BREAKING UP IS HARD TO DO DURING COMPETITION AGENCY REVIEW: FIXING BEFORE FILING CAN BE THE EASIER PATH TO CLOSING

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CPI Antitrust Chronicle October 2021

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Breaking Up Is Hard to Do During Competition Agency Review: Fixing Before Filing Can Be the Easier Path to Closing

By William MacLeod

Mergers are surging, enforcement is changing, but one element of competition practice remains remarkably stable. A divestiture can save a deal otherwise destined for challenge. The substance of divestiture review still follows the principles applied in the past, and practice at the agencies remains reassuringly familiar. In an era of tougher and longer reviews, however, deal structure and timing may merit a new approach. Merging parties that fix deals before the culmination of review, and perhaps before the beginning of review, will have significant advantages. The challenge to parties and competition counsel is to assess the likely vulnerabilities of a deal, and undertake the repairs in advance of filing, instead of committing the transaction to a process they cannot control.

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Commentators throughout the competition community have reported, analyzed, and opined on the changes in merger and acquisition review in 2021. Vertical merger guidelines have been rescinded. Early terminations at the FTC are gone for the time being. Horizontal merger guidelines are under review. Investors, not just companies, are new subjects of interest. Adding to the uncertainty surrounding M&A, Congress is contemplating numerous bills to change burdens of proof and create special rules for concentrated markets. Meanwhile, the FTC has expressed doubts over the advice that staff has given on premerger issues.[2] And after all is done, new consent orders may require companies to get permission of the FTC before consummating future deals.[3] With a prior-approval clause in place, the agency could stop any deal covered by the order, regardless of its legality. What will come out of the Department of Justice, which awaits the next Assistant Attorney General, remains to be seen, but nobody is betting on the status quo.

In the wake of these shifting tides, one element of merger practice remains remarkably stable. A divestiture can save a deal otherwise destined for challenge. More encouraging, the substance of divestiture review remains largely consistent with the principles applied in years past, and the practices of the agencies bear more similarities than differences than before. In an era of heightened review, however, deal structure and timing may merit a new approach. Merging parties that fix deals before the culmination of review, and perhaps before the beginning of review, will have significant advantages.

The analysis, as always, should start with the law. Section 7 of the Clayton Act prohibits deals the effect of which "may be substantially to lessen competition, or to tend to create a monopoly." Some legislators want to make that standard easier – for example, Senator Klobuchar's bill, S. 225, would change the standard to "create an appreciable risk of materially lessening competition." Antitrust veterans recall when the more rigorous terms were enough to block a merger that resulted in a firm with less than 10 percent of a market and to prompt Justice Stewart to observe in dissent that "sole consistency that I can find is that, in litigation under § 7, the Government always wins." (*United States v. Von's Grocery Co.*, 384 U.S. 270 (1966) (Stewart, J. dissenting)) But the debate over standards should not matter to deals that present no risk or tendency to begin with. A deal shorn of overlaps does not violate the law.

Most deals that raise concerns are reported to FTC and DOJ before the overlaps have been eliminated. Parties may have plans for the most obvious divestitures, but it is not always obvious what concerns the investigating staff might raise, and parties are understandably reluctant to give up on a piece of business that they hope to talk an agency into allowing them to keep. The decision of what to divest becomes a collaboration between the agencies and the party, and the collaboration involves an intense investigation. Demonstrating to enforcement officials that an ancillary transaction will preserve competition means prodigious document productions, interviews of potential buyers, parsing of the contract terms, and more. The FTC offers an overview with a guide that scratches the surface of what parties should be prepared to face.[4] Selected instructions include:

- provide Compliance staff with the steps taken and concerns about any aspect of the diligence process;
- obtain direct access to [the spinoff's] information, facilities, and employees;
- obtain direct access to the hold separate business, the hold separate monitor and the hold separate manager
- explain the structure of the funding for the investment, including any limitations of the funds;
- provide all sources of financing for the acquisition of the divested assets, including private equity or other investors, and explain the criteria used for evaluating such sources;
- make representatives from the financing entities available for discussions with staff;
- provide detailed financial and business plans, with supporting documentation….

2 Holly Vedova, Bureau of Competition, FTC, "Reforming the Pre-Filing Process for Companies Considering Consolidation and a Change in the Treatment of Debt," Aug. 26, 2021, available at https://www.ftc.gov/news-events/blogs/competition-matters/2021/08/reforming-pre-filing-process-companies-considering.

3 Release, "FTC Rescinds 1995 Policy Statement that Limited the Agency's Ability to Deter Problematic Mergers," July 21, 2021, available at https://www.ftc.gov/news-events/press-releases/2021/07/ftc-rescinds-1995-policy-statement-limited-agencys-ability-deter.

4 Bureau of Competition, FTC, "A Guide for Potential Buyers: What to Expect During the Divestiture Process," Available at https://www.ftc.gov/system/files/attachments/merger-review/a_guide_for_potential_buyers.pdf.

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Additional instructions apply to spinoffs of less than an entire business entity. Not surprisingly, reviews of divestitures take months, and typically don't commence in earnest until after staff has concluded that the principal transaction can progress if the divestiture is effective. This author has been involved in divestitures that took over a year to negotiate and clear, as well as spinoffs that wrapped up in a few months. In every case, the divestiture added time to the transaction. For a recent example of an extended review, see the FTC consent addressing the overlaps in Gallo's acquisition of assets from Constellation, announced in April of 2019 and closed in December of 2020.[5]

Several months of unexpected delay can strain a deal to the breaking point and run up hundreds of millions of dollars of expenses from renegotiations, rearranged financing, and postponed business opportunities. All this should be taken into account in light of the new developments at the FTC. Agency leadership has warned repeatedly that deals are getting closer scrutiny from staff already overworked from a surge in Hart Scott Rodino ("HSR") notifications, that second requests are going to be more difficult to negotiate, and that reviews will be more extensive.[6] And that does not count the delays that could occur if the staff deems divestitures are needed. In short, certifying compliance will take longer. And parties that get to the HSR finish line have been warned that if they certify and close before a review is done, they should not assume that their deal is safe from attack.[7] The risk of an agency challenging a deal months or years after it has closed has always existed, of course, but the business is forewarned that the odds have apparently increased.[8]

It is hazardous to predict how long HSR review will take in the new administration, but one factor is clear. When a deal is presented to the staff with an obvious divestiture to be negotiated, the merging parties lose control over the timing of the transaction. A proposed acquisition that presents a probable competitive problem is a deal that has to be negotiated with the staff and resolved with a complaint and consent. The more significant the problem, the easier it is for an agency to attack an entire transaction.

By contrast, a transaction structured to eliminate obvious problems before it is notified to the agencies puts the parties in control of timing. The benefits of removing investigative subjects will be immediate. At the outset, overlaps are the main cause of extended investigations. With the overlap eliminated, there is less for the staff to review. The efficacy of the overlap will likely get some attention, but that attention comes with less leverage. No longer is the main deal an obvious target of an easy attack. For example, the FTC declined to challenge a transaction properly structured on arrival in the *Reynolds-Lorillard-Imperial* deal in 2015. The agency issued a complaint and consent order approving the deal as proposed, while one Commissioner said the fix obviated the action altogether:[9]

> As a matter of principle, in a three (or more) way transaction, an order is unnecessary if the transaction—taken as a whole—does not give reason to believe competition will be substantially lessened. [That] a component of a multi-part transaction is likely anti-competitive when analyzed in isolation does not imply that the transaction when examined as a whole is also likely to substantially lessen competition.

This rationale would have obvious appeal to a federal judge considering a motion for a preliminary injunction.

In an agency strapped for resources, a resource-intensive merger battle is not likely to erupt over marginal issues. Parties can comply with the second request and let certification start the clock toward litigation or closing. Most likely, the result will be closing. As always, the agencies can warn that the investigation will continue even after the deal is closed, but history reveals that such warning will seldom materialize in action. If a challenge does come, and the repair is defensible, the agencies would face much higher burden persuading a court to grant the relief that the staffs could readily obtain during negotiations. Needless to say, an inadequate fix will not shift the burden, as Sysco and U.S. Foods discovered

5 See, e.g. *E & J Gallo Winery/Constellation Brands*, December 23, 2020, available at https://www.ftc.gov/news-events/press-releases/2021/04/ftc-approves-final-order-imposing-conditions-e-j-gallo-winerys

6 Holly Vedova, Bureau of Competition, "Making the Second Request Process Both More Streamlined and More Rigorous During this Unprecedented Merger Wave," Sept. 28, 2021, available at https://www.ftc.gov/news-events/blogs/competition-matters/2021/09/making-second-request-process-both-more-streamlined (predicting investigations into "how a proposed merger will affect labor markets, the cross-market effects of a transaction, and how the involvement of investment firms may affect market incentives to compete.").

7 Holly Vedova, Bureau of Competition, FTC, "Adjusting merger review to deal with the surge in merger filings," Aug. 3, 2021 available at https://www.ftc.gov/news-events/blogs/competition-matters/2021/08/adjusting-merger-review-deal-surge-merger-filings ("Companies that choose to proceed with transactions that have not been fully investigated are doing so at their own risk.").

8 See e.g. Evans, Merger Enforcement in the Biden Administration, https://www.kelleydrye.com/News-Events/Publications/Client-Advisories/Merger-Enforcement-in-the-Biden-Administration.

9 *In the Matter of Reynolds American Inc. and Lorillard Inc.*, Dissenting Statement of Commissioner Joshua D. Wright, FTC File Number 141-0168,

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when they divested fewer assets than the FTC alleged were necessary to preserve competition if they merged.[10]

Fix-it-first has long been a mantra in merger clearance. Up until now it typically meant that parties must prepare to negotiate with the staff during the investigation over how to restructure an entire deal. The announcements of longer, tougher reviews from the FTC bring new variables into the equation. Those factors add significant value to the benefits of fixing a deal before the review begins. The challenge to parties and competition counsel is to do more of their own assessments of the likely vulnerabilities of a deal, and to undertake the repair in advance, instead of committing the transaction to a process they cannot control.

10 See, e.g. Case Summary, *Sysco/USF Holding/US Foods*, available at https://www.ftc.gov/enforcement/cases-proceedings/141-0067/syscousf-holdingus-foods-matter.

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