Professional Perspective

A Merging Parties' Approach to New FTC HSR Policy

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In 1976, Congress enacted the Hart-Scott-Rodino Act (HSR). Under the HSR merger review process, parties to transactions above certain thresholds must provide advance notice to the Federal Trade Commission (FTC) and the Department of Justice (DOJ) and may not complete the transaction until expiration of the statutory waiting period.

The FTC and DOJ retain jurisdiction to review transactions before or after closing, regardless of whether an HSR waiting period has expired—though historically, the FTC and DOJ rarely have investigated transactions after allowing the HSR waiting period to expire. The FTC has upended the review process with its recent practice of issuing warning letters with respect to transactions that have been through HSR review. The practice coincides with an unprecedented merger wave of 4,130 acquisitions filed with the agencies in 2021, reportedly straining the FTC's resources.

The warning letters are part of several new tactics that are causing further delay and uncertainty in merger review and clearance. This article discusses those tactics and their immediate impact. The general approach has been a doubling down on enforcement, stripping away of exemptions and interpretations, and more burdensome investigations with less predictable outcomes.

Warning Letters

In 2021, the FTC began issuing letters to parties in transactions the agency may investigate after the HSR waiting period expires. For deals with unclear issues, the FTC is issuing the new warning letters often without an investigation.

The warning letters have not been tested in any court challenge to date. Nonetheless, deal documents should be crafted to reflect the possibility of warning letters. Buyers should insist on closing conditions that are contingent on both the expiration of applicable waiting periods and the absence of warning letters or ongoing investigations.

Recent agreements in public company transactions have reflected this language, including 3D Systems Corp.'s agreement to acquire Oqton Inc. and Universal Corp.'s agreement to buy Shank's Extracts Inc. The parties' agreements provided that if a warning letter is issued, the investigation would be treated as closed 30 days after receipt of such letter.

Changes to Second Requests

In August 2021, the FTC announced plans to make the Second Request process both "more streamlined and more rigorous." Merger investigations will examine additional factors, including labor markets, cross-market effects, and the impact on incentives of investment firms.

Even as merger investigations have become more rigorous, the changes do not streamline the Second Request. The investigations will require analysis in areas that the FTC has not examined closely before, if at all. Merging parties should expect productions that go beyond financials and product market analysis. Merging parties may also need to hire additional experts to analyze those additional factors, such as labor markets.

Chilling Effect

The specter of FTC enforcement looms large in recent M&A activity. Spirit Airlines' negotiations with JetBlue and Frontier airlines were clouded by potential regulatory concerns. Spirit Airlines' board originally leaned toward Frontier's $2.9 billion offer over JetBlue's higher $3.4 billion offer due to concerns that the FTC would challenge a deal with the larger JetBlue. Frontier and JetBlue modified their offers to include breakup fees, if the deal did not go through. Ultimately, JetBlue gained Spirit's approval with a $3.8 billion offer and a combined $470 million in breakup fees to Spirit and its shareholders if the deal is not consummated for antitrust reasons.

In 2018, defense contractor Northrop Grumman settled with the FTC and completed its $7.8 billion acquisition of Orbital ATK, Inc., the then-direct competitor to Aerojet. Yet, in February 2022, defense contractor Lockheed Martin Corp nixed plans to acquire rocket engine maker Aerojet Rocketdyne for $4.4 billion, just three weeks after the FTC challenged the transaction.

Notably, in a single week in June 2022, two different proposed hospital mergers, RWJBarnabas Health/Saint Peter's and HCA Healthcare/Steward Health Care System, were called off after FTC challenges.

Prior Approval Requirement

Historically, consent decrees relating to merger settlements required notification of certain limited future acquisitions. The FTC has exchanged its long-standing policy of a notification requirement for a prior approval requirement, thus "requiring merging parties subject to a Commission order to obtain prior approval from the FTC before closing any future transaction affecting each relevant market for which a violation was alleged."

The prior approval requirement will restrict the merging parties' deal activity for a minimum of 10 years and will also extend to divestiture buyers for a minimum of 10 years, thereby requiring prior approval for any future sale of the assets they acquire. With this shift to prior approval requirements, merging parties are forced to accept a broad and lengthy approval provision—or otherwise litigate.

The FTC included the new provision in its October 2021 consent decree settling a proposed transaction by DaVita Inc., a dialysis service provider. DaVita is now required to receive prior approval from the FTC for 10 years before any new acquisitions in Utah. The FTC also included the prior approval requirement in two recent oil and gas transactions, EnCap Energy Capital Fund XI, L.P.'s acquisition of EP Energy Corp.'s crude oil production operations in Utah's Uinta Basin and Buckeye Partners, L.P.'s acquisition of 26 light petroleum product terminals from Magellan Midstream Partners, L.P.

While burdensome, grant of prior approval is not out of reach. In February 2022, the FTC announced its first prior approval grant since the policy change. There, the FTC approved Sartorius Stedim Biotech S.A.'s acquisition of Novasep Process SAS in the chromatography technologies sector.

Moreover, merging parties should expect the FTC to require the prior approval provision for geographic markets that go beyond the ones in question. In a June 2022 concurring statement, commissioners Christine S. Wilson and Noah Joshua Phillips emphasized this issue in the proposed consent order settling JAB Consumer Partners SCA SICAR's acquisition of SAGE Veterinary Partners regarding the market for individual specialty veterinary services and emergency veterinary services. The commission alleged three local markets would be affected. Yet, the FTC imposed prior approval across all of California and Texas.

Withdrawal of Vertical Merger Guidelines

Vertical transactions are between firms at different levels in the supply chain. Historically, antitrust enforcement of exceptional vertical mergers was rare and difficult given the previously presumed efficiencies generated by such transactions. Vertical mergers can eliminate double marginalization, in which firms at each level mark up prices above marginal cost. Elimination of one markup can result in lower prices and be pro-competitive.

In September 2021, the FTC withdrew the recently issued vertical merger guidelines issued in 2020. Those guidelines acknowledged certain efficiencies gained through vertical mergers.

In February 2022, two months after an FTC challenge, chip supplier Nvidia abandoned the proposed $40 billion acquisition of UK chip design provider Arm Ltd. The FTC claimed the transaction would "undermine Nvidia's rivals" through Nvidia's control over Arm's essential design technology that rivals use.

Similarly, in February 2022, the DOJ sued to block UnitedHealth Group's $13 billion acquisition of Change Healthcare, a health care technology company with access to broad insurer data. The complaint alleged the acquisition would harm the market for a vital technology used by health insurers by giving UnitedHealth access to competitively sensitive information of its rivals. In April 2022, the merging parties extended their merger agreement, and UnitedHealth included a $650 million breakup fee if the deal is ultimately blocked by the court.

Vertically merging parties need to identify potential FTC concerns that go beyond the elimination of double marginalization. Parties should rely on established jurisprudence relating to vertical transactions to justify proposed transactions.

In January 2022, the FTC requested information in specific areas for guidelines revisions, including:

- Purpose and scope of merger review.
- Presumptions that certain transactions are anticompetitive.
- Use of market definition in analyzing competitive effects.
- Threats to potential and nascent competition.
- Impact of monopsony power, including in labor markets.
- Unique characteristics of digital markets.

Rescinding the Consumer Welfare Standard

In July 2021, the FTC rescinded its policy interpreting its statutory mandate to root out "unfair methods of competition" as coterminous with promoting consumer welfare under the Sherman and Clayton Acts. Merging parties should be prepared for more standalone FTC Section 5 challenges.

Merging parties that would previously been likely to gain approval will now have to consider the FTC's recent challenges, consent decrees, and statements to make an informed evaluation of risk profile. Expect longer review times and increased merger transaction costs.

Narrowing Product Markets

In December 2021, Wilson published a co-written article explaining that narrower market definitions have resulted in more stringent antitrust enforcement. Merging parties should be prepared to justify broader product market definition with persuasive evidence.

Labor Markets Enter Antitrust

Government investigations and private litigation relating to no-poach and wage-fixing agreements are ballooning. Merger investigations now routinely include requests for employee compensation data, inquiries regarding non-compete and non-solicit agreements, and are more likely to delve into both the merger's effects on labor and the parties' prior labor practices. For example, the DOJ's challenge to Penguin Random House LLC's proposed acquisition of Simon & Schuster Inc. focuses on harm to the labor market for authors.

The FTC is reviewing Microsoft Corp.'s $75 billion acquisition of Activision Blizzard Inc. Anticipating regulatory concerns, Microsoft entered into a labor neutrality agreement in June 2022 that will ease Activision employees' ability to communicate and unionize with the Communications Workers of America (CWA). As a result, the CWA has voiced its support for the acquisition.

In a June 2022 response letter to Senator Elizabeth Warren relating to the transaction, FTC Chair Linda M. Khan stated, "[a]lthough antitrust law in recent decades generally has neglected monopsony concerns and harms to workers, I strongly believe that merger investigations must scrutinize the impact on labor markets." In a June 2022 interview, Khan also made clear that the FTC is evaluating a new regulation restricting non-compete clauses.

At least one federal jury has been skeptical of these efforts. The DOJ brought criminal no-poaching conspiracy charges against dialysis provider DaVita Inc. and its former CEO Kent Thiry. In April 2022, a federal jury acquitted DaVita and Thiry on all charges.

<u>Practice Tips</u>:

Merging parties would be wise to do the following:

- Buyers should consider making the absence of a warning letter a condition precedent to closing. Alternatively, parties should make the resolution of the FTC's investigation a condition precedent to closing.

- Buyers looking to close irrespective of a warning letter should evaluate the risks of litigation. Buyers have established jurisprudence to rely on.

- Sellers should negotiate a breakup fee in case the deal does not close due to an FTC or DOJ challenge.

- Merging parties should set lengthier expectations for an expected closing date.

- Merging parties and divestiture buyers should expect a prior approval requirement of a minimum of 10 years as a condition to any settlement. Companies should evaluate the implications of such a prior approval requirement for future growth plans.

- Vertically merging parties need to identify efficiencies beyond the elimination of double marginalization. A vertical buyer should expect heavy regulatory pushback if the seller is an essential service or product that rival companies rely on.

- Merging parties should be prepared to provide policy justifications beyond consumer welfare to the FTC and DOJ that explain the deal's benefits to a community or other interest. Alternatively, merging parties should review the case law to assess the likelihood of a successful trial—consumer welfare remains the foundation of established antitrust case law.

- Merging parties should prepare justifications for their preferred product market definition. Companies in a narrower product market are more likely to face an uphill battle.

- Merging parties should evaluate labor market concerns in the merger. It is worth considering labor concessions the merging parties potentially can make to accommodate FTC or DOJ concerns. A labor neutrality agreement may garner labor support for the deal. Meanwhile, the FTC and DOJ will be skeptical of existing no-poach or non-compete agreements.

- Merging parties should be politically aware and clear-eyed as to how a deal in their specific industry will be viewed by regulators. Certain industries are receiving greater regulatory attention than others.

Merging parties should remain up to date on the plans of the FTC and the DOJ's Antitrust Division. The recently confirmed Democratic majority on the FTC may be the green light to implement Khan's ambitious agenda to reshape antitrust policy and established law. Closing a deal will require companies to be earnest and tactful to navigate the changing landscape of antitrust policy.