Title: Managing and Mitigating Antitrust Risk in Transactions.

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Overview

- How will I know if the transaction will draw antitrust scrutiny?
- How can I value the deal? – Managing Due Diligence
- Negotiating the contract
- No mingling until consummated – managing integration planning
Assessing the Risk
Determining Antitrust Risk

- Not every deal presents meaningful antitrust risk
- But if it does the risk will impact the management of the transaction from timing, contract negotiation to document exchanges
- Risk analysis can change based on the current enforcement environment and changes in the marketplace (Staples/Office Depot challenged in 1997, Office Depot/Office Max 2013 cleared – Staples/Office Depot 2015?)
Characteristics of Antitrust Risk (1)

- Insufficient Number of Significant Competitors
  - Not just a monopoly
    - Leaving only 1 or 2 other players in a space can cause concern
  - Smaller players may not be credited, if can’t meet customer needs

- Close Competitors
  - Even if there are other players in the space, if the parties are each other closest competitors, the deal may draw scrutiny

- Maverick
  - If one of the parties is an aggressive price-cutter or innovator
Characteristics of Antitrust Risk (2)

- **Enhancement of Market Power**
  - Even if there are several significant competitors, the creation of a “behemoth” can cause concern

- **Strong Customer Complaints**
  - Less important in Court, but an unhappy customer can cause delay
  - Customer relations and attractive terms can soften the blow
Characteristics of Antitrust Risk (3)

• Hot Documents
  – Predicting price increases and other unhelpful statements can be hard to overcome

• Niche Markets
  – Technology

• High Concentration in Localized Geographic Area
  – Supermarkets
  – Banking
Other Risk Factors

- Bad reputation at the agencies
- Angry competitors who want to create problems
  - Ultimately a competitor is not as credible as a customer, but they can cause problems
- Hot industry
  - Pharmaceutical deals are of special interest to the FTC which is focused on lowering healthcare costs
  - Hospital mergers where the geographic market may have limited choices
Preliminary Tools to Determine Risk

- Deal documents
  - Can identify potential issues
  - Can greatly impact the outcome
- SEC filings
  - Are the parties mentioned as competitors in the 10-K?
- Press Coverage
- Client Interviews
- Websites
  - Incredibly important for Private Equity to assess the risk of all portfolio companies
Information Sharing
Limits to Sharing Information

• Enforcement agencies recognize need for sharing some information
  – Due diligence for valuation
  – Transition planning for operating the acquired business immediately after closing

• But there are limits – cannot:
  – Exchange competitively sensitive information pre-closing
  – Transfer effective operational control of seller to buyer
The Legal Risks

- The laws
  - Clayton Act – HSR gun jumping
  - Sherman Act – Section 1 violation
- All reportable transactions subject to gun jumping concerns
- Section 1 violations only a concern where buyer and target compete
- Either may apply
  - Violate HSR Act only if parties don’t compete
  - Violate §1 only where filing not required
Enforcement

• Sherman Act always a concern
  – Sharing of information – what if deal doesn’t go through?
• HSR gun-jumping – recent hi-profile cases
• But cases deal with egregious conduct – close calls are more difficult to counsel
• Also note – similar concerns over gun jumping in many foreign jurisdictions
Due Diligence
Competitively Sensitive Information

- How can information be shared
  - Must have deal-related rationale
  - Can only be used in evaluating the deal
  - Can only be shared with people in those capacities
Consider Safeguards

- Limit collection, exchange and distribution of competitively sensitive information to “clean teams”
- Use a third party (e.g., consulting firm, outside counsel) to review, assess and aggregate competitively sensitive information
- Have outside counsel review competitively sensitive contracts and redact competitive terms (price, contract terms, etc.)
Consider Safeguards

• Consider confidentiality agreement
  – Existing NDA may not cover antitrust issues
• Conduct due diligence in phases, as needed
• Clean team should be made up of people without day-to-day business and operational responsibility
  – Especially with regard to pricing, marketing responsibilities
• Set up firewalls
• Educate the due diligence team
Okay to Share

- Current and projected sales revenues, costs, and profits by broad product categories
- Descriptions of current products, manufacturing operations, distribution assets
- Real estate, leases, general business activities
- HR information (practices and procedures, but not specific salary information)
- Most financial statement information (balance sheets, income statements, tax returns)
- IT information
Not Okay to Share

• Prices and deal terms (including bidding, discounts, credit terms, reductions or rebates),
• Product-specific information on significant costs, margins, or profitability
• Production capacities, planned investments/ expansion plans, R&D programs, new products in pipeline (to the extent such information would not otherwise be known)
• Specific customer information, sales figures broken down by customer (but okay anonymously or aggregated)
Simple Test

• Would the business people be happy with the acquiring company having the shared information if the deal did not go through?
Negotiating the Contract
What Do you Want? Seller

- As a Seller you want the Buyer to do everything to get the deal done
- But you don’t want to wait forever to get paid
  - Distraction to business while waiting
  - Potentially stuck in tough negotiation stances with customer
- If the deal doesn’t get done
  - No guarantee that can find another buyer
  - Or a good price
    - Distraction to business hurts value
    - Market smells desperation
What Do you Want? Buyer

- Want to do the deal fast and preserve value
  - Lengthy review distracts business and customer relation campaign can lead to unfavorable terms
  - Divestitures can eat away at deal value and synergies
  - Litigation/review can take a long time – may be better to cut your losses and pursue other opportunities
What’s Your Leverage?

- In demand Targets can force Buyers to take on greater risk
- Desperate Sellers may not be able to force the Buyer to take on the risk
- Can use the SEC and HSR rules to force an agency decision
$ Store Deal

- Family Dollar war started with the adoption of a poison pill to limit activist investors
- Family Dollar sells its merchandise at $10 or less
- Family Dollar agreed to a deal with Dollar Tree, who sells its merchandise at $1 or less
  - $8.5 BN
  - Tree has agreed to a limited amount of divestitures to get the deal done
In Swoops The General

• Dollar General, also sells its merchandise at $10 or less and wants to buy Family to better compete with Walmart
  – Offered more money ($9.1 BN) and to pay the traditional break fee for the Tree/Family deal
  – Potentially insufficient divestiture commitment

• Commences a Tender Offer, pushing both deals before the FTC
  – State AG offices also expressed interest
$ Outcome

- Dollar Tree threatened to pull its offer
- Family Dollar puts the Dollar Tree offer to a shareholder vote
  - Approved
- The Dollar General deal is no longer in the mix
- BUT
  - FTC still needs to approve the deal
  - Number of divestitures are up in the air
No Contract!

• If antitrust clearance is a sticking point and quite uncertain then you can file HSR on the basis of an LOI
  – No obligation to do anything
    • Allows you to test the waters
    • But if things go badly with the agencies, then there is no contractual provisions keeping the deal together
  – Contract be negotiated simultaneously
  – Depending on other conditions, upon clearance can do a sign and close
Hell-or-High-Water

- The Holy Grail for Sellers – Buyer takes all the risk
- Agrees to make any divestiture or to litigate until out of options
- Can hurt deal value if a significant divestiture is required (e.g. Buyer ends up having to divest its entire competing business, making the deal an expensive trade)
- Litigating can take a lot of time
Modified HOHW

• Parties agree to limits on divestitures and litigation remedies.
  – Limits can be specific (e.g. factory names, or # of locations)
  – Can also be more general (e.g. up to $60MM of revenues)
• If the offer is insufficient, the deal may be doomed
Drop Dead Date

- Sets an upper limit on when clearance must be achieved by
- Must be sufficiently long to allow the parties to effectively deal with the agencies
- Depending on the industry 6-12 months should be the minimum
- Can negate the effectiveness of a HOHW, if the time is not long enough to allow for a properly vetted remedy
- Likely limits litigation
- Gives the parties greater certainty of timing
Reverse Break Fee

• Buyer pays a certain amount of money to the Seller to compensate them for the deal not closing by the Drop Dead Date
• Purpose is to encourage the Buyer to agree to divestitures and get the deal cleared
• Rarely paid, but see ATT/T-Mobile, where a reverse break fee of $6 BN was paid (combination of cash and spectrum rights)
What’s The Range?

- Break fees are intimately tied to the risk assessment and negotiation leverage of the parties
- As small as 0.1% and as high as almost 40%
- Average is around 4-5%
Integration Planning
Phases and Risks

- Before HSR clearance, risks are greatest
  - HSR gun jumping (where deal is reportable)
  - Sherman Act (where parties are competitors)
- After HSR clearance
  - Sherman Act risks remain for competitors
Entities Must Remain Separate

- Continue to treat acquisition target as a separate entity until the transaction closes
  - Target business must run separately
  - Must make independent business decisions
- Higher standard for competitors
  - Continue to treat target as a competitor
- Planning decisions should not be implemented until closing
Deal Terms

• Deal terms may prohibit target from taking actions outside the ordinary course of business without buyer’s permission – important to preserve what is being acquired
  – For example, divest assets, enter into contracts over a certain dollar value

• But may NOT
  – Require approval for contract terms, customer discounts
  – Limit customers who may be approached, participation in business dev’ment activities
Integration – Do’s

- Form transition teams
- Plan the combined company’s post-merger organizational structure
- Explain employee benefits
- Interview employees and assess their qualifications for positions with the combined company
- Conduct transition team meetings for post-closing operational planning
Integration – Do’s

• Discuss financial and tax issues that do not include competitively-sensitive information
• Discuss regulatory compliance
• Discuss valuations of assets
• Determine technology capabilities and synergies in general product lines
• Jointly project overall profitability of the total combined company (not by product line)
Integration – Don’ts

• Do not implement any joint pricing, promotions, expansion plans, or other competitive practices, decisions or strategies

• Do not participate in or influence the other party’s day-to-day, ordinary-course business activities (includes making decisions jointly on business operations, conducting joint sales calls, or acting as another party’s agent)

• Do not implement integration plans or merge operations or assets
Integration – Don’ts

• Do not become involved in day-to-day operation decisions of each other’s operations;
• Do not take control or possession of any assets or business of the other firm;
• Do not hold out the employees of the target as employees of the buyer to customers.
• Do not relocate employees or have the employees of one firm report to employees of the other
Communications

- May “sell the transaction” but not the product/service
  - Okay to jointly meet with customers/suppliers to explain the transaction
  - But NOT okay to make joint sales calls
- Applies to suppliers, too
- Avoid joint statements about market share predictions, pricing policies, competitive strategies, customer/supplier relationships
- Best to limit to high level execs (not salespeople)
Remember – Deals Can Fall Apart

• Flakeboard – 2014 planned acquisition of assets of SierraPine, both particle board/fiber board manufacturers

• During negotiations, FB required SP to close a mill, although not before antitrust rules allowed

• But due to a labor dispute at the mill, the parties agreed to close it earlier
  – Before DOJ investigation ended and HSR hurdle cleared

• DOJ had objections; parties abandoned the deal
Deals Fall Apart

• Parties also agreed to transition customers from the closed mill to FB
  – SP gave FB competitively sensitive info about the mill’s customers
  – SP instructed sales people to direct customers to FB

• Result
  – Gun-jumping – $3.8 million penalty
  – Sherman Act violation - $1.15 million in disgorgement (forfeiture of illegally gained profits)
But Cases Usually Not Egregious

- *Omnicare* – 2011 Seventh Circuit decision affirming advice on bounds of lawful info exchange
- Information may be shared where reasonable and necessary to achieve the legitimate objectives of the merging firms
- But negative covenants in merger agreement kept case from being dismissed at outset
  - Contract liability of $3 million or more without buyer’s approval
QUESTIONS?