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From the Editor

Despite the Season, A Hope for Warmer Weather
When will mergers and acquisitions activity snap out of its slump? While preliminary third-quarter volume figures showed no dramatic signs of improvement, there are increasing hopes among market players that the fourth quarter, and particularly 2024, will mark a change in the weather at last.

The total value of M&A issuance fell slightly to $717.4 billion during the third quarter, according to Dealogic, compared with $738.1 billion in the same period in 2022. U.S. dealmaking was a highlight, offsetting substantial declines in European and Asian deals. As per Reuters, U.S. dealmakers advised on deals worth $356.51 billion in third-quarter **2023**, up 35% from the same period last year. By comparison, volumes in Europe and Asia Pacific fell by 31% and 9%, respectively.

The usual suspects got the blame: relatively high interest rates that the Federal Reserve shows no signs of moderating in the near or medium term; greater antitrust activity by the DOJ and FTC: and political roller-coaster instability, such as a near-government shutdown and subsequent ouster of Speaker McCarthy in early **October**.

But market players said they're starting to see buyers stuffed with cash looking for attractive strategic targets, and making substantial offers. See Cleveland Cliffs' $7.3 billion proposed acquisition of U.S. Steel, a third-quarter highlight, along with Cisco's $28 billion bid for Splunk, GTCR's $18.5 billion deal for the merchant services division of Fidelity National Information Services and Ireland's Smurfit Kappa's proposed $11 billion acquisition of its American rival WestRock.

"We're going to continue to see a steady flow of deals. We're not going to see the craziness that we had in 2021," Melissa Sawyer, global head of M&A at Sullivan & Cromwell, told Reuters. "But on the other hand, I think all these predictions of the demise of M&A are overblown."

Private equity deals remain a challenge—for the first nine months of **2023**, private equity deal volumes fell by 48% compared to the same period last year. Financing leveraged buyouts has become more difficult in the current inflationary environment, prompting some PE buyers to use earn-out structures to settle price differences (see Roark Capital's buyout of Subway). And tech deals, a key driver of M&A activity in the 2010s, are also down by roughly 50% so far this year.

The next issue of *The M&A Lawyer* will come out in early December—we hope that our readers have a wonderful autumn.

Chris O'Leary

Managing Editor

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The M and A Lawyer
By Max Seuster[a0]

M&A Deals in Europe Facing New Filing Obligation

As of **October** 12, **2023**, (ongoing and future) M&A transactions in the EU may trigger a new mandatory filing to the European Commission ("EC") under the EU's new Foreign Subsidies Regulation ("FSR"), which entered into force on July 12, **2023**. Failure to file can result in high fines. The new filing obligation for M&A transactions will increase red tape for closing M&A transaction of state-supported investors in Europe, and will add to possible notifications under EU or national merger control rules, foreign direct investment rules and/or possibly sector-specific rules (*e.g.*, for certain energy infrastructure under the EU's Third Energy Package).

This article addresses the key features of the new mandatory FSR filing regime for M&A deals in Europe, gives practical guidance for FSR filings based on the EC's recently adopted Implementation Regulation, and sets out necessary preparatory steps for businesses whose deals will potentially trigger mandatory FSR review.

M&A Deals Triggering an FSR Filing
An M&A transaction requires prior FSR approval from the EC if:

- It constitutes a **concentration** (*i.e.*, a merger or an acquisition of (sole or joint) control over another business); and
- **One of the merging undertakings** (in the case of mergers), the **acquired business** (the target) or the **joint venture is established in the EU** and **generates turnover of at least €500 million in the EU**; and
- All undertakings concerned received a combined **aggregate financial contributions from non-EU countries exceeding €50 million in the last three financial years**.

A filing obligation may apply to all **concentrations signed on July 12, 2023 or later, but which have not yet been closed on October 12, 2023**. Businesses will potentially have to file parallel notifications under EU or national merger control rules, foreign direct investment rules and/or possibly sector-specific rules (*e.g.*, for certain energy infrastructure under the EU's Third Energy Package).

Even if the above € value thresholds are not met, the EC can request an (ad-hoc) FSR filing prior to Closing where it suspects that foreign subsidies may have been granted to the undertakings concerned in the previous three years In practice, it can be expected that such ad hoc request is likely to be limited to cases where at least the financial contribution threshold is exceeded. Notifiable M&A transactions must await EC clearance prior to Closing (standstill obligation). Failure to notify can lead to high fines (of up to 10% of the company's aggregate worldwide turnover).

Wide Notion of "Financial Contribution"

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A FSR filing obligation depends, amongst other things, on whether the combined aggregate financial contributions exceed the €50 million threshold, and it can therfore apply irrespective of whether contributions were granted at arms' length or their potential effects on the EU internal market.

What constitutes a "financial contribution" is broadly defined and includes:

- **any transfer of funds or liabilities** (*e.g.*, grants, capital injections, loans, loan guarantees, below-cost financing, fiscal incentives, debt forgiveness, setting off of operating losses, compensation for financial burdens imposed by public authorities and debt to equity swaps);

- **forgoing of revenues that are otherwise due** (*e.g.*, tax exemptions and the granting of special or exclusive rights without adequate remuneration); or

- the **provision or purchase of goods or services**.

Pursuant to the FSR and the EC's Implementation Regulation adopted in July **2023** (and related Q&A guidance), companies must consider the following principles when calculating the aggregate value of the financial contributions granted:

- Financial contribution exceeding €50 million must have been granted in the last three financial years prior to the conclusion of the agreement, announcement of the public bid or acquisition of a controlling interest. The three-year period generally starts to run from the moment a beneficiary obtains a legal entitlement to receive it (and not the date on which funds are acually disbursed).
- The relevant aggregate comprises all financial contributions provided by third countries to the group, *i.e.,* the undertaking concerned, the companies directly or indirectly controlled by the undertaking concerned (subsidiaries) and those directly or indirectly controlling the undertaking concerned (ultimate parent).
- Financial contributions can be granted by any non-EU country (including Norway, Switzerland, and the UK) and include not only contributions provided by the country's central government and government authorities at all other levels but also all foreign public or private entities whose actions can be attributed to the third country.

Distortive Effects of a Foreign Subsidy?

During the FSR review process, the EC will assess whether the financial contribution gives rise to a distortive foreign subsidy, *i.e.*, whether it improves the competitive position of the undertaking concerned and thereby actually or potentially negatively affected competition in the internal market. This analysis will be based on several indicators, such as the amount, nature and purpose of the subsidy, the market situation, as well as the purpose and conditions attached to the foreign subsidy.

Foreign subsidies that the EC will consider "most likely to distort" the internal market include foreign subsidies granted to an ailing undertaking, unlimited guarantees, certain export financing measures, foreign subsidies directly facilitating a concentration or those enabling an undertaking to submit an unduly advantageous tender. Less problematic foreign subsidies include (i) foreign subsidies not exceeding €200,000 per non-EU country in any three-year period, which are not considered to be distortive; (ii) foreign subsidies to undertakings not exceeding €4 million in aggregate over the previous three years, which are 'unlikely' to be distortive; and (iii) a foreign subsidy aimed at making good the damage caused by natural disasters or exceptional occurrences (*e.g.*, COVID-19), which may not be considered to be distortive.

If a foreign subsidy is found to be distortive, the EC will consider potential positive effects of the foreign subsidy and balance these effects with its negative effects. If negative effects are found to prevail, the EC can **prohibit the transaction** or impose redressive measures/commitments from the companies that remedy the distortion. This may include **structural or behavioural measures**, such as the divestment of assets, the reduction of capacity or market presence (including by means of temporary restriction on commercial activity), granting access to infrastructure (including, for example, research facilities, production capabilities or essential facilities), repayment of the foreign subsidy (including interest), etc.

FSR Review Process

The EC has 25 working days as of formal filing to review a notifiable transaction and, if it opens an in-depth investigation, an additional 90 working days (subject to further extension). Parties are advised to engage in informal pre-notification discussions with the EC to limit reporting requirements and request possible waivers for information that must normally be reported in the FSR filing. The pre-notification process is not subject to formal timelines. By way of reference, in merger reviews, pre-notification discussions with the EC typically take two to four weeks (prior to formal filing) in straightforward cases, but can last for several months in more complex cases. The EC has far-reaching investigatory powers to assess alleged distortions, including the power to request information, conduct unannounced inspections within and outside the EU and impose fines and periodic penalty payments on companies if they provide incorrect, incomplete or misleading information or take interim measures.

Practical Guidance for FSR Filings

In July **2023**, the EC adopted an Implementing Regulation laying down the procedures for notifying, and content of, notifications of concentrations, rules for calculating time limits and other procedural aspects of the new FSR. To facilitate the preparation of and approval process for FSR filings, the EC will generally accept that parties do not report detailed information on all financial contributions granted during the last three years in the FSR filing (so-called Form FS-CO), as further clarified in the Implementing Regulation:

- Financial contributions of less than €1 million must not be reported.
- Detailed information must be provided on specific types of financial contributions (equal to or exceeding €1 million) that may give rise to certain foreign subsidies that are "most likely" to be distortive, namely (i) subsidies granted to an ailing undertaking, (ii) unlimited guarantees, (iii) certain export financing measures, and (iv) subsidies directly facilitating a concentration.
- For all other financial contributions, parties must provide an overview of all financial contributions granted per country (including description by type of contribution and range of amounts) for all countries where the aggregate financial contributions granted in the last three years were €45 million or more. No such information must be provided for (i) certain tax deferrals/double taxation reliefs; (ii) goods/services provided/purchased at market terms in the ordinary course of business (*e.g.*, when carried out following competitive and transparent tender process); and (iii) in case of acquisitions by investment funds (subject to conditions), contributions granted to related investment funds (other than the acquiring fund).

While these softer reporting requirements may facilitate the preparation of an FSR filing, businesses must still gather the relevant information to be in a position to assess what level of reporting is needed, and the EC has the discretion to request more information in individual cases where it suspects that foreign subsidies may have been granted in the last three years. In practice, parties will often have to rely on requesting a waiver from the EC for certain reporting requirements when information is not reasonably available or not necessary for the examination of the case. In any case, regardless of whether information must be reported in the FSR filing, all financial contributions granted to the parties (and their respective groups) in the last three years must be taken into account when determining whether a FSR filing is required.

Practical Impact and Preparatory Steps to Take

1. Impact on M&A transactions: As of **October** 12, **2023**, the new FSR filing obligation will significantly increase red tape for closing certain M&A transactions by State-supported investors in Europe. The new review procedure will be costly and time-consuming, and businesses will potentially have to file parallel notifications under EU or national merger control rules, foreign direct investment rules and/or possibly sector-specific rules (*e.g.*, for certain energy infrastructure under the EU's Third Energy Package). More legal uncertainty will arise for M&A transactions falling below the notification thresholds but where the EC has concerns that distortive foreign subsidies may have been granted to the parties in the last three years and the right to request notification prior to Closing. All this will need to be addressed in transaction documentation (conditions precedent, risk allocation provisions, etc.), deal timing/planning and due diligence reviews. In practice, it is also likely that third parties will increasingly use the FSR as a sword to oppose deals that are not in their strategic interests, for instance, in the context of competitive M&A processes or by launching complaints to the EC.

2. Preparatory steps: To assess possible FSR filing requirements, businesses with direct or indirect commercial or other links with non-EU states are advised to take the following steps:

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- **Start identifying and compiling a record of financial contributions received from non-EU states since at least July 12, 2020**. Businesses are therefore advised to establish systems for the collection of group-wide information relating to relevant contracts, grants, tax incentives, etc., on a global basis to ensure that financial contributions can be tracked and quantified. Ideally, businesses should keep a record going back to July 12, 2018, as the EC also has the power and discretion to investigate all financial contributions by way of an ex-officio investigation that were granted up to five years prior to the entering into force of the FSR.
- **Identify higher risk types of financial contributions, namely** (i) subsidies granted to an ailing undertaking; (ii) subsidies in the form of an unlimited guarantee for debts or liabilities; (iii) subsidies in the form of export financing measure not in line with OECD Arrangement on officially supported export credits; (iv) subsidies directly facilitating a concentration; and/or (v) subsidies enabling an undertaking to submit an unduly advantageous tender.
- **Check whether financial contributions were/are received on market terms.** While a FSR filing can be required regardless of whether a financial contribution was granted on market terms, such contributions will, however, avoid classification as (distortive) foreign subsidies and facilitate the FSR approval process.
- **Where it is not clear whether a financial contribution qualifies as a foreign subsidy or has distortive effects in the EU, it is advisable to consider its impact on any activities in the EU** and whether the policy aims of the non-EU state are supported in the EU as this could serve as possible justification and defence against EC intervention.
- **For ongoing/future M&A projects, assess possible parallel merger control, FDI and other regulatory approval requirements** and **reflect filing requirements/processes in the transaction documentation**. A **coordinated and streamlined planning and preparation** is necessary to ensure a smooth approval process for closing and strategic consistency for future transactions.

3. Remember: Non-M&A related, foreign-subsidized business activities in the EU may also trigger EC intervention under the new FSR. Participation in certain public tenders in the EU may be subject to a mandatory notification obligation as of **October** 12, **2023** where (i) the estimate contract value is at least €250 million; and (ii) the economic operator participating in the tender was granted aggregate foreign financial contributions in the three financial years prior to the notification of at least €4 million per third country. In addition, the EC has the general power and discretion to investigate foreign subsidies by way of (ex-officio) investigation. The limitation period for ex-officio investigations is 10 years, and the EC can investigate foreign subsidies granted since July 12, 2018.

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Footnotes

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The M and A Lawyer
By Jonathan Kanter [a0]

"An Overwhelming Call for Vigorous Merger Enforcement"

At the Third Annual Georgetown Antitrust Conference in 2009, the Federal Trade Commission and the Department of Justice announced the public comment process that led to the 2010 Horizontal Merger Guidelines. A lot has changed in those 14 years. While I'm sure the audience here at Georgetown had many thoughts, only 44 commenters wrote to the agencies in response to that initial call for comments. [1] The broader public showed little interest in increasing antitrust enforcement. Agency staffing levels were continuing a decades-long decline.

Today, we are working to revise the merger guidelines against a very different landscape. Since 2010, we have heard growing concerns about the level of competition in key sectors of the American economy. Waves of academic studies document how the public loses out when mergers lessen competition in industries across our economy. [2]

The problem is not limited to consumer markets. At the same time, a robust literature has emerged documenting how workers lose out from too little labor market competition. [3] We have the good fortune to have Ioana Marinescu at the division alongside heroic attorneys and EAG economists, helping revitalize our labor market efforts including in the merger guidelines. The health of our economy depends on the ability of workers to get competitive wages and terms for their efforts.

The biggest change since 2009, though, has been the public's awareness of consolidation and the resulting harms. Numbers in regressions are one thing, but real harms to real people are reawakening Americans to the importance of antitrust enforcement.

We are hearing that loud and clear in the public comment process. Our initial request for comment on the guidelines generated over 5,000 responses from the public. And [on Sept. 18], the comment period on the draft closed with over 3,000 comments submitted on Regulations.gov and thousands more e-mailed to the agencies. The public comments overwhelmingly call for vigorous merger enforcement.

For example, we received several hundred comments from writers and other creators concerned about the impacts of media-industry consolidation on their profession. We have so many comments like the one from a television writer who told us that "the more the media companies merge, the fewer jobs are available for writers, and less compensation is offered." [4]

We hear a startlingly similar concern from doctors, nurses and other healthcare workers who report that consolidation has made it harder to do what they love and treat patients with care and flexibility. One ICU nurse from California said what so many in her profession did. She worked for a community hospital that had "remarkable care" for patients. But after a merger, she says nursing ratios dropped, vacation time was stripped from nurses and practice expectations became "unsafe." Her comment urges the department to "prevent further mergers that limit choice for consumers, especially in healthcare," and to "enforce the antitrust laws already passed." [5]

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I want the writers, nurses, farmers, concerned citizens and all the other public commenters to know—the Justice Department hears your concerns. Economic harm and suffering are not just triangles and curves, they are real human consequences for real people. Citizens are speaking up and we are listening. Our litmus test for success is whether we are serving the needs of the American people. They are now watching too and they are demanding that we do more and that we do better to protect a competitive economy.

For that reason, we will read all the comments, from lay people and experts alike, with care. We will assess suggested revisions with an open mind.

As we work to finalize the guidelines, we will continue to apply an important limiting principle. We are law enforcers, and the law limits our discretion. It is up to Congress to write the antitrust laws, and the courts to interpret the laws, and it is our job at the Justice Department to enforce the laws.

That is how we think about enforcement and think about the guidelines in an era of renewed interest. The Antitrust Division should seek to vigorously protect competition with appropriate use of its legal authority.

Readers should understand that the guidelines are not the law. The Justice Department cannot write rules and regulations that change the Clayton Act and the binding rights and obligations created by the law. For that reason, we should not invent safe harbors that ignore the will of Congress or constrain our ability to analyze the facts. [6] Nor is it our job to opine on which of the many mergers that are not illegal are good, and why.

Likewise, when we explain situations we tend to think might suggest the potential for a violation, we must also acknowledge that in each case we would review other pertinent factors to reach the appropriate decision. The draft Merger Guidelines already reflect these important limitations. [7]

Our merger guidelines are still important, however. For example, they provide transparency to merging parties and impacted citizens. When we explain frameworks we most frequently apply, the agencies empower the public to engage with us. Maybe you or your clients disagree with the law or economics as we see them, but the process will work better if you know how we are thinking as we review a deal.

The guidelines also foster consist"ncy 'nd predictability, while at the same time preserving the flexibility Congress set forth in the Clayton Act. The DOJ and FTC are two separate agencies that each have hundreds of professionals. While the guidelines cannot dictate where the analysis will end in any given case, they can at least help investigations across the agencies start in the same place.

Our guidelines also shape the language that the agencies use to talk about mergers in public and in the courts. In an era when the broader public is interested in merger review, and when we are litigating more and more often, the guidelines should guide us to build cases that invite and enable the public.

So what comes next? We are thrilled to have an overwhelming comment response to our draft guidelines. We will work as quickly as we can so that our final guidelines can realize the goals of transparency and predictability.

As we undertake that revision and continue to review mergers, I will have three core principles in mind.

First, we need to ask how competition presents itself in the context of each merger. Our merger analysis must reflect market realities. The inescapable reality of modern markets is that competition plays out in many ways, across many different dimensions.

At times, we have fallen into the trap of assuming a standard model of competition for merger review. Static price competition is incredibly important, and we will continue to fight for consumers to benefit from competition through lower prices and increased quality. But we have so much more to protect as well.

Competition varies widely across industries and over time, and the nature of competition may be different from one merger to another. For example, so-called zero-price markets are increasingly important, with consumers exchanging their personal

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data and their time. [8] Competition for platforms, on platforms and to displace platforms are all critical. [9] Labor markets ensure competition for workers' wages. [10] And new forms of competition are frequently emerging, from generative AI to algorithmic pricing. [11]

That is why the draft guidelines begin by asking "how does competition present itself in this market …?"

That emphasis, on competition, follows through the rest of the document. Each of the prima facie frameworks in Section II focuses on competition. The rebuttal section uses the same approach, recasting the analysis generally in terms of effects on competition. The draft contains critical aspects of the economic analysis that are applicable to both of those sections. Focusing on competition, as Congress asked us to do, will better enable us to fit our analysis to the facts.

That brings me to my second fundamental point. What is the right question to ask about competition? I believe the Clayton Act presents that question. The Clayton Act directs us to ask whether the effect of a merger "may be substantially to lessen competition or to tend to create a monopoly." It asks us to assess the risk a merger poses to competition. This approach vindicates Congress' policy judgment that merger enforcement should be more risk-averse than a Sherman Act analysis. [12]

I think a lot about the kinds of problems articulated by that ICU nurse. Does the Clayton Act reach harm to competition that results in overworked and under supported nurses even when we cannot point to a higher price?

I recently sat by as a loved one received major life-saving surgery from dedicated and attentive professionals in a community hospital. The level of care and attention that dedicated nurses, professionals and doctors were providing to their patients was rare—if not unprecedented—by today's standards. I am eternally grateful. As I watched that, I was absolutely convinced that quality of care and attention is worthy of protection, even when it is difficult, if not impossible, to attach to it a monetary value. We must ask ourselves, is antitrust really working for the public when we reduce human life to a grayed-out triangle? The product is so much more than that, and people are so much more. Competition benefits them both.

Competition was difficult to measure in 1914, but Congress still thought it important to prevent threats to competition in their incipiency. Even more today than when the law was strengthened in 1950, competition can be an unpredictable process. It is the beauty of a rival waking up each morning not knowing what its competitor will do next. Not knowing how much a competitor will pay their nurses, or what new feature an adjacent firm will unveil.

That uncertainty drives the innovation and opportunity that make our economy tick and delivers ever-increasing rewards to consumers and workers alike. As enforcers in Washington, D.C., how can we measure what we hope the rivals in the competitive process themselves could not predict?

That is why the Clayton Act prohibits all mergers where the effect "may be" substantially to lessen competition or to tend to create a monopoly. In any given transaction, we should use the best analytical and evidentiary tools available to help us identify a risk of harm. [13]

Importantly, the risk assessment framework applies to both the evaluation of the agencies' prima facie case and to rebuttal evidence. As the draft guidelines explain, we first ask whether facts show that the effect of the merger "may be" to substantially lessen competition. Then on rebuttal, we take seriously other evidence that demonstrates the merger does not, in fact, "threaten" to lessen competition. [14]

I have to acknowledge on this point the incredible work that Susan Athey, Aviv Nevo and the staff of EAG and BE did evolving the draft guidelines to better reflect a toolkit that maps to the Clayton's Act's risk assessment framework and invites the development and use of state of the art analytical methods. As the in-depth discussion of economic tools in the draft guidelines demonstrates, this lens opens up the analysis to better use the full array of modern economic and analytical tools to get the right answers in our merger reviews. Indeed, the draft guidelines have extended and evolved the economic toolkit, which serves as a cross-cutting foundation of our approach to analyzing competition as it presents itself in each merger.

Third, let me briefly address how we do that. Merger analysis is not a one-size-fits-all exercise. In different situations, different tools will shine the clearest light on a merger's risk of harming competition.

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Three important examples are direct evidence, empirical evidence and market structure. The draft guidelines describe these important tools in detail.

In some cases, we have direct evidence. [15] Documents and testimony can reveal that merging parties live rent-free in each other’s heads. What more do we need to know than that a merger will eliminate rivalry that has driven lower prices, better service or innovation in the past? If the CEO said a merger would eliminate a nascent threat, the Clayton Act says we should listen and pay attention to the “man behind the curtain.”

In other cases, red flags may emerge from the data. The draft merger guidelines add econometric analysis to the “sources of evidence” section from prior guidelines. As they explain, analytical work can help us understand competitive dynamics. That’s true even if the data or modeling techniques don’t report results as a specific price effect prediction. As I have been saying, it’s time to modernize, and that means relying on the full set of available empirical and evidentiary tools that help us understand how competition plays out.

Ask yourselves this question: in **2023** should we use static models to model the behavior of “rational consumers” or should we use cognitive science, behavioral economics and the full range of analytical tools and evidence to understand the idiosyncratic behavior of humans? The answer to that question should be obvious.

Another useful tool remains looking at how a merger will change the structure of the market. The structural presumption tells us something about the risk a merger poses to competition. When a merger further concentrates a highly concentrated market, we should be concerned it may eliminate important competition between firms and create a risk of oligopoly coordination. As the draft guidelines say, the greater the concentration, the greater the risk. The courts say that as well, again and again.

I should say that I have heard concerns from some members of the defense bar that the approach to the structural presumption in the draft guidelines is inconsistent with modern district court cases. They can rest assured that, even at 60 years old, *Philadelphia National Bank* is alive and well. In fact, since 2010, the federal courts have treated the structural presumption as a key feature in 23 of the 25 agency horizontal merger cases they decided. [16] As the Third Circuit reiterated in the *Hackensack* case just last year, if the structural presumption is met, a plaintiff “need[s] no further evidence to … establish [a] prima facie case.” [17] Like it or not, courts are clear that the structural presumption is one of many paths—but not the only path—for the government to establish its prima facie case. This has been the law for decades and standard practice at the Division across administrations of both parties since the Supreme Court decided *Philadelphia National Bank*.

As you know from the draft guidelines, those are just a few of the tools the agencies most often use to identify a risk of harm to competition.

We also need to be clear-eyed that none of these tools can perfectly predict or measure the complex and dynamic economy in which we live. The tools of merger review are signals of potential danger, not photos of the future or a crystal ball. This means that we must construct our investigation to the probabilistic and prophylactic standard that animates Section 7 of the Clayton Act.

That also means that in many instances we cannot map competition with enough precision to engage in reconstructive surgery to restore competition. As many of you know, for nearly two years, the Antitrust Division has been careful not to pursue incomplete or uncertain remedies that ask the public to shoulder the risk of failure. Patchwork quilts of carve-out divestitures, complex merger consent decrees involving extensive entanglements and ongoing dependence between the merged firm and the divestiture buyer often fail to protect the harm to competition from an otherwise anticompetitive merger. Simply put, we need the appropriate level of confidence that a remedy will be sufficient to address the risk of harm to competition presented by the underlying deal.

I am pleased to report that our remedies policy is working. We are seeing dramatically fewer illegal mergers, which benefits the public, conserves valuable resources and provides greater clarity and predictability to the business community. We continue to see thousands of mergers per year. The difference now is that fewer deals present violations of the law.

I would like to conclude my remarks with a couple of commitments. First, we are committed to carefully reviewing the comments on the draft as we work to issue the final guidelines.

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Second, even as that happens, we remain deeply committed to promoting competition in the American economy. We are committed to protecting consumers from the harms of higher prices, lower quality, reduced choice, lower standards in healthcare and diminished innovation that result from lessened competition. We are similarly committed to protecting workers from the harms that result when they face too little competition for their labor. And we are committed to promoting, for all Americans, a dynamic and vibrant economy in which competitive markets drive innovation and opportunity. Those are core ingredients of a thriving democracy that we are duty bound to protect.

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Footnotes

a0 Jonathan Kanter is Assistant Attorney General for the Antitrust Division of the Department of Justice. The following is edited and adapted from remarks he gave at the Georgetown Antitrust Law Symposium on September 19, 2023, in Washington, D.C.

1 *See* Christine A. Varney, Assistant Attorney General, Antitrust Division, U.S. Dep't of Justice, An Update on the Review of the Horizontal Merger Guidelines, Remarks as Prepared for the Horizontal Merger Guidelines Review Project's Final Workshop (Jan. 26, 2010).

2 For example, Nate Miller and Matthew Weinberg's work shows how consumers pay more for beer as a result of a merger cleared by the Division. *See* Nathan Miller & Matthew C. Weinberg, *Understanding the Price Effects of the MillerCoors Joint Venture*, 85 Econometrica 1763 (2017). Leemore Dafny and coauthors have found harms from consolidation in health insurance, a critical sector of the economy. Leemore Dafny et al., *Paying a Premium on Your Premium? Consolidation in the US Health Insurance Industry*, 102 Am. Econ. Rev. 1161 (2012). And the recent work of Vivek Bhattyachara and his coauthors suggests our enforcement policy has been too permissive, permitting mergers to raise prices across a range of retail markets. Vivek Bhattyachara et al., Merger Effects and Antitrust Enforcement: Evidence from U.S. Retail, NBER Working Paper No. 31223 (2023) (finding that U.S. retail mergers on average increased prices and decreased transacted quantities). *See* John E. Kwoka, Jr., Mergers, Merger Control, and Remedies: A Retrospective Analysis of U.S. Policy (Cambridge, MA: The MIT Press, 2015) (finding that more than 80% of studied mergers resulted in price increases); Orley Ashenfelter et al., *Did Robert Bork Underestimate the Competitive Impact of Mergers? Evidence from Consummated Mergers*, 57 J. Law And Econ. 67 (2014) (concluding that 36 of the 49 compiled studies resulted in higher prices). *See also* Ryan A. Decker et al., *Changing Business Dynamism and Productivity: Shocks Versus Responsiveness*. 110 AM. ECON. REV. 3952 (2020); Germán Gutiérrez & Thomas Philippon, *The Failure of Free Entry*, NBER Working Paper No. 26001 (2019); Jan De Loecker et al., *The Rise of Mark*et Power and the Macroeconomic Implications, 135 Q.J. Econ. 561 (2020).

3 *See* Elena Prager & Matt Schmitt, *Employer Consolidation and Wages: Evidence from Hospitals*, 111 AM. ECON. REV. 397 (2021); *see also* José Azar et al., *Labor Market Concentration*, 57 J. Hum. Res. S167 (2022); David Berger et al., *Labor Market Po*wer, 112 Am. Econ. Rev. 1147 (2022).

4 Comment from Hanna McIntosh (https://www.regulations.gov/comment/FTC-2023-0043-0717) (Aug. 15, 2023); *see also* Comment from Jon Wolf, (https://www.regulations.gov/comment/FTC-2023-0043-0572) (Aug. 8, 2023) ("I am a member of the Directors Guild of America and I strongly support the FTC investigating recent and future mergers in the entertainment industry. As entertainment firms consolidate, they routinely demolish individual development departments, destroying jobs and diminishing the opportunities for creatives.").

5 Comment from Gale Galarza, (https://www.regulations.gov/comment/FTC-2023-0043-1034) (Aug. 20, 2023) (former ICU nurse detailing the harms resulting from hospital system merger and urging the

Agencies to "prevent further mergers that limit choice for consumers, especially in healthcare."); *see also* Comment from Elizabeth Slattery (https://www.regulations.gov/comment/FTC-**2023**-0043-0551).

6 *See* General Elec. Co. v. E.P.A., 290 F.3d 377, 383, 54 Env't. Rep. Cas. (BNA) 1385, 32 Envtl. L. Rep. 20672 (D.C. Cir. 2002) ("if the language of the document is such that private parties can rely on it as a norm or safe harbor by which to shape their actions, it can be binding as a practical matter.") (internal citation omitted); *see also* Center for Auto Safety v. National Highway Traffic Safety Admin., 452 F.3d 798, 809 (D.C. Cir. 2006) ("There is also nothing to indicate that automakers can rely on the guidelines as 'a norm or safe harbor by which to shape their actions,' which might suggest that the guidelines are binding as a practical matter.") (quoting *Gen. Elec.*, 290 F.3d at 383).

7 U.S. Dep't Justice & Fed. Trade Comm'n, ***2023*** *Draft Merger Guidelines* at 5 (July 19, **2023**) ("These Guidelines create no independent rights or obligations and do not limit the discretion of the Agencies or their staff in any way. … The Agencies assess any relevant and meaningful evidence to evaluate whether the effect of a merger may be substantially to lessen competition or to tend to create a monopoly. Merger review is ultimately a fact-specific exercise. The Agencies follow the facts in analyzing mergers, as they do in other areas of law enforcement.").

8 *See* Cass R. Sunstein, *Valuing Facebook*, 4 Behavioral Pub. Policy 370 (2019); John M. Newman, *Antitrust in Zero-Price Markets: Foundations*, 164 U. Penn. L. Rev. 149 (2015).

9 *See* Susan Athey & Fiona Scott Morton, *Platform Annexation*, 84 Antitrust L.J. 677 (2022); UK Competition & Mkts. Auth., Online Platforms and Digital Advertising: Market Study Final Report (Jul. 1, 2020).

10 *See* Ioana Marinescu & Herb Hovenkamp, *Anticompetitive Mergers in Labor Markets*, 94 Ind. L.J. 1031 (2019); Suresh Naidu, Eric A. Posner & Glen Weyl, *Antitrust Remedies for Labor Market Power*, 132 Harvard L. Rev. 536 (2018).

11 *See* Fed. Trade Comm'n, Generative AI Raises Competition Concerns (June 29, **2023**); Am. Bar. Assn., Artificial intelligence & Machine learning: Emerging Legal and Self-Regulatory Considerations (2021).

12 *See* Brown Shoe Co. v. U.S., 370 U.S. 294, 318, 82 S. Ct. 1502, 8 L. Ed. 2d 510 (1962) ("The Report of the House Judiciary Committee on H.R. 515 recommended the adoption of tests more stringent than those in the Sherman Act.") (citing 15 U.S.C.A. §§ 1-7, 15 note. H.R.Rep. No. 596, 80th Cong., 1st Sess. 7); *id.* at 318 n. 32 ('The intent here * * * is to cope with monopolistic tendencies in their incipiency and well before they have attained such effects as would justify a Sherman Act proceeding.') (quoting S.Rep. No. 1775, 81st Cong., 2d Sess. 4-5, U.S.Code Cong. and Adm.News, 1950, p. 4296); United States v. AT&T, Inc., 916 F.3d 1029, 2019-1 Trade Cas. (CCH) ¶ 80685 (D.C. Cir. 2019)(citing *Brown Shoe* on this point and explaining that the Clayton Act prohibits "incipient monopolies and trade restraints outside the scope of the Sherman Act … [t]herefore, Section 7 applies a much more stringent test than does the rule-of-reason analysis under Section 1 of the Sherman Act."). *See also* Peter C. Carstensen & Robert H. Lande, *The Merger Incipiency Doctrine and the Importance of "Redundant" Competitors*, 2018 Wisc. L. Rev. 783 (2018); Richard M. Steurer, *Incipiency*, 31 Loy. Consumer L. Rev. 155 (2018); Robert H. Lande, *Resurrecting Incipiency: From* Von's Grocery to Consumer Choice, 69 Antitrust L.J. 875 (2001).

13 *See* Eric A. Posner, *Market Power, Not Consumer Welfare: A Return to the Foundations of Merger Law* (May 30, **2023**) (http://dx.doi.org/10.2139/ssrn.4364084); Carl Shapiro, *Protecting Competition in the American Economy: Merger Control, Tech Titans, Labor Markets*, 33 J. Econ. Perspectives 69 (2019); Steven C. Salop, *Invigorating Vertical Merger Enforcement*, 127 Yale L.J. 1742 (2018).

14 U.S. Dep't Justice & Fed. Trade Comm'n, ***2023*** *Draft Merger Guidelines* at 31 (July 19, **2023**) ("Supreme Court precedent also examines whether 'other pertinent factors' presented by the merging parties

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nonetheless ‘mandate[] a conclusion that no substantial lessening of competition [is] threatened by the acquisition.’”) (citation omitted).

15 *See* C. Scott Hemphill & Tim Wu, *Nascent Competitors*, 168 U. Penn. L. Rev. 1879, 1904 (“When the parties say something specific and detailed about their anticompetitive plan, we should believe them. … [A] firm’s broader pattern of acquiring nascent competitors sheds light on its intent in making each acquisition. Such evidence might be reinforced by proof of an internal program to identify rising competitors that matches the firm’s completed and attempted acquisitions.”).

16 Federal Trade Commission v. Penn State Hershey Medical Center, 838 F.3d 327, 347, 2016-2 Trade Cas. (CCH) ¶ 79767 (3d Cir. 2016) (acknowledging that market structure is a significant and standalone indicator of illegality in the absence of rebuttal); United States v. Bertelsmann SE & Co. KgaA, 646 F. Supp. 3d 1 (D.D.C. 2022) (same); United States v. UnitedHealth Group Incorporated, 630 F. Supp. 3d 118 (D.D.C. 2022), dismissed, **2023** WL 2717667 (D.C. Cir. **2023**) (same); Federal Trade Commission v. Hackensack Meridian Health, Inc., 2021-2 Trade Cas. (CCH) ¶ 81763, 2021 WL 4145062, at *20 (D.N.J. 2021), aff’d, 30 F.4th 160, 2022-1 Trade Cas. (CCH) ¶ 82035 (3d Cir. 2022); In re AMR Corporation, 72 Bankr. Ct. Dec. (CRR) 93, **2023** WL 2563897 (2d Cir. **2023**), cert. denied, **2023** WL 6377970 (U.S. **2023**) (same); New York v. Deutsche Telekom AG, 439 F. Supp. 3d 179, 2020-1 Trade Cas. (CCH) ¶ 81082 (S.D. N.Y. 2020); Federal Trade Commission v. Peabody Energy Corporation, 492 F. Supp. 3d 865, 903 (E.D. Mo. 2020) (same); United States v. Sabre Corp., 452 F. Supp. 3d 97, 135, 2020-1 Trade Cas. (CCH) ¶ 81157 (D. Del. 2020), order vacated, 2020-2 Trade Cas. (CCH) ¶ 81294, 2020 WL 4915824 (3d Cir. 2020); Federal Trade Commission v. RAG-Stiftung, 436 F. Supp. 3d 278, 310, 2020-1 Trade Cas. (CCH) ¶ 81075 (D.D.C. 2020); Federal Trade Commission v. Sanford Health, Sanford Bismarck, 2017 WL 10810016, at *12 (D.N.D. 2017), aff’d, 926 F.3d 959, 2019-1 Trade Cas. (CCH) ¶ 80799 (8th Cir. 2019); Federal Trade Commission v. Tronox Limited, 332 F. Supp. 3d 187, 198, 2018-2 Trade Cas. (CCH) ¶ 80510 (D.D.C. 2018); Federal Trade Commission v. Wilh. Wilhelmsen Holding ASA, 341 F. Supp. 3d 27, 47, 2018-2 Trade Cas. (CCH) ¶ 80509 (D.D.C. 2018); Federal Trade Commission v. Advocate Health Care, 2017-1 Trade Cas. (CCH) ¶ 79931, 2017 WL 1022015, at *7 (N.D. Ill. 2017); United States v. Aetna Inc., 240 F. Supp. 3d 1, 43, 2017-1 Trade Cas. (CCH) ¶ 79877 (D.D.C. 2017); United States v. Anthem, Inc., 236 F. Supp. 3d 171, 256-257, 2017-1 Trade Cas. (CCH) ¶ 79906 (D.D.C. 2017), aff’d, 855 F.3d 345, 2017-1 Trade Cas. (CCH) ¶ 79975 (D.C. Cir. 2017); United States v. Energy Solutions, Inc., 265 F. Supp. 3d 415, 441, 2017-1 Trade Cas. (CCH) ¶ 80050 (D. Del. 2017); Federal Trade Commission v. Staples, Inc., 190 F. Supp. 3d 100, 131, 2016-1 Trade Cas. (CCH) ¶ 79627 (D.D.C. 2016); United States v. Tribune Publishing Company, 2016-1 Trade Cas. (CCH) ¶ 79544, 2016 WL 2989488, at *4-5 (C.D. Cal. 2016); Saint Alphonsus Medical Center - Nampa, Inc. v. St. Luke’s Health System, Ltd., 2014 WL 407446, at *21 (D. Idaho 2014), aff’d, 778 F.3d 775, 2015-1 Trade Cas. (CCH) ¶ 79053 (9th Cir. 2015); Federal Trade Commission v. Sysco Corporation, 113 F. Supp. 3d 1, 55, 2015-1 Trade Cas. (CCH) ¶ 79221 (D.D.C. 2015); United States v. Bazaarvoice, Inc., 2014-1 Trade Cas. (CCH) ¶ 78641, 2014 WL 203966, at *64-65 (N.D. Cal. 2014); F.T.C. v. OSF Healthcare System, 852 F. Supp. 2d 1069, 1082 (N.D. Ill. 2012); U.S. v. H & R Block, Inc., 833 F. Supp. 2d 36, 72, 2011-2 Trade Cas. (CCH) ¶ 77678 (D.D.C. 2011).

17 Federal Trade Commission v. Hackensack Meridian Health, Inc., 30 F.4th 160, 173, 2022-1 Trade Cas. (CCH) ¶ 82035 (3d Cir. 2022).

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27 No. 9 M & A Law. NL 2

The M & A Lawyer
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The M and A Lawyer
By Alan S. Goudiss, Jeffrey D. Hoschander, K. Mallory Brennan, Susan Loeb, and Carter Gantt [a0]

Delaware Court Of Chancery Rejects Stockholder Demand for Corporation to Supplement Its Section 220 Production with Searches and Production of Email

On August 25, 2023, Magistrate Bonnie W. David of the Delaware Chancery Court issued a post-trial report denying stockholder requests for supplemental productions of emails from Zendesk, Inc. (the "Company") pursuant to a books and records demand. In *In re Zendesk Inc.*, [1] plaintiffs served the demands pursuant to 8 Del. C. § 220 seeking to investigate possible wrongdoing in connection with the Company's entry into a merger (the "Transaction"). The Company voluntarily produced "Formal Board Materials," including board minutes, presentations, and other board-level documents in response. Plaintiffs, however, asserted that there were "gaps" and "inconsistencies" that purportedly necessitated searches and production of email. The Court found that plaintiffs "have not met their burden to prove that [the requested] electronic communications … are essential to accomplishing the proper purposes stated in their [d]emands."

The Company allegedly received an unsolicited acquisition proposal from a consortium of private equity firms (the "Consortium") in February 2022 for a price between $127 and $132 per share. The board rejected that offer, concluding that it "significantly undervalued" the Company. During the following months, an activist investment firm called for replacement of the board and its management or a sale of the Company. The activist investment firm threatened a proxy contest and litigation related to the Company's annual meeting. The board entered into settlement discussions with the activist and the terms of a draft settlement agreement contemplated the resignation of the CEO and several board members. In June 2022, however, the Consortium submitted a new proposal to acquire the Company for $77.50. Around the same time, management reduced the Company's long-range forecasts. The board approved the sale to the Consortium—*i.e.*, the Transaction.

In response to the books and records demands, the Company produced board minutes and other formal board-level documents concerning the Transaction; the activist; bid process letters and written offers; director questionnaires; advisor engagement letters; reports from proxy advisory services; copies of financial projections and forecasts; and NDAs with potential acquirers. But plaintiffs also sought searches and productions of email from several custodians.

The Court held that plaintiffs had demonstrated a "proper purpose" for books and records in seeking to investigate "potential wrongdoing in connection with the Transaction." The Court explained that plaintiffs were required to "present some evidence to suggest a credible basis" that wrongdoing "may have occurred" and that the "credible basis standard imposes the lowest possible burden of proof." Plaintiffs alleged that management "may have favored a sale to protect their positions … or … to protect their reputations." The Court found that the "facts in the aggregate establish a credible basis to investigate."

Nevertheless, the Court held that plaintiffs failed to establish that the electronic communications they sought were essential to accomplishing their purported purpose. The Court noted that the "scope of inspection" is "fact-specific" and that the court has "broad discretion," but the stockholder "bears the burden of proving that each category of books and records is essential" and

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is not entitled to more than what is "sufficient." The Court highlighted that "Formal Board Materials are the starting point—and typically the ending point—for a sufficient inspection."

The Court found that the board "honored corporate formalities in the process leading to the Transaction" and that the Company's production of Formal Board Materials was sufficient to serve the purpose of plaintiffs' purported investigation. The Court ordered the supplemental production of a limited set of additional financial information, but rejected plaintiffs' demands for email searches and productions. As the Court explained, "[w]hile incremental details could be helpful to flesh out [p]laintiffs' theories, that does not support [p]laintiffs' request for comprehensive, discovery-style email production through a books and records action."

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Footnotes

a0 Alan Goudiss and Jeff Hoschander are partners, and Susan Loeb is an associate, in the New York office of Shearman & Sterling LLP. Mallory Brennan is a partner in the Houston and New York offices of Shearman & Sterling. Carter Gantt is an associate in the Houston office of Shearman & Sterling. Contact: alan.goudiss@shearman.com or jeff.hoschander@shearman.com or mallory.brennan@shearman.com.

1 *In re Zendesk, Inc. Section 220 Litig*., C.A. No. **2023**-0454-BWD (Del. Ch. Aug. 25, **2023**).

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27 No. 9 M & A Law. NL 5

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The M and A Lawyer

The Return of Middle Market M&A?

Mergers and acquisitions of middle-market companies have had a challenging period over the past 18 months, much like the rest of the M&A world.

That said, there are signs of a potential middle-market renaissance, perhaps starting late this year and growing in strength in 2024. "The middle market has been more resilient compared to the larger mega-deals," said Seyfarth Shaw LLP partner Andrew Lucano. "For one thing, some buyers can be less reliant on debt to do a middle-market deal and more willing to use equity for the right deal. The middle market has more flexibility and creativity." [1]

Seyfarth Shaw's latest Middle Market M&A SurveyBook [2] (the "Survey") analyzes key transaction terms from more than 105 middle market private target acquisition agreements signed in 2022 and in the first half of **2023**. While deal volumes in 2022 were above pre-pandemic levels, with North America M&A activity posting 18,576 deals for a combined value of $2.2 trillion, M&A activity in first-half **2023** failed to hit comparative 2022 levels.

As per the Survey, factors affecting M&A deal activity include: relatively high interest rates and inflation; bank failures and a drying up of capital availability; and a push for more comprehensive due diligence that is leading to a more deliberate pace of closing deals.

"It's been a tough first half of the year as well as through the summer," said Lucano, who is based in Seyfarth Shaw's New York office. "Despite the relatively quiet M&A markets, there have been deals here and there. However, even the deals where term sheets have been executed, the pace of the deals is moving more slowly than in the past number of years."

"Some reasons for the M&A slowdown are that interest rates are high, and with money being more expensive, the margin for error for buyers is much more slim, and there appears to be a valuation gap that's really in play right now," he added. "Some parties on the sell-side are looking back to the hot M&A market of 2021 as to what they think their companies should be valued at, but buyers naturally have different opinions."

That said, there's a growing sense that interest rate-related volatility may have stabilized for now. "Recall that the zero to 2% interest rates we had [in the 2010s] was historically unheralded, and that current interest rates, while relatively high, are not that extraordinarily high given the backdrop of history. So I think people will have to get used to the new 'normal' interest rates," Lucano said.

Many private equity sponsors are focusing on add-on acquisitions rather than large platform buyouts. For example, in 2022, add-ons accounted for a record 71.9% of buyout deals, which were easier to finance "due to their smaller size and ability to rely on their larger acquirer's credit," the Survey noted.

Lucano said that "there is still a lot of cash sitting on the sidelines, a lot of dry powder that needs to be deployed. In the last few weeks I've been hearing about a lot more opportunities. More people are at least talking about doing deals than they were six months ago. As long as there is no other major situation happening in the world, we will likely see more activity in the last quarter, and more activity driving into 2024. We'll still have to negotiate our way through this valuation gap."

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Deal Terms

The Survey focuses on a few key deal terms in middle-market deals, including those comprising the "indemnity package" essential to many private target acquisition agreements—those terms that address a seller's potential post-closing liability to a buyer and set the parameters of a buyer's ability to claw back purchase price from a seller.

For one thing, there are no signs of any waning popularity for representation and warranty ("R&W") insurance in private middle market M&A transactions. Roughly 58% of the transactions reviewed for the Survey included R&W insurance, just a touch less than the 59% of the transactions reviewed in the previous 2020/2021 Survey.

"Reps and warranties insurance has shown that it has staying power. It has created a track record for being a viable tool for both buyers and sellers," Lucano said. "It's not the new kid on the block anymore. It's a tool that's now seen as being tried and true: it's proven to be a win-win for both parties. The policies are working with claims being paid and it's being used to make transactions more efficient and more streamlined."

"Buyers have become more comfortable that reps and warranties insurance can replace the old-fashioned seller indemnity involving an indemnity escrow of 10% or more of the purchase price," he added. "Of course, you can't use R&W insurance for known issues, but for unknown breaches, R&W insurance has become accepted as solid protection. In fact, buyers have become so comfortable with the product, particularly in the seller's market that was in place over the last number of years, that many buyers have been willing to even forego a small indemnity escrow to cover a portion of the retention under policies in order to make their bids more attractive and willing to live with a "no-survival" deal relying completely on the insurance to back up the reps and warranties."

Not surprisingly, terms of the typical indemnity package differ substantially in R&W insurance deals versus non-R&W insurance deals, the Survey found. For example, the indemnity escrow amount and indemnity cap size tend to be much lower in transactions using R&W insurance than non-R&W deals.

With respect to "no survival" private target acquisitions, in which the representations and warranties of the seller terminate at closing, the Survey showed growth in "no survival" deals when R&W insurance is used. However the opposite proved true for deals where buyers don't obtain R&W insurance. The Survey also showed a continued trend of decreased use of an indemnity escrow when R&W insurance is in play while greater indemnity escrow usage occurs when R&W insurance is not involved. In a "no survival" deal, an R&W insurance policy is typically a buyer's primary (or exclusive) remedy, the Survey said.

The Survey also examined private target acquisition agreements that include "fraud" exceptions to certain limitations on buyers' indemnification rights and remedies, such as caps and baskets, and whether and how "fraud" got defined across those transactions.

"While specifically defining fraud in a purchase agreement is typically more seller-friendly, it's also a sign of the sophistication that's being brought by dealmakers now," Lucano said. "It's the increasing understanding of the parties that using an undefined simple reference to the term 'fraud' under Delaware law can include reckless fraud—that a party can be just so reckless that Delaware courts can find it amounts to fraud, that 'although you may not have been intentionally lying or actually knew that your representation was false when made, you were so reckless in how you were making representations that it is deemed to be fraud.'"

"Sellers want to do away with this "reckless" piece and buyers are more receptive—agreeing that "fraud" is talking more about if you're actually lying in your representations," Lucano said. "Parties are more willing to draft to that point and parties are also more willing to live within the four corners of the purchase agreement, eliminating claims that "fraud" may have occurred in activities that are not covered by the contract."

Further, because of the growth of R&W insurance, sellers have become more comfortable with representations being broader in scope. "With more expansive reps and warranties expressly included in the purchase agreement, more buyers are comfortable in not having to rely on a fraud exception to cover items outside of the contract because they're getting the reps they need directly in the purchase agreement," he added.

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Footnotes

1 For articles on previous editions of this survey, *see The M&A Lawyer*, April 2022, Vol. 26, Issue 4; *The M&A Lawyer*, May 2020, Vol. 24, Issue 5; *The M&A Lawyer*, May 2019, Vol. 23, Issue 5.

2 For the complete survey, *see*: https://www.seyfarth.com/dir_docs/publications/2023_MA_SurveyBook.pdf.

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27 No. 9 M & A Law. NL 1

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The M and A Lawyer
By Rachel S. Brass, Mark D. Director, Sophia A. Hansell, Cynthia Richman, Daniel G. Swanson, Chris Wilson, Jamie E. France, and Zoë B. Hutchinson [a0]

FTC Challenges Roll-Up Strategy as Illegal Monopolization

On September 21, 2023, the Federal Trade Commission ("FTC"), delivering on recent agency promises to increase scrutiny of private equity-backed transactions and strategies, released a complaint filed against private equity sponsor Welsh, Carson, Anderson, and Stowe ("Welsh Carson") and U.S. Anesthesia Partners ("USAP"), a Texas-based provider of anesthesia services and a Welsh Carson portfolio company. With this slate of claims, the FTC takes aim at Welsh Carson and USAP's serial acquisitions over a decade, post-merger conduct, and the "roll-up" strategy employed by USAP and Welsh Carson.

The complaint alleges numerous violations of Sections 1 and 2 of the Sherman Act, asserting defendants monopolized, conspired to monopolize, and entered into agreements to fix prices and allocate markets with respect to commercially-insured hospital-only anesthesiology services. The complaint also claims defendants violated Clayton Act Section 7 and Section 5 of the FTC Act through a string of serial acquisitions which allegedly lessened competition in Texas. The complaint asserts that defendants' "roll-up" strategy represented an "unfair method of competition." Finally, the complaint alleges that Welsh Carson's acquisitions, pricing actions, and horizontal agreements together represent a "scheme to reduce competition in Texas" under Section 5 of the FTC Act. The FTC has asserted in this complaint a novel test for "unfair methods of competition" that forms the basis for separate and standalone claims under Section 5.

Roll-Up Strategy

Private equity firms look for opportunities to use their deal-making, operational, and financial expertise, along with their significant equity funding resources, to create more efficient companies in competitively fragmented landscapes. One strategy, the "roll-up" (also often referred to as a "buy and build" strategy"), entails combining numerous, smaller companies in a particular industry. Private equity firms typically start with an initial, larger "platform" company acquisition, which then makes often numerous additional acquisitions to create a significantly larger organization that can achieve efficiencies and develop new or greater service offerings through scale, scope, and integration. These strategies can lower prices for consumers and provide other procompetitive benefits by reducing costs through centralizing common support functions or infrastructure costs, using size and scale to increase utilization and often obtain more favorable financing (driving down costs of debt), enhancing purchasing power to produce lower operating costs, and spreading costs across a larger buyer base to allow for innovation and growth into new products and services in ways that would be too expensive for independent smaller businesses.

The FTC's Theories of Harm

Over the past several years, there has been a marked increase in rhetoric from enforcers related to antitrust scrutiny of private equity firms. Although the FTC has discussed [1] leveraging new tools to police private equity, much of the FTC's complaint against Welsh Carson and USAP relies on traditional antitrust theories of anticompetitive conduct and harm. The complaint defines a relevant product market ("commercially-insured hospital-only anesthesia services") and several relevant geographic markets (metropolitan statistical areas, respectively, of Austin, Dallas, and Houston). It alleges that the serial acquisitions resulted in monopoly level market shares for USAP of 60%-70% in each geographic area. The complaint asserts that high

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switching costs for hospitals, high barriers for entry, and horizontal agreements (both related to prices and territories) with other providers contributed to higher prices for consumers and an inability by hospitals to constrain prices for anesthesia services.

The more novel aspects of the FTC's complaint include the joint Section 7 Clayton Act and Section 5 FTC Act claims, attacking the parties' acquisitions and general roll-up strategy. The complaint takes aim simultaneously at multiple acquisitions over the course of years. Count 2 alleges a roll-up of the Houston market via three acquisitions over a period of three years, and Count 5 alleges a roll-up of the Dallas market via six acquisitions over a period of three years. This complaint continues a recent trend of U.S. agency review of consummated and long-past transactions under Section 7 of the Clayton Act, where historically such transactions rarely received oversight or enforcement so long after consummation. With the "roll-up" cause of action envisioned in the complaint, however, the FTC seems to open the door to challenging transactions well after closing, and with the benefit of hindsight assessment of the resulting impact of a multi-deal, multi-year M&A strategy, as part of an alleged broader conspiracy.

The complaint also includes a novel standalone Section 5 claim (Count 8), broadly challenging defendants' alleged "scheme to reduce anesthesia competition in Texas." This claim is unusual in that the FTC has refrained from asserting Section 5 where "enforcement of the Sherman or Clayton Act is sufficient to address the competitive harm arising from the act or practice." [2]

This divergence from past practice seems driven by an interest in developing an independent (and perhaps more flexible) framework for prosecuting "unfair methods of competition" in line with policy statements by the FTC issued over the last several years. The complaint's allegation of a scheme to lessen competition through acquisitions and agreements with other providers across Texas rests solely on Section 5 authority. It alleges harms to consumers in the form of increased prices through mechanisms suitably addressable by Clayton Act Section 7 and Sherman Act Sections 1 and 2 (and are addressed through these laws in the other counts). Where the Section 5 count differs is that it alleges a scheme across the state of Texas, and utilizes Section 5 to claim "unfair methods of competition" without defining a relevant product or geographic market as they did with the local metropolitan region claims. If judicially recognized, this would allow the FTC to pursue claims against consolidation and pricing actions with fewer requirements and lower burdens of proof via effects-driven analysis over econometric analysis through established and defined relevant markets. Use of Section 5 as standalone authority may also attempt to circumvent the four-year statute of limitations restrictions on antitrust claims, as many of the contested transactions date farther back than four years.

Implications and Takeaways

All businesses, not just private equity sponsors, whose growth strategy includes significant M&A activity should remain mindful of the context in which it engages customers in price negotiation and competitors in collaborative agreements. As market shares increase, so too does the possibility of broader antitrust scrutiny. Although the complaint identifies the serial acquisitions as one cause of antitrust harm, the alleged pricing actions and agreements with competitors by a growing market participant may have precipitated the investigation and litigation.

Businesses that engage in mergers and acquisitions as part of their growth strategy should consider future M&A plans in light of past acquisitions. Businesses, particularly private equity firms, engaged in multiple acquisitions as part of a "consolidation" strategy (especially transactions where consequent price adjustments are expected) should prepare for increased scrutiny at the investigation stage regardless of the outcome of this lawsuit.

In this shifting and aggressive enforcement landscape, it is important to consult with counsel early and consider potential antitrust risks in M&A strategy broadly, and not just with respect to individual transactions. While roll-ups can be effective in enhancing competition in many different markets, private equity sponsors and their portfolio companies should be mindful that as an M&A-driven growth strategy produces market share increases, their strategy and overall conduct may attract increased agency scrutiny. Counsel can help advise proactively on risks in strategic initiatives and pipeline acquisitions, as well as assess the potential risk of enforcement involving past M&A-focused growth strategies and post-acquisition market conduct.

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1 *See, e.g.* Draft Merger Guidelines, U.S. Department of Justice and Federal Trade Commission (July 19, **2023**) (available *here*: https://www.ftc.gov/system/files/ftc_gov/pdf/p859910draftmergerguidelines2023.pdf); Statement of Commissioner Rohit Chopra Regarding Private Equity Roll-ups and the Hart-Scott-Rodino Annual Report to Congress Commission, File No. P110014 (July 8, 2020) (available *here*: https://www.ftc.gov/system/files/documents/public_statements/1577783/p110014hsrannualreportchoprastatement.pdf); Statement of Chair Lina M. Khan, Joined by Commissioner Rebecca Kelly Slaughter and Commissioner Alvaro M. Bedoya Regarding JAB Consumer Fund/SAGE Veterinary Partners (June 13, 2022) (available *here*: https://www.ftc.gov/system/files/ftc_gov/pdf/2022.06.13%20-%20Statement%20***o***f%20Chair%20Lina%20M.%20Khan%20Regarding%20NVA-Sage%20-%20new.pdf).

2 Statement of Enforcement Principles Regarding "Unfair Methods of Competition" Under Section 5 of the FTC Act (August 13, 2015) (available *here*: https://www.ftc.gov/system/files/documents/public_statements/735201/150813section5enforcement.pdf).

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The M & A Lawyer
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The M and A Lawyer
By Maria Cruz Melendez, Andrew M. Good and Ryan D. Junck [a0]

DOJ Previews M&A-Focused Guidance on Voluntary Self-Disclosure of Corporate Misconduct

In recent remarks, Principal Associate Deputy Attorney General ("PADAG") Marshall Miller of the Department of Justice ("DOJ") revealed that Deputy Attorney General Lisa Monaco will soon announce new voluntary self-disclosure guidance specifically tailored to mergers and acquisitions.

The forthcoming M&A-related policies will be instituted "[a]s part of the Department's ongoing effort to enhance consistency, transparency, and predictability in corporate enforcement," and in response to feedback about self-disclosure from the private sector, PADAG Miller said during a talk at the Global Investigations Review Annual Meeting on September 21, **2023**. [1]

Notably, he explained that the DOJ's efforts to incentivize corporate responsibility should not engender "unintended consequences," such as deterring corporations with strong compliance programs from merging with or acquiring companies with histories of corporate misconduct. Emphasizing the DOJ's ongoing focus on the quality of internal corporate compliance programs, PADAG Miller provided the encouraging message that companies should not be penalized for acquiring a company with previous internal compliance issues where the acquiring company engaged in "careful pre-acquisition diligence and timely post-acquisition integration to detect and remediate misconduct at the acquired company's business."

PADAG Miller noted that existing DOJ policies currently encourage voluntary disclosure of misconduct discovered during acquisitions. Specifically, he advised that the Criminal Division's Corporate Enforcement Policy offers the incentive of a potential declination, which he described as a "safe harbor," for reporting misconduct uncovered during due diligence pre- or post-acquisition to the DOJ. He also explained that the Criminal Division's Evaluation of Corporate Compliance Programs underscored the high value of including compliance personnel in the M&A process.

As an example of the benefits of voluntary disclosure in the M&A context, PADAG Miller cited the voluntary self-disclosure by Safran S.A. of information about pre-acquisition payments to consultants that had been made by two companies Safran acquired. The companies knew that some of the payments would be used to bribe senior government officials in order to win contracts with the Chinese government. The self-disclosure, cooperation and remediation by Safran resulted in a declination of prosecution with disgorgement in December 2022.

According to PADAG Miller, a similar approach will be extended across all relevant areas of the DOJ to continue to promote and standardize similar voluntary self-disclosures and to "highlight the critical importance of the compliance function having a prominent seat at the table in evaluating and de-risking M&A decisions."

Practical Considerations

In anticipation of the expected voluntary disclosure policies relating to M&A previewed by PADAG Miller, companies should review internal policies and procedures to ensure, among other things, that:

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- Compliance personnel are actively involved in the due diligence process.
- Due diligence includes reviews of the quality of target company compliance programs.
- Companies engage with target company compliance personnel and management to determine potential risk of corporate misconduct.
- Whistleblowing and reporting channels are rolled out to merged or acquired companies.
- Any ongoing misconduct reported by or identified at acquired or merged companies is remediated.
- Compliance programs of acquired companies are brought up to industry standards.
- Merged and acquired companies are integrated into compliance programs.
- A culture of compliance is encouraged within newly merged or acquired companies.

Companies should prepare to incorporate the new guidance into their M&A processes when it is released. But, for now, by initiating the compliance measures above, a company can lay the groundwork for a more positive resolution with the DOJ in the event potential misconduct is discovered and ultimately voluntarily disclosed.

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1 *See* https://www.justice.gov/opa/speech/principal-associate-deputy-attorney-general-marshall-miller-delivers-remarks-global.

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27 No. 9 M & A Law. NL 6

The M & A Lawyer
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The M and A Lawyer
By Sarah Gingrich, Brad Schneider, Grant McGlaughlin, Caitlin Rose and Paul Blyschak [a0]

Delaware's Corporate Opportunity Waiver Comes to Canada: Takeaways for U.S. Private Equity and Cross-Border M&A

Its not unusual for Canadian courts to look to Delaware caselaw for guidance, particularly in M&A disputes. It is less common for Canadian legislators to take a page out of Delaware's statutory playbook. But this was recently done by Alberta when it adopted, *near verbatim*, Delaware's corporate opportunity waiver into the province's *Business Corporations Act* ("ABCA").

We explore the practical implications of this noteworthy development for U.S. cross-border investment into Canada, including by private equity buyers and investors. Numerous points warrant highlighting.

First, Alberta's adoption of Delaware's corporate opportunity waiver represents an additional and incrementally "private equity friendly" aspect of the ABCA. Second, the risk mitigation opportunities offered by Alberta's corporate opportunity waiver (as well as the other "private equity friendly" aspects of the ABCA) to U.S. investors *into Canada* need not necessarily be limited to investment *into Alberta*. Third, even though Alberta's corporate opportunity waiver is essentially identical to Delaware's *as written*, we caution against expecting it to be *interpreted and applied* in lockstep with its Delaware forebear.

DGCL s.122(17): The Original Corporate Opportunity Waiver

The duty of loyalty has been called "a cornerstone of Anglo-American corporate law" as well as the "most *demanding* and *litigated* fiduciary obligation" imposed on directors. [1] The decision by the Delaware legislature in 2000 to create a statutory right to waive a "crucial part" of the duty of loyalty—the corporate opportunities doctrine—has therefore been described as a "dramatic departure from tradition." [2]

That said, the motivation of Delaware lawmakers in allowing corporate opportunity waivers is well known. A "growing chorus of critics" were arguing that the "exacting requirements" of the duty of loyalty was impeding "corporations' ability to raise capital, build efficient investor bases, and secure optimal management arrangements." [3] Proponents of corporate opportunity waivers highlighted that private equity and venture capital were subjecting their financial sponsors to "fiduciary duties in profound conflict with either their larger business plans or with fiduciary obligations they owe to other business entities." [4] Such proponents also highlighted the "conundrum of allocating corporate opportunities between a parent and its partially owned subsidiary, both operating in a similar industry and sharing common board members and officers." [5]

The solution was *Delaware General Corporation Law* ("DGCL") s.122(17), which provides that:

> Every corporation … shall have power to… [r]enounce … any interest or expectancy of the corporation in, or in being offered an opportunity to participate in, specified business opportunities

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> or specified classes or categories of business opportunities that are presented to the corporation or 1 or more of its officers, directors or stockholders.

ABCA s.16.1(1): Alberta Brings the DGCL North

That Alberta's recent adoption of corporate opportunity waivers was (at least in part) inspired by Delaware is manifest. In near mirror fashion to DGCL s.122(1), ABCA s.16.1(1) provides:

> [A] corporation may waive any interest or expectancy of the corporation in or to, or in being offered an opportunity to participate in, a specified business opportunity or specified classes or categories of business opportunities that are offered or presented to the corporation or one or more of its officers, directors or shareholders.

As with Delaware, the Alberta legislature was also clearly seeking to encourage increased private equity and venture capital investment in the province. [6] Among other things, in announcing the amendments the Alberta government expressly acknowledged it sought to accommodate investors who often "choose to invest in corporations in the same line of business," who "frequently … sit on the boards of companies they have invested in," and who "may be reluctant to invest in a company if it means they will never be able to invest in another similar venture in the future." [7]

Advantage ABCA for Private Equity in Canada?

Canada does not have a law prohibiting interlocking directorates similar to Section 8 of the *Clayton Act*. However, the Supreme Court of Canada (the country's highest court) has ruled that fiduciary duties in Canada, including the duty of loyalty, are "pervaded" by a "strict ethic" and should be "strictly applied." [8] The adoption of corporate opportunity waivers by Alberta, the first (and only) Canadian province to do so, is therefor notable: it represents a clear break from the otherwise "strict ethic" characterizing fiduciary duties in Canada.

That said, it is also important to appreciate that Alberta's adoption of Delaware's corporate opportunity waiver represents an additional and incrementally "private equity friendly" aspect of the ABCA. Perhaps most importantly, the ABCA is *also* Canada's *only* corporate statute that allows nominee directors to weigh the interests of their *nominating shareholder* alongside the interests of the corporation in honouring their directors' duties. Specifically, ABCA s.122(4) provides:

> In determining whether a particular transaction or course of action is in the best interests of the corporation, a director, if the director is elected or appointed by the holders of a class or series of shares … may give *special*, but *not exclusive*, consideration to the *interests of those who elected or appointed the director* (emphasis added).

Other "private equity friendly" features of the ABCA include the absence of any Canadian residency requirements for directors, the recently expanded "due diligence" defence available to directors, and the recently expanded ability of corporations to indemnify directors.

What are the key practical takeaways for U.S. private equity and cross-border M&A into Canada? We briefly consider two.

First, U.S. private equity considering the acquisition of or investment into an Alberta-incorporated company should seek to maximize the private equity friendly features of the ABCA. At the point of acquisition or investment this includes the availability of a Delaware-style corporate opportunity waiver. Over the lifecycle of the investment this includes the ability of nominee directors to give special (but not exclusive) consideration to the private equity sponsor's interests.

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Second, U.S. private equity considering the acquisition of or investment into a Canadian company incorporated *outside Alberta* can consider continuing the company into Alberta to gain access to the benefits offered by the ABCA. In the case of an acquisition, this can be effected as part of closing or post-closing. In the case of an investment (as opposed to an outright acquisition), this can be made a condition of the investment. In either case, continuation into Alberta does not impede doing business outside the province, and it is not uncommon for a business incorporated in one Canadian jurisdiction to have most —or even all—of its operations in other Canadian jurisdictions.

How Much Corporate Opportunity Can an ABCA Company Waive?

Returning to the specific matter of Alberta's new Delaware-style corporate opportunity waiver, exactly how far can such waivers go?

Somewhat surprisingly, although enacted in 2000, the "footprint" of Delaware's corporate opportunity waiver in "caselaw and commentary has been surprisingly faint." [9] Stated differently, few Delaware courts have had occasion to "opine on the validity of a broad and general renunciation of corporate opportunities, as contrasted with a more tailored provision addressing a specified business opportunity or a well-defined class or category of business opportunities." [10]

However, even had the subject been thoroughly explored by Delaware's courts, there is reason to question whether Canadian courts would walk an identical path.

First, as noted above, Canada's highest court has held that fiduciary duties in Canada are "pervaded" by a "strict ethic" and should be "strictly applied." [11]

Second, and in what is essentially a legislative echo of the foregoing court ruling, each of Canada's common law provinces' corporate statutes (including the ABCA) specifies that "no provision in a contract, the articles, the bylaws or a resolution relieves a director" from their fiduciary duties or "from liability for a breach of that duty." [12] By contrast, DCGL s.102(b)(7) "permits a charter provision to eliminate [a director's] monetary liability for breaches of the duty of care." [13]

Third, a difference between Alberta's corporate opportunity waiver and that of DGCL s.122(1) is that, while the latter can be effected via the corporation's certificate of incorporation *or* "by action of its board of directors," the former may *only* be effected via the corporation's articles of incorporation or a unanimous shareholders agreement and *not* at the board level. This more circumscribed means of implementation arguably reflects a more guarded attitude on the part of Alberta's legislators than exhibited by Delaware's.

It may therefore be that Alberta courts will take a more restrained approach to the interpretation and application of corporate opportunity waivers than Delaware courts. For example, an Alberta court may require the "specified classes or categories of business opportunities" to which the waiver applies to be identified with greater particularity than expected by a Delaware court.

Concluding Comments: Private Equity's Card to Play

Empirical research confirms the "enormous appetite" exhibited by U.S. corporations for "contracting out of the duty of loyalty when freed to do so." [14] So too has such research confirmed the "often … capacious scope and reach" of the corporate opportunity waivers adopted by Delaware corporations. [15]

It remains to be seen whether Alberta's corporate opportunity waiver will encounter the same eager demand. We would, however, expect private equity, venture capital and other sophisticated financial investors to lead the charge. We also highlight that the risk mitigation opportunities presented by Alberta's corporate opportunity waiver (as well as the other "private equity friendly" aspects of the ABCA) to U.S. investors *into Canada* need not necessarily be limited to investment *into Alberta*. Finally, while corporate opportunity waivers under Delaware have often exhibited a "capacious scope and reach," we would caution towards a more conservative approach under Alberta law, at least based on current indications and a high-level comparison of broader corporate law hallmarks between the two jurisdictions.

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1 G. Rautenberg & E. Talley, "Contracting Out of the Fiduciary Duty of Loyalty: An Empirical Analysis of Corporate Opportunity Waivers," (2017) 117 *Columbia Law Review* 1075 [Rautenberg & Talley] at page 1076 (emphasis added).

2 Rautenberg & E. Talley p. 1075.

3 Rautenberg & E. Talley p. 1079-1080.

4 Rautenberg & E. Talley p. 1080.

5 Rautenberg & E. Talley p. 1093.

6 As a noteworthy aside, the professional commentary of one of this article's authors, Grant McGlaughlin, was cited by the Alberta legislature in approving the ABCA's corporate opportunity waiver.

7 Government of Alberta, Service Alberta, Business Corporations Act Fact Sheet (PDF; https://www.alberta.ca/system/files/custom_downloaded_images/sa-business-corporations-act-proclamation-fact-sheet.pdf) (2022).

8 *Can. Aero v. O'Malley*, 1973 CanLII 23 (SCC), [1974] SCR 592 at pp. 593, 607, 610.

9 Rautenberg & E. Talley p. 1098.

10 *Alarm.com Holdings, Inc. v. ABS Capital Partners Inc.*, 2018 Del. Ch. LEXIS 193 at *22 note 46.

11 *Can. Aero v. O'Malley*, 1973 CanLII 23 (SCC), [1974] SCR 592 at pages 593, 607 and 610.

12 ABCA s.122(3).

13 *New Enterprise Associates 14, L.P. v. Rich, 295 A.3d 520* at *549 *(Del. Ch. 2023)*.

14 Rautenberg & E. Talley p. 1075.

15 Rautenberg & E. Talley p. 1075.

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