US merger review:
changing at the edges

With the new Republican administration settling in, Rossella BRAMBILLA spoke to FTC Chairman Robert Pitofsky, former DOJ antitrust chief Douglas Melamed and leading US antitrust lawyers about priorities for the future of US merger review procedure and policy

As President Bush begins his term, companies and investors are wondering what the future holds for antitrust policy under a new Republican administration. During the Clinton Democrat administration, in response to a number of factors (increased consolidation and globalisation of the markets, a strong economy, deregulation, the growing number, complexity and scale of deals and the expansion of high tech industries), the US antitrust agencies created an atmosphere of antitrust activism. Will there now be a shift towards non-enforcement and *laissez faire* as there was when the Reagan administration took over after a period of intense antitrust activism during the Carter administration?

During the Reagan years the two US agencies responsible for antitrust enforcement (the Department of Justice (DOJ) Antitrust Division and the Federal Trade Commission (FTC)) cut their budgets by 50% and market forces were left to remedy most competition problems. However, the experience of that period seems to have been dictated primarily by the then prevailing Chicago School of Economics with its devotion to free markets. Republican administrations before Reagan (including those of Eisenhower, Nixon and Ford) had taken a vigorous approach to antitrust enforcement. After Reagan, under Bush senior's Republican administration, both agencies switched back to more active enforcement of antitrust laws.

Today, the importance of antitrust law is recognised on both sides of the political divide. Most commentators do not therefore anticipate any radical shift in approach to merger review policy un-

der the new administration. "We are unlikely to see the sea change that we witnessed in 1981," observes Janet McDavid of Hogan & Hartson in Washington. "The existing 'antitrust mainstream' is likely to endure in the new administration and changes are likely to be at the margin rather than on core issues," she says. Kenneth Logan of Simpson Thacher & Bartlett in New York agrees: "Although it is way too early to tell, there is no suggestion that there will be any significant change. I do not think there is serious, partisanship disagreement about the application of antitrust law. In the vast majority of cases the political philosophy will not change, particularly as far as the merger area is concerned."

Robert Pitofsky Chairman, Federal Trade Commission

Changes in the economy may have an impact. "If the US economy slows, mergers actually could increase as cash rich companies perceive opportunities for acquisitions," explains Ben Crisman of Skadden, Arps, Slate, Meagher & Flom in Washington. "The antitrust regulatory environment might even be more favourable as mergers and acquisitions of dot-com companies are looked upon as preserving advanced technology that otherwise might disappear with a company's collapse," he says.

It is possible that fewer vertical merger cases will be challenged and that the emphasis might turn to horizontal mergers. The position of a vertically integrated company able to foreclose market access to competitors is comparable to that of a monopoly. "The increased stress on horizontal mergers means that we may not see as many substantive monopolisation cases such as Microsoft or the *Visa/Mastercard* case, which was based on really novel theories of consumer injury," observes Bill Kolasky of Wilmer, Cutler & Pickering in Washington. In addition, borderline horizontal merger cases might also enjoy a better chance of being cleared. "In close merger cases I imagine the new administration coming out in favour of letting a transaction go forward. The potential for tension between the US and the EU – which under Mario Monti has leaned in the direction of more aggressive merger enforcement analysis – may therefore become greater," he adds (*see www.lawdepartment.net/global "Getting tougher: the Merger Task Force 10 years on", GC, 2000, V(10), 29*).

Janet McDavid Hogan & Hartson, Washington

Robert Joffe of Cravath, Swaine & Moore in New York points out that although antitrust was not a campaign issue, a new administration affords an opportunity for the agencies to take a fresh look at their policy.

Much will depend on the views and personalities of those appointed by the new administration to head up the FTC and DOJ. "You need to know who is going to be in charge to get a good feel of what's to come," says William Baer of Arnold & Porter in Washington.

The DOJ Antitrust Division is organised such that final decisions are ultimately taken by one person – the Assistant Attorney General. A. Douglas Melamed, who took over as Acting Assistant Attorney General after Joel Klein's resignation in September 1999, himself resigned on President Bush's inauguration. At the time of going to press the announcement of the nomination of Charles James as the new Assistant Attorney General had just been made. James held the same position in the administration of Bush senior.

A.Douglas Melamed, Former Acting Assistant Attorney General, Antitrust Division Department of Justice

At the FTC final decisions are made by five Commissioners, each appointed for seven year terms by the President. The term of the current FTC Chairman, Robert Pitofsky, ends in September 2001, although it is open to him to resign before that date. Speaking at the time of going to press, Pitofsky says that he is not sure at the moment what he is going to do. "I set no final date", he says, "I could stay until September, I may choose to go earlier." He adds, however, that he does not anticipate a change in policy such as to precipitate a decision to resign.

Against this background, *Global Counsel* asked leading US practitioners which practical aspects of the US merger review process the agencies should focus on going forward. Of all the issues raised, three aspects of the process have a particularly significant impact on merging companies:

- Second requests.
- The "buyer up front" rule.
- The efficiency defence.

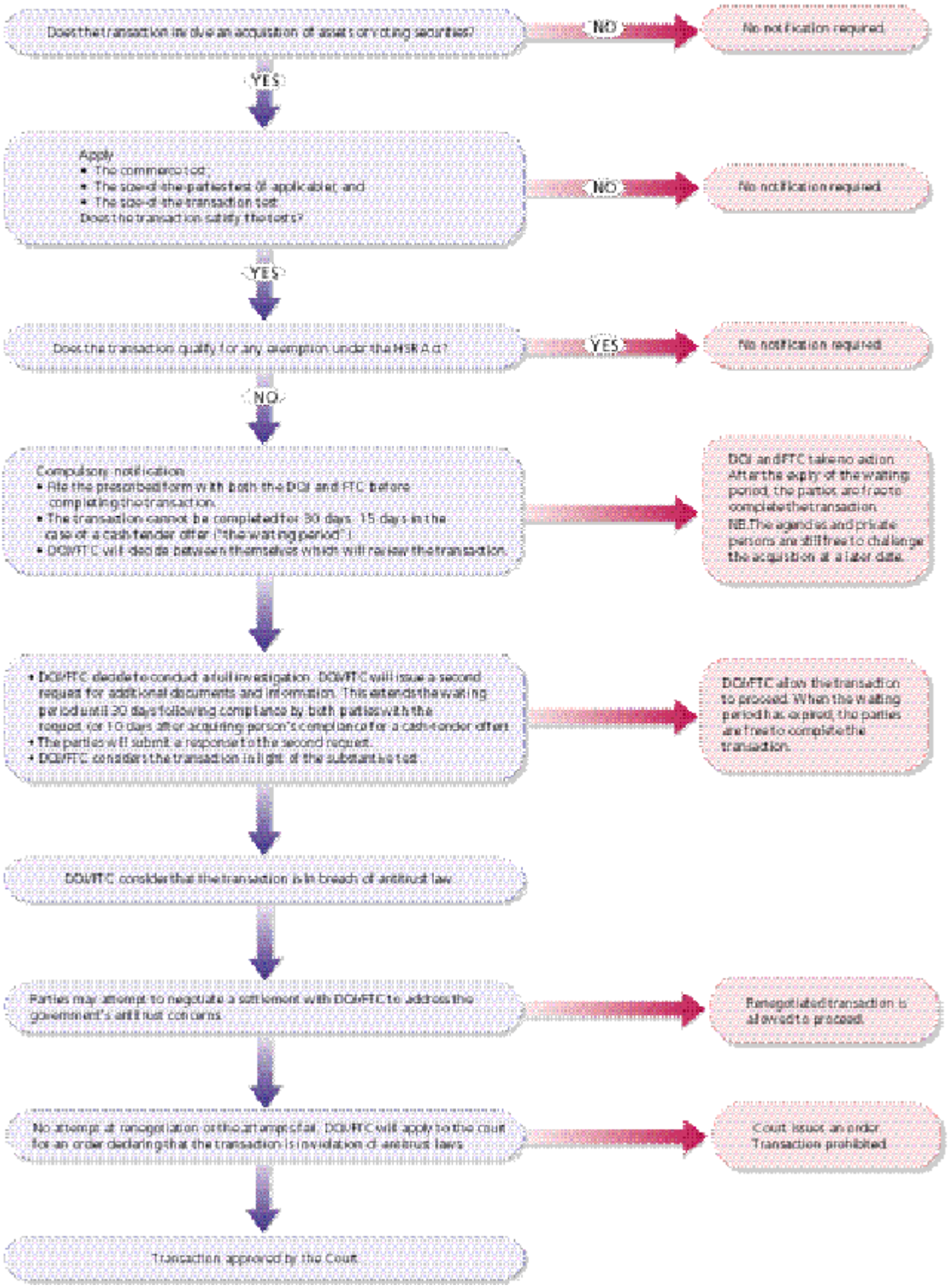
Second requests

If a proposed merger has to be notified (*see box "Merger notifications"*), the review process can consist of a number of stages, including:

- A first stage "waiting period" during which the agencies allocate the transaction between themselves (the clearance process) and decide whether the transaction should be investigated more fully.
- Depending on the conclusions reached during the waiting period, the issue of a second request (a formal request for additional documents and information).
- If, having analysed the replies to the second request, the agencies decide that the transaction is anti-competitive and the parties cannot negotiate a settlement, the agencies can apply to the appropriate court for an order declaring that the transaction violates antitrust law.

The preparation of a response to a second request usually involves the compilation and production of an enormous amount of material. McDavid, counsel to Mobil in the Exxon merger, recalls that: "We produced 20,000 boxes of documents. If you do the math at 2,000 pages per box that gives you an idea. The interrogatory answers alone on my side filled several hundreds of boxes."

Merger notifications



This chart is taken from the US chapter of the Global Counsel Competition Law Handbook 2000, by Ronan P.Harty and Joel M.Cohen, Davis Polk & Wardwell (see www.lawdepartment.net/global "Global Counsel Reports")

Hart-Scott-Rodino Act amendments

On 1st February, 2001, amendments to the Hart-Scott-Rodino Antitrust Improvements Act (HSR Act) took effect. On 25th January, 2001 the FTC, with the concurrence of the DOJ, issued interim regulations to implement the changes. The legislation amending the HSR Act and the interim rules can be found on the FTC's website at *www.ftc.gov*

The amendments to the HSR Act are likely to reduce the number of transactions subject to the pre-merger notification requirements by approximately 50%. However, because the FTC and DOJ are not precluded from challenging transactions that are not subject to the pre-merger notification requirements, there likely will be an increase in investigations of these acquisitions. Generally, the investigations will be initiated based on press reports and complaints from customers and competitors. Unfortunately, these investigations will not be subject to the statutory timetables established by the HSR Act.

The principal changes to the HSR Act include:

• The increase in the size of transaction threshold from US$15 million to US$50 million.

• The elimination of the 15% size of transaction threshold. This means that the US$50 million threshold is the absolute floor. Previously, the acquisition of 50% or more of the voting securities of a corporation valued at less than the dollar reporting threshold was subject to the HSR Act requirements if the corporation had sales or assets of US$25 million or more. This so-called "controlled issuer" threshold is no longer applicable.

• Transactions valued at more than US$200 million will require notification regardless of the size of the acquiring and the acquired persons. The size of person requirement (generally, one party must have total assets or annual net sales of $100 million or more and the other party must have total assets or annual net sales of US$10 million or more) will no longer apply to transactions valued at greater than US$200 million. This change will have its greatest impact on acquisitions by investment companies that make acquisitions through newly-formed entities that are not "controlled" under the current HSR regulations. Previously, these acquisitions often did not require notification because the size of person threshold was not met.

• Filing fees, required to be paid by the acquiring person, will be based on a three-tier system depending on the aggregate value of the assets and voting securities that will be held as a result of the acquisition. The fee will remain US$45,000 for transactions valued at greater than US$50 million but less than US$100 million. For transactions valued at US$100 million but less than US$500 million, the fee will be increased to US$125,000. For transactions valued at US$500 million or more, the fee will be increased to US$280,000.

• The creation of a three-tier system based on the value of a transaction will require filing persons to determine the value of their transactions at a level of precision until now not required under the HSR Act. The HSR Notification and Report Form now includes several detailed questions regarding valuation. In addition, the agencies have adopted new notification thresholds consistent with the three-tier filing fee system that will require close monitoring by persons holding minority stock interests.

• Waiting periods that are set to expire on a Saturday, Sunday or a holiday will now be extended until the end of the next business day.

• The length of the waiting period that follows substantial compliance with a request for additional information and documentary materials, commonly known as a second request, will be 30 days for most transactions, instead of 20 days as it is under current law.

• Procedures will be established within the FTC and DOJ providing a mechanism whereby parties may file a petition to determine whether a second request is unreasonably cumulative, unduly burdensome or duplicative or to determine whether substantial compliance with a second request has been achieved.

John M. Sipple, Jr, Clifford Chance Rogers & Wells, Washington, DC

Many feel that second requests are out of hand and that the documentation burden imposed on companies is unhealthy, too expensive and unnecessary. A model second request form, introduced first in 1994 (available from the FTC, *www.ftc.gov*) was intended to decrease the compliance burden and streamline the process. However, most practitioners agree that the model request has not really helped the situation – second requests are still substantial and time-consuming. A number of factors are at play:

• US regulators always have at the back of their minds the possibility that they might have to litigate. If they ultimately go to court they will have to bear the burden of proof. The statutory system only allows them one opportunity to request information – at the time of the second request. "If the agencies do not ask for the information at that stage, there is no guarantee that they will ever get it, so there is every incentive for them to make sure that they haven't overlooked any relevant information," says Melamed. Any information they do not ask for in a second request can only be obtained by the agreement of the parties or through a fairly time-consuming compulsory procedure, which in many cases will not be practical given the time pressures involved. Therefore they have to be thorough in making the information request.

• Linked to this is what one antitrust expert refers to as "the unwarranted amount of suspicion that pervades the system." The burdensome document requirements are, he claims, born out of a fear on the part of the agencies that "there might be something out there." Many of the document types required for a second request are not the smoking gun documents that would be used in a trial. Documents produced by sales staff, for example, are usually not suffi-

ciently important. The documents that really hurt (the chairman notes, board minutes and so on) will inevitably surface in the second request process. In his view it would be better to get on top of the facts faster and to separate the important from the unimportant.

• In the US, as in Europe (*see www.lawdepartment.net/global "Getting tougher: the Merger Task Force 10 years on", GC, 2000, V(10), 29*), antitrust has moved from being predominantly about market share to an analysis of overall competitive effects. This entails a much wider review of information than was previously the case. If the parties expect the agencies to undertake this kind of analysis they have to provide the relevant information. "Second requests are a necessary evil," comments Kevin Arquit of Clifford Chance Rogers & Wells in New York.

• The increase in requests for certain types of information has caused particular problems. In the retail industry, for example, to test price movements the agencies ask for scanner data, of which there can be a huge volume. Also, having to retrieve entire e-mail archives makes life more complicated and expensive for the filing parties. Commentators feel, however, that the policy on information is not likely to change, and with some good reasons. "Some of the best government evidence in the Microsoft case was the e-mail evidence, so the government is not going to give that up just because we say it is very burdensome," says Arthur Golden of Davis Polk & Wardwell in New York.

• Where the company has a worldwide presence, documents from all over the world will have to be translated into English.

• Some believe, particularly in the case of the extremely visible, high profile "marquee" mergers (the mergers that are likely to attract attention), that the agencies use the second request process as a means to buy time so that they can better understand and evaluate the industry, often because they are overworked and understaffed (*see box "Staffing problems"*). This is compounded by the relative inexperience of some of the lawyers who undertake the investigations. "The lawyers on the staff are often very junior, they do not know the industries well and are less able to identify the information they really need," comments Golden.

In practice, therefore, the negotiating stage (after the second request has been issued) is vital. "The issue of burden must be judged by comparing what the agencies ask for with what is subsequently negotiated and agreed on," says Veronica Kayne of Wilmer, Cutler & Pickering in Washington. "There is often a huge difference between the text of a second request as it is sent to a party to a merger and what the agency really wants to see or might be prepared not to require," she adds.

But do not expect the process to be straightforward. "There is a lot of inconsistency between the agencies and from lawyer to lawyer within the agencies," points out Mary Lou Steptoe of Skadden, Arps, Slate, Meagher & Flom in Washington. "When you get your universal second request and you try to negotiate it down, you do not want to have to exhibit every price point for the last five years. Some attorneys at the agencies will accept that it is an unreasonable request and try to help, others won't."

The attitude of the agencies when dealing with second requests is influenced at least in part by their perception of the party's openness to cooperation (*see box "Be prepared"*). "It is important for parties to be forthcoming with the agencies about whether they are prepared to fix any problems - where there is mutual agreement that there is a problem - or whether the parties convey either by body language or orally that they are prepared to litigate," says Kolasky. "If you give the impression that the matter is likely to end in litigation, the agencies will behave very differently in terms of their willingness to modify the second request and in terms of the standards they apply to substantial compliance," he points out.

Pitofsky accepts that there is an issue. Having to deal with approximately 4,700 mergers yearly it is not possible for the FTC to ask for a vast amount of information at the beginning of the investigation. The second request stage represents the first opportunity for the FTC to gather relevant information. Some progress has already been made. The percentage of second requests issued has actually decreased between 1991 and 1998 (from 4.2% to 2.6%) and more than half of the total number of second requests is closed down by the FTC before all the required information is provided, in other words as soon as the FTC begins to form an idea of what the transaction is about. Pitof-

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Staffing problems

Along with many other public sector bodies, the US antitrust agencies are perceived by many of those who deal with them as grossly understaffed. The potential crisis in human resources at the agencies is identified by the 2001 American Bar Association Task Force Report on the Federal Antitrust Agencies (*American Bar Association, Section of Antitrust Law, Report on the State of Federal Antitrust Enforcement, www.abanet.org*). The Report highlights the difference between entry level salaries at the agencies (approximately US$50,000) with those paid by major law firms, which amount to between two and three times that amount, without taking into account additional bonuses and allowances for the bar examinations. The salary gap becomes even more startling for more experienced lawyers.

It still seems to be the case, however, that young people coming out of law school have an incentive to work for the government. "Young talented lawyers come to the DOJ to get the kind of experience that they would not necessarily enjoy in private practice," says Douglas Melamed. Mary Lou Steptoe of Skadden, Arps, Slate, Meagher & Flom agrees: "I do not think they find it difficult to recruit high quality people because antitrust, particularly over the last 10 years, has been very dynamic and starting with the government is now perceived as very prestigious. Young lawyers feel that with the agencies you are given responsibility for your own cases earlier than you would in private practice."

Although retention of staff is a problem for the agenices, the high level of turnover has its advantages. "The effectiveness of the US antitrust system is due in part to the fact that so many people that come out of the agencies to go to private practice will have a broader understanding of how the agencies operate and general sympathy for the underlying principles of antitrust law," says Charles Stark of Wilmer, Cutler & Pickering in Brussels.

Some believe that instead of hiring lawyers fresh out of law school, the agencies should put the emphasis on finding more experienced people. But this is not easily done. "They are not going to get more experienced people unless they pay them more," says Robert Joffe of Cravath, Swaine & Moore. "It is hard to persuade someone who has been in a law firm for five years and is about to become a partner to go and work for the government for a fraction of that," he says.

FTC Chairman Robert Pitofsky points out the difficulty faced by the agencies: "There is a serious problem", he says, "but we are controlled by civil service regulations, so we cannot on our own decide to pay more money."

In a bid to address the problem, the DOJ Antitrust Division has taken recently to contracting out some of its work, particularly where very senior trial input was required, as in the appointment of David Boies to act for the DOJ in the Microsoft litigation (*see www.lawdepartment.net/global " Bringing Microsoft to account", GC, 1999, IV (10), 20*). Recruiting outside help has a number of advantages: "It is both an opportunity for someone in private practice to go into public service and have an impact; and at the same time, it offers agency staff attorneys access to seasoned legal talent who can act as mentors," comments Ben Crisman of Skadden, Arps, Slate, Meagher & Flom. Pitofsky believes, however, that contracting out in general can have adverse effects on morale. "Of course if you can get a David Boies, any consequences are worth it, but in general we have not done it because we have just enough senior trial staff and very successful records on winning our cases."

It is not entirely clear to what extent the budget increase signed in December 2000 by (then) President Clinton will help to ease the pressure. The funding for the FTC was hiked by 15% - "the first substantial increase in 20 years," according to Pitofsky. How are the additional funds going to be allocated at the FTC? "Firstly there will be an automatic pay rise," he says, "then we have to allocate funds to gain some extra space: about 15% of the increase will be used to cover overheads. Of the remainder, the lion's share will go to consumer protection enforcement, which is Congress' preference, and the remainder (approximately one third) to antitrust matters," he explains.

sky concedes, however, that there are other second requests that are very substantial and burdensome and adds that the FTC is working on those. "We have addressed second requests; they remain a problem; they should be a priority for the new administration," he says.

The Committee on Antitrust and Trade Regulation of the New York Bar Association has recently advanced a number of practical suggestions designed to expedite the merger review process and to reduce the burden of compliance with second requests (*see box "Proposals of the New York Bar Association"*). New legislation that came into effect on 1st February, 2001 has now introduced a number of amendments to the merger review process (*see box "Hart-Scott-Rodino Act amendments"*). One of the amendments requires each agency to appoint an officer (the ombudsman) who:

- Does not have any direct responsibility for the merger investigation.

- Can hear complaints from companies relating to the second request process.

It is obviously too early to assess the impact of the ombudsman system, endorsed by the American Bar Association (*American Bar Association, Section of Antitrust Law, Report on the State of Federal Antitrust Enforcement, www.abanet.org*), but commentators are sceptical as to whether it will have any significance. "It is usually easier to talk to the staff and resolve things that way. People just want to get on with the deal, achieve synergies in a fast moving market," remarks Arquit. "My guess is that companies will not use the ombudsman very frequently. The best way is to work with the staff to overcome problems," agrees Logan.

Pitofsky thinks that the reform is a very useful approach. "I think it will help in some specific cases, and will give the staff an incentive to be more cautious," he says.

Buyer up front rule

In 1995 the FTC cleared Schnuck Markets Inc.'s acquisition of National Food

Be prepared

Global Counsel asked leading US antitrust practitioners for their practical advice for companies contemplating a global merger likely to require US antitrust clearance.

Preliminary and strategic considerations

- Consider the glass to be half full, not half empty. All deals are now motivated by synergies and efficiencies. Concentrate on this issue, particularly when creating written documents, rather than on barriers to entry or fear of principal competitors.

- Start early to articulate a strong pro-competition story for the transaction, if necessary with the help of antitrust lawyers on both sides of the Atlantic. Also consider involving economists.

- Do not try to change reality – present the part of reality which makes the most sense and deal with the part which is not good for the case. The agencies will do this in reverse.

- Work out what the case is on merits. Anticipate the possible downsides and problems, evaluate the potential risks. Pre-empt the agencies' objections. For instance, prepare examples of recent entry – make it a non-issue.

- Carefully consider the wording of internal documents. Often a poor choice of language puts companies on the defensive in the merger review process more than they should ever be.

- Ideally, write as little as possible about any potential deal. Don't write anything unless you have to. For example, do not write about barriers to entry just for the sake of it. Write memos and documents on the subject as though a third party might see them, as though you were writing a letter to the FTC or DOJ. In this way, you'll reduce the chances of producing bad 4(c) documents, the type that sets the alarm bells of the agencies ringing as evidence of potential anti-competitive behaviour. (Item 4 (c) of the Pre-merger Notification and Report Form requires companies to submit studies, surveys, analyses and reports prepared by or for directors and officers for the purposes of analysing the transaction with respect to markets, market shares, competition and other similar topics).

- Prepare for the eventuality of having to hand over to the agencies current business documents regarded as crucial for the smooth running of the business.

- If divestitures are likely to be an issue, consider spinning off the offending assets before filing to avoid the up front buyer requirement, but be aware of the possible drawbacks (*see main text, "Buyer up front rule"*). Be prepared to treat the loss of value of a forced divestiture as a cost of the transaction.

Choosing the appropriate lawyer

- When selecting advisers, it is important to understand exactly how much prior experience they have had with each agency, particularly in relation to merger review. Talk to the general counsel of other companies who have instructed them in the past to get a sense of how well they negotiated with the agencies. The advisors need to be able to earn and maintain the trust of the regulators. It is vital that the reputation of your legal advisers is credible – the agencies are often surprised at the representations made by some firms.

- You want your advisers to be realistic about how difficult it is going to be, how long it will take and what you will have to give up to get the deal cleared. Lawyers who are new to a client may be reluctant to explain all the difficulties and pitfalls involved.

- You need counsel who are sensitive to the substantive and subtle differences between the approach in the US and EU. Some arguments might work in the US, but not in the EU. Understanding these nuances is important. For example, efficiencies often are viewed sympathetically in the US, while in the EU they can be seen as enhancing a dominant position. Also, the Brussels regulators look favourably on arguments supporting the view that a transaction will balance out the bargaining power between suppliers and customers. In the US this is not necessarily perceived as an antitrust concern if the current balance is not adversely affecting consumers.

Dealing with the agencies in the US and worldwide

- It is essential to establish a credible relationship with the agency staff involved in the transaction and to maintain their trust. They inevitably bring a healthy scepticism or suspicion to the table. You need to find a line between accommodating them and not compromising what is good for the deal. The lawyers who approach the agencies must be very familiar with the commercial issues and must be trusted by the agencies.

- If the agencies are late in replying during the waiting period, consider withdrawing the filing and re-filing within the next 24 hours to start a new waiting period. This will avoid an automatic progress to the second request stage and you will not have to pay another filing fee. Bear in mind, however, that if the agency still goes ahead with the second request you will have lost 30 days. Another downside is that you have to attach to the new filing any new 4(c) documents created within the period between the two filings.

- Choose your strategy: each deal will need a different one. You may be willing to go to some distance to resolve any perceived problem, but decide that there is a line beyond which you will not go. If this is the case, make it clear to the agencies from the outset in a very resolute way that you are prepared to litigate.

- Do not underestimate the state agencies. Any decrease in Federal involvement with the new administration may be counteracted by more intervention on the part of the State Attorneys, as was the case in the 1980s during the Reagan administration. In the US, State Attorney Generals have power to bring antitrust proceedings in conduct and merger cases. "When they feel that Federal enforcement is lagging behind, that is exactly when they decide to jump more vigorously into the fray," says Veronica Kayne of Wilmer, Cutler & Pickering.

- If you need worldwide approval, get information on the worldwide operations of the target. Make a filing assessment to establish where you will need to file and how much will it cost.

In the last year or two the authorities have become less tolerant of companies (particularly foreign companies) that have forgotten to file. Previously, if it was possible to convince the authorities that there was a genuine reason why you forgot. Nowadays they are less likely to be sympathetic.

Think about where it might be preferable to apply first. Identify the hotspots around the world. Inside the EU, Germany has always been difficult and the UK has now become tougher. France and Italy also deserve more attention. Brazil, Mexico Argentina, Australia, South Africa are all more active and Canada will continue to be active.

When dealing with agencies in different countries there will normally be confidentiality agreements in place protecting the companies' documents. Many experts feel, however, that in the long term companies' interests are better served if they grant waivers of confidentiality and allow the agencies to exchange the information and to cooperate fully. There are practical risks, however. Most of the information exchanged between the countries' agencies will be oral or in the form of agency-to-agency memoranda. When the object of the exchange are confidential business documents, however, one potential risk to the parties comes from the different standards on business confidentiality that statutorily exist in different countries. These differences might allow for protection of business secrets in one country, yet expose the same business secrets in another country.

The lawyers representing the company in different jurisdictions should coordinate very closely, so that the various agencies are not given conflicting messages and told different stories.

Approaching the agencies informally

There are different circumstances in which the agencies can be informally approached at an early stage to help clarify in advance any difficult issues:

Before filing, to seek clarifications and guidance on general aspects of the proposed deal. FTC Chairman Robert Pitofsky explains that companies often approach the FTC asking for general advice, with questions such as "How difficult will this deal be? How long will it take?" He encourages companies to do so and believes that dealing with these queries is part of the service that the FTC should provide to the private sector. He points out, however, that at that stage the FTC cannot give an opinion on the merits of the deal because it does not yet know the facts. Also, if companies wanted to make an argument on the outcome of the case "they would be wasting their time."

After filing, to discuss any potential clearance overlap. Pitofsky does not encourage parties to do so. "This is not the business of filing parties," he says. Others believe that although the parties can do very little to influence the final decision (and if they did they would probably trigger a backlash), they can at least influence the speed with which the process works. "We represent GE in the GE/Honeywell deal," says Baer "On that occasion we had very productive discussions with staff at the FTC and at the Antitrust Division and at the end of the consultative process they agreed that the matter should be handled by the Antitrust Division."

After filing, to help the agencies understand the market and the transaction. Some experts believe that this is particularly important in the case in the case of "marquee" or controversial mergers, not so much in connection with less high profile transactions. In a "marquee" situation, it is likely that the opposition will also approach the agencies at an early stage. If the opposition is going to talk to the agencies early, companies should also do it - it should not be left until it is too late. In the AOL/Time Warner merger, for example, a lot of political opposition translated into antitrust issues. It made sense for the parties to go to the agencies early to counter the objections and complaints.

Approaching customers

Some experts believe that it is important to get your customers on your side as soon as possible once the deal is public. Aggrieved customers who hear about the deal in the press may complain to the agencies, and even if they do not, the agencies are likely to ask the parties for a list of major customers and canvass their opinions. It makes good business sense and good antitrust sense to have senior personnel within the parties visit customers early on in the planning process and convince them that there are good reasons to like the deal and highlight the pro-competition aspects of the transaction.

Others disagree. The government is likely to ask customers who has contacted them and if they say that the parties or their advisers have done so the effects can be counterproductive for the company and the credibility of customers can be undermined. Ultimately, the government's lawyers are smart enough to be able to tell if a customer is not happy about a proposed merger, and the fact that companies have been talking to customers is not going to make any difference.

Tips from the regulators

- Do not exaggerate your case.
- Come in early to discuss the matter with the staff.
- Be realistic about what you can achieve.
- If assets have to be divested in order to clear the deal, be prepared to do so early.
- The biggest mistake is to try to persuade the staff of something that is not true. When the staff finds out, the credibility of the company and its advisers will be lost.
- Supply the necessary information and answer the questions.
- Pay attention to what is in the minds of the investigators and the senior staff; address those concerns.
- Ask yourself what you would be concerned about if you were the government.
- Appreciate that the agencies' analysis is very sophisticated.

Proposals of the New York Bar Association

In recent years the Committee on Antitrust and Trade Regulation of the New York Bar Association has proposed some modifications to the merger review process and made some practical suggestions as to how the burden of second request compliance could be reduced by modifying the wording of the model second request accordingly (*letters to the FTC Deputy Assistant Director of 29th June, 1999 and 18th January, 2000*). The letters state the five general principles underlying the proposals:

- Second requests should be designed to conduct relatively limited investigations. Most second requests in their unmodified form require the production of an enormous volume of materials, many of which are unnecessary even for the most comprehensive merger review. Even with modifications, second requests can generate thousands of boxes of documents in large transactions and hundreds of boxes for mid-sized and smaller transactions.

- The merger review process should be more investigatory and less prosecutorial. The process should be used by the agencies primarily to attempt to determine objectively whether a transaction is likely to present a violation of law, and not to prepare a case against the transaction. The difference in approach is reflected in the scope of the document request, the detail and volume of information sought by interrogatories and the manner in which interviews are conducted and depositions taken.

- Prompt compliance should be a realistic objective. Although compliance time will vary depending on the specific facts of each transaction, the following time periods may generally be adequate: weeks for smaller transactions, one or two months for larger transactions, and perhaps an additional month for the very largest transactions.

- The second request process requires a good faith balancing of the agencies' need for information to assess the likely competitive impact of a transaction and the parties' need to avoid burden and delay.

- The appeals process should be more accessible and transparent. At the moment, the process is largely ignored. If it is to be used more, the agencies must make the process more expeditious and its outcome more transparent. A new appeals procedure has now been introduced as part of the recent amendments to the Hart-Scott-Rodino Antitrust Improvements Act (*see box "Hart-Scott-Rodino Act amendments"*)

Against this background, the Committee has put forward a number of practical suggestions, including the following:

- The number and categories of company personnel whose files must be inspected should be limited. The search should be restricted to those employees who have decision-making authority for some important aspects of the design, production or sale of the relevant product or service in the relevant area.

- Electronic document productions should be narrowed. Second requests should not require the compulsory production of documents that are not readily accessible by employees in the ordinary course of business, such as for example documents deleted from a word processing system, e-mail communications that have been placed into the electronic "trash bin" and documents that exist only as part of back-up electronic files.

- Foreign document productions and translations requirements should be reduced. The model second request should require parties to produce only those foreign documents that relate to whether foreign sources could be shifted to prevent a price increase in the US. Another suggestion is that parties could be asked to produce foreign documents in their original form, and the agencies could obtain the capacity to review the documents in question (for example, by way of cooperation with other foreign antitrust agencies) or, as a compromise, a portion of the translation costs could be covered by the government.

Markets on condition that, following the acquisition, the company would divest 24 supermarkets in the St. Louis area. As soon as the acquisition was completed it became clear that Schnuck had no intention of honoring the asset maintenance agreement attached to the FTC's order - it started closing departments of the divested stores, unlisting telephone numbers and referring customers to other Schnuck branches that were not being divested. During the year it had to sell the stores, the sales for those stores declined by approximately 35% (*see www.ftc.gov*).

This commonly quoted "horror story" was one of the driving forces behind a study commissioned by the FTC in the summer of 1999. The study analysed divestiture orders made between 1990 and 1994 and their results, and came to the conclusion that many deals failed to restore competition effectively. According to the study, approximately 25% of divested businesses went to companies that were not capable of being effective competitors, while the most successful mergers involved the sale of an ongoing business to a buyer with experience in the industry and willingness to stay in the market (*see American Bar Association Task Force, 2001 Report on the Federal Antitrust Agencies, www. abanet.org*).

Barry E. Hawk Skadden, Arps, Slate, Meagher & Flom, New York

The FTC has now adopted the approach of requiring companies to identify a suitable buyer "up front" as part of the merger review process. Parties are required to obtain FTC approval for the buyer and enter into a transfer agreement simultaneously with the closing of the main deal. This runs counter to the traditional way of thinking. As Barry Hawk of Skadden, Arps, Meagher & Flom in New York puts it, "If you are the seller, you just want to close the deal and get the money. You want the buyer to have to deal with any antitrust issues."

Commentators charge that in many instances the buyer up

front rule gives rise to long delays and distorted transactions, and allows buyers too much leverage. In industries where there are very few potential buyers, "you end up in a situation where the one or few potential buyers very much get themselves into the driver's seat to command very attractive terms," says Arquit. The end result can be a "fire sale" situation, where assets have to be sold for a considerably lower price than they would have been as a result of a normal negotiation.

"When you are looking for a buyer, the entire deal often becomes a three way negotiation between the seller, the buyer and the agency, and the seller has to make very tough decisions," says Steven Sunshine of Shearman & Sterling in Washington. "For example, if a US$100 billion deal is at risk because of a US$1 billion divestment, the seller may need to sell the asset at a vastly reduced price just to get on with the deal. The buyer often plays this trump card and the seller has no choice but to accept."

The "fix it first" approach can sometimes help. "If you think there is going to be a problem," explains Baer, "one strategy is to find a buyer and enter into an agreement so that you can present to the agency a proposed purchase that does not involve the offending assets." Fix it first, however, has its downsides. "Let's say that you sell these assets and the bigger deal for whatever reason does not happen, you will have given away your left arm. This is not a risk companies may necessarily be prepared to run," comments Arquit.

William Kolasky
Wilmer, Cutler & Pickering, Washington

Some practitioners are of the view that the FTC is taking too strict a line on the rule, and that a degree of fine tuning should be a priority for the new administration. "At the moment the policy is being administered in a wooden way, without flexibility as to when it should be used," says McDavid. "The agencies are not being sufficiently thoughtful about the circumstances in which they should impose the requirement," she says.

McDavid explains that in the Exxon/Mobil deal she persuaded the agencies to move away from the requirement in relation to certain of the assets because of the practical implications. As it can take up to a year to sell an oil refinery (because of the environmental due diligence issues and employment questions), it was simply not realistic to close the purchase agreement simultaneously with the principal merger. The agencies satisfied themselves that there was an acceptable buyer and the main transaction was allowed to proceed.

Ronan P. Harty
Davis Polk & Wardwell, New York

Other antitrust experts feel that sometimes the rule can work to the parties' advantage. "I do not think that it is all either negative or positive, it depends on the circumstances," says Kolasky. "If you are divesting before you have the consent order in place, you can conduct a more leisurely auction that might give you an opportunity to create competition for the assets and more bargaining leverage with potential buyers," he explains. He advocates, however, more flexibility on the part of the agencies. "Like everything else I would prefer the agencies not to adopt a rigid policy one way or the other, I'd like them to be flexible and look at what works for each transaction," he says. Ronan Harty of Davis Polk & Wardwell in New York agrees: "The idea should be to apply the policy only to those divestitures that could be problematic rather than apply it across the board".

Pitofsky does not accept that the rule needs to be used more flexibly. "I think we are already enforcing the rule with considerable discretion," he says. "Usually we do not ask for an up front buyer. Commonly we accept the divestiture proposal on the assumption that there will be someone out there ready to buy," he adds. He explains, however, that there are some industries where nothing will have been achieved and the competition problem will not be dealt with if the assets are divested to an incompetent buyer. "We must make sure that the buyer will stay in the market and be effective."

Pitofsky does concede that fire sale situations may arise, but explains that in general an up front buyer policy remains essential. "Our job is to restore competition to the state it was in before the transaction occurred. It is not appropriate for us to take advantage of companies or to ignore their concerns, but that's a secondary issue. Our first priority is to protect consumers," he says.

The European Commission is also becoming stricter in its approach to remedies, and requests divesting parties to ensure that their proposed buyer is a viable competitor (*see www.lawdepartment.net/global "Getting tougher: the Merger Task Force 10 years on", GC, 2000, V(10), 29*). In its recently published Notice on the remedies acceptable to solve competition problems raised by mergers and acquisitions, it states that the assets to be divested must consist of a viable business that, if operated by a suitable purchaser, can compete effectively with the merged entity (*Notice on remedies acceptable under Council Regulation (EC) No 447/98 published on 21st December, 2000, available from www.europa.eu.int/comm/competition*). Commissioner Monti and Director General Schaub have recently indicated that the EU is also considering the introduction of an up front buyer requirement. In the context of the EU tight schedule for merger approval, however, the implementation of the remedy is regarded as more difficult to achieve.

The efficiency defence

The existence of a general efficiency theory has never been questioned by legal and business experts. Efficiency arguments put forward by companies to explain why a transaction will have pro-competitive effects are seen as a positive way of presenting a business case for a merger or an acquisition.

As markets worldwide become more consolidated, however, the viability of the efficiency defence is a subject of debate. Used as a defence, the efficiency argument is that a transaction that would otherwise be anti-competi-

tive should be allowed if the cost savings involved are sufficient to counterbalance its anti-competitive effects.

Many regard the defence as very difficult to use because the alleged pro-competitive effects must be merger-specific. Parties can only use it if they have lost their case on merits and the deal has been declared anti-competitive. At that stage it is hard to get the agencies to change their mind. Melamed agrees. He points out that efficiencies will always play a role in merger analysis. "In a preliminary sense, if the parties do not have a good efficiencies story to tell, the agencies wonder why they are doing the merger," he says. However, efficiencies play out as a technical defence in a more difficult way. "Once you have determined that a merger is anti-competitive you expect the parties to be able to put forward very strong arguments before you feel you can clear a transaction," he explains.

He does not believe that the existence of efficiencies depends on the number of competitors. The number of competitors, however, affects the seriousness of any anti-competitive implications. The greater the anti-competitive risk, the greater must be the showing of efficiencies.

The issues have recently been revived in the case involving H.J. Heinz Co's proposed acquisition of Beech-Nut Nutrition Corporation. The FTC tried to block the merger on the basis that it would bring the number of competitors in the baby food market down from three to two, creating a situation very close to a monopoly. The two companies successfully argued before a District Court Judge that the efficiencies of the merger (alleged annual savings of between US$9 and 12 million) substantially outweighed any anti-competitive effect. The FTC appealed the order before the Court of Appeals. At the time of going to press the parties were presenting their oral arguments. The court is not expected to issue a ruling until at least mid-March.

Some draw a parallel between the argument used in the proposed MCI WorldCom/ Sprint merger (blocked by the European Commission in July 2000) and the defence as it has been articulated in the baby food case. A senior executive at MCI Worldcom emphasised that the deal was important as it would have allowed number two and three in the market to compete with number one, AT&T. "It is an interesting efficiency argument but also a double-edged sword," says Arquit. "It is also an acknowledgment that entry barriers are difficult. If numbers two and three are not big enough to compete with number one, how can you possibly argue that numbers 10 and 11 would even have a reasonable shot at competing with number one?" he adds.

Europe has only recently been moving towards a collective dominance analysis, which has enabled it to block a deal if two or more firms can dominate a market by acting together (*see www.lawdepartment.net/global "Getting tougher: the Merger Task Force 10 years on", GC, 2000, V(10), 29*). A test for detecting whether market participants are so close to each other that, in effect, they operate as a single monopolist is the coordinated effect test (applied by the European Commission in the proposed Gencor/Lonhro merger and endorsed by the Court of First Instance). Arquit points out that the coordinated effect test has always been part of the US antitrust analysis. As a result, at every level there are limits on the extent to which the efficiency defence can be successfully adopted.

When Pitofsky started at the FTC he stated an intention to clarify the defence. He explains that there were several cases, including one in the plastics industry and one in the pharmaceutical industry, where the transactions would have been illegal had it not been for the efficiency defence. The cases are not reported because the FTC accepted the defence with no litigation taking place.

The only other case in which the parties have tried to use the defence is the baby food case, where Pitofsky hopes the FTC will win the appeal. He points out that the defence works best when the number of competitors is reducing from six to five or from five to four, and the Merger Guidelines state very clearly that efficiencies should not be a justification for a merger that leads to a monopoly or duopoly. He thinks efficiencies are effective. "There is no question in my mind", he says, "that the FTC one day will lose a case in court as a result of a powerful efficiency defence."

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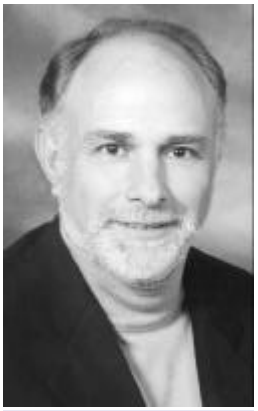

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