Time-of-Suit Challenges to Mergers and the New Hart-Scott-Rodino Act Reporting Requirements

BY JEFFREY I. SHINDER

Many in the business community undoubtedly cheered when Congress raised the Hart-Scott-Rodino Act requirements, which govern when proposed mergers must be reported to the antitrust agencies prior to closing. Modest sized transactions "reportable" under the old rules can now close without any hassles from the Federal Trade Commission ("FTC") or Antitrust Division.[1] This change will save corporations filing fees, not to mention the delays and stress that often accompany the merger review process. But this development has resurrected a different issue for the business community: the prospect of antitrust enforcers examining and perhaps challenging unreported transactions after they close under the time-of-suit doctrine.

Although no such challenges have been brought in the first six months of the new rules, they are inevitable. There has been an increase in the complaints the government has received from competitors and customers about completed transactions that would have been reported, and perhaps challenged, under the old regime. Some executives, perhaps emboldened by their freedom from the Hart-Scott-Rodino reporting requirements, are raising their prices or otherwise exercising their newly acquired market power. If they believe their firm's conduct will fall below the radar screen simply because they were not required to report their transaction prior to closing, they might be in for a rude awakening. Transactions that were previously reportable will be challenged after closing if they threaten to substantially lessen competition.

The Time of Suit Doctrine

In fact, if this trend intensifies, the antitrust agencies may select a test case and sue to rescind a previously reportable merger that potentially violates Section 7 of the Clayton Act, the principal antitrust statute governing mergers.[2] Such a case would be brought under the "time of suit doctrine," which provides that the legality of a merger or acquisition should be determined at the time of suit, rather than at the time the acquisition was consummated.[3] Underlying this doctrine is the premise that the Clayton Act is designed to stop restraints of trade or the formation of market power brought on by mergers in their "incipiency," which the Supreme Court defines as "any time when the acquisition threatens to ripen into a prohibited effect."[4]

The government's ability to invoke the "time of suit doctrine" to challenge a merger after closing is reinforced by the longstanding rule that the defense of laches — that the claimant sat on its claims for an extended period of time — does not apply to suits brought by the government.[5] Thus, an acquisition that was not challenged when consummated may be declared illegal many years later if the government can show that the transaction threatens to substantially lessen competition at the time of suit. The requisite finding may be based on evidence that industry concentration has increased since the merger, resulting in a possible (or actual) lessening of competition through coordinated action. Or, the merger could be invalidated if the government can show that the merged entity has profitably imposed a small but significant and sustained price increase after the merger (or could do so in the future).

Post-Acquisition Evidence

The specter of a time-of-suit lawsuit puts an obvious premium on post-acquisition evidence, including the merged entity's conduct. Unfortunately for those defending such lawsuits, the weight given such evidence varies depending on whether the evidence shows anticompetitive effects and whether the evidence is within the control of the merging parties. If the evidence shows harm to competition, the merger is in trouble.[6] On the other hand, the Supreme Court has warned that post-acquisition evidence that the merger has not harmed competition should be given "limited weight," to prevent merging parties from exploiting a self serving record of innocuous conduct. If substantial weight were accorded to such evidence, the parties to the merger could forestall a challenge by "merely refraining from aggressive or anticompetitive behavior when such a suit was threatened or pending."[7]

Courts have offered another justification for their refusal to credit evidence that the acquisition has not harmed competition. In merger cases, the critical issue is whether the transaction might lessen competition in the future. This renders the assessment of whether the transaction has already impaired competition of secondary importance. As the Court of Appeals for the Ninth Circuit explained, "the mere non-occurrence of

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a substantial lessening of competition in the interval between acquisition and trial does not mean that no substantial lessening will develop thereafter."[8]

While the case law seems to create a "heads-I-win, tails-you-lose" scenario in favor of the government, defendants in merger cases can utilize post-acquisition evidence that the merger has not harmed competition, particularly if it is derived from sources outside their control, to defend their transactions. In fact, the rationale for ignoring such evidence disappears when post-acquisition changes in market structure are caused by forces beyond the control of the merging parties. In those instances, evidence of vibrant competition, such as vigorous price competition, increased industry output, decreased industry concentration, greater innovation or the introduction of new sources of competition should be given considerable weight. As the Supreme Court noted, such evidence goes "directly to the question of whether future lessening of competition was probable."[9]

A more difficult question arises when the post-acquisition evidence of no impact is based on the conduct of the merged entity. For example, if the acquisition was completed years before the trial and the evidence shows that the merged entity acted in a pro-competitive manner, should that evidence be given little or no weight merely because of its source? Another way to examine this issue is to ask the following question. Would any firm elect not to exercise its market power for years and years simply to postpone a challenge to an acquisition made long ago? If one accepts that rational firms would not act that way, a major justification for disregarding evidence of no impact coming from the defendants falls away.

As a result, when faced with evidence of defendants post-acquisition conduct, courts should consider the interval between the transaction and the time of suit. If the interval is short, there is an increased risk that defendants good behavior was designed to innoculate their merger from challenge, and evidence of their conduct should be given little or no weight. On the other hand, if a long time has passed, courts should feel free to consider evidence of the defendants alleged pro-competitive conduct. This evidence should be evaluated along with any other evidence that might be relevant to whether the merger threatens to substantially lessen competition in the market.

Requesting Advance Review of the Transaction

The distinct possibility of time-of-suit challenges to previously reportable mergers raises another question. Should corporations voluntarily report such mergers that raise clear competitive concerns for advance review prior to closing? Parties facing this issue should not make a Hart-Scott-Rodino filing when their merger is below the thresholds, as their filing will be returned by the FTC. The better course is to approach the FTC merger litigation section to discuss, and perhaps make a presentation about, the proposed deal. Although the FTC staff cannot say that they will not challenge your merger in the future, having a transaction cleared in advance reduces the likelihood of a time-of-suit lawsuit.

On the other hand, requesting an advance review of the transaction carries some down sides. As an initial matter, it might put the transaction on the government's radar screen. However, where the parties are certain that the transaction inevitably will be brought to the government's attention by competitors, this concern is not terribly important. Of potentially greater significance, the antitrust agencies might seek additional information, triggering a full blown merger review process that will be time consuming and costly. And, at the end of the day, even if the agencies indicate that they do not currently intend to challenge the merger, they are free to revisit the transaction post-closing if the circumstances warrant.[10]

Conclusion

While the enforcement agencies have been understandably reluctant to invoke the time-of-suit doctrine to challenge deals they have cleared in advance of closing, the doctrine will be making a comeback. In fact, with more mergers escaping the pre-merger notification process, the enforcement agencies will be faced with threats to competition that will justify invoking the doctrine. If executives think their mergers are immune from antitrust review merely because their deals are no longer subject to the pre-merger notification process, their aggressive conduct will virtually guarantee time-of-suit challenges. ❧

1 Under the new rules, which went into effect on February 1, 2001, the size-of-transaction threshold was raised from $15 million to $50 million. Transactions valued at between $50 and $200 million are reportable only if one of the merging parties has annual net sales or assets of $100 million or more, and the other party has net sales or assets of $10 million or more. All transactions valued at over $200 million must be reported irrespective of the annual net sales or assets of the merging parties. A complete discussion of the Hart-Scott-Rodino Act reporting requirements is beyond the scope of this article.

2 The Clayton Act prohibits mergers and acquisitions, which may substantially lessen competition or tend to create a monopoly. 15 U.S.C. '18 (1994).

3 *United States v. E.I. du Pont de Nemours & Co.*, 353 U.S. 586 (1957).

4 Id.

5 By contrast, the defense of laches applies to a time-of-suit lawsuit brought by a private plaintiff. Moreover, the time-of-suit doctrine does not extend the statutory four year damage period governing private suits. And one of the few cases applying the time-of-suit doctrine in a private challenge suggested that the plaintiff must demonstrate an anticompetitive use of the acquired assets, a more stringent standard than the Clayton Act=s incipiency standard. *Midwestern Machinery Co., Inc. v. Northwest Airlines, Inc.*, 990 F.Supp. 1128, 1137-38 (D. Minn. 1998).

6 In *United States v. General Dynamics Corp.*, 415 U.S. 486, 505 n. 13 (1974), the Supreme Court held that Apost-merger evidence showing a lessening of competition may constitute an incipiency on which to base a divestiture suit, but evidence showing that such lessening has not, in fact, occurred cannot be accorded too much weight.

7 Id.

8 *Ash Grove Cement v. FTC*, 577 F.2d 1368, 1379 (9th Cir.), cert. denied, 439 U.S. 982 (1978).

9 *United States v. General Dynamics Corp.*, 415 U.S. 486, 506 (1974)

10 It is worth noting that, even when the government clears a reportable transaction, it can bring a subsequent challenge to the deal based on the time-of-suit doctrine if the transaction threatens competition.

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