COMMENTARY: KENNETH DAVIDSON, PREMATURE CONSUMMATION: AN EVALUATION OF HSR GUNJUMPING RULES

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COMMENTARY

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Author: Kenneth M. Davidson, AAI Senior Fellow

Contact Information: kdavidson@antitrustinstitute.org

PREMATURE CONSUMMATION: An Evaluation of HSR Gunjumping Rules

Premature consummations of reportable mergers has posed an antitrust problem from the start of the HSR premerger notification program. Although the Department of Justice has now brought numerous civil penalty actions on behalf of the FTC and the Antitrust Division and taken other actions to maintain the waiting period mandated by Congress, the cases reflect more *ad hoc* reactions to egregious violations than the implementation of a coherent policy. I think the development of a theory that implements the intention of Congress is long overdue. Such a consistent policy could help both merging firms and the antitrust agencies. My suggestions of what would constitute a desirable policy reflect experiences investigating preconsummation actions over a twenty year period. Although age and experience do not automatically confer wisdom, they provide me some perspective based on the many different circumstances that I investigated.

Where we were

Years ago, I was sitting in a windowless conference in the old FTC staff building at 601 Pennsylvania Ave with an FTC attorney who was conducting a merger investigation. Across from us sat attorneys for an acquiring firm in the merger investigation. The staff attorney asked for my assistance because of certain activities of the merging parties seemed inconsistent with the mandatory HSR waiting period.

The waiting period had been established by Congress in order to give the government antitrust officials premerger notification of proposed mergers. After notifying the Federal Trade Commission and the Antitrust Division of the US Department of Justice, the merging parties were forbidden from consummating their merger until the statutory time granted for antitrust review by the agencies expired. The prohibition on consummation before the review was complete had been enacted because Congress was persuaded that

once separate firms were integrated, it was costly, difficult, time consuming or sometimes impossible to fully restore the competition that had been lost as a result of integrating the operations of the firms. The problem separating integrated operations was often referred to as "unscrambling eggs."

My assistance on this case was sought because I had worked for a number of years on HSR issues. The issue in this case hinged on the legality of a contract provision that was common to many merger agreements. The provision at issue required the to-be-acquired firm to not diminish the value of its assets and to obtain the approval of the acquiring firm prior to entering into any major contract. The event that triggered our meeting was the notice given by the to-be-acquired firm that it intended to enter into a contract that would have expanded its production capacity significantly in a particular geographic area. The acquiring firm opined that such capacity would not be necessary after the merger and advised the to-be-acquired firm to buy a smaller set of machines.

The staff attorney learned of this discussion between the firms in the course of the merger investigation. The attorney expressed some concern to the lawyers for the acquiring firm about the advice given to the to-be-acquired firm. The lawyers for the acquiring firm requested an immediate meeting to discuss the matter because there was a pressing need to finalize the purchase of equipment. The three lawyers representing the acquiring firm were experienced merger lawyers and one specialized in HSR notification matters. They asserted that this prior approval provision was common and necessary to protect the value of the to-be-acquired firm. They argued that their client could not guarantee the price it had offered without the protection of such a provision.

We responded by granting the legitimate interest of the acquiring firm in preventing the dissipation of the value of the to-be-acquired firm. We suggested that the acquiring firm had other ways to protect itself, by revaluation for any diminution of value or the right to cancel the acquisition on the grounds that it constituted a material change in the to-be-acquired firm. The lawyers countered that such alternatives were much more complicated and not satisfactory to the merging parties because they introduced considerable uncertainty into the finality of the transaction.

Ultimately, however, we persuaded the lawyers that their position that the acquiring firm could, in effect, decide for the to-be-acquired firm made sense only if the merger was going to occur. If it was decided that the merger would be anticompetitive, then the purchase of less productive equipment would put the formerly to-be-acquired firm at a significant disadvantage vis-a-vis the erstwhile acquiring firm. We persuaded them that preventing acquiring firms from making such changes in the to-be-acquired firms was precisely why Congress had established the waiting period. Congress had recognized that to wait might cause some inconvenience to the parties, but that was why Congress gave the antitrust agencies only a limited time to review the proposed transactions.

With considerable reluctance, the lawyers for the acquiring parties granted that our analysis of the purpose and effect of the HSR waiting period was correct and they agreed to advise their clients to modify the agreement. We said that we had not had an

opportunity to discuss the issue with the Bureau Director or Commissioners and thus were not in a position to suggest specific language or procedure for implementing the change. We promised to make such suggestions within a few days.

To our great surprise, the Bureau decided that the FTC should not interfere with the existing contract. Those who made the decision conceded that our analysis of the legal issues was correct, but that they thought it would be unwise to invalidate a provision that was so universally used. The Bureau decided rather that the matter be studied. Accordingly, the FTC lawyer called the acquiring firm's lawyers and told them, "Nevermind."

Where we are today

I think it is fair to say that were this set of facts to arise today, both the FTC and the Antitrust Division would conclude that the actions of the acquiring firm described above constitute a violation of the HSR Act and probably also a violation of the Sherman Act or FTC Act. The settlements of HSR civil penalty actions in *Gemstar-TV Guide International, Inc., Computer Associates, Imput/Output Inc., Titan Wheel International,* and actions in many other cases makes it clear that the direct operation of a to-be-acquired firm by an acquiring firm during the HSR waiting period is a violation of that Act. One can fairly infer that even absent contractual authority to control the target firm the fact that such control is agreed to or exercised is sufficient to establish a violation.

These cases are the tip of a much larger iceberg made up of investigations that have never been made public. One of these was resolved by formal agreement between the FTC and respondents that required respondents to cease certain preconsummation behavior and undo certain procedures. Other investigations accomplished the same objective through informal agreements. Still others, indeed the greatest number I would estimate, were investigations that were abandoned.

A number of these were abandoned because of a lack of resources. Having resolved the antitrust merits of the matter, the FTC was unwilling to devote the resources needed to prove the violation of the waiting requirements. This reason for closing an HSR investigation is surprising in principle, but understandable in practice. In principle, HSR obligations exist independent of antitrust merits therefore the settlement of the antitrust merits should be irrelevant. Indeed, a review of the HSR civil penalty actions would show that a small minority of these were matters that raised serious antitrust concerns. Nevertheless, the closing of these premature consummation cases is understandable because many of them would have required many more resources than is typical of other HSR violations. Typically HSR violations rest on an explicit agreement or an action that is sufficiently blatant that little investigation is necessary.

A problem for staff with current policy

Abandoned investigations commonly involved matters in which the parties are asked to submit scores of boxes of documents and require numerous depositions of both senior

corporate officials and lower ranking employees who may or may not have acted in violation of the HSR Act. Although generally these HSR investigations begin during the waiting period, their resolution would require a much longer investigation. For example, there may have been an allegation that the merging firms agreed to a coordinated course of action by their sales personnel. The evidence of the agreement might have been suggested by a document containing agenda items of planning sessions or references in emails during the waiting period. If the parties claimed no agreement was reached, or it was reached but not implemented, or argued that the action was conditioned on final consummation of the merger, the evidence to prove the violation required at least a full inquiry as to the practice of the parties prior to the merger agreement and an examination of the actions of the target during the waiting period. This led in one investigation to examination of thousands of emails, in others it has required the examination of dozens of persons who were hired or fired.

I remember vividly one case in which the merger was to be a true integration of the two companies. On the day the premerger notification was filed, the two companies announced the names of persons who would be directors and officers or the newly formed giant international conglomerate. The reason for making this announcement was to reassure the business community that these large diversified firms that competed in many of the same markets had seriously evaluated the challenges that integration would require and were prepared to take all necessary actions.

This announcement raised many of the issues that I had faced in earlier discussions about what actions could be taken by firms during the HSR waiting period. The Bureau in this later case made a distinction that would allow firms to "plan" during the waiting period, but could not implement changes until the end of the waiting period. The firms had set up a very elaborate evaluation process that was designed to plan the integration of the two firms with committees of officials from both firms during the waiting period. These officials did not share with their counterparts any data on profits, prices or output. Those numbers were given to an independent consulting firm that analyzed the data and estimated where and how the combined firm could realize efficiencies.

On the one hand, there was much to say in favor of this planning. Megamergers, despite their continuing popularity, have a dismal record of success. No doubt part of the reason for the many disappointing mergers is that the parties did not understand the obstacles to successful integration. On the other hand, detailed plans for the future operation are likely to result in immediate changes of personnel and operations. Some managers are likely to leave immediately if they are not assured that their jobs are secure. In this case, we were asked to look into the lawfulness of the actions during the waiting period after it was learned that the head of a division was hired to take over the operations of other firm's competing division and an informant from another division began calling us with information that two other divisions were in the process of integrating their operations.

Lawyers representing the firms strongly asserted that the firms were only engaged in planning, that they had established detailed rules that prevented implementation of plans or of sharing competitively sensitive data. While they conceded that it was possible that

some isolated violation of their rules might exist, the requirements of the waiting period were being respected. They agreed, however, to supply us with information concerning one of the many divisions to satisfy the FTC that no violations were occurring.

So we requested documents concerning the division in which we had a secret informant. That resulted in the submission of a dozen or so boxes of documents. While the documents submission was far from complete, it was sufficient for us to understand the general outline of the relationship between the competing divisions of the two firms. We discovered that the head of one division and deputy (in Company A) had left and the head position remained unfilled. We further discovered that the head of the other division (in Company B) had already been selected to head the combined division and that he had interviewed a former associate and recommended that this person be hired by the other company (Company A) as deputy. The person was then hired by the official in Company A to whom the division reported. That official never interviewed the candidate. We also discovered that the joint committees of the two divisions were exchanging details on IT procedures, marketing, and manufacturing in order to plan how the divisions would be integrated. It was this last that most disturbed our informant who worked in a manufacturing plant. He felt his company was giving away its technology to Company B.

Armed with this information, we wrote a preliminary memorandum outlining what we had found. Briefly stated, we said that we had found some actual integration – the hiring of a manager of Company A by a manager of Company B – and the sharing of voluminous information on the operations of the two companies. The sharing of this information would have dramatically altered competition between the two companies if they had remained separate. I concluded that the notion that planning was consistent with the requirements of the waiting period so long as there was no integration was a null set. I argued that permitting planning had no support in the concept of an HSR waiting period. Planning, at least of this type, would inevitably and irrevocably alter future competition between the firms if they remained separate. We thought it more than probable that further investigation would reveal additional exercises of integrated operational control but finding specific instances would take time and we could be forced to prove (what seemed obvious) that hirings were made by the joint company rather than the separate companies. Absent a large series of hirings and comparable operational decisions, we doubted that a court would impose civil penalties for isolated violations. Accordingly, we sought advice from the agency whether we should pursue the investigation premised on an illegal sharing of confidential business information or greatly expand our investigation to search out individual illegal actions. We never received advice in response to the memorandum. Ultimately we recommended closing the investigation on the grounds that it was unreasonable to keep the investigation open indefinitely.

I am sorry to say the result in that investigation has not been unusual. I have conducted investigations of different preconsummation actions with virtually all of the members of the Compliance Division. Some of these were settled informally, others resulted in civil penalty actions, but many were simply abandoned because the pressure to work on active

merger investigations precluded devoting the time needed to fully investigate the activities. The waiting period actions ranged from submitting joint bids, to jointly working on the project that was the objective of the merger, to providing the acquiring firm with the to-be-acquired firm's customer list, to canceling a major advertising campaign, to replacing a planned production facility with a supply depot. In these and other cases the parties' lawyers consistently represented that the actions were taken by the firms acting independently. While they conceded that planning was going on, the firms were making all their decisions independently and further that they were entitled to continue to engage in joint activity of the sort that would have been lawful absent any merger.

In all of these investigations, it was clear to everyone that if staff could prove that the preconsummation action was a product of the agreement to merge then it would be an unlawful action. By now, there may have been sufficient gunjumping cases to discourage most blatant violations but the current implicit approval of planning activities during the waiting period is almost an invitation to firms to proceed with implementation actions by a wink or a nod during the waiting period.

The antitrust agencies do not appear to seriously oppose "planning-related" actions by parties that are proposing mergers. The reason is that very few mergers are opposed in their entirety and those in which the agencies have objections to the proposed transaction, the orders resolving the cases usually involve only a small portion of the companies products or facilities. These orders resolving cases of multibillion dollar mergers typically involve divestitures valued at tens or hundreds of millions of dollars. In other words, from the date of filing it is often understood that the investigation or resolution of the competitive concerns will only involve a single product. Consequently one can believe that, in general, the preconsummation activity was efficient and even procompetitive.

The investigation of a single competitive issue may be protracted or the design of a divestiture that will maintain competition may be very time consuming, but often the fact that there will be a merger is never in doubt. In these circumstances, I think the agencies may believe that strict enforcement of waiting period violations that have little likelihood of causing competitive harm is unfair to the companies.

A problem for the filing parties with the current policy

Having worked on many of these investigations, I have some sympathy for the reasons that the agencies seem to have adopted an unprincipled implicit approval of planning by the merging companies. I do not think the means chosen is acceptable. It is not only unseemly for the government to act by means of a wink or a nod, the means can be used by firms whose mergers pose serious competitive problems. By facilitating evasions of the waiting obligations, the agencies have created the opportunity for the very problem that premerger notification program was intended to avoid.

The fundamental problem is the length of time that it takes to resolve some merger investigations by an order. Congress provided for a short antitrust review period: a maximum of thirty days to look at a proposed merger plus another twenty days to examine the submissions required by the agencies from the parties. It was not unreasonable for the Congress to imagine that the expectant parties to a merger to do nothing during a less than two month review period. Much of that Congressional expectation has been realized. Most filings in which the parties request early termination of the waiting period are resolved in two weeks. It is unlikely to be a hardship for parties to sever communications for a two week period.

Unfortunately, the cases in which premature consummation issues arise are generally more complex cases. Complex filings that involve substantial submissions of documents represent a small percent of the total filings. Roughly three percent of persons filing HSR notifications receive Second Requests. It takes the parties' time to collect and review or create the required documents. Finding an acceptable resolution also takes time. Negotiating order provisions and finding acceptable buyers for divested assets may take a total of more than a year. Some of this time could be diminished if parties were forthcoming in a way that facilitated quicker resolution of issues. But realistically, a very small number of merger investigations are going to take a substantial amount of time to resolve. Parties ought to have an expectation that the agencies will understand that companies can be harmed by an extended review process. Parties are also entitled to expect that the agencies will consider whether they can accommodate some business uncertainties created by a protracted review process.

A suggestion for limiting harm to the businesses of merging parties

By making premerger policy more explicit, parties would be better able to determine what is and is not lawful premerger activity. The agencies ought to begin by a statement of policies and objectives. I think it would be appropriate for the antitrust agencies to state (by regulation or policy statement) that once an agreement in principle has been achieved, there should be no further discussions between the parties on how the integration of the firms is to take place. My reason for drawing the line at the point of the agreement to merge is that the incentives of the parties change at that point. If one of the firms is clearly being acquired, then the management is likely to look upon requests by the future owner as orders and the sellers have little reason to resist such demands. Prior to the agreement, the sellers may be reluctant to reveal confidential business information and place strict limitations on who may see what information and extract promises concerning what use can be made of the information. Once financial terms are settled sellers may have little further interest in the operation of the firm. The risks are those of the buyer.

Even among mergers of equals, the nature of incentives to limit integration changes. The sooner the parties can align their operations, the sooner the combined firm will realize efficiencies that they seek. Unless there is a substantial risk that the merger will not occur, the parties will have established a community of interest that will at least diminish reasons for directly competing. In this context the difference between agreeing on a plan

and agreeing to implement a plan is illusory. If the parties have agreed on their common interest it is a fiction to say that they are separately implementing that plan.

Having identified the agreement to merge as the point at which joint planning or decision making must cease does not satisfy the needs of at least some businesses that undergo a lengthy antitrust review. For example, if one firm had been a supplier of the other there would be no reason to require termination of such arrangement. Nor, if the firms made complementary products and had a pattern of making joint bids, would it make sense, normally, to prevent the continuation of such joint activity. A policy statement or regulation could make clear that the waiting period bans only new integration.

There are also instances where new integration would not pose a competitive problem and there ought to be a mechanism to permit such activity. Frequently the staff identifies early in an investigation product areas that are and are not of competitive concern. Negotiations over "quick looks" and modifications of Second Requests are based on conclusions that some aspects of a proposed merger do not pose competitive problems. It may be possible therefore to identify areas in which information exchange and planning does not pose a competitive problem. The formulation of safe areas may be made more complex by issues of competitive viability that might require the divestiture of entire units rather than specific products, but in principle it should be possible to permit some discussions or even some implementation about aspects of the merger that are not problematic.

The agencies ought to be open to entering into interim orders or hold separate type agreements where they are persuaded that the merger will be consummated regardless of the disposition of the competitive concerns about other products. The agencies should have wide discretion in formulating such agreements based on the needs of the merging parties, the cooperation of the parties in the review process, the length of review process and other factors. They have precedents in interim orders, hold separate agreements and independent monitor agreements to accommodate urgent needs of firms that suffer because of a protracted review process. The burden should be on the parties to show that any preconsummation activity is urgent because absent a final order it is unlawful to consummate any part of an illegal merger.

To be sure this is not an ideal process. It could remove some leverage of the agencies have by potentially allowing partial consummation of transactions that are under review. Moreover the negotiation of such agreements could become distractions to final resolution of the merger under investigation. The advantages outweigh the disadvantages, however, by establishing a more rational process for allowing what frequently takes place currently in a more ambiguous and uncertain legal setting.