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2009 Massachusetts Avenue, NW
Washington, DC 20036
202.588.0302 wlf.org

U.S. Merger Review Process Changing Before Our Eyes

by Steven Cernak

In 1976, Senators Hart and Scott, and Representative Rodino, led the debate in Congress that drastically changed the way federal antitrust authorities reviewed mergers. After Congress passed the law that bears their names, parties to many mergers would need to notify the federal government before closing their deals. Under Hart-Scott-Rodino (HSR), the FTC and DOJ would quickly assess these filings and decide which ones required a closer examination to determine if they violated the antitrust laws.

HSR did not play out exactly as promised. Instead of the "150 largest" transactions requiring a filing each year, as suggested by Rep. Rodino, parties regularly notify thousands of transactions each year and have notified more than 150 each of the last 14 *months*. Rep. Rodino's prediction that "lengthy delays and extended searches should consequently be rare" also proved incorrect as the closer examination of many of these notified transactions stretch on for over a year. Still, merging parties, and the attorneys and economists that support them, have become used to how the HSR process has evolved. Its costs and any regulatory uncertainty are now baked into their deal analysis.

In the last several months, however, a bare majority of FTC commissioners has unilaterally made several changes to HSR's processes that, in total, add up to the greatest change in U.S. merger review since HSR was enacted. The resulting greater costs, delays, and uncertainty essentially impose a new tax on merger activity and likely will result in fewer mergers, whether anticompetitive or not. For proponents of these changes, that result likely is a feature, not a bug.

Typical HSR Process

The Hart-Scott-Rodino Antitrust Improvements Act of 1976 established notification and waiting requirements for certain large acquisitions and mergers. Congress established the original minimum size of the transactions subject to HSR's reporting requirements in the original Act. In 2000, Congress adjusted the thresholds upwards, added a filing fee requirement, and instituted a mechanism for automatic adjustments of the thresholds based on changes in the country's economy.

Congress delegated to the FTC significant authority to design the HSR notification form and documentary attachment requirements; define terms; exempt certain transactions unlikely to raise antitrust issues; and "prescribe such other rules as may be necessary and appropriate to carry out the purposes of this section." The FTC has used that delegated authority to establish rules and interpretations advising businesses on complicated question like which transactions must be reported.[1]

Once the parties have determined a filing is necessary, they submit the required form and documents to the FTC and DOJ. The FTC Premerger Notification Office, or PNO, reviews the submissions to ensure that all

[1] Fed. Trade Comm'n, *Premerger Notification Program*, https://www.ftc.gov/enforcement/premerger-notification-program.

Steven Cernak is a Partner with Bona Law PC in its Detroit, MI office who practiced antitrust law in-house with General Motors for over 20 years.

requirements are met. Then, the FTC or DOJ have thirty days to make an initial determination: Should they allow the transaction to proceed or issue a "second request" for more information? The latter route further delays consummation of the transaction for months while the agency conducts an in-depth investigation with voluminous information provided by the parties. At the end of the investigation, the agency must decide to either allow the transaction to proceed or sue to block the transaction. Generally, only a small percentage of the filings have led to "second requests" and most of those were eventually allowed to proceed.

Over the more than forty years of HSR practice, the agencies, parties, and the filing lawyers have developed a process that provides the agencies the necessary information for their review while imposing only costs and delays to which the parties have become accustomed. The PNO has gained a reputation for providing useful general advice on the need to file and the proper submission method, often in the form of informal interpretations published on its website, as well as quick and helpful responses to harried lawyers and assistants preparing the filing. The PNO has tweaked the form and its rules over the years, often after consultation with "frequent filers," both to gather more information helpful to agency review and remove requirements for information no longer necessary. The resulting system is well understood and offers parties and their lawyers a great deal of certainty.

The changes made by the FTC over the last several months have upset that understanding and increased the costs borne by both parties and the reviewing agency. Below, we explore those changes and their impact.

End of Early Termination (ET)

First, the agencies suspended the early termination program early in 2021 allegedly to conserve resources in light of a sharp increase in HSR filings.[2] That temporary suspension continues with no end in sight. In normal circumstances, the parties to a filing can request ET and, if the FTC or DOJ favorably complete their investigation before the end of the initial thirty-day waiting period, the reviewing agency notifies the parties that they are then free to close the transaction. In the past, ET usually reduced the HSR delay by about ten days. Most parties request ET because the only real downside is the publicity of the FTC publishing the agency clearance on its website. Because most HSR filings are cleared during the initial waiting period, the change in policy means that hundreds if not thousands of transactions that posed no competitive issues have been delayed ten days or more for an unclear benefit from a shift in agency resources.

End of Informal Guidance from PNO?

Determining if the unique facts of a particular transaction trigger an HSR filing requirement can be tricky. While the rules drafted by the PNO are detailed, they cannot anticipate all potential fact patterns. Fortunately, the PNO publishes informal interpretations of those rules on its website. Those interpretations usually are simply copies of emails sent to PNO staff by party lawyers with pertinent details of a transaction (with names redacted) and the PNO's reaction. Publishing them (nicely indexed to the rules) helps lawyers for subsequent transactions more easily determine their filing requirements, usually without further bothering busy PNO staff.

The PNO periodically changes these interpretations; however, the change announced by the FTC in August 2021 was significant for several reasons.[3] First, the one change announced was the withdrawal of a long-standing interpretation: Previously, the interpretation allowed parties to exclude the payoff of a

[2] *See* Karl Herchenroeder, *Philips, Wilson Push Back on Slaughter's Early Termination Suspension*, COMM. DAILY, Feb. 9, 2021, https://communicationsdaily.com/article/2021/02/09/phillips-wilson-push-back-on-slaughters-early-termination-suspension-2102080070.

[3] Holly Vedova, *Reforming the Pre-Filing Process for Companies Considering Consolidation and a Change in the Treatment of Debt*, FTC Competition Matters Blog, Aug. 26, 2021, https://www.ftc.gov/news-events/blogs/competition-matters/2021/08/reforming-pre-filing-process-companies-considering?utm_source=govdelivery.

target's debt by the acquiring person from the size of the transaction calculation in transactions involving the acquisitions of voting securities and noncorporate interests (though not of assets). The rationale had been that the purchaser of a majority of an issuer's stock automatically acquires the issuer's preexisting liabilities and so that fact presumably is reflected in the stock's acquisition price. The FTC's rationale for withdrawing the interpretation was that some parties allegedly structured transactions with unnecessary new debt that was immediately paid off so as to avoid HSR filing requirements. The announcement did not explain why other rules that allow the FTC to disregard devices used to avoid HSR filing obligations were not sufficient here. The result will be that, on the margin, more filings will just clear the HSR thresholds and require filings.

Other elements of the August announcement hinted that more changes might be in the offing. All other prior changes to PNO informal HSR interpretations had been announced by PNO staff, usually in a blog post and often after informal consultation with private attorneys who frequently make HSR submissions. Here, the announcement came out of the blue and from the head of the FTC Bureau of Competition. We hope that the bureau head involved the PNO staff and that the staff will remain involved in any future interpretation changes and their announcement.

The announcement also stated that the FTC, perhaps with the DOJ, is examining *all* its informal interpretations. If so, that list is "voluminous." The best-selling ABA Antitrust Law Section book compiling many of the interpretations groups them into 237 sections covering nearly 400 pages.[4] While it is impossible to confidently predict which interpretations are on the cutting block, it seems likely that any changes will result in more, not fewer, HSR filings. One candidate for change almost certainly is the so-called "first bite free" interpretation of several rules that has effectively allowed some new funds of large private equity companies to make some initial acquisitions without any HSR submissions.

Finally, the announcement stated that the FTC is in the process of reviewing "the voluminous log of informal interpretations [by PNO staff] to determine the best path forward." One "path forward" would be to eliminate the informal interpretations from the PNO and rely only on the formal rules and interpretations approved by commissioners. Any such move might free up some FTC resources for other purposes but would add uncertainty to the HSR process for the merging parties.

FTC Issues Warning Letters at End of Initial Waiting Period

As described above, under HSR the reviewing agency has thirty days to decide to clear the transaction or issue a second request to conduct a much longer investigation. While it has always been true that the FTC or DOJ can later challenge a transaction that it earlier investigated, such actions have been rare. The FTC recognized the benefit of such near certainty in one of its HSR Guides when it noted that "the fact [of rare post-HSR challenges] has led many members of the private bar to view [HSR] as a helpful tool in advising clients."

The FTC reduced that beneficial near-certainty in August when it announced that it would begin issuing standard form letters at the end of the initial waiting period to many filing parties when the agency had not yet completed its review.[5] The letters will note that the FTC's investigation is ongoing and, while the parties are free to close the transaction, they would be assuming the risk that the FTC would later challenge the transaction and seek to unwind it.

In issuing such letters, the FTC seems to be indicating that such post-HSR review investigations will become much less rare. The rules and timelines of such investigations are unclear but will be set by the FTC,

[4] *Premerger Notification Practice Manual, Fifth Edition*, ABA Antitrust Section, Mar. 6, 2021, https://www.americanbar.org/products/inv/book/188486575/.

[5] Holly Vedova, *Adjusting Merger Review to Deal with the Surge in Merger Filings*, FTC Competition Matters Blog, Aug. 3, 2021, https://www.ftc.gov/news-events/blogs/competition-matters/2021/08/adjusting-merger-review-deal-surge-merger-filings?utm_source=govdelivery.

not HSR. The result will be less certainty and closure for merging parties whose HSR filings are reviewed by the FTC.

Withdrawal of New Vertical Merger Guidelines

In September, the FTC moved on to changes to the substantive standards for merger reviews by withdrawing support for the Vertical Merger Guidelines (VMGs).[6] The FTC issued those VMGs jointly with DOJ only last year after months of public input and debate. The 2020 version replaced similar guidelines from 1984 that everyone considered outdated and, like the Horizontal Merger Guidelines, were meant to provide guidance to parties and courts on how the agencies will evaluate such mergers.

A 3-2 majority of the FTC commissioners voted to withdraw the VMGs. The majority's rationale was that the VMGs improperly contravened the Clayton Act's language with its approach to evaluating potential pro-competitive efficiencies of such mergers, especially the elimination of double marginalization.

The action drew a stinging dissent from the two Republican commissioners. They lamented both the confusion the withdrawal will generate and the process used for the withdrawal—no public input and, seemingly, no discussion even at the FTC outside the offices of three Commissioners. Two prominent antitrust academics echoed those remarks, saying that the majority's statement "relied on specious economic arguments."[7]

Again, the result will be increased uncertainty for merging parties. Because the DOJ has not yet withdrawn support for these VMGs (although it did announce that it will study potential revisions), analysis of potential vertical mergers might depend on which agency is conducting the review. If that review is being done by the FTC, the analysis to be used is unclear, other than it will now be more skeptical of the merger's asserted efficiencies. Merging parties can only hope that there will not be another 30+ year gap between VMG versions—and that any revisions or withdrawal of the even more important Horizontal Merger Guidelines will not be announced one day with no warning.

Return (With a Vengeance) of Prior Approval Provisions

In the typical HSR second request process, the agency and the parties learn a lot about the position of the other side as documents are produced and oral testimony is obtained. Often the result is an agreement that the parties will adjust their transaction, usually with a partial divestiture to an appropriate buyer, and the agency will forego any court challenge to the modified merger. That agreement is always memorialized.

In October, the FTC announced that going forward such agreements typically will contain "prior approval" provisions, under which the parties must submit future transactions to the FTC for review under rules and timelines more favorable to the FTC than HSR's.[8] Those provisions certainly would apply to future transactions in the markets affected by the original transaction but might apply to all such transactions of any size. The FTC might also try to impose such prior approval requirements on the buyer of any divested assets and even on parties that abandon an HSR transaction before the FTC decides to challenge it.

The FTC described this new policy as a return to a practice used regularly before a 1995 decision to abandon it and rely only on HSR filings. That earlier practice, however, had been heavily criticized[9] even

[6] Fed. Trade Comm'n Press Release, *Federal Trade Commission Withdraws Vertical Merger Guidelines and Commentary*, Sept. 15, 2021, https://www.ftc.gov/news-events/press-releases/2021/09/federal-trade-commission-withdraws-vertical-merger-guidelines?utm_source=govdelivery.

[7] Carl Shapiro and Herbert Hovenkamp, *How Will the FTC Evaluate Vertical Mergers?*, PROMARKET, Sept. 23, 2021, https://promarket.org/2021/09/23/ftc-vertical-mergers-antitrust-shapiro-hovenkamp/.

[8] *Statement of the Commission on Use of Prior Approval Provisions in Merger Orders*, https://www.ftc.gov/system/files/documents/public_statements/1597894/p859900priorapprovalstatement.pdf.

[9] Steve Cernak, *FTC Continues to Unilaterally Repeal the HSR Merger Review Process*, The Antitrust Attorney Blog, Oct. 28, 2021, https://www.theantitrustattorney.com/ftc-continues-to-unilaterally-repeal-the-hsr-merger-review-process/.

though the prior approval provisions were applied to fewer transactions and for shorter periods of time than envisioned by the new policy. The FTC majority that approved the new policy expects to save FTC resources as fewer "facially anticompetitive" mergers are proposed and so need to be investigated and challenged. The two dissenting commissioners instead predict more litigation as the cost of resolving merger challenges short of court increases.[10]

Conclusion—Consequences, Intended or Not

Individually, none of these changes is huge. Together, however, they represent the largest change in U.S. merger review since HSR's passage in 1976. Some of their effects seem nearly certain. For instance, the cost of mergers will rise as more mergers require HSR submissions; more submissions trigger second requests; more second requests trigger more FTC challenges, at least some of which will be resolved in litigation; and more parties are subject to longer and more intensive non-HSR reviews by the FTC.

Costs from greater uncertainty also will increase. Less or less helpful guidance from the PNO will mean that parties will be less certain of their HSR filing requirements. No or uncertain substantive guidelines will keep parties guessing about the agency's analysis. And parties whose mergers get reviewed by DOJ will face a process and analysis different in some uncertain ways.

Because all these extra costs will fall on all proposed mergers, one likely result will be fewer mergers that could have benefited consumers. If you think that the economy has suffered from too many recent mergers and an increase in concentration, that result might not trouble you. (Even under that view, it is not clear why these changes are necessary to challenge more allegedly problematic mergers. DOJ just challenged a "5-to-4" merger in the publishing industry with an interesting monopsony theory and did not need to change the HSR process to do it.[11]) In short, these policy changes implicitly assume that the benefit to the FTC from not needing to challenge the bad mergers outweighs the costs to consumers from losing the benefits of the good ones never pursued.

More than that, these changes significantly modify the way the HSR merger review process was enacted and has evolved. Instead of legislative changes debated and voted on by elected officials, we have pronouncements from the offices of three appointed commissioners. Instead of engaging experts, users of the system, and officials closest to the action to better understand the real world practice and obtain some buy-in for any changes, we have top-down surprise announcements. Instead of prioritizing guidance to parties trying to comply with a complicated law, we have policies designed to increase uncertainty and chaos. Instead of an attitude of a public servant trying to best serve all its constituents, we have bureaucrats more focused on perfecting their own internal processes.

HSR and its related processes are not so perfect that they cannot be improved; these changes and the way they were made, however, do not qualify as improvements for parties or FTC staff. Instead, they will simply slow down economic activity so the FTC can get even more involved, which probably was the plan all along.

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[10] *Dissenting Opinion of Commissioners Christine S. Wilson and Noah Joshua Phillips Regarding the Statement of the Commission on Use of Prior Approval Provisions in Merger Orders*, Oct. 29, 2021, https://www.ftc.gov/public-statements/2021/10/dissenting-statement-commissioners-christine-s-wilson-noah-joshua-phillips.

[11] Justice News, *Justice Department Sues to Block Penguin Random House's Acquisition of Rival Publisher Simon & Schuster*, Nov. 2, 2021, https://www.justice.gov/opa/pr/justice-department-sues-block-penguin-random-house-s-acquisition-rival-publisher-simon.