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Expanded Merger Review Under the Biden FTC: Implications for Horizontal and Vertical M&A

Application of New Theories Regarding Market Competition and Consumer Harm

WEDNESDAY, FEBRUARY 16, 2022

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today's faculty features:

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K&L GATES

February 16, 2022

Antitrust Earthquake!

What corporate M&A attorneys need to know about recent developments in antitrust merger enforcement under the Biden Administration

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The Rise and Fall of the Chicago School

RISE OF THE "CHICAGO SCHOOL"

- Since the early 1980s, Republican and Democratic antitrust enforcers applied a "consumer welfare" standard to evaluate mergers
  - Big is not necessarily bad
  - Mergers are predominately procompetitive – create efficiencies and facilitate economic growth, innovation, and lower prices
  - Market concentration ***alone*** does not warrant government intrusion
  - Anticompetitive harm consists primarily of higher prices
  - Purposefully excludes any consideration of lost jobs, impact on small businesses, or other populist objectives
- Commonly referred to as the "Chicago School" of antitrust enforcement – championed by University of Chicago professors

"CHICAGO SCHOOL" ENFORCEMENT IN PRACTICE

- Wholly vertical mergers were not challenged, and only rare vertical mergers required contractual remedies to address problems
- Transactions that resulted in five or more market participants were almost *never* investigated or challenged
- Transactions that resulted in four or fewer market participants received investigations and could be challenged
  - *However*, the FTC and DOJ would credit economic arguments demonstrating that merging parties could not profitably increase prices

MERGER LITIGATION UNDER THE "CHICAGO SCHOOL"

- Antitrust enforcers developed successful merger litigation strategies using the Chicago School concepts
- FTC and DOJ ramped up enforcement in the 2010s
  - Regular, successful challenges of health care mergers
  - Successful challenges based on the ability to discriminate against a narrow subset of customers
  - Increased investigations of potential vertical effects
  - Limited increase in vertical merger challenges
    - AT&T/DirecTV (DOJ)
    - Illumina/GRAIL (FTC)
- Regulators remained committed to the core "Chicago School" question . . . *Will the transaction result in increased prices to consumers?*

NUMEROUS LEGISLATIVE PROPOSALS FOR ANTITRUST REFORM

- Standard Merger and Acquisition Reviews Through Equal Rules ("SMARTER") Act (Introduced Oct. 26, 2020)
- Competition and Antitrust Enforcement Reform Act of 2021 ("CALERA") (Introduced Feb. 4, 2021)
- Trust Busting for the Twenty-First Century Act (Introduced Apr. 21, 2021)
- A Stronger Online Economy: Opportunity, Innovation, Choice (Introduced Jun. 11, 2021)
- Open App Markets Act (Introduced Aug. 11, 2021)

THE BIDEN ANTITRUST EARTHQUAKE

- President Biden critical of Chicago School – chaired the 1987 opposition to Robert Bork for the Supreme Court
- White House views the last 40 years of antitrust enforcement as a "failed experiment"
  - Tim Wu – Key Biden antitrust advisor, serves on the National Economic Council, author of *The Curse of Bigness: Antitrust in the New Gilded Age*
  - "[I]n too many American industries there is far too little competition . . . Market consolidation makes it harder for workers to bargain for higher wages or better working conditions. It's harder for consumers in a concentrated market to demand lower prices or better quality."
  - The Chicago School "is very challenging . . . there's a broader view needed that takes into account much more than just the laser-like focus on the prices paid by consumers."
  - "[O]ur administration's revitalization of antitrust, in many ways, marks a return to the traditions of this country."

THE BIDEN ANTITRUST AGENDA

- A confluence of events seems to have created a remarkably aggressive, pro-worker antitrust agenda across the entire executive branch
  - Appointees and antitrust policy advisors all call for an end to the consumer welfare standard
  - Desire to expand focus to impact of mergers on labor, emerging markets, the environment, and social welfare
  - Openly advocate for breaking up industries (e.g., “Big Tech”)

Executive Order

EXECUTIVE ORDER

- Executive Order on Promoting Competition in the American Economy (Jul. 9, 2021)
- States goals
  - “reduce the trend of corporate consolidation”
  - “increase competition”
- Launched 72 initiatives by more than a dozen federal agencies
- Broad scope beyond just M&A

EO: MERGER ENFORCEMENT

- Called on the DOJ and FTC to reconsider both the horizontal and vertical merger guidelines
- Within an hour, Lina Khan, the Chair at the FTC, and Richard Powers, the Acting Assistant Attorney General of the Antitrust Division at DOJ, issued a joint statement that they will undertake a "hard look" at the guidelines
  - Should "reflect current economic realities and empirical learning and that they guide enforcers to review mergers with the skepticism the law demand."
- Encourages challenges to consummated mergers that led to significant market concentration

EO: REPORTS ON COMPETITION

- Multiple agencies received deadlines to submit reports to the White House on the competitive nature of specific markets – presumably to guide further action
  - FTC; DOJ; HHS; DOT; USDA; FCC; FDA; Federal Reserve; FDIC; and Office of the Comptroller of the Currency
- Specific markets identified: large technology firms, consumer finance, airlines, food industries, beer, wine, spirits, labor, defense, prescription drugs, healthcare

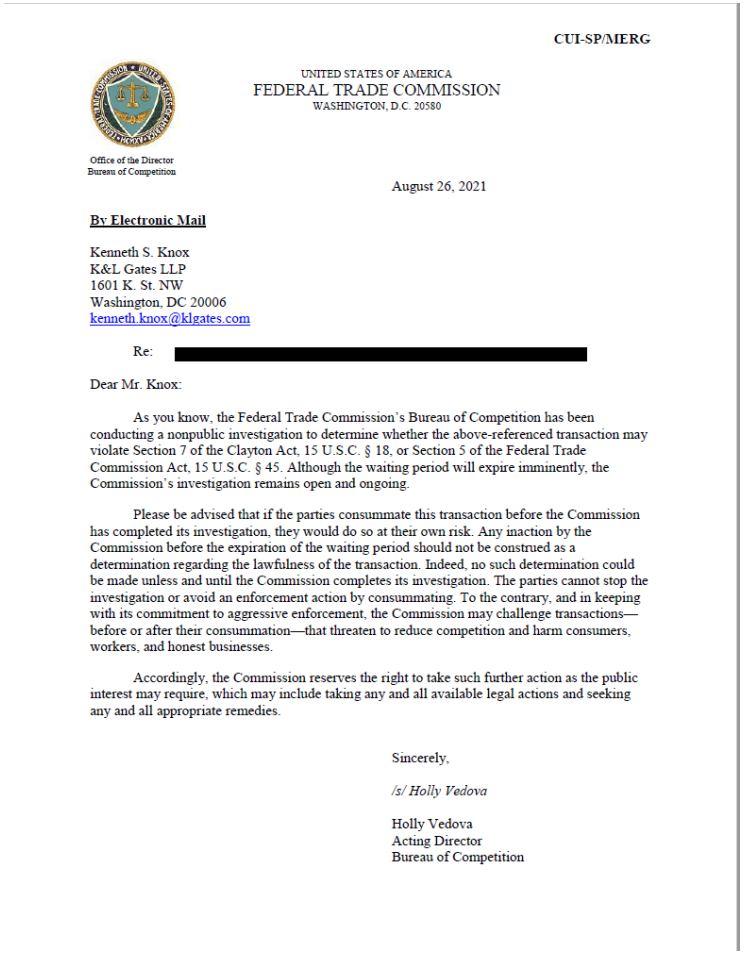
EO: DOMINANT PLATFORMS

- Addresses “dominant technology” firms
  - Firms with the “power to exclude market entrants, extract monopoly profits, and gather intimate personal information that they can exploit to their advantage”
- Greater scrutiny of mergers involving dominant “Big Tech” platforms purchasing nascent competitors (“killer acquisitions”)
  - Focused on “serial offenders” / businesses that accumulate data and compete in “free products”
- Transactions (often $500 million+) in emerging tech markets may present no traditional consumer welfare concerns, but FTC increasingly asks about vertical issues and impact on labor and privacy
  - Antitrust lawyers should scrutinize every technology transactions to see if these issues exist

Recent FTC and DOJ Activity

WARNING LETTERS

- New response from FTC after HSR filings
- FTC has not completed its investigation despite the HSR waiting period expiring
- Parties “close at their own risk”
- No similar letters from DOJ



CUI-SP/MERG

UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

Office of the Director
Bureau of Competition

August 26, 2021

By Electronic Mail

Kenneth S. Knox
K&L Gates LLP
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kenneth.knox@klgates.com

Re: [redacted]

Dear Mr. Knox:

As you know, the Federal Trade Commission's Bureau of Competition has been conducting a nonpublic investigation to determine whether the above-referenced transaction may violate Section 7 of the Clayton Act, 15 U.S.C. § 18, or Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45. Although the waiting period will expire imminently, the Commission's investigation remains open and ongoing.

Please be advised that if the parties consummate this transaction before the Commission has completed its investigation, they would do so at their own risk. Any inaction by the Commission before the expiration of the waiting period should not be construed as a determination regarding the lawfulness of the transaction. Indeed, no such determination could be made unless and until the Commission completes its investigation. The parties cannot stop the investigation or avoid an enforcement action by consummating. To the contrary, and in keeping with its commitment to aggressive enforcement, the Commission may challenge transactions—before or after their consummation—that threaten to reduce competition and harm consumers, workers, and honest businesses.

Accordingly, the Commission reserves the right to take such further action as the public interest may require, which may include taking any and all available legal actions and seeking any and all appropriate remedies.

Sincerely,

/s/ Holly Vedova

Holly Vedova
Acting Director
Bureau of Competition

FTC'S FORMAL PUBLIC POSITION ON THE WARNING LETTERS

Adjusting merger review to deal with the surge in merger filings

By: Holly Vedova, Bureau of Competition | Aug 3, 2021 12:28PM

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Given the recent surge in merger filings, the FTC is reviewing its processes to determine how best to use its limited resources.

- In response to a "tidal wave of merger filings"
- Reiterate FTC's power to investigate transactions even after they close

IMPLICATIONS OF WARNING LETTERS IN PRACTICE

- When does the FTC send Warning Letters?
  - Investigations where parties have otherwise heard nothing from the FTC in the initial 30-day HSR waiting period.
  - Short investigations that appear to have concluded in the initial 30-day waiting period
    - "We don't have any more questions"
- Two schools of thought on Warning Letters
  - Positive: they are a great alternative to issuing Second Requests
  - Negative: excessive regulatory "placeholders" that inject uncertainty

PRACTICAL M&A CONTRACTING CONSIDERATIONS

- M&A contract / HSR risk shifting terms should contemplate receiving a Warning Letter
  - Will the agreement specifically address such a letter?
  - Will a buyer agree to close after receiving such a letter?
- Do the letters *actually* present post-close risk to buyers?
  - In practice, they do not appear to present a realistic increase in post-close investigation risk
  - Risk-averse buyers may fear post-close shareholder derivative lawsuits if the FTC subsequently challenges a transaction that has received a Warning Letter

INCREASED "TIRE KICKING"

- FTC and DOJ appear to be calling about all transactions presenting any horizontal or near-horizontal overlap
- Agencies also appear to be taking more interest in vertical relationships that previously would not have received any inquiry
- Calls do not necessarily mean a Second Request is more likely

"We have not yet opened a formal investigation but we have some questions."

NEW QUESTIONS FROM FTC AND DOJ IN HSR REVIEW

- FTC and DOJ are asking questions that go beyond traditional consumer welfare concerns
  - FTC Chairperson Khan advocates for a “holistic” assessment of a transaction’s effects on independent businesses and workers
  - FTC Staff are asking about mergers’ potential impact on labor markets, privacy, environment, and other social objectives
  - FTC will likely expand to asking additional questions that blur the line of the FTC’s role as an antitrust enforcer with its role as a consumer protection agency

CHANGES TO HSR FILINGS – EARLY TERMINATION

- Until recently, early termination of the HSR waiting period was typically granted by the FTC's Premerger Notification Office (PNO)
- On February 4, 2021, the PNO announced that it was temporarily suspending this practice due to "the transition to the new Administration and … the unprecedented volume of HSR filings for the start of a fiscal year"
- The PNO has shown no inclination to end the suspension

CHANGES TO HSR FILINGS – RETIRED DEBT

- In equity transactions, any debt payoffs have always been deducted from the transaction price
  - Moneys used to pay off debts are not received by the selling shareholders
- On August 26, 2021, the PNO announced that any debt payoffs "should be included in calculating the Acquisition Price in any instance where selling shareholder(s) benefit from the retirement of that debt"
- The PNO has offered no additional insights on which situations require debt payoffs to be included in the transaction value, and which do not

CHANGES TO HSR FILINGS – INFORMAL INTERPRETATIONS

- Historically, the PNO has provided advice to HSR counsel on whether unusual transaction structures and fact patterns are reportable under the HSR Act
  - Many of these are published as “informal interpretations” on the FTC’s website, and are an invaluable research tool for HSR counsel
- On September 15, Commissioner Chopra referred to informal interpretations as “loopholes” and called on the Commission to vote on any interpretations
- The PNO has published no new informal interpretations since June 2021 and is advising clients facing uncertainty to make a HSR filing.

FTC PRECLEARANCE CONDITIONS

- Historically, FTC remedies addressed only competition concerns raised by a particular transaction and did not limit merging parties from engaging in future transactions.
- The FTC now imposes a “preclearance” condition in settlements, giving it veto power over parties’ future transactions even if wholly unrelated to the settlement

WITHDRAWAL OF VERTICAL MERGER GUIDELINES

- FTC voted 3-2 on party lines to withdraw the 2020 Vertical Merger Guidelines
- Republican commissioners have long opposed increased scrutiny of vertical mergers, viewing them as presumptively procompetitive
- DOJ has not yet withdrawn the Vertical Merger Guidelines, but new Division head Jonathan Kanter referred to them as “flawed”

CHANGES TO THE HORIZONTAL MERGER GUIDELINES?

- Democratic FTC commissioners suggested they may vote to withdraw the 2010 Horizontal Merger Guidelines
- Potential changes to the guidelines
  - Removing so-called “efficiencies defense”
  - Lowering the threshold for when a market is “concentrated”
  - Defining anticompetitive effects beyond price – including impact on labor, environment, and other social objectives

ONGOING "BIG TECH" LITIGATION

- *US v. Google* – DOJ suit filed October 2020 challenging monopoly maintenance in the search and search advertising markets
  - Trial set for September 12, 2023
- *FTC v. Facebook* – FTC filed suit to challenge prior acquisitions of Instagram and WhatsApp; filed an amended complaint following June dismissal in federal court
- *FTC v. Nvidia* – Nvidia abandoned $40 billion vertical acquisition of ARM following FTC and foreign challenges
- Ongoing investigations of Apple and Amazon
- Likely investigation of Microsoft's acquisition of Activision

STEPPING INTO THE DEFENSE INDUSTRY

- *FTC v. Lockheed Martin* – FTC voted unanimously to challenge Lockheed Martin's $4.4 billion acquisition of engine-builder Aerojet
- Historically, antitrust agencies deferred to the Department of Defense on transactions affecting the defense sector.
- Investigations raising concerns were resolved with consent decrees imposing behavioral remedies.
- Just this week, Lockheed announced that they abandoned the transaction

Potential Pushback

CONSTITUTIONAL CHALLENGES TO THE FTC

- FTC and DOJ split merger review responsibilities on largely arbitrary grounds
  - DOJ can only challenge mergers in federal court
  - FTC can challenge mergers in an administrative proceeding that it never loses
- *Axon v. FTC* – asserts that disparate treatment of merging parties and FTC's structure violates Fifth Amendment due process
  - Supreme Court granted certiorari – suggests at least four votes to curtail FTC's administrative powers

DISPARATE ENFORCEMENT AT DOJ AND FTC

- Differences between agencies is not unheard of – so-called turf battles are common in government
  - DOJ is not sending warning letters
  - DOJ did not affirmatively withdraw the vertical merger guidelines, but has stated that it continues to review the vertical *and* horizontal guidelines
- Statements by the recently appointed head of the Division, Jonathan Kanter, suggest DOJ will follow its own aggressive path

Surviving the Earthquake

CONSIDER RETAINING ANTITRUST COUNSEL ON A BROAD RANGE OF TRANSACTIONS

- Clients have historically had a good understanding of when transactions raise competition concerns under the traditional consumer welfare model
  - What antitrust agencies may now consider competitive harm appears to change by the month
  - Clients now require both an assessment under traditional standards and under the FTC and DOJ's latest theories
- Parties should prepare for some agency engagement on almost any transactions with some horizontal overlap
- Advanced preparation to educate the agencies about your business and industry is now more important than ever

THE END OF "FILE AND DUCK"

- Traditionally, most merger control lawyers advised against proactive communication with the agencies after a filing
  - A strategy of "let them call us" would frequently result in no interaction and closing within 30 days
- Now two strong reasons to consider pro-active communications
  - Large number of filings – contacting agencies could get their attention sooner
  - Agencies are looking at everything anyway

DO NOT ASSUME A TRANSACTION IS TOO SMALL

- The FTC and DOJ, as well as state attorneys general, can review transactions that do not meet the HSR filing threshold
  - The FTC has regional offices that may take an interest in small transactions affecting regional, state, or smaller geographic areas, and Chairperson Khan is re-activating offices that have been closed since the 1980s
  - Washington State has a statute requiring filings for health care transactions
- Under the Biden EO, FTC and DOJ are encouraged to review acquisitions of “nascent” competitors

NO REASON TO PANIC…. AT LEAST NOT YET

- Despite the increased scrutiny, FTC and DOJ can only challenge or block transactions based on established precedent
- Enforcement to date in line with historical precedent
  - No court challenges yet on novel theories
  - No Second Requests where no traditional horizontal or vertical concerns existed
- An unexpected call after the HSR filing does not mean a Second Request or challenge is coming

Plan ahead – Call your lawyers – Avoid becoming a test case

DUE DILIGENCE CONSIDERATIONS

- Increased antitrust enforcement at all levels of the government
- Avoid potentially problematic sharing of competitively sensitive information – or even the appearance!
- Precautionary tips:
  - Make sure your corporate team is sensitive to antitrust issues
  - Do's & Don'ts Guidelines
  - Clean Team
  - Agendas for DD meetings and consider using counsel to help monitor particularly sensitive topics/meetings

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