Buyer Beware: Consummating Non-HSR Reportable Transactions May Prove Costly in the End

By: Harry S. Davis, Michael E. Swartz, and Matthew S. Wild (not pictured) *

Parties to a merger or acquisition that is not reportable under the Hart-Scott-Rodino Antitrust Improvements Act ("HSR Act") sometimes assume they will not have substantial antitrust exposure from the transaction. That is anything but the case. Although non-HSR reportability does significantly increase the odds that a transaction will not be subject to a government enforcement action or private litigation, ironically this "free pass" to closing ultimately may leave the parties – and in particular the buyer – with increased antitrust exposure. The failure to eliminate any potential anticompetitive effects of the transaction before closing leaves the parties vulnerable to a claim that the transaction led to a price increase or other adverse effect. Thus, without any remedial measures pre-closing, the buyer may be subject to (1) post-closing divestitures that are even more burdensome than would have been pre-closing, and (2) substantial private litigation risk. Indeed, this potential outcome has become more likely after 2001 when Congress amended the HSR Act to increase the reportability thresholds.

The HSR Act was designed to provide the Federal Trade Commission ("FTC") and the Antitrust Division of the United States Justice Department ("Antitrust Division") with advance notice of certain mergers or acquisitions to afford them the opportunity to study their potential anticompetitive effects and to block them before they close. In enacting HSR's pre-merger notification requirements, Congress expressly recognized the comparative difficulty of eliminating the harmful effects of an anticompetitive merger – by "unscrambling the assets" – after the fact rather than preventing the merger from going through in the first place. Recognizing that the original notification thresholds established in 1976 had grown obsolete and overly burdensome over time – as the average size of deals grew larger and many small deals that were not anticompetitive still required pre-merger notification – Congress amended the HSR Act in 2001 to raise the notification thresholds. This increase was intended to reduce the burden on the antitrust agencies and the parties of pre-merger review for seemingly less significant transactions, thus allowing many smaller deals to avoid pre-merger notification. As a result, parties consummate many smaller deals every year without giving the competition authorities an opportunity to review them pre-merger for potential anticompetitive effects. Although the vast majority of deals that do not meet the pre-merger notification thresholds are pro-competitive or neutral in terms of their effect on competition, some anticompetitive deals have closed without any pre-merger review.

In an effort to rectify this problem, the FTC has recently shown an increased interest in challenging consummated mergers that may harm competition. In July and August 2006, the FTC challenged two mergers that had been consummated and obtained divestiture orders in both cases. Although the FTC had challenged consummated mergers before Congress amended the HSR Act in 2001 to reduce its coverage, these more recent actions illustrate that the FTC does in fact "devote more effort to identifying (through means such as the trade press and other news articles, consumer and competitor complaints, hearings, and economic studies) those unreported, usually consummated mergers that could harm consumers."

Indeed, since 2001, the FTC has challenged at least seven consummated mergers. By contrast, while the Antitrust Division has concurrent jurisdiction to challenge consummated mergers, it has rarely done so.

As a result of this focus, it is important for corporate and antitrust practitioners to understand that whenever a newly-combined firm raises prices based upon market power acquired through an anticompetitive merger (a "supracOMPETITIVE price increase") as distinguished from changes in supply and demand, the parties might very well receive scrutiny from the federal antitrust authorities. Obviously, a successful government challenge to an anticompetitive merger – regardless of the size of that merger – can have significant adverse consequences for the merging parties. This article explains those consequences. In particular, this article examines the remedies available to federal antitrust authorities, state attorneys general and private plaintiffs for mergers that violate federal and state antitrust laws. In addition to exploring equitable remedies – including injunctive relief – that might be ordered in the face of a consummated anticompetitive merger, this article further analyzes the parties' potential exposure to damage awards.

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from direct purchasers under the federal antitrust laws as well as indirect purchasers under state antitrust laws. Defendants theoretically can be liable for as much as three times the amount that they caused purchasers to overpay for their products and those of their competitors and, in certain states, three times what indirect purchasers may have overpaid.

Injunctive Relief

A merger that actually causes supracompetitive pricing likely would violate Section 7 of the Clayton Act and Section 1 of the Sherman Act.⁹ Equitable relief for violations of those statutes is available, under Sections 4 and 16 of the Clayton Act, to many different types of plaintiffs including the Antitrust Division, state attorneys general, customers and consumers (and, under limited circumstances, competitors). In particular, Section 4 of the Clayton Act authorizes the Antitrust Division to challenge anticompetitive mergers,¹⁰ and Section 5 of the Federal Trade Commission Act authorizes the FTC to challenge them in administrative proceedings.¹¹ Similarly, Section 16 of the Clayton Act authorizes customers, consumers, actual and potential competitors (under certain circumstances) and state attorneys general acting as parens patriae to seek injunctive relief.¹²

Courts have discretion to fashion broad equitable relief that will remedy the harm caused by an anticompetitive merger.¹³ Notably, in addition to a consent decree that may require a post-closing divestiture, most post-merger injunctions typically impose ongoing restrictions and continuing obligations on the parties. Depending upon the anticompetitive effects caused by the challenged merger, conduct remedies can include restrictions on acquiring or operating competitors, mandatory intellectual property licensing, transfer of employees and ongoing compliance reporting to the FTC and/or Antitrust Division.¹⁴ Such provisions may be more burdensome in the context of a consummated merger, where the assets and employees may already have been integrated. Consent decrees often last for ten years.

Monetary Relief

An anticompetitive merger can create substantial monetary exposure to the FTC, customers and consumers (or state attorneys general as parens patriae). Section 13 of the FTC Act authorizes the FTC to obtain disgorgement of profits derived from supracompetitive price increases.¹⁵ While the FTC has emphasized that it will seek disgorgement only in "exceptional circumstances,"¹⁶ this remedy nevertheless exists and can increase the monetary exposure of the parties.

Moreover, a successful government challenge to a consummated merger because of post-deal supracompetitive price increases also can bring attention to a transaction and spark private class action litigation.¹⁷ Plaintiffs may claim that, as a result of the merger, the prices of the defendant's products increased (or did not decrease as much as they otherwise would have), resulting in overcharge damages. Treble damage awards to direct purchasers can be substantial and exceed the entire supracompetitive profit that the defendant obtained as a result of the anticompetitive merger.¹⁸

In addition, if the so-called "umbrella standing" doctrine were available under Section 4 of the Clayton Act, a defendant could theoretically be liable for the direct purchaser overcharge damages of the entire industry. In a highly concentrated industry of the type that would allow the merged firm to charge supracompetitive prices,¹⁹ one can expect competitors to follow the price increase announced by the firm that gained market power through the anticompetitive merger.²⁰ Consequently, customers that purchase the product directly from one of the merged firm's competitors also may suffer overcharge damages. Courts are split as to whether those plaintiffs have suffered antitrust injury allowing them to obtain treble damages under Section 4.²¹ This exposure could be many times more than the supracompetitive profits that the merged firm actually earned from the anticompetitive merger.²²

Damages exposure can multiply if indirect purchasers sue under state law. As a result of the limitation of damages recoveries under federal law, indirect purchasers have relied upon state law for compensation. In some states, either the legislatures have amended their antitrust laws or courts have interpreted them to provide damages (often trebled) to indirect purchasers.²³ State law claims challenging anticompetitive mergers can arise generally under two types of state statutes. First, six states have statutes that are comparable to Section 7 of the Clayton Act but also allow recoveries to indirect purchasers.²⁴ Second, ten states have statutes that are comparable to Section 1 of the Sherman Act but also allow recoveries to indirect purchasers.²⁵ If these state law analogues are interpreted consistently with the Sherman Act,²⁶ consumers in these states can also recover. Lastly, one other state seems to establish liability for anticompetitive mergers under its consumer protection statute.²⁷ While there are no reported cases of indirect purchaser litigation arising from an anticompetitive merger, the amount of damages exposure that these laws allow may make them a useful tool in challenging anticompetitive mergers.

Merging parties should not assume that after consummation, their mergers will never be challenged.
consummated merger, such litigation has become typical for other alleged antitrust violations where indirect purchasers have claimed that they absorbed overcharge damages. Those cases illustrate that, as a result of the interplay between Section 4 and certain state laws, defendants might be subject to litigation seeking many multiples of damages — treble damages to direct purchasers and, in some states, damages (often trebled) to indirect purchasers.

Such a result can arise because (1) direct purchasers are entitled to treble overcharge damages even if they passed on the entire overcharge to their customers; and (2) in certain states, indirect purchasers are entitled to treble damages based upon the overcharge that they observed. To illustrate, assume that a consummated merger between two widget manufacturers resulted in a price increase of $1 per widget and further assume that (1) the combined firm sells its widgets to independent distributors who operate in a competitive market; and (2) the independent distributors sell the widgets to ultimate consumers and, in doing so, the independent distributors pass on the $1 price increase. Under this hypothetical, direct purchasers (the independent distributors) of the combined firm would be entitled to treble damages of $3. As economic theory suggests that firms in a perfectly competitive market pass on cost increases, one would expect that the distributors passed on the entire $1 price increase to their customers (the ultimate consumers). The independent distributors would therefore have suffered no overcharge damages, but the ultimate consumers would have paid $1 more per widget. In states that allow damages suits by indirect purchasers, the ultimate consumers might also claim $3 of damages (after trebling). Thus, the combined firm can be subject to litigation seeking $6 per widget sold even though it only inflated the price by $1. In addition, if the combined firm’s competitors were able to increase their prices because of the merger and the umbrella standing theory were accepted, it is possible that the combined firm also can be subject to litigation from its competitors’ customers seeking treble overcharge damages. Thus, under certain limited circumstances, the parties to the acquisition could be exposed to litigation where plaintiffs’ aggregate damages demands would exceed six times the damages caused by the merger.

Direct and indirect purchasers in Kansas might do even better. Kansas law prohibits anticompetitive mergers, and allows a plaintiff to recover "full consideration damages." This measure provides plaintiffs (both direct and indirect purchasers) with damage awards of the full amount that they paid for the defendant’s product and then trebled. Thus, if the statute is applied in this manner, the combined firm could theoretically owe Kansas plaintiffs 600% of the price that they paid for their widgets -- 300% to direct purchasers and 300% to indirect purchasers. While arguments have been made that such a result would violate the Eighth Amendment’s prohibition against “excessive fines,” no court has resolved this issue. In two cases where the constitutionality of the Kansas antitrust statute’s damages provisions were challenged on Eighth Amendment grounds, the trial courts deferred ruling on the motions to dismiss. In doing so, both courts held that any constitutional decision would be premature until after the jury determined the amount of damages.

Finally, Massachusetts law creates even more exposure. The Massachusetts Consumer Protection Act authorizes ultimate consumers to obtain nominal damages of $25 per person if they absorbed at least a fraction of the overcharge. If the product subject to the overcharge was an ingredient in a product widely consumed by individuals (e.g., citric acid) and a class action of all Massachusetts consumers were certified, this class could obtain substantial damages (which theoretically could exceed $150,000,000 if every resident in the state were an indirect purchaser). Parties to an anticompetitive merger might have the same liability because the Massachusetts Consumer Protection Act likely applies to mergers. As with Kansas, a damages award of this sort would present constitutional problems. Indeed, to avoid this constitutional issue, class certification has been denied where nominal damages were available under other statutes. However, no court has decided the constitutionality of the Massachusetts statute as applied to an award of damages to a class of Massachusetts consumers, or to the authors’ knowledge, certified a litigation class under such a theory.

Conclusion

Merging parties should not assume that after consumption, their mergers will never be challenged. If the combined firm increases prices because the merger gave it market power,
government detection and challenge of the merger is a genuine possibility. In such a case, the merging parties should understand that not only may they be subject to a government consent decree to resolve the competition concerns, but they may also be exposed to costly private class action litigation with the possibility of high damage awards or settlements. Any such awards may dwarf the profits that the combined firm would have received from its price increase. ■

ENDNOTES

* Harry S. Davis and Michael E. Swartz are litigation partners with Schulte Roth & Zabel LLP whose practices focus on complex litigation and antitrust counseling. Matthew S. Wild is a litigation associate with Schulte Roth & Zabel LLP whose practice focuses on antitrust counseling and litigation.

1 The HSR Act requires parties to a merger that exceeds a certain size and where at least one of the parties has sales or assets of a certain amount to notify the FTC of the prospective merger and imposes an initial thirty-day waiting period before the parties can close. The statute and regulatory scheme allow the FTC and Antitrust Division additional time to investigate if they choose and an opportunity to seek a court order enjoining the merger before the parties close the transaction. Enacted in 1976, Congress amended the HSR Act effective February 1, 2001 and increased the thresholds for the size of the parties and value of the assets subject to pre-merger notification to reflect more realistic values in 2001 dollars and adjust annually for inflation.

2 As Peter Rodino, Jr., a sponsor of the original HSR Act, explained, "[t]he HSR Act stopped 'midnight mergers.' ... [E]ven when [the government] won, competition was often impossible to restore. The merged company had already closed plants, cut jobs and scrambled assets. ... That had to be corrected." Statement of Peter W. Rodino, Jr. on the 25th Anniversary of the Hart-Scott-Rodino Act.


4 See, e.g., FTC v. Elders Grain, Inc., 868 F.2d 901, 907 (7th Cir. 1989); Matter of the Heart Trust, FTC File No. 991-0323


7 It appears that the DOJ has only challenged one consummated merger since 2001. See United States v. Dairy Farmers of Am., Inc., 426 F.3d 850 (6th Cir. 2005).

8 Indeed, one former Director of the FTC's Bureau of Competition warned that "[a]ntitrust counsel would be well advised to counsel their clients about the likely consequences of consummating transactions that raise substantial competitive issues." FTC Press Release, "FTC Challenges Chicago Bridge's Acquisition of Pitt-Des Moines' Industrial and Water Storage Tank Assets," (Oct. 25, 2001).

9 See, e.g., FTC v. Libbey, Inc., 211 F. Supp. 2d 34, 50 (D.D.C. 2002) (preliminarily enjoining merger because "the effect of the amended agreement could result in the elimination of what is now Anchor as a competitor in the food service glassware market ... Although no statistics were presented, ... the best evidence of its potential effect is the impact of the original agreement because the post-merger landscape could quite possibly be similar to the terrain that would have been created if Libbey had acquired all of Anchor's business"); Todd v. Exxon Corp., 275 F.3d 191, 206 (2d Cir. 2001) ("If a plaintiff can show that a defendant's conduct exerted an actual adverse effect on competition, this is a strong indicator of market power. In fact, this arguably is more direct evidence of market power than calculations of elusive market share figures").


13 See, e.g., id., 495 U.S. at 295.

14 See note 6, supra.


17 See In re First Databank Antitrust Litig., 209 F. Supp. 2d 96, 99 (D.D.C. 2002) ("The FTC submits that private attorneys[] ... [o]fficially 'piggyback' on a prior case, in particular one in which the government conduct[]ed the investigation and perform[ed] much of the 'spadework'").

18 Where a plaintiff claims that it paid too much because of an anticompetitive price increase ("overcharge damages"), the Supreme Court has held that only customers that purchased the goods or services directly from the defendants (or any of their co-conspirators) have suffered antitrust injury. The Supreme Court therefore denied damages recoveries to "indirect purchasers," holding that their injuries were too remote to justify recovery under Section 4. See Illinois Brick Co. v. Illinois, 431 U.S. 720, 745 (1977).

19 See FTC and DOJ Horizontal Merger Guidelines (Rev. Apr. 8, 1997) at 16.

20 See, e.g., Clamp-All Corp. v. Cast Iron Pipe Inst., 851 F.2d 474, 484 (1st Cir. 1988) (Breyer, J.) ("A firm in a concentrated industry typically has reason to decide (individually) to copy an industry leader. ... One does not need an agreement to bring about this kind of follow-the-leader effect in a concentrated industry").

21 See, e.g., FTC v. Mylan Labs, 62 F. Supp. 2d at 38-9 & n.4 (collecting cases).

22 Under certain limited circumstances, actual and potential competitors also can recover treble damages -- for example, where the merger foreclosed them from a market. See Gulf States Reorganization Group,


29 See, e.g., Jeffrey M. Perloff, Microeconomics (2d Ed. 2001) at 31.


33 See id., 253 F. Supp. 2d at 1153.


36 According to the 2000 U.S. Census, Massachusetts has a population of 6,349,077. Thus, $25 per resident would equal $158,726,925.

37 See note 27, supra.

38 See, e.g., Parker v. Time Warner Entm’t Co., 331 F.3d 13, 26 n.4 (2d Cir. 2003).