The Deal
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SMALL DEALS SPURRING BIG ANTITRUST PROBLEMS?

Managing Risk that Deals Too Small to Be "HSR"-Reportable Could Still Trigger an Antitrust Investigation

BY MICHAEL W. JAHNKE, DANIEL FERREL MCINNIS AND MARK R. BUTSCHA, JR.

Companies entering into M&A deals often believe that if the deal value is small enough to escape the mandatory reporting threshold of the Hart-Scott-Rodino Act (HSR)—currently $75.9 million—they are in a safe harbor, free from scrutiny by U.S. antitrust regulators. There is no safe harbor. Enforcement data released in 2014 demonstrates that increasingly, low-value deals as small as $5 million can carry substantial enforcement risks, including potential unwinding. This article examines this trend and suggests tips for when a closer look at antitrust risk may be warranted in deal due diligence.

HSR, enacted in the late 1970s, created a process that empowers antitrust regulators to investigate deals before closing. The problem HSR addressed was that anticompetitive deals were being consummated before either the Federal Trade Commission (FTC) or the Antitrust Division of the Department of Justice (DoJ) ("the Agencies") knew of the deals or could act. The only remedy was post-consummation litigation that sought to "unscramble the egg" by requiring the parties to split up already-integrated assets to restore pre-transaction competitive dynamics. Such litigation was difficult, costly and hardly timely.

HSR addresses this problem by requiring a filing for certain deals and imposing a minimum 30-day "waiting period," during which closing the deal is prohibited pending agency review. If there are no obvious concerns, this period may be shortened by so-called "early termination." On the other hand, if a reviewing agency has substantive concerns that are not resolved during the initial 30-day waiting period, then it will either (1) allow the parties to "pull and refile" their submissions to restart the initial 30-day waiting period, or (2) issue a so-called "second request" for information. A second request is an extensive discovery request that requires a lengthy open-ended period of time (rarely shorter than three months) for the parties to reach "substantial compliance," triggering another 30-day waiting period.

The HSR filing requirement is triggered only if the value of the voting securities or assets of the target that will be held by the buyer after closing reaches $75.9 million (absent an exemption). This threshold is known as the "size of transaction" test, which adjusts annually for inflation, rising only $25.9 million from a base of $50 million over the last decade.

HSR enforcement data does not report the universe of all non-reportable deals, but such deals are certainly numerous and may even be increasing relative to reportable deals. For example, from 2012 to 2013, transactions in one of the largest HSR categories—$500 million to $1 billion—jumped 31%, while reportable deals in smaller categories all declined. This does not, of course, mean that fewer small deals occurred; just that more of them may have "flown under the radar" of HSR. If we assume that the overall number of small deals has not been declining, then more non-reportable deals are occurring and risk investigations. This trend may well be the explanation for the DoJ's decision to release data in 2014.

As HSR has become more ensconced in the regulatory framework to which M&A business people and their lawyers are accustomed, an unintended consequence emerged: dealmakers tend to equate the presence of some degree of antitrust risk, however small in a given transaction, with the need to make a HSR filing. This is not to say that sophisticated dealmakers believe all filed transactions bear substantive risk, but perhaps that only filed transactions do—or at least that non-reportable deals are treated relatively nonchalantly.

In practice, deals where the valuation likely exceeds $75.9 million tend to trigger involvement of antitrust specialists, whether inside the company or external, who in turn help the parties evaluate the need to file and the risk of delays associated with a filing, i.e., that the Agencies will issue a second request. Conversely, deals valued below $75.9 million, or qualifying for one of a number of exemptions from HSR, tend to be viewed as not necessitating antitrust review.

Of course, rational business organizations will deploy resources more often in deals subject to mandatory regulatory scrutiny than in those that fall outside it. But this approach goes too far when it results in deals with red flags being ignored just because HSR is not required.

HSR is, after all, a relatively young procedural counterpart to the substantive standard for antitrust review—Section 7 of the Clayton Act, which is celebrating its centennial this year. Section 7 has always set the substantive standard for antitrust review: whether the effect of a transaction "may be substantially to lessen competition, or to tend to create a monopoly." Nothing in HSR's history has ever suggested that it sets a new bar for Clayton Act enforcement; to the contrary, antitrust observers have long noted deals of relatively small size being investigated by the Agencies.

Yet it was nevertheless surprising to many when, earlier this year, DoJ for the first time released data confirming how frequently DoJ has devoted substantial investigatory resources to non-reportable deals. In a speech entitled "Non-reportable Transactions and Antitrust Enforcement" given on April 25, 2014, DoJ's Leslie Overton, Deputy Assistant Attorney General for Civil Enforcement, made a number of key points:

• There is no "safe harbor" for non-reportable deals.
• DoJ actively looks for non-reportable deals that may raise issues, scouring the press and trade publications and listening to customer and competitor complaints.
• Investigations of non-reportable deals are not isolated occurrences—from 2009 to 2013, one in five of all merger investigations was for a nonreportable deal.
• Investigations of non-reportable deals are serious—more than one in four resulted in a challenge.
• There is no de minimis threshold for deal size—the challenge in U.S. vs. Election Systems and Software, Inc., involved a deal valued at only $5 million.
• Challenges often include consummated deals. In other words, the outcome that HSR was designed to avoid—having to "unscramble" a consummated transaction—remains a major risk factor.

While the released data only addressed DoJ's recent enforcement efforts, there is no reason to believe that the FTC would be any less zealous in its enforcement efforts.

The DoJ's and the FTC's nonreportable deal investigations can be lengthy. In the Bazaarvoice/ PowerReviews matter, DoJ launched an investigation two days after closing, which led to a trial approximately seven months later and a settlement nearly two years later. Similarly, in the Heraeus Electro-Nite/Minco acquisition, DoJ reported learning of the transaction shortly after it was completed, with the resulting investigation leading to a consent judgment approximately 16 months later.

So, to sum up the risk, at minimum, an investigation of a nonreportable deal can create major distraction and expense. At worst, the Agencies could challenge or even seek to unwind a done deal. On these grounds, it is best to consider whether there are red flags that may trigger agency review in any transaction, not just those requiring HSR.

Traditionally, the likelihood of a deal being investigated is enhanced when the parties are among a relatively small number of competitors in properly defined product and geographic "markets." This risk is exacerbated if there are (a) likely customer complaints, (b) so-called "barriers to entry," and/or (c) "hot" documents or similarly inflammatory public statements demonstrating potential anticompetitive harm, such as discussions of the importance of eliminating a competitor, achieving market dominance, allowing for higher prices, reducing innovation/ R&D spend, or other exercises of "market power."

These factors remain central to analysis of nonreportable deals as well; customer complaints apparently triggered the Heraeus/ Minco investigation, and Microsemi's announcement of proposed price increases "in the low teens" (to federal customers DoD and NASA, no less) clearly influenced that investigation.

Based on the nonreportable deal investigations uncovered in recent years, however, there are at least four additional red flags now worthy of consideration by dealmakers:

1. The deal effects a consolidation of players in an industry that has been the focus of recent regulatory action, such as pharmaceuticals, health care, technology/patents or energy.
2. The deal results in highly localized harm, such as diminished competition in a particular region of the country in a non-national marketplace.
3. The deal affects narrow product markets, such as the election machines at issue in the $5 million Election Systems and Software, Inc. transaction.
4. The deal involves so-called "key inputs," such as the "single-use sensors and instruments, which are essential to the manufacture of millions of tons of steel annually," or semiconductor devices used by DoD and NASA "for programs essential to our nation's security, including many of 'the largest and most complex military applications ever designed, ranging from satellites to submarines.'"

At minimum, the presence of red flags provides cause to consider possible enforcement interest and delays to deal timing and investigational expense. Whether those red flags are sufficiently serious to warrant a full analysis, or even voluntarily engaging the Agencies, is a far more difficult and fact-specific question. But it is a question that dealmakers ignore at their peril.

Michael W. Jahnke and Daniel Ferrel McInnis are partners at Thompson Hine LLP in the firm's Antitrust, Competition & Distribution practice and Mark R. Butscha, Jr. is an associate.

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