

RECENT DEVELOPMENTS IN U.S. MERGER CONTROL

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In the past few months, the U.S. merger control regime has celebrated two significant milestones. The summer of 2002 marked the twentieth anniversary of the 1982 Merger Guidelines, a landmark event that fundamentally altered the substantive approach of U.S. antitrust enforcement authorities to merger review and competition policy.¹ Also recently noted was the twenty-fifth anniversary of the Hart-Scott-Rodino Act (“HSR Act”),² which transformed merger enforcement by requiring pre-merger notification of certain proposed transactions.³ The HSR Act mandates that the parties provide critical information to the government before the deal closes and establishes a “waiting period” for the government to review the transaction and take enforcement measures if deemed necessary.

Although recent economic conditions have led to a downturn in merger activity, merger enforcement remains vibrant in the U.S. Through the first six months of its fiscal 2002, the Federal Trade Commission (“FTC”) took enforcement measures in seventeen proposed mergers and authorized the filing of three federal complaints seeking to block

¹ See Timothy J. Muris, Chairman, Federal Trade Commission, Prepared Remarks on the Occasion of the Celebration of the Twentieth Anniversary of the 1982 Merger Guidelines, (June 10, 2002), [available at http://www.ftc.gov/speeches/muris/1982mergerguidelines.htm](http://www.ftc.gov/speeches/muris/1982mergerguidelines.htm).

² Hart-Scott-Rodino Antitrust Improvements Act of 1976 (“HSR Act”), 15 U.S.C. § 18a.

³ See Marian R. Bruno, Prepared Remarks before the American Bar Association’s “Mergers & Acquisitions: Getting Your Deal Through the New Antitrust Climate” (June 13, 2002), [available at http://www.ftc.gov/speeches/other/brunohsr25.htm](http://www.ftc.gov/speeches/other/brunohsr25.htm).

proposed mergers.⁴ In its fiscal 2001, the Antitrust Division of the U.S. Department of Justice (“DOJ”) was likewise very active, initiating over 100 HSR investigations, issuing over forty second requests, and filing eight actions in district court.⁵ It is therefore critical for the antitrust practitioner to remain abreast of the latest developments in the U.S. merger control regime. As discussed below, recent developments include: (1) significant amendments to the HSR Act and its implementing regulations; (2) enforcement actions targeting violations of HSR Act rules that require the disclosure of competition-related documents in the pre-merger filing and that govern the conduct of the parties while waiting for approval of the transaction; and (3) efforts by both DOJ and FTC to review merger “best practices” and to increase the efficiency and alleviate the burden of compliance with merger investigations and second requests.

I. RECENT CHANGES TO THE HSR ACT

The basic operation of the HSR Act is well-known to practitioners in the field. The HSR Act requires parties to a proposed merger to file a pre-merger notification form and pay a filing fee, if certain threshold circumstances and other jurisdictional requirements are met. The filing is reviewed by either the Antitrust Division of DOJ or by the FTC’s Bureau of Competition. Which agency will review a given merger depends primarily on the industry involved and the agencies’ respective areas of expertise. Once the notification form is filed, the parties cannot close the merger until an initial waiting period has elapsed. During this period, the reviewing agencies will assess the likely competitive consequences of the transaction, and decide to (1) allow the merger to be

⁴ See Federal Trade Comm’n, Building a Strong Foundation: The FTC Year in Review 2-3 (2002), available at <http://www.ftc.gov/os/2002/04/ftcyearreview.pdf>.

⁵ See “Antitrust Division Workload Statistics, FY 1992-2001”, available at <http://www.usdoj.gov/atr/public/10108.htm>.

consummated; (2) oppose the merger, in which case the agency may file a lawsuit to have the merger blocked; or (3) engage in further investigation of the deal, in which case the agencies may extend the period of prohibition on closing.

Amendments to the HSR Act were passed in December 2000 and became effective on February 1, 2001.⁶ These are the first truly significant changes made to the HSR Act in its twenty-five year history. The changes incorporated parts of various proposals to reform the pre-merger reporting process, but did not include some of the broader reforms that have been urged over recent years.

The amendments increased the reporting thresholds and filing fees for pre-merger notifications, and made other adjustments to the pre-merger reporting program. All transactions must now be reported (regardless of the size of the parties) if the acquiring person will hold an aggregate amount of the voting securities and assets of the acquired person in excess of \$200 million.⁷ Furthermore, if as a result of the transaction, the acquiring person will hold more than \$50 million (but less than \$200 million) of the voting securities and assets of the acquired person, the transaction must be reported if (a) the seller has at least \$10 million in total assets (or, if engaged in manufacturing, annual net sales or total assets), and the buyer has at least \$100 million in net sales or total assets, or (b) the seller has at least \$100 million in annual net sales or total assets and the buyer has at least \$10 million in such sales or assets.⁸

Transactions under the pre-amendment HSR Act were not reportable unless they satisfied both a “size-of-person” test and a “size-of-transaction” test. The new law raises

⁶ 15 U.S.C. § 18a, as amended, Pub. L. No 106-553; 114 Stat. 2762 (Dec. 21, 2000).

⁷ See 15 U.S.C. § 18a(a)(2)(A).

⁸ See 15 U.S.C. § 18a(a)(2)(B).

the size-of-transaction test and also creates a new test based solely on transaction size. The two-tiered threshold system is intended to reduce the number of reportable transactions and simplify the analysis for large transactions. For example, nearly half of the 4,340 transactions reported in FY 1999 would not have been reportable under these new thresholds. Importantly, the threshold levels are now indexed for inflation to stay consistent in real terms over time, and will be adjusted every three years based on changes in the U.S. gross domestic product.

The new filing thresholds are also accompanied by a graduated fee schedule. The prior \$45,000 fee has been retained for transactions in which the acquirer will hold less than \$100 million of stock and assets of the seller. However, for transactions over \$100 but less than \$500 million, the fee is \$125,000, and for transactions involving stock and assets of over \$500 million, the fee is now \$280,000. The dollar thresholds for these fees are similarly indexed to growth of the gross domestic product, although the actual fee amounts will not change.

The amendments also contained modest steps to reform the “second request” process. The HSR Act imposes a waiting period of thirty days after a proposed transaction is reported before the deal may be consummated. If the reviewing agency determines that it requires additional time or information to assess the deal’s likely competitive effects, it can issue a request for additional information – the so-called second request. Once issued, the parties may not close the transaction until thirty days after they have substantially complied with the second request. Determining if the parties are in substantial compliance depends on many factors.

Second requests have evolved into very extensive, detailed inquiries that frequently require months to complete and often result in significant cost and delay. In an attempt to alleviate some of the burden, the amendments now provide for a limited internal review or “appeal” process. Parties may now seek review of claims that the second request issued by the agency is unreasonable or that the parties have achieved substantial compliance with the second request. The appeal is to be reviewed by an individual (designated by the agency) who has no direct responsibility for the enforcement recommendation in the case.⁹ Both agencies have implemented internal rules governing the procedures to be followed for making an appeal.¹⁰

Perhaps most importantly, the amendments required both the FTC and DOJ to undertake an internal review of the entire merger review process to eliminate unnecessary burdens, duplication, and delays. Both agencies instituted such a review, and had in fact already begun the process of initiating voluntary reforms in anticipation of the December 2000 amendments. Nevertheless, the statutory reforms of the second request process left the agencies broad discretion to both identify problems and devise solutions. A further description of the agencies’ efforts on this front is set forth in Section III below.

II. ENFORCEMENT OF HSR ACT VIOLATIONS

The recent amendments did not alter many of the most significant—and perplexing—aspects of pre-merger review. One of these areas is Item 4(c) of the pre-merger notification form, which requires the parties to submit with their notification certain types of documents that address the competitive aspects of the proposed

⁹ See 18 U.S.C. § 18a(e)(B)(i).

¹⁰ See 16 C.F.R. § 2.20 (FTC); “DOJ Second Request Internal Appeal Procedure,” (June 2001), [available at http://www.usdoj.gov/atr/public/8430.htm](http://www.usdoj.gov/atr/public/8430.htm).

transaction, such as information about market shares, competition, competitors, markets, and the potential for sales growth or expansion. Item 4(c) documents constitute an integral part of the information available to the agencies in their assessment of the acquisition. Nevertheless, because there is often great uncertainty as to what documents must be provided in response to Item 4(c), the matter continues to attract attention, and has even sparked a discussion in the pages of the American Bar Association's Antitrust magazine.¹¹

As recently demonstrated in the Hearst case,¹² there can be severe consequences for failing to take the Item 4(c) requirement seriously. The case arose from Hearst's acquisition of Medi-Span, a company that maintained a database used by doctors, pharmacies, and hospitals to obtain information about drug prices, drug effects, drug interactions, and eligibility for drugs under certain payment plans. The only other widely-used database was owned by First DataBank, a subsidiary of Hearst. In December 1997, Hearst and Medi-Span filed pre-merger notification forms for the proposed acquisition. After the expiration of the 30-day HSR waiting period, the deal was consummated in January 1998.

Dramatic price increases and consumer complaints soon followed. The FTC launched an investigation in December 1999, and through compulsory process, the FTC obtained from Hearst several high-level corporate documents that evaluated the Medi-Span acquisition and its effect on competition, including deal-related that went to

¹¹ See, e.g., William J. Baer & Deborah Feinstein, Item 4(c): the Next Step in HSR Reform, Antitrust (Spring 2002), at 43; Marian R. Bruno et al., Some Practical Guidance for the HSR Practitioner: Locating and Identifying Item 4(c) Documents, Antitrust (Spring 2002), at 46.

¹² See United States v. The Hearst Trust, Civil Action No. 1:01CV02119 (D.D.C. complaint filed Oct. 11, 2001), available at <http://www.usdoj.gov/atr/cases/f9200/9288.htm>.

Hearst's board of directors. The documents were clearly Item 4(c) documents that should have been, but were not, disclosed in the pre-merger notification filing.

As a result of Hearst's failure to produce these documents, the DOJ sued Hearst for civil penalties. In October 2001, Hearst agreed to pay \$4 million in fines.¹³ In addition, the FTC sued in federal court in April 2001, claiming that the acquisition itself created an illegal monopoly in the sale of integratable drug information databases. In December 2001, the FTC announced a proposed settlement with Hearst. The settlement required Hearst to divest the Medi-Span business and pay \$19 million as disgorgement of unlawful profits. This was an unprecedented step for the agency. Although disgorgement is commonly used in consumer protection cases, the FTC has very rarely sought disgorgement of unlawful profits in antitrust cases,¹⁴ and prior to Hearst the FTC had never done so in the merger context. There is little doubt that the perceived bad faith of Hearst in failing to comply with HSR Act requirements contributed to the severity of fines and remedies obtained by the government.

If Hearst illustrates why the parties must provide the agencies with information required by the HSR Act, other recent enforcement actions have demonstrated that, during the waiting period, the parties must refrain from acting in a manner that presupposes the merger will be approved. Particularly illuminating is the Computer

¹³ See DOJ Press Release, "Hearst Corporation to Pay \$4 Million Civil Penalty," (Oct. 11, 2001), available at http://www.usdoj.gov/atr/public/press_releases/2001/9292.htm.

¹⁴ See Joel Grosberg, Disgorgement and Mergers: Has the FTC Gone Too Far?, Clayton Act Newsletter (ABA Section of Antitrust Law), Winter 2002, at 25, available at <http://www.abanet.org/antitrust/committees/computer/clayton/winter02.pdf>.

Associates “gun jumping” case,¹⁵ which highlights the type of conduct that is prohibited prior to the closing of the transaction.

In March 1999, Computer Associates (“CA”) and a competing computer software manufacturer, Platinum Technology, announced a merger in which CA intended to acquire all of Platinum’s issued and outstanding shares through a \$3.5 billion cash tender offer. The merger agreement contained several provisions that governed how Platinum could conduct its business during the pre-consummation period, pending approval of the deal by the reviewing agencies.

While it is not unusual for a merger agreement to require that the acquired entity carry on its ordinary course of business in substantially the same manner as before the agreement, the obligations imposed on Platinum’s conduct were unusually severe. Under the merger agreement, Platinum could not enter into any customer contract in which it would provide services at a fixed price for longer than thirty days. Platinum was prohibited from entering into any customer sale or license agreement that varied from an agreed-upon standard contract, and it could not offer discounts to customers in excess of twenty percent off of list price. Furthermore, Platinum was barred from entering into any contract to provide year 2000 (“Y2K”) remediation services. CA had the sole discretion to grant exceptions to these restrictions. CA even installed one of its corporate vice presidents at Platinum’s headquarters to review proposed customer contracts that might deviate from these terms. Platinum’s Chief Executive Officer, Chief Operating Officer,

¹⁵ See United States v. Computer Assoc. Int’l, Civil No. 01-02062(GK) (D.D.C., competitive impact statement filed Apr. 23, 2002), available at <http://www.usdoj.gov/atr/cases/f11000/11082.htm>.

and Chief Financial Officer agreed to be held personally liable if Platinum failed to live up to these restrictions.

The government challenged this agreement under Section 1 of the Sherman Act and as a violation of the HSR Act. The essence of the complaint was that, because the merger agreement allowed CA to exercise operational control over significant aspects of Platinum's business (including setting contract prices and conditions), the agreement undermined the HSR Act's requirement that the parties remain separate and independent economic entities during the waiting period. CA was assessed \$638,000 in civil penalties for violating the HSR Act.

Computer Associates is an example of extremely intrusive pre-closing restrictions. It does not implicate the legality of many customary covenants that limit the acquired firm's operations during the waiting period. It is still acceptable for parties to agree that the acquired firm will continue to operate "in the ordinary course of business." Moreover, the government found no difficulty in accepting the parties' agreement on provisions that limit the acquired firm's ability to declare or pay dividends; issue or encumber its securities; amend its organizational documents; acquire other businesses; sell its intellectual property or other assets outside of the ordinary course of business; agree to make large capital expenditures; and the like.¹⁶ Although these customary restrictions limit Platinum's ability to make certain business decisions, they are considered a necessary part of protecting the value of the transaction. These should be distinguished from the impermissible restrictions found in Computer Associates which

¹⁶ See id. at 7.

severely compromised the acquired firm's ability to act as an independent economic entity, particularly with regard to the pricing and other terms of customer contracts.

III. MERGER "BEST PRACTICES"

In the past few months, both DOJ and FTC have undertaken initiatives to explore ways of increasing the efficiency and reducing the burden of merger review investigations and the second request process. Though reform efforts are still very much on-going, they have already yielded a number of important results.

In October 2001, the DOJ unveiled its "Merger Review Process Initiative," an effort by the Antitrust Division to identify quickly the significant competitive issues regarding a proposed merger and to facilitate efficient and focused merger investigations.¹⁷ Although it does not set forth mandatory procedures, the initiative establishes a basic framework for conducting merger investigations. During the initial waiting period, the staff is encouraged to be proactive in narrowing and refining the relevant issues if possible. Parties should engage with the staff and expect to provide certain information voluntarily during this period, including business and strategic plans, lists of competitors, suppliers, and customers, and data regarding sales and output. In-person meetings with the staff are also encouraged, and it may often be appropriate for business persons involved in the deal to be present as well. Greater flexibility is to be exercised in limiting the scope of second requests, and the staff is authorized to act with greater openness and discretion in fashioning suitable relief for problematic mergers.

¹⁷ See DOJ Press Release, "Antitrust Division Releases Details of Merger Review Process Initiative," (Oct. 12, 2001), available at http://www.usdoj.gov/atr/public/press_releases/2001/9305.htm.

The FTC has likewise engaged in efforts to improve the merger review process. Over the summer of 2002, the FTC held a series of “Merger Best Practices” public workshops across the country. These meetings were intended to elicit ideas for improving the FTC’s merger review process. The workshop format allowed the agency to obtain input from a broad range of groups, including corporate personnel, in-house and outside attorneys, economists, consumer groups, and others who are interested in the merger review process.

The Best Practices workshops focused on a range of issues relevant to streamlining all stages of the merger review process. The topics included using submissions of voluntary information during the initial waiting period to help clarify the issues; addressing shortcomings in the standard second request instructions on sorting and organizing responsive documents; resolving concerns about the burdens of producing English translations of foreign-language documents; and improving the process for negotiating modifications to the second request, including tactics for reducing the number of employees whose documents are covered by the request. Also addressed were the unique problems posed by the production of e-mail and other electronic documents, which often exist in such volume as to create significant burdens for responding parties and reviewing agencies alike. Many participants discussed using software that searches electronic records for key words to identify responsive electronic documents, and suggested that the information technology personnel of the agencies and the merging parties should coordinate directly with each other on technology compatibility matters. The FTC’s website contains a great deal of information on the “Best Practices” issues,

including written submissions from interested parties and transcripts of the public workshops.¹⁸

A common theme raised in these workshops is that the agencies should take an approach to their document demands that is consistent with the objectives of the second request. The second request process should allow the government to obtain reasonably necessary information and documentation so that it can assess the competitive impact of the transaction. It is not well-suited to serve as a substitute for civil discovery in a litigated case. Many participants in the merger workshops noted that, at the second request stage, the agencies need not demand every conceivably relevant fact and document, as one might expect in civil litigation. Indeed, only a very small percentage of all transactions are litigated, and the majority of second requests are resolved sometime before the parties have substantially completed the request. If the agency determines that additional information is needed, or that the case will likely be litigated, other tools (such as civil investigative demands) are available to obtain such information. Other approaches may be effective as well. In comments recently filed in conjunction with the FTC's Merger Best Practices workshops, the influential Section of Antitrust Law of the American Bar Association suggested that in some circumstances the agencies should consider trading-off an abbreviated second request (with accelerated review) in exchange for promises that the parties will agree to additional discovery if the agency decides to challenge the merger.¹⁹ This is one example of greater procedural flexibility that would

¹⁸ See "FTC Merger Best Practices" (and related links), available at <http://www.ftc.gov/bc/bestpractices/index.htm>.

¹⁹ See Letter from Roxane C. Busey, Chair, Section of Antitrust Law, American Bar Association, to Joseph P. Simons, Director, Bureau of Competition, Federal Trade Commission (Aug. 6, 2002), available at <http://www.abanet.org/antitrust/simons.doc>.

improve the efficiency of the merger review process while protecting the agencies' ability to obtain sufficient information to assess the transaction.

IV. CONCLUSION

Merger control remains an essential component of U.S. antitrust enforcement. While the government has demonstrated its commitment to streamlining the merger investigation process (importantly, with the input of concerned parties and the antitrust bar), the government has also made clear that it will not let parties undermine the purposes of the HSR Act or its ability to conduct meaningful merger review.