support the divestiture business
         c. A business plan that shows both the ability and the commitment to compete in the market with at least the same competitive force as did the divestiture seller premerger
    4. The DOJ and FTC almost always require a "buyer upfront"
       - Before the agency will agree to a divestiture consent decree—
         a. The parties must identify a divestiture buyer and sign a definitive divestiture agreement for the sale of the divestiture business conditioned only on agency approval
         b. The divestiture buyer must present a business plan to the agency as to how it will operate the divestiture business
         c. The agency's approval of the upfront buyer follows the standards described in Observation 3

What did the consent settlement require?

- Scope of assets to be divested
  - All real and personal property, tooling, inventory, intellectual property, permits, contracts, customer lists, R&D data, and other tangible and intangible assets needed for SCHROTH to operate as a viable, standalone airplane-restraint-system supplier in the hands of the divestiture buyer
  - TransDigm must give full due-diligence access, warrant asset operability, and provide transition services (IT and other support) for up to 12 months, with a possible six-month DOJ extension

What did the consent settlement require?

- Employee provisions
  - SCHROTH employees must be able to receive offers from the buyer
  - TransDigm must waive non-competes/nondisclosures, vest benefits, and refrain from soliciting or rehiring those employees for two years unless the buyer consents
- Backstop "divestiture trustee"
  - If divestiture is not completed on time, the court will appoint a DOJ-selected trustee with full authority—and at TransDigm's expense—to sell the assets
  - TransDigm may object only in cases of trustee malfeasance
    - The divestiture trustee operates independently of TransDigm's control and has no fiduciary obligation to TransDigm to seek the highest price or otherwise act in TransDigm's interest."
- No seller financing
  - TransDigm may not finance any portion of the purchaser's acquisition

What did the consent settlement require?

- Hold-separate obligation
  - Until closing, SCHROTH must be held separate and operated independently to preserve its competitiveness and asset value as an effective standalone competitor pending the closing of the divestiture sale
  - TransDigm executives assigned to SCHROTH are barred from sharing SCHROTH's competitively sensitive information with personnel responsible for AmSafe
    - A firewall plan must be submitted to—and approved by—DOJ
- Monitoring & reporting
  - TransDigm must submit sworn compliance affidavits every 30 days and give DOJ full access to records, facilities, and personnel for inspections

What did the consent settlement require?

- Prior notice of future acquisitions
  - For the decree's term, TransDigm must give DOJ at least 30 days' advance, HSR-style notice (even below HSR thresholds) before acquiring any other airplane-restraint-system assets or interests for the 10-year term of the consent decree
    - Applies globally, not just to the acquisition of companies doing business in the United States
- No reacquisition
  - TransDigm is prohibited from reacquiring any of the divested SCHROTH assets during the term of the consent decree
- Duration & enforcement
  - The Final Judgment lasts 10 years
    - DOJ may terminate after 5 years if decree is no longer necessary
  - DOJ retains authority to seek contempt, extend the decree once, and recover fees and costs for enforcement

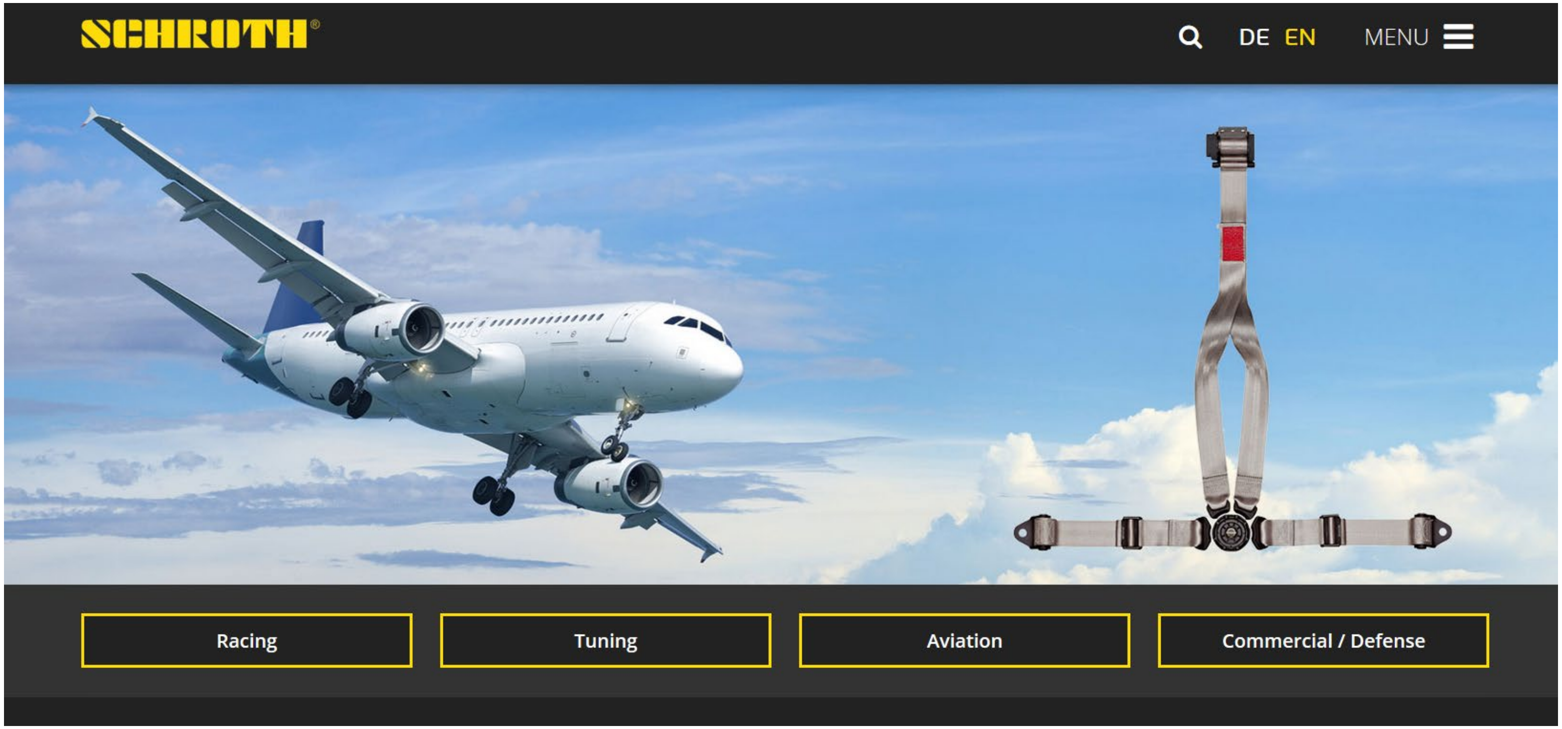
Business rationale for divestiture

- Why did TransDigm agree to divest SCHROTH?
  - What were TransDigm's alternatives?
    1. Continue the litigation
    2. Settle with a consent decree acceptable to the DOJ
  - Why did TransDigm agree to settle?
    - Almost surely the least costly alternative
    - DOJ had a strong case: TransDigm was very likely to lose the litigation, and the DOJ would have obtained a litigated permanent injunction ordering the same divestiture
  - When did TransDigm agree to settle?
    - In the course of the investigation—Prior to litigation
    - Complaint and proposed consent decree were filed simultaneously with the court

The divestiture buyer

- To whom did TransDigm sell SCHROTH?
  - A management buyout (MBO)
    - Business unit's management + a private equity investor (Perusa GmbH)
  - Why sell to management?
    - The DOJ almost surely wanted a "buyer upfront"
    - An MBO was probably both—
      - The quickest solution, *and*
      - Offered the greatest return
  - Did the MBO get a good purchase price?
    - Almost certainly
    - Consent decree solutions almost always involve a "fire sale" of the divestiture assets
      - TransDigm 10-K reported a $32 million impairment charge to write down the assets to fair value. (p. 21)
      - TransDigm paid $90 million to acquire SCHROTH
      - So it is likely the MBO paid only about $58 million for the business
        - Actually, $61.4 million (from TransDigm 8-K, Jan. 26, 2018, at 3)

SCHROTH today



- Reportedly:
  - Approximately 250 employees
  - Sales volume around $51.2 million

First Meeting with the Client

The setup

- You are counsel to TransDigm
  - Prior to signing the purchase agreement, TransDigm’s management seeks your advice on—
    1. Whether the antitrust authorities will investigate the transaction?
    2. Whether the DOJ or FTC will challenge the transaction on the merits?
    3. Whether the merging parties can successfully defend on the merits?
    4. If unsuccessful—
       a. What will be the consequences?
       b. What, if anything, can TranDigm do to increase the probability of closing the deal?
       c. Will we be successful?

These are the fundamental questions every client asks at the beginning of a deal

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 an aggressive "new" entrant with a small share*
- *There are few if any other firms in the business*

But no other meaningful information

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
  - If the transaction is not HSR reportable, the agency will not investigate the transaction UNLESS they learn about it
    - Can find out from—
      - Reading the newspapers or the trade press, or
      - Someone complains to the agency about the transaction
        - Customer
        - Competitor
        - A disgruntled employee
    - NB: There is no “statute of limitations” for government investigations or prosecutions of mergers
      - The DuPont/GM challenge
      - Today, Meta is being challenged for its past acquisitions of Faccebook and WhatsApp

Teach the client the operational test

- Tell the client how the investigating agency is going to find the facts about the likely competitive effect
  - If the agency opens an investigation, it will—
    1. Entertain a presentation from the merging parties on the deal and engage with the parties throughout the investigation
    2. Interview—and perhaps later depose under oath—employees of the merging parties
    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

The most powerful evidence against a transaction often consists of bad documents, executives' admissions against interest in investor presentations or interviews, or customer complaints

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: 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

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