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Merger Process Reforms

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Mergers and acquisitions that may raise competitive concerns undergo significant investigations by the Federal Trade Commission (FTC) or the Antitrust Division of the Department of Justice (DOJ). The principal tool used by the agencies in their investigations is a Request for Additional Information and Documentary Material, commonly referred to as a second request. Second requests typically involve broad document and data requests as well as detailed interrogatories. Responding to one can delay the closing of a transaction by many months and cost millions of dollars.

While many antitrust attorneys and their clients have long believed the second-request process was unduly burdensome, recent years have seen an explosion in the volume of documents and data that are required to comply with a second request. As the burden has grown, so too has the call for reform.

On Feb. 16, the FTC responded to these concerns with a series of changes aimed at streamlining the process. See Reforms to the Merger Review Process, http://www.ftc.gov/os/2006/02/mergerreviewprocess.pdf. The new policies are a good start and address some of the core problems with the merger-review process. But open and honest communication between the agency staff and the parties will be required to ensure that the benefits of these reforms are realized.

The growing burden of second requests

By any measure, second requests are burdensome. At a time when senior executives are already consumed with due diligence, closing requirements, transition planning and managing investor relations, in addition to running the business, a wide-ranging investigation into the company's products, marketing and competitive position puts a significant strain on management.

A large second request can typically require searching 70 to 100 or more employees for a broad range of documents, submitting huge volumes of competitively sensitive data and answering detailed interrogatories. The expenses involved can also be significant. A recent report estimated that second requests typically last six months and cost the parties $5 million, with complex cases taking an additional year and costing up to $20 million. Cecile Kohrs Lindell, "Majoras Hopes to Streamline Reviews," The Deal, May 10, 2005, http://www.thedeal.com.

Over the last several years, this burden has grown significantly. The FTC identifies two reasons for this change, to which we add a third. First, the FTC notes that it

has begun to rely less on market shares and the structure of a given industry to analyze whether a merger or acquisition will harm competition. Rather, it conducts a detailed analysis of the effects of the transaction. This necessarily fact-intensive review requires greater access to data and documents.

Second, the FTC points to the explosion in electronic documents and document-storage technology. With companies storing electronically significantly more data and documents than even a few years ago, the sheer volume of the average second request has grown substantially. Indeed, the FTC reported that in fiscal year 2005, it received nine document productions that exceeded a million pages, up from two just a few years ago. One merger approved by the DOJ last year reportedly involved 25 million pages of documents.

In addition to these two factors, the focus of second requests has increasingly moved toward preparing for litigation, rather than assessing whether divestiture or some other remedy is warranted. Thus, the scope of second requests has expanded to cover issues that could arise in litigation, but may not be central to the agency's analysis.

The need for reform has been apparent for several years. Earlier attempts at change made relatively minor adjustments that were largely ineffective. The most recent reforms, however, may significantly improve the process.

The FTC's announced reforms make five changes that could substantially reduce the amount of time, costs and resources spent responding to a second request. The first, and perhaps most important, change is a new presumption that parties will be required to search no more than 35 employees. Staff also has the discretion to go below this ceiling. This cap excludes central or corporate files. The director of the Bureau of Competition can authorize a larger search list, but if this presumption holds for most second requests, the number of documents that must be reviewed should be significantly reduced. The number of custodians is the most important factor for the size of the production.

In return for this cap, parties must provide the FTC with organization charts so the FTC can identify relevant employees; make employees available to meet with the FTC to discuss their responsibilities and how the company maintains data; provide written job descriptions of various employees, if requested by the FTC; and produce material responsive to the second request 30 days before declaring substantial compliance with the request (giving the FTC 60 rather than the statutorily required 30 days to review the filing), or agree with staff about the timing of the production. If the FTC challenges the transaction, the parties must agree to propose jointly with the FTC a scheduling order that has a 60-day discovery period. Many of these trade-offs already occur through negotiations between experienced counsel and staff.

While these steps create small upfront delays, they often save time in the end by reducing the volume of the second request. Of course, if a transaction is challenged in court, the mandatory discovery period will likely lengthen any litigation. But parties should be aware that only a small handful of cases are challenged in court. In a recent two-year period, the DOJ reported that it challenged only four of the 180 transactions that received second requests. See Cecile Kohrs Lindell, "Kinder, Gentler Regulators," The Deal, March 2, 2006, http://www.thedeal.com.

The second significant reform is a presumption that only documents created in the last two years need to be produced, which is reduced from the current period of three years. The effect of a shorter time period is obvious. The time period covered by a second request is the second big driver of document volume. If staff does not regularly seek to override this presumption, this limitation should reduce the burden on parties. The date presumption does not apply to data requests, such as reports from sales databases. Typically, the date limits on a data request do not significantly affect the costs or time to produce the material.

The third change is a presumption that parties will only have to preserve back-up tapes for two days identified by the FTC staff. By eliminating the need to maintain all back-up tapes during the course of an investigation, the new policies eliminate a significant cost to companies and reduce the chances that the company will have to restore back-up tapes so they can be searched.

The fourth major change is that the FTC will no longer require parties to produce a full "privilege log" listing each privileged document withheld from a production. Parties can submit a list with each custodian for whom documents were withheld and the number of privileged documents in his or her files. The FTC can then request a full log for a few custodians. Because preparing a full privilege log for all custodians can consume several weeks and cost thousands of dollars, this is a significant reform.

The fifth reform is a requirement that FTC staff discuss with parties their theories and the types of empirical evidence that could be used to test those theories early in the investigation. Without clear explanations of the staff's concerns, parties are unable to provide relevant information to assist in completing the investigation. This policy should help ensure that staff is upfront about its concerns and that useful economic data is reviewed early in an investigation.

The FTC's reforms also institute several smaller changes, which, taken together, should speed up the second-request process. These include clearer rules about removing duplicates from electronic productions and a revised definition of "documents" that excludes information, such as tax documents, that is not relevant to an antitrust investigation.

Following through on the new policies

For these new policies to have a real impact, both the FTC and private parties must follow through by honoring the need for honest negotiations implicit in the reforms. FTC staff should avoid regularly seeking exceptions to the custodian and data limitation and should be clear about their potential theories of harm. Private parties also must operate in good faith and should be upfront in responding to the FTC's questions.

One glaring problem is that the DOJ has yet to adopt any reforms to its merger-review process. The costs and burdens on parties should not vary depending on which agency is reviewing the transaction. The DOJ should move quickly to initiate reforms and give parties a single set of rules to follow.

The FTC has taken a good first step by addressing the core issues that typically lengthen and increase the costs of a merger investigation. If the FTC and private parties can work cooperatively in this new framework while aggressively protecting their clients' interests, future reviews should be more efficient and less burdensome and costly.

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