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BLOG

DOJ Signals Heightened Scrutiny in Four Areas of Merger Review Process

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In a September 17, 2022 speech to the Annual Meeting of the ABA Business Law Section, Deputy Assistant Attorney General Andrew Forman of the Department of Justice's Antitrust Division (DOJ) highlighted several new enforcement priorities of the DOJ. These enforcement priorities should be of particular interest to businesses, such as private equity funds, that regularly make Hart-Scott-Rodino (HSR) filings in connection with M&A transactions.

First, and most notable from Forman's speech, was the news that the DOJ is more closely scrutinizing the sufficiency of merging parties' searches for documents responsive to Items 4(c) and (d) of the HSR filing. As part of their HSR filing, merging parties must respond to Items 4(c) and (d), which require the production of all documents prepared by or for officers or directors that analyze the transaction with respect to competition, synergies, and related topics. The DOJ believes that some merging parties have adopted "lax processes" to search for documents responsive to Items 4(c) and (d) and that these "lax processes" may violate the HSR rules. As a result, the DOJ is "taking a closer look" at the processes used by certain filers to search for documents responsive to Items 4(c) and (d). Forman singled out certain "regular filers" as a specific target for the DOJ's investigation. Typically, the term "regular filers" would be used to refer to private equity funds that regularly make HSR filings in connection with M&A transactions. The DOJ's apparent focus on private equity here is consistent with recent announcements from the DOJ and the FTC signaling increased scrutiny of M&A transactions involving private equity firms, a topic we have previously covered here, here, and here.

Although Forman suggested that the DOJ understands that mistakes can occur from time to time, he also noted that civil penalties for violating the HSR Act, including for incomplete responses to these Items, accrue at the rate of $46,000 per day. It is unclear from Forman's comments whether the DOJ's investigation into the "lax processes" used by certain merging parties focuses only on future filings or whether the DOJ also has opened up a more broad-based investigation to effectively audit past filings of certain merging parties, including so-called "regular filers."

Second, the DOJ recently opened a gun-jumping investigation related to what Forman described as a "fairly standard material contracts consent clause" in a purchase agreement. Gun-jumping occurs when a purchaser acquires—or the parties engage in conduct that amounts to the transfer of—beneficial ownership of the equity or assets of the target prior to closing by prematurely transferring control of day-to-day business decisions of the target or the inappropriate sharing of competitively sensitive information. According to Forman, a "fairly standard"

interim covenant that required the seller to obtain buyer's consent before the target business entered into contracts above a certain materiality threshold created gun-jumping concerns. Specifically, the DOJ was concerned the clause restricted the target's ability to make future competitive bids without the purchaser's consent.

Third, consistent with recent statements from other senior DOJ leadership, Forman reiterated that the DOJ will continue to take a close look at transactions that advance a trend of concentration in an industry, including so-called roll-up strategies by private equity firms. "Roll-up" strategies involve a firm that acquires multiple smaller players in an industry to create a large, combined player. Because a roll-up strategy involves acquiring small firms, it may occur under the radar of the antitrust enforcers because the transactions may be too small to be reportable under the HSR Act. Importantly, just because a transaction is not reportable under the HSR Act does not make it immune from challenge under the antitrust laws, before or after closing.

Finally, the DOJ views with increasing skepticism merging parties' offers to divest a carve-out of assets to another firm to restore the competitive status quo. The DOJ is particularly skeptical of such "fixes" in the context of "a transaction that presents obvious antitrust concerns." Such skepticism is long-held and consistent with the DOJ's 2020 Merger Remedies Manual, which sets forth certain "red flags" to help identify divestiture proposals that may not effectively preserve competition, including the divestiture of less than a standalone business (see our prior discussion here). Forman notes that such "fixes" were not the norm for the 100-plus-year history of the Clayton Act and suggests that the DOJ may be reevaluating its past willingness to regularly rely on divestitures as a fix to an otherwise problematic transaction. Notably, however, Forman's speech occurred before several high-profile DOJ losses in merger trials raising the specter of how these decisions will temper DOJ's position on this issue or impact its litigation strategy in future cases.

Takeaways

- The DOJ is continuing to set its sights on private equity firms and is closely scrutinizing the processes used by PE firms and other "regular filers" to identify and collect documents responsive to Items 4(c) and (d) of the HSR filing. Failure to produce responsive documents can result in significant civil penalties. Even if penalties are not levied, such investigations are time-consuming and expensive and can delay the parties' ability to close their transaction. Parties should work closely with antitrust counsel to ensure that they follow a robust process to search for responsive documents.
- The DOJ continues to closely scrutinize activities of the merging parties between signing and closing for anything that may constitute gun-jumping, including consent provisions that M&A practitioners may not consider problematic.
- The DOJ remains committed to investigating so-called roll-up strategies and businesses employing such strategies. Private equity firms should consider consulting with antitrust counsel regarding the risk associated with transactions that are part of such a strategy, even if the transactions are not HSR-reportable.
- The DOJ is increasingly skeptical that merging parties' divestiture offers will fix an otherwise "problematic" transaction and remains particularly skeptical of such proposals that involve less than a previously standalone business.

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