

## Post-Closing Challenges Illustrate Importance of Antitrust Review – Even for Small Transactions

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A substantial uptick in the number of non-reportable deals challenged by the Federal Trade Commission (FTC) and the Department of Justice Antitrust Division (DOJ) in the last few years signals increased scrutiny of transactions too small to require pre-merger notification to the government. In light of this trend, companies are well advised to tread carefully when determining whether, and how, to pursue a transaction that is not subject to mandatory pre-closing review.

Section 7 of the Clayton Act<sup>1</sup> sets forth the substantive standards for evaluating mergers and acquisitions. Section 7 forbids acquisitions that substantially lessen competition. The Hart-Scott Rodino Act (HSR)<sup>2</sup> establishes a procedural mechanism that requires many significant transactions to be reported to the DOJ and the FTC before they are completed, so the antitrust review can be completed prior to closing. However, contrary to what some may believe, that a transaction does not require an HSR filing does not mean the transaction is lawful.

Even smaller deals that do not require an HSR filing may cause substantive antitrust concerns. The antitrust agencies are willing to challenge even the smallest deals. For example, in the past year the DOJ challenged a five million dollar acquisition and a three million dollar acquisition.<sup>3</sup> Our review of the

announced complaints and challenges shows an increasing trend of post-closing governmental challenges to non-reportable deals. Since the start of 2010, the FTC and DOJ challenged 13 deals after the acquisition had closed.

The cause for this increased activity in post-closing challenges may arise from a variety of factors. For example, the overall deal flow is down significantly in light of the economic environment, which may have freed FTC and DOJ resources to investigate non-reportable mergers. The increase in the transaction size that triggers HSR reporting, from the historical level of \$15 million to the current \$66 million, also has allowed more mid-sized transactions to close without going through the HSR process, so the investigation and challenges occur post-closing. In any event, post-closing antitrust investigation is a trend that businesses should be aware of, and take note of as they plan transactions.

### The Polypore Case

One recent FTC challenge provides some key insights into factors the FTC will view as critically important in a post-closing transaction review. The FTC stressed that a company's behavior leading up to and immediately following a deal can determine whether the transaction is lawful. The FTC opinion

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*In the Matter of Polypore Int'l Inc.*<sup>4</sup> highlights the importance of pre-deal and post-deal conduct, especially in light of the new Horizontal Merger Guidelines that stress the importance of a competitive effects analysis, rather than a traditional approach focused initially on market definition. In *Polypore*, the FTC case proceeded under the traditional framework of defining a market and establishing high concentration within it. Despite that traditional approach, the FTC stressed that the company's pre-deal and post-deal conduct gave rise to a finding of adverse competitive effects which would have led to the transaction being unlawful standing alone, without any need to proceed through a market definition/concentration analysis. While these factors may not be new, or surprising, the FTC opinion makes clear how these factors can be dispositive under its interpretation of the new Horizontal Merger Guidelines.

Polypore International Inc. was the parent corporation of its wholly owned subsidiary, Daramic. In 2008 Polypore purchased Daramic's competitor, Microporous. The FTC challenged the acquisition seven months after the deal closed. In its opinion affirming an administrative law judge's conclusion that the transaction was unlawful, the FTC found that the transaction substantially lessened competition and ordered Polypore to completely divest all Microporous assets. The FTC's opinion in this case highlights several items companies should consider while determining whether, and how, to engage in a transaction.

### **Loose Lips Sink Ships: Anticompetitive Language in Pre-Closing Documentation Can Support a Section 7 Violation**

A company's documentation of the rationale for an acquisition is crucial and may make or break the government's investigation. If the reason for entering into a transaction is anticompetitive – and in writing – the FTC will have a much stronger case that a deal violates the antitrust laws.

In *Polypore* the FTC stated: "Documents created by the merging parties in the ordinary course of business are often highly probative of both industry conditions and the likely competitive effects of a merger."<sup>5</sup> The FTC further stated: "Evidence that sheds light on the strategic objectives of the merging parties" is "probative of likely anticompetitive effects."<sup>6</sup> Documentation stating Polypore's intent to raise prices following the transaction was key to the FTC finding the transaction unlawful. The FTC focused on "Daramic's documents [establishing] that Daramic was motivated to acquire Microporous at least in part to eliminate a competitive threat" and to enable price increases.<sup>7</sup> Moreover, the FTC found that Daramic's internal business documents, including documents given to Polypore's board of directors in advance of a meeting to consider the acquisition, clearly stated Daramic's anticompetitive intent. Controlling the documents created to analyze a transaction is critical to smoothing the merger review, whether under an HSR investigation or for a non-reportable deal.

### **Actions Speak Louder than Words: Post-Closing Conduct is Critical**

Post-closing behavior can have an even more critical impact on the government's view of the legality of a transaction. In *Polypore* the FTC found that there were post-acquisition price increases that were not supported or justified by increases in costs. Commissioner Rosch's concurrence notes that "Daramic announced significant and wide-ranging post-acquisition price increases that were consistent with its pre-acquisition intent documents."<sup>8</sup> More importantly, Commissioner Rosch made clear that he would skip the market definition analysis in a post-merger context and instead look for direct evidence of anticompetitive effects.<sup>9</sup> Indeed, he found that direct evidence of anticompetitive behavior, standing alone, was sufficient to violate Section 7.<sup>10</sup> Commissioner Rosch stated that "[i]n the case of a consummated merger . . . there is no need to predict whether the transaction is likely to result in anticompetitive effects" because the merger has already occurred.<sup>11</sup>

Therefore, the "competitive effects themselves may define the relevant market" and market definition should be "defined after the effects of the transaction are identified."<sup>12</sup> Under that view, post-closing behavior then, such as a price increase, can be sufficient on its own to show the transaction was unlawful, without any need to consider other issues such as the definition of the relevant market using more traditional approaches. Thus, companies must ensure that any post-closing behaviors, like price increases, are supported by competitive justifications, and not a result of anticompetitive behavior aided by increased market power achieved through a transaction.

### **Pre-Transaction Antitrust Review Can Minimize or Avoid Post-Closing Headaches**

Avoiding the abovementioned documentation and pricing pitfalls is necessary, but not sufficient, to avoid antitrust challenges. While evidence of post-merger price increases can be offered as evidence that a deal was anticompetitive, the lack of such a price increase does not make a transaction lawful. Since a company can control its own pricing, it could decide to hold off on price increases for some period following the merger or acquisition to avoid possible government scrutiny. As Commission Rosch wrote in *Polypore*, "drivers are more careful when they see a police car nearby (or think that one may be nearby)."<sup>13</sup>

Thus, if a company has documentation indicating that it believes its transaction will allow it to reduce competition and raise prices, and in fact implements post-acquisition price increases, the government will have powerful evidence to support a challenge to that transaction. Even if a company steadfastly avoids these problems, the government may still challenge the transaction if other factors indicate that the deal is likely to harm consumers through increased prices, reduced service, or reduced innovation – but the government will have a much more difficult time proving its case.

Parties need to be sure they do not hurt their chances by preparing bad documents or engaging in post-closing conduct that will invite scrutiny. But even if they do that, they are well advised to obtain solid counsel on the legality of their transaction in light of the competition that will remain, or would likely enter, following a transaction.

### **Extreme Remedies Put a Premium on Proactive Analysis**

No matter the size of the transaction, if the government successfully challenges a deal post-closure, the remedies can be extreme. It is imperative companies understand their antitrust risks on a non-reportable transaction, because the remedies can be so intrusive (and expensive).

In *Polypore*, the FTC stated that "complete divestiture is generally the most appropriate way to restore competition lost through an unlawful acquisition."<sup>14</sup> The FTC ordered Polypore to completely divest its recent acquisition of Microporous to cure what the FTC found to be its anticompetitive behavior. *Polypore* is not an outlier. The FTC imposed similar relief in another recent case.<sup>15</sup> The Fifth Circuit affirmed this relief on appeal, finding that the divestiture order was "not overbroad nor punitive."<sup>16</sup>

These extreme remedies provide a powerful incentive for a buyer to engage in a thorough pre-closing antitrust review. In fact, given the downside risks, including complete divestiture of the acquired business, the stakes can be higher than they would be in an HSR reportable transaction where the governmental antitrust review generally precedes the transaction closing. It is important to know whether a proposed transaction is likely to raise concerns. It is just as important not to prepare documents or engage in post acquisition conduct – such as price increases – that at a minimum can invite unwanted scrutiny and potentially can serve as the very evidence used by the regulators or a court to demonstrate the transaction was anticompetitive in the first place.

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1 15 U.S.C. § 18.

2 15 U.S.C. § 18a.

3 See Press Release, Department of Justice, *Justice Department Requires Key Divestiture in Electronic Systems & Software/Premier Election Solutions Merger* (Mar. 8, 2010); Press Release, Department of Justice, *Justice Department Files Antitrust Lawsuit Challenging George's Inc.'s Acquisition of Tyson Foods Inc.'s Harrisonburg, Va., Poultry Processing Complex* (May 10, 2011).

4 Opinion of the Commission, Docket No. 9327 (F.T.C. Dec. 13, 2010)("Polypore").

5 *Id.* at 10.

6 *Id.* at 9.

7 *Id.* at 29.

8 Concurring Opinion of Commissioner Rosch at 5.

9 *Id.* at 1-2.

10 *Id.*

11 *Id.*

12 *Id.*

13 *Id.* at 3.

14 *Polypore* at 24.

15 *In re Chicago Bridge & Iron Co.*, 138 F.T.C. 1024 (FTC 2005).

16 *Chicago Bridge & Iron Co. v. FTC*, 534 F.3d 410, 440-42 (5th Cir. 2008).

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