

**Antitrust Modernization Commission
Assessment of U.S. Merger Enforcement Policy
Hart-Scott-Rodino Second Request Process**

**Statement of
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November 17, 2005

Summary

The second request process is a flawed aspect of a generally admirable U.S. merger enforcement system. The costs and burdens of second request compliance exceed the benefits to the government's enforcement mission, and they are increasing, mainly due to greater information storage capacities within businesses and to increased government requests for transactional data. The antitrust agencies can readily accomplish meaningful reforms without the need for legislation, and they have indicated an intention to do so. The Modernization Commission should encourage these reforms, and the business community and antitrust bar should help implement them.

The most pressing need is to reduce the volume of documents that must be collected, reviewed and produced in response to second requests. The agencies should do this primarily by reducing and capping the number of individuals whose documents must be produced, and limiting the time period covered by the second request. Any deviations from these limits should be confined to extraordinary circumstances, should be staff's burden to seek, should be authorized at the highest levels of the agencies, and should be communicated personally to the parties' representatives. Information about how the reforms are being implemented should be made public. Concerns about implementation in specific cases – such as parties' failure to provide accurate information – should be dealt with using existing means, and should not prevent reforms from being adopted. These steps will substantially reduce the second request compliance burden while providing the agencies with the information they need to do their jobs.

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Statement

Thank you for the opportunity to appear today to discuss the second request process.

There are many aspects of U.S. merger enforcement that other countries would do well to emulate. The Federal Trade Commission and the Antitrust Division of the Department of Justice are staffed with skilled antitrust lawyers and economists; they apply an economically sensible analysis; and they operate under procedural rules that are, in the main, fundamentally fair. The FTC's premerger staff serves the public well by providing timely and reliable guidance on complicated filing issues under the Hart-Scott-Rodino Act and regulations. There are some problems – for example, too often the inter-agency clearance process bogs down and the FTC and DOJ spend days or weeks arguing over which of them will review a particular deal rather than conducting the review itself. I agree with calls for this Commission to support a new effort to reform the inter-agency clearance process along the lines of the aborted inter-agency agreement in 2002.² Usually, however, the agencies use the HSR Act's initial 30-day review period effectively, clearing the vast majority of reported transactions within that window.³ So while there are aspects of the U.S. merger enforcement process that can be improved, most of these issues are more about adjusting an already effective system than about addressing major flaws.

² See, e.g., Testimony of Michael N. Sohn before the Antitrust Modernization Commission, October 24, 2005, at 6-7; Comments of the Business Roundtable Regarding the Issues Selected for Study by the Antitrust Modernization Commission, November 4, 2005, at 12-13 (“Roundtable Comments”).

³ The agencies have also worked with merging parties and their counsel to add some flexibility to the HSR Act's strict deadlines, such as the practice under which parties withdraw and resubmit their filings to restart the initial 30 day waiting period in cases when the agency is unable to complete its review in that initial period, but believes it may be able to do so within the additional 30 days.

The second request process, however, is in need of significant reform. The cost, delay and disruption to business operations associated with a typical second request are disproportionate to the benefits to the government's enforcement mission, and they are increasing. Those costs and burdens can be reduced substantially without impairing the government's ability to do its job. In addition, excessive agency demands for documents and information can do significant, if unquantifiable, harm to the government's mission to the extent that they undermine respect for the HSR process. It is not uncommon for business executives who have gone through a merger investigation to come away impressed with the quality of the agency's analysis and with the skill of the its staff. The second request process does not provoke similar feelings. Business people are realists, and one reality is that the government is entitled to take a close look at mergers that raise antitrust issues. But the second request process as it exists today is not efficient, as becomes clear to all who come into contact with it.

The good news is that meaningful reform is not difficult to accomplish. There are simple ways for the agencies to address the most glaring problem – the volume of documents and information required by second requests – while still fully performing their duties to make informed enforcement decisions and prepare for possible litigation. And the agencies have the ability to do this themselves, without the need for legislation.

Previous efforts to reduce second request burdens have been incremental and largely ineffective. I know this both from having participated in some of

these unsuccessful efforts while at the FTC, and from having operated under the system in the private sector. The current leaders at the FTC and DOJ have an opportunity to do it right. The Antitrust Modernization Commission should encourage this effort, and the bar and the business community should prepare to help implement reforms in good faith. We should not lose this opportunity to improve an inefficient aspect of an otherwise admirable merger review system.

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Criticism of the second request process often begins with the observation that when the Hart-Scott-Rodino Act was passed in 1976, Congress envisioned that the Act would give the FTC and DOJ authority to review the 150 largest transactions each year, and that requests for additional information would be limited to information that is “readily available to the merging parties.”⁴ In application, however, the Act encompasses many more transactions, resulting in thousands of filings each year even after statutory amendments in 2000 raised the basic filing threshold from \$15 million to \$50 million and indexed the threshold to inflation. And second requests quickly came became the equivalent of very broad civil discovery demands, requiring the production of “all documents” located anywhere in the world that relate to a wide array of subjects.

Why second requests expanded far beyond Congress’s original intent is, in some respects, understandable. From the perspective of the agency charged with investigating a complex transaction under strict statutory deadlines, it is easy to take the view that more is better when it comes to obtaining information. A decision to limit the request seems to pose risks (I may miss something

⁴ See Roundtable Comments at 12-13.

important, I may want this later for litigation, I may be second-guessed by my supervisors) without, from the government's perspective, much apparent downside. Most of the costs are borne by the parties. No judicial intervention is required to enforce the request, and in practice the government faces little risk that the parties will litigate over second request issues. Nor is there any real reward for forbearance, other than the occasional thanks of a grateful party.

From the merging parties' perspective, the costs of complying with a second request in terms of time, money and disruption are enormous. But a realistic cost-benefit analysis almost always indicates that the most effective route to accomplishing the parties' goal of timely deal clearance is simply to seek whatever limitations on the second request that the agency will grant, and then comply, rather than litigating whether the second request is legitimate or what constitutes "substantial compliance." The delays alone, to say nothing of the costs, usually are enough to make litigation infeasible when the ultimate goal is to consummate the transaction as soon as possible.⁵

With all its flaws, and despite several efforts in the past to improve it, the second request process has continued in basically its current form for years. But for a couple of recent developments, there might have been little reason to expect things to change. A few years ago, it was still possible to think of \$1 million as a reasonable starting point for the direct cost of complying with a

⁵ The aborted litigation over second request issues earlier this year related to the proposed Blockbuster/Hollywood Video transaction arguably illustrates some of these complexities. At some point, the circumstances of a particular case could make such litigation feasible for the parties. If and when that happens, the government will face a significant programmatic risk, since the first real judicial review of how the agencies implement the second request provisions of the HSR Act could conceivably force significant changes.

second request, and to expect to produce a few hundred boxes of documents and a couple of binders of narrative interrogatory responses. Those days are gone. Antitrust lawyers often tell their clients who are new to the process that they have no idea what they are in for when they get a second request. Now, even businesses that have complied with a second request before may be in for a surprise when they deal with one today. Second request responses have transmogrified into even more massive efforts that typically entail several million dollars in direct costs, and result in the collection, review and production of not hundreds but thousands of boxes of documents (or their electronic equivalent) as well as complex and costly data responses.

There are at least two reasons for this recent increase in the already substantial burden of a second request response, one technological and one analytical. The technological driver is the increasing capacity of computers and IT systems. Old rules of thumb about the number of documents likely to be produced per individual are obsolete, replaced by new assumptions that may be ten times greater. This results in increasingly massive document productions even when the scope of the request and the number of people searched is held constant. The analytical driver might be termed the *Oracle* (or the *Staples*) problem.⁶ As the agencies and parties, and in turn the courts, rely more heavily on econometric analysis of business data to assess a merger's likely competitive effects, the demands for such data in merger investigations are increasing. The data issue is also a technological one – as companies are able to collect more

⁶ *United States v. Oracle Corp.*, 331 F. Supp 2d 1098 (N.D. Cal. 2004); *FTC v. Staples, Inc.*, 970 F. Supp. 1066 (D.D.C. 1997).

data for business purposes, there is more information available for the government to request.

It is also important to keep in mind that many transactions are subject to merger reviews in numerous countries, so the burden associated with a U.S. merger investigation is only part of the story. The number of countries in which even moderate-sized deals often must be notified, and the cost and time involved in completing these multi-jurisdictional reviews, is substantial and growing.⁷ The U.S. antitrust agencies have been strong advocates for efficient merger review processes abroad, both in bilateral discussions with enforcers abroad and in multilateral forums like the International Competition Network. This advocacy is more likely to be persuasive to the extent that the U.S. merger review system itself is efficient, and to the extent that the U.S. agencies are perceived as willing to tackle problems with their own system.

The time is right for second request reform. The agencies have indicated that they recognize this, and they have raised expectations in the antitrust community that they intend to do something “real” this time. Whether this is prompted in part by the agencies’ own difficulties in handling the enormous document and data productions they receive is beside the point – if true, it would simply confirm that there is a shared interest in making changes.

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⁷ See, e.g., PriceWaterhouseCoopers, *A Tax on mergers? Surveying the time and costs to business of multi-jurisdictional merger reviews* (June 3, 2003) (study commissioned by the International Bar Association and the American Bar Association). The data reported in that survey arguably is already obsolete.

Here are some elements of an approach to second request reform that could be accomplished quickly, without the need for legislation,⁸ and without impairing the government's ability to do its job under the HSR Act.

The most pressing need is to reduce the sheer volume of documents that must be collected, reviewed and produced in response to a second request. This is also one of the easiest problems to address. Document volume is a function of several things, including the substantive scope of the request; the time period covered; the number of people subject to the search; and the number responsive of documents each person has. Of these, the substantive scope of the request matters, but relatively less than other factors, because much of the cost is incurred once a person's files must be collected and reviewed at all. The number of documents each person has varies, of course, but as noted earlier this variable is rapidly increasing across the board as data storage capabilities grow. The time horizon is important, because document collection can (especially with electronic documents) more readily be limited to documents created during a specific time period.

The number of people who are subject to the search is critical: there is a strong correlation between this number and the time, cost, burden and volume of documents produced. The issue is not merely how many thousands of boxes of documents are shipped to the agencies, but the substantial costs associated with

⁸ There is nothing inherently wrong with a legislative approach to merger process reform, but non-legislative approaches have several advantages. They can be adopted more quickly; and they avoid the "Pandora's Box" issue – once the HSR Act is reopened for major reforms, the process becomes subject to all sorts of proposals, not all of which would necessarily be improvements.

extracting documents from the people concerned and then having them reviewed by legal professionals for responsiveness, substance and privilege.

The agencies routinely negotiate the number and identity of people within each party to the merger whose documents must be produced in response to a second request. These negotiations usually result in scores and sometimes even hundreds of these “file owners” or “custodians” being covered. Yet many of the thousands of boxes produced under these broad requirements often go unopened, and documents unread. I believe a candid internal assessment by the agencies would reveal that in the vast majority of merger investigations, the agencies actually rely on documents from a much smaller group of people, and that those people can readily be identified up front – senior business leaders, people who were closely involved in planning the transaction, people in functions that are relevant in the context of the particular deal. Decades of experience with second requests have given the agencies the ability to hone in on a much smaller group of people who are likely to have relevant documents.

This learning can be used to narrow second requests and the burdens they impose. The agencies can require documents from a much smaller number of people from each company – more on the order of 20-25 than the 80-100 or more people who often are covered today – and still obtain the information that they actually tend to use in practice.

The other parameter that greatly affects the volume of second request productions is the time period covered by the request. The agencies’ model second request uses a three-year period, but the agencies frequently expand this

in practice. A two-year period that is rigorously adhered to would significantly reduce the number of documents that must be collected, reviewed and produced – again, without adversely affecting the agencies’ work.

If we leave aside entirely the debate about the role that “hot docs” should play in merger analysis, and assume for the sake of this discussion that documents sometimes play a legitimate role in agency decisionmaking (and undeniably play a role in litigation), it would still be clear that the agencies do not need the volume of documents they now obtain in order to make well-informed enforcement decisions and to begin the process of preparing for possible litigation.

There are other specific aspects of the second request process that need to be addressed as well, focusing on changes to the agencies’ model second requests. I believe the agencies are giving these other issues a serious look, with input from the ABA and others. I do not mean to minimize the importance of addressing these issues, but they may be more in the nature of the incremental changes made in previous reform efforts. The compelling need is to break the back of the sheer volume of material that companies must produce.

I believe the FTC and DOJ should establish across-the-board caps on the number of file owners from each company whose documents must be reviewed and produced, and limit the timeframe for responsive documents, along the lines I have described. This would not be difficult to implement. It would require the same type of preliminary discussions between the agencies and the parties that occur now in negotiations over the scope of the second request – the parties

provide organizational charts and other information on individuals who are most likely to have responsive documents, and the agency identifies which individuals it wants to include. The difference is that significantly fewer people would be included, and a shorter time frame would be used.

One question that might be raised about such an approach is whether the agencies can count on obtaining the cooperation from the parties that would be needed to make it work. FTC Chairman Majoras noted in a speech last summer that she is committed to instituting reforms to make the merger review process more efficient and effective, but she pointed to “the unproductive and unprofessional conduct of some members of our bar or their clients” and said that “if we do not have a reasonable level of assurance that parties are dealing in good faith, new rules and process reforms will be, I fear, dead-on-arrival.”⁹ The Chairman is right that the merger review process depends on good faith dealings by everyone involved. That is the case under the current system, and it will be the case under a reformed system. Reforms should be tailored to the mainstream practices of the antitrust bar, not to the lowest common denominator.

Moreover, if a party fails to provide the information the government needs to narrow the number of people who must produce documents, the limitations would be unavailable. And if a party or its counsel acts in bad faith, the agencies have at their disposal a variety of means to deter such conduct. If there are legitimate reasons to question the reliability of information or of its source, the agencies can, for example, increase the level of formality of their requests, from

⁹ Deborah Platt Majoras, Chairman, Federal Trade Commission, Reflections on My First Year, remarks before the 2005 ABA Annual Meeting (August 6, 2005), at 10.

requiring written responses when oral responses might otherwise have sufficed, to requiring that certain information be provided under oath, to taking appropriate disciplinary action in cases of demonstrated misconduct.

Other questions that might be raised about this proposed approach to second request reform relate to whether the approach would impair the government's ability to prepare for litigation in the event of a challenge. Agency staff have at times pointed out that when they are investigating a merger, they must both evaluate the merits in order to make an internal enforcement recommendation, and begin to prepare for litigation – because of the HSR Act's deadlines, they cannot postpone the latter entirely while they do the former. The second request is viewed as the agency's main bite at the apple to obtain information from the parties. But the premise of this reform approach is that the agencies will still obtain the vast majority of the information that they need, and that they typically use in practice today, both in reaching their enforcement decisions and in litigation. Moreover, the second request is not the agencies' only bite at the information apple. When the agencies file suit to block a deal, the federal courts routinely grant the agencies a reasonable period for post-complaint, pre-hearing discovery. If there is concern that this might not happen in a particular case, the parties could provide the agency with a discovery stipulation up front, as a condition to obtaining the benefit of the second request limitations.

Another possible question is whether setting firm caps on the number of people from whom documents will be obtained will unduly limit the agencies'

flexibility to act in a special case. The reform approach I am describing here is one that the agencies would self-implement, making legislation unnecessary. As a self-implemented policy, the agencies would have the power to change it. So it seems to me reasonable to expect the agencies to include some sort of provision for “extraordinary circumstances.” Such language has been used in other antitrust policy statements, and to my knowledge invocation of extraordinary circumstances has been rare, perhaps because the agencies understand that the legitimacy of their policies is undermined if the “extraordinary” becomes commonplace.

But this issue of potential deviations highlights the need for institutional steps to ensure that these reforms work where others have failed. One reason past reform attempts have been ineffective is that they did not address some of the incentives that come into play. For example, we know from experience that when parties must approach higher agency officials to seek relief from staff decisions on issues such as second request scope – whether by informally seeking management oversight, or by formally pursuing the agencies’ internal appeals processes – there are powerful incentives for the parties to refrain from doing so. Rightly or wrongly, the parties may believe that seeking such a review will alienate the staff or the management, and that this could have adverse consequences for them in this deal or the next deal. The parties may also conclude that internal reviews seldom produce significant results. A related issue is transparency: how the agencies actually implement the reforms should be known so that the reforms’ success or failure can be monitored.

Again, there are ways to deal with these issues. Any agency decision to deviate from the second request limitations should be made by a very senior agency official, upon the request of the agency staff, rather than requiring the parties to seek review of a staff decision. The deciding official should communicate such a decision personally to the parties' representatives. And the agencies should, consistent with confidentiality obligations, report publicly on how they are implementing the reforms and how often they have deviated from them.

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The other increasingly burdensome aspect of second request compliance is the production of transactional data that agency economists want to analyze in assessing the deal's likely competitive effects. As I noted earlier, this issue is becoming more prominent as the agencies and the courts focus more on quantitative evidence, and as companies collect increasing amounts of data. Some key questions here include whether it is appropriate for the government to require parties to perform extensive data manipulation and compilation as part of the investigative process, and the extent to which the government can or should require the production of entire company databases as opposed to seeking specific information.

The data issue seems more difficult to address than the document issue, and I do not have any reform proposals to make. It may be that data issues are too case-specific to lend themselves to simple solutions, or that more experience is needed before such solutions will become apparent. Quantitative analysis can

be useful in predicting competitive effects, and the agencies are surely entitled to obtain information that they reasonably need in order to make this assessment. This is an area where cooperation between the parties and the agencies may be especially important. The parties will need to explain clearly the complexities that can be associated with requests that the agencies regard as are simple – why, for example, it may be difficult, impossible or useless to simply “turn over” a “database,” or the burdens and costs associated with providing data in the precise manner the agency seeks. The government will need to be sensitive to these business realities, and to define its requests as specifically and quickly as possible so the parties can understand what is being sought and why. This kind of dialogue will help both sides deal more efficiently with data issues.

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The second request process is a flawed aspect of a generally admirable merger enforcement system. There are straightforward ways to address some of the main flaws. I urge the agencies to take this opportunity to reform the second request process, reducing the cost and burden the process imposes on merging parties and on the agencies themselves, while preserving the agencies’ ability to perform their important job. The Modernization Commission should encourage such reforms, and the bar and business community should support their effective implementation.