The Practitioner Transactional Law

Merger Hindsight

Time-of-Suit Doctrine Is Making a Comeback

By Jeffrey I. Shinder

Imagine the following nightmare scenario: After months of negotiations and painful due diligence, your client is ready to close a merger critical to its strategic plans. You are pleased to discover that the new Hart-Scott-Rodino rules allow the deal to close without having to report it to the antitrust regulators in Washington. See 15 U.S.C. Section 18(a) (as amended Feb. 1, 2001). Your client does not have to waste time and precious money complying with intrusive document demands about its business. Nor does it have to negotiate with the antitrust regulators over their concerns.

The deal closes, and the two firms integrate. Years pass, and the merged entity exploits synergies derived from the deal, perhaps achieving competitive advantages over its rivals. Having achieved those advantages, the last thing that you would expect is a government suit to unwind a deal that closed years ago. Think it can't happen? Think again.

This scenario is made possible by a somewhat obscure body of law called the time-of-suit doctrine. Under this doctrine, the legality of a merger should be determined at the time of suit, rather than at the time the acquisition was consummated. *United States v. E.I. du Pont de Nemours & Co.*, 353 U.S. 586 (1957). Thus, a merger may be declared illegal many years after it closed if it is likely to lessen competition substantially.

It does not matter whether your client's deal was reported to the government before closing; the time-of-suit doctrine can be invoked by the government to challenge any deal that threatens competition at the time of suit.

This can happen for many reasons: The government may have reviewed the transaction and made a mistake in permitting it to go forward; the deal may have been innocuous at closing but now threatens competition; or the transaction may have escaped the government's attention because it did not meet the Hart-Scott-Rodino thresholds and, thus, was not reported to the antitrust agencies before closing.

Even though the time-of-suit doctrine has been around for years, it has been invoked rarely by the government in recent years. For starters, the antitrust agencies are loathe to challenge deals that they reviewed before closing, because a subsequent challenge implies that they blundered when they cleared the deal in the first place. Also, it is much easier to exercise prosecutorial discretion to block a transaction before it closes than to unscramble it after the two firms have been integrated.

But the doctrine has made a comeback. When the Hart-Scott-Rodino Act thresholds were raised effective Feb. 1, transactions that were previously reportable (i.e., certain transactions valued at between $15 million and $50 million) began to close without any prior antitrust review.

In the months since the new rules went into effect, the antitrust agencies heard complaints from competitors and customers about some of these transactions. Some executives appear to be exercising their newly acquired market power, perhaps in the mistaken belief that their deals are immune from antitrust scrutiny after they close.

In fact, at the August American Bar Association meeting, the chairman of the Federal Trade Commission, Tim Muris, warned that his agency will challenge previously reportable transactions if they threaten to lessen competition substantially. And he followed through on that promise when the Federal Trade Commission challenged several completed mergers last month.

As if the prospect of a time-of-suit challenge to a completed transaction were not unsettling enough, these lawsuits come with unique evidentiary problems for defendants. As an initial matter, parties can doom their transactions by engaging in anti-competitive or predatory conduct that reveals the antitrust issues raised by their mergers.

> **Those who think their transaction will be immune merely because it falls below the notification thresholds will be in for a rude awakening.**

Such conduct includes (but is by no means limited to) imposing a small but significant and sustained price increase, raising rivals' costs by foreclosing their access to necessary inputs or methods of distribution and collusion with rivals.

While the merged entity's anti-competitive conduct undoubtedly would be cited against the transaction, its pro-competitive conduct typically would be given limited weight if it were offered in defense of the transaction. The case law offers several justifications for this apparent "heads I win, tails you lose" scenario in favor of the government.

The Supreme Court has warned against relying on the merged entity's benign conduct, as the merging parties have every incentive to create, and then exploit, a self-serving record of innocuous conduct to immunize their transaction from antitrust challenge. See *United States v. General Dynamics Corp.*, 415 U.S. 486 (1974).

In a different vein, some courts have noted that evidence of past conduct, derived from the defendants or other sources, is of secondary importance when a merger is challenged under Section 7 of the Clayton Act, the principal antitrust statute governing mergers. See *Ash Grove Cement v. Federal Trade Comm'n*, 577 F.2d 1368 (9th Cir.), cert. denied, 439 U.S. 982 (1978).

This reasoning is consistent with Section 7's incipiency standard, which is designed to stop potentially anticompetitive concentrations of economic power in their formative stages. As a result, the principal inquiry in Section 7 cases is whether the merger threatens to lessen competition substantially in the future, rendering evidence of past conduct of somewhat lesser importance.

In any event, parties defending time-of-suit challenges can and should use post-acquisition evidence that shows that their merger has not, and would not, lessen competition substantially. Given the judicial suspicion of post-acquisition evidence from the defendants, the most compelling evidence would be derived from sources outside of the defendant's control.

Examples would include third-party evidence of vigorous price competition, increases in industry output, decreases in industry concentration, new innovation, increasing competition in both price and nonprice dimensions and/or evidence that entry is easy and that new sources of competition recently have been introduced. A strong defense presentation would include, if possible, testimony from upstream or downstream customers, as well as from competitors.

Defendants also can offer evidence of their own conduct, particularly if the merger challenge comes years after the acquisition. The primary reason for disregarding the merged entity's conduct when it is offered in defense of the transaction makes no sense when years have passed since the acquisition.

Rational firms do not refrain from exercising their market power for many years simply to prevent a long-completed merger from being challenged by the antitrust agencies. When a long period has passed between the transaction and the time of suit, defendants should cite vigorously their own pro-competitive conduct because courts can (and should) give this evidence substantial weight.

The prospect of a time-of-suit challenge raises the question of whether the merging parties can do anything to avoid such a lawsuit if a proposed deal raises clear antitrust concerns. Some parties have chosen to make a pre-merger filing under the Hart-Scott-Rodino Act rules, even though their transaction does not meet the thresholds. This should not be done. The Federal Trade Commission will bounce a filing when the merger does not satisfy the thresholds.

The better course is to approach the Federal Trade Commission merger litigation section to discuss, and perhaps to make a presentation about, the deal. While the staff cannot say that they will not sue to rescind the deal in the future, bringing it to their attention before closing undeniably reduces the risk of such a challenge.

On the other hand, voluntarily bringing a transaction to the government's attention carries certain risks. Once the deal has been brought to the regulators' attention, they may raise concerns and initiate a time-consuming investigation of the transaction.

However, if competitors or customers will be complaining to the regulators about the transaction, it will fall on their radar screen, in any event. In those situations, the parties must balance the risk of delaying the transaction by giving regulators advance notice against the possibility of the deal being challenged and unwound after closing. If there is a substantial risk of a post-merger challenge, the prudent course is notify the regulators in advance of closing and make your arguments to defend the transaction.

Whatever the case, the biggest mistake that you can make is to assume that a prospective deal will not be challenged after closing. Executives who think that their transaction will be immune from antitrust challenge merely because it falls below the pre-merger notification thresholds will be in for a rude awakening. Their merger will be challenged under the time-of-suit doctrine, and their aggressive conduct will doom the transaction in court. Don't let your client's deal be the one that contributes to the resurrection of the time-of-suit doctrine.

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