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Before the Antitrust Modernization Commission

The Hart-Scott-Rodino Pre-Merger Review Process

November 17, 2005

Good afternoon. It is a great pleasure to appear before this Commission to provide some thoughts on the merger review process under the Hart-Scott-Rodino Act.

As we approach the 30th anniversary of the HSR Act, it is an appropriate time to reflect on the goals and purposes of the statute, its application over time, and suggestions for the future. Let us start by stating the obvious – something that should be known to all enforcers and practitioners – the HSR Act has fundamentally altered the orientation of the antitrust review of proposed mergers away from litigation and towards government regulation. Without question, for all but a few mergers today the outcome is determined by agency action as shaped by the review process under the HSR Act rather than by litigation.

With apologies to William Shakespeare, we make this statement to praise the HSR Act, not bury it. The process as a whole has worked reasonably well in protecting the interests of the enforcement agencies and the merging parties, and promoting a sound and increasingly transparent antitrust merger policy. Generally speaking, while the costs of review under the Act are high, they may not be so high when compared to the total value of the typical transaction or from alternate means of achieving sufficient merger review. More importantly, most would agree that the

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outcomes of federal merger review are by and large correct. Mergers that should be cleared are cleared and mergers that present competition issues are fixed or are challenged. Nevertheless, the nature of the HSR Act review does lead to instances where by virtue of the process outcomes are distorted and the time and cost of the review are excessive. To explain our conclusions, we examine below the application of the HSR Act to our own grouping of three basic categories of mergers to see where the Act works and where it needs to work better.

I. The HSR Act Process as Government Regulation.

The drafters of the HSR Act designed the statute to preserve the ability of the agencies to litigate merger challenges effectively.[1] At that time, concerns were raised about the ability of merging parties to consummate mergers prior to public notice (so called "midnight mergers") and to defeat merger enforcement through prolonged litigation during which the government's case could be challenged both on the merits and on lack of remedy. The HSR Act was intended to provide to the antitrust agencies the time and the basic information needed to determine whether to institute a merger enforcement action in federal court. Compliance with a second request was thought to be quick and require only a modest amount of resources. Indeed, Representative Peter Rodino, one of the original sponsors of the HSR Act, stated that under the Act "in most cases, the Government will be requesting the very data that is already available to the merging parties, and has already been assembled and analyzed by them."[2]

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[1] The legislative history indicates that the HSR Act is to give "the government antitrust agencies a fair and reasonable opportunity to detect and investigate large mergers of questionable legality before they are consummated. The government will thus have a meaningful chance to win a premerger injunction . . . ." H.R. Rep. No. 1373, 94th Cong., 2d Sess. 5 (1976).

[2] 122 Cong. Rec. 30877 (1976).

Thirty years later, very few merger investigations proceed to contested litigation. Of course, a wide variety of factors lead to this result, including the time, cost and uncertainty of merger review before the federal courts and the financial and business challenges facing the merging parties in trying to hold a deal together during this time period. As these constraints have prevented substantial merger litigation, at the same time (and perhaps to fill the void) the HSR Act process has evolved into a full pre-complaint investigation of proposed transactions.

In doing so, the DOJ's and FTC's Merger Guidelines are applied to proposed transactions, with a highly detailed analysis conducted by the agencies legal and economic staffs when substantial antitrust concerns are implicated. Voluminous amounts of documents and information are collected from the merging parties and other industry participants. Witnesses are often deposed. After application of the agencies' guidelines to these intensive investigations, transactions are either "cleared," "fixed," or "challenged." Fixed and cleared transactions receive no meaningful court review,[3] meaning that the agency action is in essence determinative of outcome. At most, only a few transactions are challenged among the thousands that are notified in any given year. It is for these reasons that we refer to the HSR Act process as largely regulatory – transactions are scrutinized in an agency investigation according to "rulemakings," and agency action determines the approval or disapproval of the merger. Only in very limited situations are agency "determinations" reviewed in court.

Today, the cost of a second request review under the HSR Act process is

[3] Cleared transactions close without further action. Fixed transactions can be resolved under a "fix it first" approach under which the agencies clear a modified transaction, or approved subject to a consent decree. At the FTC, a consent decree is approved by vote of the Commission. At DOJ, court approval of the consent decree is required under the Tunney Act, but done under a broad public interest standard with little likelihood of rejection.

significant and much more burdensome than simply submitting materials that have already been assembled, as Rep. Rodino envisioned. In a typical second request transaction, each merging party must pay its attorneys fees, outside vendor costs (principally electronic documents and photocopying), translation fees (if there are foreign language documents) and economists and other experts (although this last category is often shared). In our experience, a second request in a deal with a reasonably sized, affected business will, at a minimum, be in the $5 to $10 million range per party. Deals with larger or more affected businesses or transactions with difficult antitrust issues can be much more. These estimates do not account for the tremendous amount of time dedicated by in-house counsel and business people in determining strategy before the agencies, in complying with the document and data requests, preparing information and presentations for the agencies, and sitting for interviews and depositions, as well as the costs from the overall distraction to the business.

The HSR review process also takes several months. In an admittedly non-scientific sample, we compiled data from 2000 and 2005 to measure the time for merger review from announcement of the deal to announcement of a DOJ consent decree or Commission approval for deals involving a second request:

Average Time of Merger Review with Second Requests (months)

Agency	2000	2005
FTC	11.4	7.8
DOJ	5.4	5.7

Of course, this data represents averages with some transactions proceeding more quickly and some more slowly. Transactions without second requests by definition typically

proceed in no more than 30 days from HSR filing (admittedly not necessarily on the date of announcement) with certain exceptions (e.g., when an HSR is "pulled and re-filed"). We also note the difference between the average lengths of each agency's review and offer a partial hypothesis below.

Fully acknowledging the substantial time and costs associated with the review of the HSR process, a central question of review of the system has to focus on whether the desired outcomes are achieved. To perform this analysis properly, one would have to weigh the actual outcomes of merger review compared to ideal outcomes, the costs to society of errors in outcomes, and the total cost of administering the merger review process (including the costs of both the merging parties and the agencies themselves). While many would argue that this measurement is not possible, we will not be so foolhardy to try it directly in connection with our testimony today.

Nevertheless, we will not shy away from this question and suggest an answer indirectly. Our own beliefs are that: (1) the Merger Guidelines, although imperfect, represent the most reliable analytical framework accepted by mainstream antitrust lawyers and economists; (2) the agencies on balance are effective at applying the Merger Guidelines; and (3) accordingly substantial errors in outcome are relatively infrequent. We show below that these "errors" are more likely during the HSR Act review when the relative positions of the agencies on one hand and the merging parties on the other are out of balance. We propose some modifications to the existing system to attempt to address some of these concerns. Of course, there are likely other ways to drive

unnecessary cost out of the system as well and we support efforts to identify and eliminate such waste, although we do not dwell on them in this context.[4]

On a more general level, however, we argue that the HSR Act review process is a success, at least compared to an alternative system of litigating merger reviews. As anyone familiar with present day litigation will attest, the trial of a complicated matter (such as a merger) would likely take as long or longer and cost the same or more than an HSR Act review. Importantly, there is no assurance of a better outcome. Based on admittedly imperfect information, it is our belief that a higher percentage of litigated merger cases arguably reached the wrong result than the percentage of agency outcomes.[5] Some would argue that certain of the litigated merger cases in recent years have reached the wrong result and that the overall error rate is higher in federal court than before the agencies. If the foregoing is true, then generally speaking the HSR process provides a means for both the agencies and the merging parties to seek an appropriate outcome and to do so in a process that may be more efficient than originally intended by the HSR Act drafters.

Assuming that the regulatory process is preferred over litigation, this leads squarely to the next question – what improvements can be made to the existing process?

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[4] One area of high compliance costs is the collection and review of electronically stored documents. Over the last 10 years, the percentage of electronically stored documents as part of the total second request compliance has increased dramatically and is typically the majority of the production. Most companies keep an enormous amount of electronic materials and the identification and review of potentially responsive documents is an evolving area. We applaud the agencies' efforts to address these issues, as well as others, in its Merger Process Task Force.

[5] We recognize that strictly speaking this is not a fair comparison since typically "marginal" cases are more likely to be litigated.

II. Making the HSR Act Work Well.

We chose to title this section "making the HSR Act work well" because we assumed that, at least at this juncture, it would be difficult to dispute this as a goal. To try to make this more concrete, however, we decided to divide mergers into three general categories and examine how the HSR Act works in each case. For this review, we elected to define the categories based on the nature of the antitrust concerns presented as compared to the totality of the proposed transaction. Our first category is entitled "No brainers," or those transactions that do not present a serious antitrust issue. The second category is the (we think) aptly-named "Purgatory," which captures deals with a substantial antitrust issue in a relevant business which is only part of a larger transaction which otherwise passes muster. Our final category is "Show stoppers," deals in which there is a substantial antitrust issue that cannot be fixed without destroying the value of the transaction for the merging parties. For each category, we offer some observations on the application of the HSR Act process to the transaction in question.

A. "No brainers."

Most transactions do not involve serious antitrust problems. Not surprisingly, the HSR Act review statistics indicate that the vast majority of transactions notified receive clearance during the typical initial 30-day waiting period. If these two statements are true, then there are two principal questions to ask: (1) can such reviews be accomplished more efficiently; and (2) are there transactions which should be further reviewed but escape notice under the HSR notification system. With respect to the second question, we believe that the set of such transactions, if any, is rather small

(especially in today's age of the Internet where it is difficult for any deal to pass unnoticed) and the cost and increased burden in reporting for all transactions would outweigh any enforcement gains.

We offer some suggestions for more efficiently reviewing "no brainers." First, an improved clearance system for selecting the reviewing agency for a reported transaction will help promote faster reviews. As known to this Commission, merger review authority is concurrent for the DOJ and FTC in most industries. Decisions about which agency should review a merger are taken under a clearance agreement that specifies the appropriate agency on the basis of relevant experience. A proposal was raised in 2001 by FTC Chairman Timothy Muris and Assistant Attorney General Charles James to provide a clear and bright-line allocation of industries between the agencies.[6] This would have created a clear set of responsibilities and experience in each agency with some positive effects. First, by giving each agency more concentrated experience, it is likely that more informed decisions will be made more quickly on whether to proceed with any substantive investigation. Second, such an agreement will significantly reduce the number of "clearance battles" between the agency, which delay the investigation of the merger at hand, create incentives for interagency rivalry, and provide generally poor press about the functioning of the system.

The burden in making an HSR filing could also be reduced. First, it is our experience that the most burdensome part of making an HSR filing is often the collection of documents responsive to Item 4(c) of the HSR Act premerger notification form. That item requires the collection of all documents prepared by or for an officer or director of

[6] Certain members of the private bar consulted on the proposal, including Kevin Arquit, William Baer, Joe Sims, and Steve Sunshine, unanimously recommending it to the heads of the enforcement authorities.

the company that analyzes the transaction with respect to certain competition-related issues. It is not unusual in a large organization to have dozens of such documents (or more if the company is relatively free in conferring officer status, such as a financial institution). Given recent HSR Act enforcement actions for failure to provide 4(c) documents at the time of filing, counsel for the merging parties often spend considerable time in searching for and assembling such documents.

At the same time, we recognize that 4(c) documents provide valuable information for the reviewing agency. We propose that a variant of a short form notification be considered for transactions that the notifying parties believe do not present substantive antitrust issues. Under this proposal, a party may elect to do a limited 4(c) document search[7] and indicate to the agencies that it is making the election because the parties do not believe there to be any material substantive issues with the deal. To protect the agencies, we would propose that the agencies then have until the 20th day of the waiting period to request a full submission of 4(c) documents, with the initial waiting period then expiring 10 days after the submission of those additional documents.

Second, another burdensome requirement is that parties list in the HSR filings certain revenues for 1997 and the most recent year organized by North American Industry Classification System (NAICS) codes. Other than possibly identifying rough potential overlaps in certain areas, this data appears to provide no substantive insights into the potential antitrust issues raised by the deal. In fact, on more than one occasion, agency staff members have commented to us in the course of an investigation involving

[7] Precisely what a limited search means should be further explored. Possibilities include limiting to materials presented to the Board of Directors or senior management to authorize pursuit of the transaction or limiting the absolute number of documents that must be submitted with some hierarchy of which should be submitted first.

our clients that they do not even look at most of the HSR Form. Any material overlaps between the merging parties will most likely be apparent from the 4(c) documents or a quick review of the parties' businesses based on readily available public information. Therefore, we would propose that this revenue data no longer be required in HSR filings or at a minimum, that 1997 data be omitted.

Third, we suggest that the Commission reconsider the use of filing fees. Unlike other governmental filing fees, the HSR filing fee does not bear any significant relation to the amount of work the agencies may or may not do to review the merger. No other aspect of antitrust review by the agencies requires the payment of a fee by the subject of the review. Furthermore, the current system of escalating filing fees based on the value of the transaction is problematic because the value can be difficult to measure when it consists of non-cash consideration and can fluctuate over time. In the interest of fairness and avoiding undue burden, we suggest that the agencies consider funding merger enforcement from the general budget.

As a final item in this category, the Commission may wish to consider a mechanism to provide a formal channel to allow extensions of the initial waiting period by agreement of the parties. In a recurring situation, the agencies and merging parties have often discovered that at the end of the initial HSR Act waiting period, the agency is not prepared to close its investigation, but believes that a relatively limited amount of additional work and time is required to finish its work. In many of these situations, the merging parties are prepared to give the agency more time in the hope of avoiding a second request completely or perhaps receiving a narrower one. In this context, a practice of "pulling the HSR form and re-filing" has arisen whereby the acquiring party

formally withdraws the filing and resubmits a new one, thereby restarting the initial waiting period. This process is cumbersome and provides some unnecessary hurdles for the merging parties with relation to re-certification of compliance and filing fees.[8] These gymnastics are required because of an interpretation that it is outside the authority of the agencies to modify the statutory waiting period. A modification of the statute to allow the government to agree on an extension without the re-filing of the HSR forms would increase flexibility and avoid some burden.[9]

B. "Purgatory."

Many transactions are by and large competitively unobjectionable but nevertheless raise serious competition issues in a discrete area. In this situation, counsel for the merging parties are likely to recognize that although there may be no show stopper, there is a problem and seek an agreed-upon solution with the agencies. Merger review policy should facilitate the timely and efficient completion of these transactions with an appropriate divestiture that remedies any antitrust concerns. Although these principles are easy to articulate, we believe that in practice important improvements can and should be made to how this category of transactions is handled.

Often for mergers in this category, litigation with the antitrust authorities is not a realistic option. That may be so because individually or in the aggregate: (1) the time litigation would take would threaten the viability of the deal; (2) the incremental

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[8] The FTC's Premerger Office takes the position that no new filings are required if the transaction is re-notified within two days. In requiring a new certification of compliance, however, the merging parties are also obligated to "refresh' their search for documents responsive to Item 4(c), as well as update other relevant information in the HSR Form.

[9] Some practitioners may be concerned that this power could be leveraged by the antitrust authorities to seek additional time. We are not sure that the leverage would change substantially by creating this ability, and in any event, would suggest limiting it to one extension of up to a fixed amount of time.

cost of the divestitures is less than the value of completing the transaction sooner; or (3) the merging parties would likely lose the litigation in the discrete area at issue and be left in the same position of needing a curative divestiture. Whatever the reasons, short of abandoning the transaction, the merging parties are left with little practical alternatives but to complete the deal on terms that are acceptable to the reviewing agency. Perhaps it is now apparent why we label this category "Purgatory."

Problems for the merger review process often arise when the merging parties have no alternatives. In this context, the agencies quickly appreciate the parties' dilemma and can extract real leverage to ensure their preferred outcome. It is not unusual for an investigating staff to make a particular demand for settlement and when the parties attempt to negotiate the staff will decline and simply continue the substantive investigation. As postulated in this category of transactions, the merging parties do not have a litigation alternative and so must ultimately return to the negotiations on the agency's terms.

None of the foregoing is intended to suggest that it is wrong for the agencies to have superior bargaining power at certain points in the HSR Act review process or that agency staffs are not open to persuasion with arguments about the proper outcomes under the antitrust laws. Where we see distortions in outcome is when this leverage is combined with the application of strict standards regarding curative divestitures, including the assets necessary for viability and the timing delays of obtaining all third party approvals and consents. Heightened standards were developed over the last five to ten years in response to concerns that the agencies' merger remedies were not effective. Using both the clean sweep doctrine and concerns about the viability

of the assets, the agencies' remedy policy tends to try to recreate one of the two merging parties in its exact premerger form in the relevant market. By design, it often errs on the side of adding more assets and "protections" to the remedy.

Problems with this approach arise from several facts. First, the merging parties' businesses are usually organized across product and geographic spaces broader than the relevant market at issue. Recreation of the business in its exact form may require the divestiture of assets useful in other markets or the structuring of inefficient combinations of assets.

Second, given the collaborative nature of many business endeavors, third parties often have a participation in some of the relevant assets, ranging anywhere from a joint venture partner, a license of a key technology, a supply contract, to a lease on real property of a store location. These third parties may need to provide a necessary consent and it is not unusual for these third parties, who appreciate the bind of the merging parties, to seek some form of windfall from the merging parties who must pay it to get their deal done.

Third, the agency often takes the position that merging parties have to take the complete risk of execution. Thus, if any third party consents remain outstanding, the deal may not be closed. While this position is reasonable in many situations, it has been applied to situations where a multi-billion deal is placed on hold waiting for a shopping center or medical building landlord to consent to transfer the leases.

We suggest that in reviewing its remedy policies, the agencies weigh the effectiveness of their policies against their costs. We suspect, but do not know, that the incremental benefit of this policy in establishing strong remedies is not high. At the same

time, we see a number of costs including artificially low prices for the sale of divested assets, significant above fair market value payments to third parties, and the creation of costly structures for long periods of transition. In addition, there are also significant costs from delaying the entire merger, including both transactional costs to the parties but also costs to competition in all the markets in which the merging parties compete, owing to lack of focus and uncertainty.

For inclusion in this study, we have three suggestions. First, the agencies should consider adopting more of a balancing standard when evaluating a proposed remedy. Their analysis should include some thought as to overall cost and effects on other markets. By necessity, such a standard would mean a departure from strict reliance on the recreation of a business that replicates the premerger business. Reasonable viability, particularly in connection with the assets that the third party purchaser brings to the equation, may articulate the standard in a more useful way. We argue that there should be a recognition of the tradeoffs between effects in the relevant market of concern and all other markets affected by the merger.

Second, the agencies at present are organized differently to handle evaluation and processing of proposed remedies. The DOJ's investigating staff fashions the remedy and fully negotiates the divestiture. The FTC, on the other hand, has a separate compliance staff to evaluate the divestiture in conjunction with, or sometimes after, the investigating staff's input. As noted above, the time that each agency takes to review a merger with substantial concerns suggests that the FTC on average takes longer than the DOJ. In 2000 and 2005, the FTC's review took an additional six months and two months, respectively, as compared to DOJ's. While there are many possible

explanations for this discrepancy, such as the complexities of the deals at each agency at a given time, it cannot be discounted that the differing length of the review was at least due in part to a separate compliance staff at the FTC.

In any event, the merits of the approaches of both agencies should be considered. Whichever model is chosen, we believe that to provide a proper balance of the relevant considerations, as suggested above, authority should be centered in staff (however constituted) with a stated mission to apply a balanced remedy policy.

Our third suggestion is an attempt to provide an additional option for the merging parties to implement divestitures. It is not uncommon for merging parties to appreciate that they have an antitrust problem in a relatively narrow area and therefore "presell" the business to a third party to avoid competition concerns and expedite the review process. This presell can take several forms but the idea is that the presold assets fix the competition problem and that the deal can be reviewed and cleared. While the agencies in certain instances have resisted this notion, in two recent cases, *FTC v. Libbey, Inc.*[10] and *U.S. v. Dairy Farmers of America, et al.*,[11] the courts have applied Section 7 to the original transaction as subsequently modified by the parties to address the antitrust concerns. Picking up on this principle, it may be useful to create a formal process under the HSR Act to accomplish a modification of the transaction. For example, the HSR Act regulations could allow the merging parties to amend their notification by filing something akin to an amended HSR premerger notification form and attaching the agreement and materials similar to Item 4(c) documents that analyze the modification.[12]

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[10] 211 F. Supp. 2d 34, 43 (D.D.C. 2002).
[11] 426 F.3d 850 (6th Cir. 2005).
[12] The agencies would have a legitimate interest in receiving sufficient documents from the merging parties and the third party purchasers to evaluate the modification. We have proposed submission of key

The filing of this notification could perhaps extend the waiting period from 45 days from the date of filing or 30 days from substantial compliance with the original second request, whichever is later.

We recognize that this proposal may change the dynamics of the merger review process in certain circumstances. The agencies would of course still be free to challenge the sufficiency of the divestiture, albeit under a standard where it has the burden of showing the modified transaction will tend to substantially lessen competition. The *Libbey* and *Dairy Farmers* cases indicate, however, that this is the state of the law in any event. We think that the ability to make this modification may allow the merging parties to have a more clearly defined alternative when they know they have to fix the transaction. All in all, we would think that this would result in both the agencies and the merging parties reaching acceptable outcomes in shorter periods of time and with lesser overall costs.

C. "Show stoppers."

Certain transactions cannot be fixed. Generally speaking, this occurs when the cost of achieving a curative divestiture would destroy the value in accomplishing the transaction as a whole. When the merger involves a "show stopper," the merging parties have two choices. They can seek to persuade the agencies that the merger does not violate the antitrust laws or, failing that, they can seek to litigate the case in court.

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documents with the modification along with a 45-day waiting period to allow for adequate investigation. There are other solutions to address this issue as well.

Many companies pursuing such a transaction seek to persuade the agencies that the issue is not a show-stopper, either because there is a workable fix or because of an argument that the transaction is not anticompetitive. As long as the merging companies seek to persuade the agencies on the merits, the HSR Act review process works as well here as it does in other contexts. Information is provided to the agencies and issues are joined.

In what we suspect to be relatively rare circumstances, the merging parties may conclude at a point in the review that the chances of persuading the agency that the deal does not present a show stopper are outweighed by cost of the delay. In these narrow circumstances, the merging parties may wish to place this matter in front of a court for a decision. If so, the burdens and delays of fully complying with the HSR Act may only serve to slow the matter down, particularly if the agencies can get the material they need in civil discovery. We propose searching for a mechanism under which the agencies can get enough material and time to make an informed litigation decision while at the same time all parties can get to a court without undue delay.

There may be several ways to approach this matter. For example, if the transaction is headed towards litigation, the merging parties could elect that in exchange for agreeing to a temporary restraining order preventing closing of the deal, the merging parties and the agencies will work out any disputes over substantial compliance in the context of civil discovery and setting the hearing schedule with the court.[13] In this manner, substantive issues can be joined while "discovery" disputes are handled as they normally would be in a court proceeding. Alternatively, a different standard of

[13] We recognize that for this proposal to work there may have to be a distinction between substantial compliance and failure to comply.

compliance could be adopted to address the situations in which the parties understand that they will be litigating the merits of the transaction.

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In conclusion, we would like to affirm our belief that on the whole the HSR Act process works reasonably well in achieving its goals. We have proposed certain modifications that we believe will increase the efficiency of the process. We understand that the agencies are also working actively to reduce unnecessary burden and of course we applaud and fully support those efforts as well.

Thank you again for the invitation to offer our views. We would be pleased to elaborate on any of these thoughts if the Commission would find it useful.