

## EDGEWELL/HARRY'S: WHEN A MAVERICK IS MORE THAN ITS MARKET SHARE

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On February 2, 2020, the Federal Trade Commission (“FTC”) filed an administrative complaint seeking to block the merger of Edgewell Personal Care Company and Harry’s Inc., two suppliers of wet shave razor systems. Edgewell owns a portfolio of wet shave razors, including the second-largest brand, Schick, whereas Harry’s is a relative newcomer. The FTC’s complaint alleged that Harry’s competitive significance went far beyond its modest market share. According to the FTC, Harry’s had broken up a long-standing duopoly and was a vital independent competitor in the industry. On February 10, Edgewell announced that it had terminated its merger agreement with Harry’s.

The FTC’s challenge to the Edgewell/Harry’s transaction highlights the U.S. antitrust agencies’ focus on deals involving a nascent or disruptive competitor and serves as a reminder of how influential ordinary course and deal-related documents and statements can be. Harry’s reported potential lawsuit against Edgewell after the termination serves as a reminder of the importance of both the regulatory efforts and termination provisions of a negotiated agreement.

### Background: The Transaction

Historically, Gillette and Schick have been the two most successful wet shave razor brands in the United States (“dominant” per the FTC). The Gillette brand, now owned by Procter & Gamble, was introduced over 100 years ago, and the Schick brand, now owned by Edgewell, is nearly as old. According to the FTC, although there are six wet shave players in the U.S., Procter & Gamble and Edgewell had a long-standing duopoly with a history of raising prices until increasing competition from Harry’s threatened these brands’ once-secure position.

Edgewell is the number two manufacturer of wet shave razors and a significant supplier of private label razors in the United States. It owns over 25 consumer brands, including such wet shave brands as Schick, Intuition, Hydro Silk, and Skintimate. Traditionally, Edgewell has

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had a ubiquitous presence at brick-and-mortar retailers but, in 2017, it also launched a website through which consumers could purchase razors online directly from Edgewell.

Harry's was founded in 2013 and, in the words of an Edgewell investor deck, "is one of the most successful challenger brands ever built."<sup>1</sup> Harry's established itself through a direct-to-consumer (DTC) sales model, where customers purchased a subscription online and received handles and blades in the mail directly from Harry's. In 2016, Harry's moved into brick-and-mortar retail—first into Target stores and subsequently into Walmart and others. In 2018, Harry's introduced its first women's razor under the Flamingo brand name. Harry's also manufactures private label systems razors and owns and operates a factory in Germany.

On May 9, 2019, Edgewell and Harry's announced their intention to merge through a cash and stock transaction that valued Harry's at \$1.37 billion. Following their merger announcement, Harry's and Edgewell touted the combination as bringing together "Edgewell's strong intellectual property, best-in-class product technology, global scale and stable of strong consumer brands" with Harry's "demonstrated expertise in brand building and direct-to-consumer marketing."<sup>2</sup> In early August, the FTC began an ex-

tended review of the transaction (known as a Second Request), and on February 2, 2020, the FTC filed an administrative complaint and authorized staff to seek a temporary restraining order and preliminary injunction, if necessary, to enjoin the transaction.<sup>3</sup> On February 10, Edgewell announced that it had terminated the merger agreement and planned to move forward as a standalone company.<sup>4</sup>

### Maverick Firms Are More Than Their Market Share

The antitrust agencies traditionally consider current competition between merging parties and look to their existing market shares as indicators of competitive strength. However, recent agency challenges show an emphasis on preventing an established incumbent from acquiring a smaller, disruptive competitor that threatens to shake up the status quo—even when there is only a small incremental increase in market share.

A key component of the FTC's complaint was Harry's role as "a uniquely disruptive competitor that interrupted the P&G/Edgewell duopoly" in a wet shave razor market that was "ripe for disruption."<sup>5</sup> According to the FTC's complaint, while Harry's online success did not stop Edgewell and P&G from continuing annual price increases in brick-and-mortar retail stores,

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## The M&A Lawyer

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(ISSN#: 1093-3255)

“[e]verything changed in August 2016, when Harry’s expanded into brick-and-mortar retail.”<sup>6</sup> The complaint alleged that Harry’s took shelf space at Target away from Edgewell’s Schick brands, among others, and quickly took share from both Edgewell and P&G due to aggressive pricing.<sup>7</sup>

At the time Harry’s launched in Target in 2016, its prices were roughly \$10 cheaper than Gillette and Schick products, leading P&G to forgo an annual price increase and instead significantly reduce its prices. Meanwhile, Edgewell increased its promotional efforts: it not only lowered its prices starting in 2018, following Harry’s expansion into Walmart stores, but also innovated, launching a new razor. The complaint alleged that Harry’s expansion into women’s shaving had similar procompetitive effects.<sup>8</sup>

Citing Harry’s additional recent brick-and-mortar expansion into Hy-Vee, Meijer, and Kroger, the complaint alleged that “Harry’s products are likely to expand into additional retailers in the near term regardless of whether Harry’s is acquired by Edgewell,” demonstrating the likelihood that Harry’s current market share understated its competitive significance, while at the same time undercutting any argument that access to Edgewell’s retailer relationships was necessary for Harry’s to gain share in brick-and-mortar stores.<sup>9</sup>

The Edgewell/Harry’s complaint is the latest in a string of challenges from the U.S. antitrust agencies seeking to prevent an acquisition of a disruptive competitor:

- In December 2019, the FTC challenged Illumina’s proposed acquisition of PacBio, a competitor in DNA sequencing systems. The FTC alleged that PacBio was poised to take increasing share from Illumina in the future as it continued to improve its innovative product offering and that, absent the transaction, Illumina would likely have discounted the prices of its systems, improved their quality, and developed new products in the face of this competition.<sup>10</sup> The merging parties

terminated their proposed transaction on January 2, 2020.

- In August 2019, the Department of Justice sued to block Sabre’s proposed acquisition of Farelogix. Farelogix offered an alternative system for booking airline tickets that disrupted incumbent competitors and was poised to grow significantly as the industry transitioned to this new technology. The DOJ alleged that Sabre is seeking to “eliminate this scrappy competitor once and for all by acquiring it.”<sup>11</sup> As of February 26, the parties were awaiting the judge’s decision following the trial that ended February 6, 2020.
- In March 2018, the FTC challenged CDK Global’s proposed acquisition of Auto/Mate, Inc., a competitor in the supply of automobile dealer management systems. The FTC alleged that, despite Auto/Mate’s relatively small market share, it was uniquely positioned to take business from CDK and deliver substantial competitive benefits in innovation, price, and quality.<sup>12</sup> Shortly after the challenge, the merging parties abandoned the deal.

These challenges show that considering the target’s level of sales or market share alone can ignore other indicia that a transaction will raise antitrust concerns. According to the research firm Euromonitor, the Harry’s brand accounted for just 2.6% of the U.S. men’s razor market in 2018.<sup>13</sup> Similarly, according to the challenging agencies, PacBio’s market share was 2%-3% and both Farelogix and Auto/Mate had small market shares in the relevant markets.

Incremental share gains as low as 2% resulting from a transaction typically suggest a low risk of an agency challenge, but where a target company represents a unique competitive threat that has the potential to disrupt incumbents, market share can understate the significance of the transaction’s likely effect on competition.

### Removing a Disruptive Competitor Can Raise Concerns About Coordinate Effects

In addition to considering the unilateral effects arising from the elimination of competition between two merging parties, the antitrust agencies assess whether a transaction would increase the ability of a broader set of competitors to engage in coordinated conduct that is profitable for each of them only as a result of the accommodating reactions of the others—so-called “coordinated effects.”<sup>14</sup>

Coordinated effects are often more difficult to prove using quantitative evidence as compared to unilateral effects. It is not uncommon, however, for agency challenges (including Evonik/PeroxyChem (Aug. 2019),<sup>15</sup> Linde/Praxair (Oct. 2018),<sup>16</sup> Tronox/Cristal (Dec. 2017),<sup>17</sup> AT&T/Time Warner (Nov. 2017))<sup>18</sup> to include allegations of both unilateral and coordinated effects.

The Edgewell/Harry’s challenge included an allegation that the transaction was likely to result in coordinated effects by making “an already susceptible market more vulnerable to coordination by eliminating a disruptive competitor.” The complaint contended that the wet shave razor market was vulnerable to coordination because competitors “can promptly and confidently observe the competitive initiatives of their rivals” and “relatively few customers would switch to the deviating firm before rivals are able to respond, limiting the incentives to deviate from the terms of coordination.”<sup>19</sup> According to the complaint, “[p]rior to Harry’s entry into brick-and-mortar retail, each year Gillette raised . . . prices; and each year Edgewell would do the same.”<sup>20</sup>

In addition to these alleged general indicia of a market that is vulnerable to coordinated effects (*i.e.*, transparent pricing and slow customer switching) the FTC concluded that the Edgewell/Harry’s transaction was especially likely to result in coordinated effects because it eliminated a disruptive competitor.<sup>21</sup> The agencies consider that an acquisition eliminating a “maverick” firm in a market vulnerable to coordinated conduct is

likely to cause adverse coordinated effects.<sup>22</sup> The FTC’s inclusion of coordinated effects in Edgewell/Harry’s shows that parties to a transaction involving a potentially “disruptive” competitor cannot limit their analysis to unilateral effects, but must assess potential effects on coordination in the relevant market as well.

### Increased Scrutiny Warrants Increased Attention to Internal Documents and Public Statements

Internal documents and public statements are often the most compelling evidence available to the antitrust agencies because they can offer a viewpoint that regulators feel is unvarnished from the parties’ advocacy efforts. The Edgewell/Harry’s complaint included many references to both internal documents and public statements to investors.

The complaint alleged that “[b]oth Edgewell and P&G have publicly recognized that the Proposed Acquisition is likely to benefit them rather than consumers” and cited statements from Edgewell and P&G quarterly earnings calls. The complaint alleged that a quote from Edgewell’s CEO that Edgewell was “not interested” in “lead[ing] a new round . . . of value destruction” showed that Edgewell was not interested in price competition or lowering prices.<sup>23</sup> As evidence of the closeness of competition between the parties, the complaint also pointed to an investor statement from Edgewell’s CEO that Harry’s launch at Walmart represented “the most significant impact” on Edgewell’s wet shave business in 2018.<sup>24</sup> Edgewell’s dramatic characterization of Harry’s as “one of the most successful challenger brands ever built” was quoted in the opening paragraph of the complaint—taking a statement meant to drum up investor support for the deal and turning it against the parties’ arguments about competition in the industry.<sup>25</sup>

The complaint also contained numerous redacted references to statements in the parties’ internal documents that assessed the closeness of competition between Harry’s and Edgewell and documented each party’s strategies to compete with the other.<sup>26</sup>

The evidence cited in the FTC challenge underscores the breadth of documents that the agencies consider in an investigation. The balance between marketing a transaction to investors or potential buyers and maintaining a record that accurately presents the state of competition can be a difficult exercise. Parties to a transaction should assume that any of their documents or statements could end up being seen by a regulator and consider potential tensions between positions they may be taking before investors and before an antitrust authority.

### Recent Entry Is Not Evidence of Likely Future Entry

In some respects, the emergence of new, disruptive competitors can demonstrate that barriers to entry to the alleged product market are low, and that further entry into the market would likely be sufficient to counteract any potential harm to competition resulting from the deal. However, regulators may argue that disruptive competitors took advantage of a unique set of circumstances that may not be available to other future prospective entrants.

In the Edgewell/Harry's complaint, the FTC argued that the wet shave razor market had high barriers to entry, including purchase or construction of a razor factory, time and investment to develop a competitive razor blade, obtaining necessary IP rights, and securing distribution and product placement agreements. While the complaint argued that these steps on their own would likely make new entry untimely to counteract competitive harm to customers, it also argued that any future entrants would have "a much steeper path to scale than the one Harry's had." According to the complaint, Harry's identified an unmet opportunity to offer a value-priced no-frills razor, leveraged nascent online marketing channels, and was the first to place a value offering in brick-and-mortar stores, where a gap for such products existed. Since Harry's "has plucked the low-hanging fruit online and in stores," future opportunities for entry would be more difficult and less profitable.<sup>27</sup>

The complaint also underscored the importance of considering the competitive significance of any remaining market players when assessing whether they are true competitors to the merging parties. The FTC's position that any "significant competitor" must be able to manufacture and sell its own blades effectively discounts the competitive significance of private label sellers and other market participants without their own production capacity.

### Ambiguous Risk-Sharing Provisions Can Lead to Costly Litigation

Outside of the context of the FTC's review of the transaction, the Edgewell/Harry's deal provides an example of the potential dangers that can arise from ambiguous antitrust risk-sharing provisions in transaction agreements.

The transaction agreement required each party to "use its reasonable best efforts to oppose or defend against any action to prevent or enjoin consummation of [the transaction], including by defending any [a]ction brought by any [g]overnmental [a]uthority," but contained no express limitations on this obligation.<sup>28</sup> The agreement was terminable by either party if a governmental authority had issued an order or any other action permanently enjoining or otherwise prohibiting the consummation of the transaction, and such order or other action has become final and non-appealable, provided that the party seeking termination had complied with its obligations to oppose such an order.<sup>29</sup> The agreement allowed either party to terminate if closing had not occurred on or prior to February 8, 2020, but this date was automatically extended to May 8, 2020 if all closing conditions were satisfied except the antitrust approvals conditions.<sup>30</sup>

Following the news of the FTC's complaint, the CEO of Edgewell said, "we will review the FTC's decision and respond in due course," and the co-CEOs of Harry's stated that they were "evaluating the best path forward."<sup>31</sup> On February 10, eight days after the FTC's complaint was filed, Edgewell announced that it had

terminated the merger agreement and also that Harry's had informed Edgewell that it intended to pursue litigation against Edgewell, which Edgewell believed had no merit.<sup>32</sup> Presumably, the fact that there was less than 3.5 months between the FTC challenge and the outside date of the merger agreement factored into the decision not to litigate.

It can be assumed that Harry's believed that "reasonable best efforts" required at least an attempt to defend against the FTC complaint, while Edgewell did not wish to pursue litigation. Ambiguous terms such as "reasonable best efforts" may result in misaligned stances and potentially even costly litigation. Further, it is important to consider the outside date to the extent the parties want to preserve a credible option to litigate.

## Conclusion

The FTC's challenge of Edgewell/Harry's is an example of the antitrust agencies' focus on transactions that are likely to eliminate a new, disruptive competitor, and their arguments that a target company's competitive significance is greater than its market share may reflect. Parties to a transaction potentially involving a recent entrant with new technology, aggressive pricing, or other innovative qualities should consider the increased likelihood of competition concerns resulting from both unilateral and coordinated effects and adjust their risk assessments accordingly. The increased antitrust risk from these transactions should also motivate parties to pay greater attention to statements in both internal and external documents, as well as both any ambiguous risk-shifting provisions in transaction agreements and the outside date.

## ENDNOTES:

<sup>1</sup>Edgewell and Harry's Combination Investor Presentation, Edgewell Personal Care Products (May 9, 2019) (available at: <https://ir.edgewell.com/~media/Files/E/EdgeWell-IR/reports-and-presentations/quarterly-earnings/edgewell-harrys-combination-investor-presentation.pdf>).

<sup>2</sup>Press Release, Edgewell Personal Care Products,

Edgewell Personal Care to Combine with Harry's, Inc. to Create a Next-Generation Consumer Products Platform (May 9, 2019), <https://www.prnewswire.com/news-releases/edgewell-personal-care-to-combine-with-harrys-inc-to-create-a-next-generation-consumer-products-platform-300847130.html>.

<sup>3</sup>Complaint, *In re Edgewell Personal Care Products*, No. 9390 (FTC Feb. 2, 2020) (hereinafter, "Complaint").

<sup>4</sup>Press Release, Edgewell Personal Care Products, Edgewell Personal Care to Pursue Standalone Value Creation Strategy (Feb. 10, 2020), <https://www.prnewswire.com/news-releases/edgewell-personal-care-to-pursue-standalone-value-creation-strategy-301001813.html>.

<sup>5</sup>Complaint at paras. 3 and 67.

<sup>6</sup>*Id.* at para. 52.

<sup>7</sup>*Id.*

<sup>8</sup>*Id.* at paras. 54-63.

<sup>9</sup>*Id.* at para. 64.

<sup>10</sup>Complaint, *In re Illumina*, No. 9387 (FTC Dec. 17, 2019), [https://www.ftc.gov/system/files/document/s/cases/d9387\\_illumina\\_pacbio\\_administrative\\_part\\_3\\_complaint\\_public.pdf](https://www.ftc.gov/system/files/document/s/cases/d9387_illumina_pacbio_administrative_part_3_complaint_public.pdf).

<sup>11</sup>Complaint, *DOJ v. Sabre Corporation*, et al. (Aug. 20, 2019), <https://www.justice.gov/opa/press-release/file/1196816/download>.

<sup>12</sup>Complaint, *In re CDK Global, Inc.*, No. 9382 (FTC Mar. 19, 2018), [https://www.ftc.gov/system/files/documents/cases/docket\\_no\\_9382\\_cdk\\_automate\\_part\\_3\\_complaint\\_redacted\\_public\\_version\\_0.pdf](https://www.ftc.gov/system/files/documents/cases/docket_no_9382_cdk_automate_part_3_complaint_redacted_public_version_0.pdf).

<sup>13</sup>Jason Del Rey, *The US government is breaking up Big Razor before it gets to Big Tech*, RECODE (Feb. 11, 2020), <https://www.vox.com/recode/2020/2/3/21120169/harrys-ftc-acquisition-edgewell-schick-gillette-dollar-shave-club>.

<sup>14</sup>See U.S. Dep't of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines § 7 (2010).

<sup>15</sup>Complaint, *In re RAG-Stiftung*, No. 9384 (FTC Aug. 2, 2019), [https://www.ftc.gov/system/files/documents/cases/d09384\\_evonik-peroxychem\\_part\\_iii\\_complaint\\_8-2-19.pdf](https://www.ftc.gov/system/files/documents/cases/d09384_evonik-peroxychem_part_iii_complaint_8-2-19.pdf).

<sup>16</sup>Complaint, *In re Linde AG*, No. C-4660 (FTC Oct. 19, 2018) [https://www.ftc.gov/system/files/documents/cases/1710068\\_praxair\\_linde\\_complaint.pdf](https://www.ftc.gov/system/files/documents/cases/1710068_praxair_linde_complaint.pdf).

<sup>17</sup>Complaint, *In re Tronox Limited*, No. 9377 (FTC Dec. 5, 2017), [https://www.ftc.gov/system/files/documents/cases/docket\\_no\\_9377\\_tronox\\_cristal\\_part\\_3\\_ad](https://www.ftc.gov/system/files/documents/cases/docket_no_9377_tronox_cristal_part_3_ad)

[ministrative complaint redacted public version 12072017.pdf](#).

<sup>18</sup>Complaint, *U.S. v. AT&T, Inc., et al.*, Case 1:17-cv-02511 (D.D.C. Nov. 20, 2017), <https://www.justice.gov/atr/case-document/file/1012916/download>.

<sup>19</sup>Complaint at para. 69.

<sup>20</sup>*Id.* at para. 67.

<sup>21</sup>*Id.* at para. 48.

<sup>22</sup>See U.S. Dep't of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines § 7.1 (2010).

<sup>23</sup>Complaint at para. 13.

<sup>24</sup>*Id.* at para. 60.

<sup>25</sup>*Id.* at para. 1.

<sup>26</sup>*Id.* at paras. 51-70.

<sup>27</sup>*Id.* at paras. 74-77.

<sup>28</sup>Agreement and Plan of Merger dated May 8, 2019, § 5.8(c), available at: <https://www.sec.gov/Archives/edgar/data/1096752/000109675219000021/epcexhibi2151319.htm>.

<sup>29</sup>*Id.* at § 7.1(c).

<sup>30</sup>*Id.* at § 7.1(b).

<sup>31</sup>Press Release, Edgewell Personal Care Products, Edgewell Personal Care and Harry's, Inc. Comment on FTC Decision (Feb. 3, 2020), [https://ir.edgewell.com/news-and-events/press-releases/2020/02-03-2020-152557573?sc\\_lang=en](https://ir.edgewell.com/news-and-events/press-releases/2020/02-03-2020-152557573?sc_lang=en).

<sup>32</sup>Press Release, Edgewell Personal Care Products, Edgewell Personal Care to Pursue Standalone Value Creation Strategy (Feb. 10, 2020), <https://www.prnewswire.com/news-releases/edgewell-personal-care-to-pursue-standalone-value-creation-strategy-301001813.html>.

## DELAWARE CHANCERY COURT CONSIDERS PANERA DEAL PRICE IN APPRAISAL SUIT

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The Delaware Court of Chancery ruled in *In re Appraisal of Panera Bread Company*,<sup>1</sup> following a six-day trial, in a 130-page decision issued on January 31, 2020, that the petitioners received more than fair value for each share of Panera Bread Company (“Panera”) in connection with its 2017 acquisition by JAB Holdings B.V. (“JAB”), with the Court relying on the deal price, minus synergies value, as the metric of fair value for the case. Because Panera had paid the appraisal petitioners the full merger price as permitted by Delaware law, it sought a refund of the amount of the deducted synergies. Addressing an issue of first impression, the Court concluded that Panera did not have a basis for a refund under Delaware’s appraisal statute. The *Panera* decision reaffirms well-established indicia used by Delaware courts to evaluate whether a sale process is reliable and probative of fair value, while providing useful guidance to merger parties when considering the important question of whether or in what amount to pay appraisal petitioners in order to reduce exposure to prejudgment interest.

### Background

*Panera* involved the acquisition of Panera, a bakery-café concept, by JAB for \$315.00 per share in cash, which was announced in April 2017 and closed in July 2017. Panera was founded by Ronald M. Shaich, who served in various roles, including as Chief Executive Officer, Co-Chief Executive Officer and on the Board of Directors, throughout his tenure at the company. Under Shaich’s leadership as CEO, Panera began implementing various initiatives focused on enhancing the company’s guest experience in 2014 and tracked these initiatives through a five-year strategic plan, which it heavily publicized to generate market recognition. In 2016, the company was approached by Starbucks, and after the parties evaluated a potential

joint venture and potential strategic transaction, Starbucks eventually informed Panera that it would not move forward with a transaction.

By February 2017, Panera reached the “inflection point” of its period of innovation and began to reap the benefits of its initiatives,<sup>2</sup> at which time Panera began discussions with JAB. In March 2017, JAB made an initial offer to Panera of \$286 per share in cash. Through negotiations, JAB raised its offer to \$296.50 per share in cash, and then finally to \$315 per share in cash, although JAB had previously indicated that it would not offer more than \$299 per share.<sup>3</sup> During negotiations, Panera and Morgan Stanley, its financial advisor, identified potential interlopers (including Starbucks), with Morgan Stanley ruling out financial sponsors, and these discussions with Morgan Stanley aligned with “Shaich’s and the board’s deep knowledge of the industry.”<sup>4</sup> Shaich had previously discussed a potential transaction with many of the potential interested parties, or had industry knowledge of their ongoing projects or company-wide issues, and Panera had already previously engaged with Starbucks. Further, no potential bidders emerged during Panera’s negotiations with JAB despite a leak, and no topping bidder emerged following announcement of the merger.

In July 2017, dissenting stockholders notified Panera of their desire to exercise appraisal rights in respect of 1,863,578 shares of Panera’s common stock. The petitioners in the case, holding 785,108 of those shares, contended a fair value of \$361 per share.

### The Court of Chancery Decision

In its decision, the Court reaffirmed the characteristics of a sale process that Delaware courts review in appraisal proceedings and weigh against any weaknesses in the sale process in order to determine whether the deal price reflects fair value. While there is no presumption that the deal price reflects fair value, the Delaware Supreme Court has long endorsed the efficient market hypothesis, and “the persuasiveness of the deal price depends on the reliability of the sale process that gener-

ated it.”<sup>5</sup> Indicia of reliability of a sale process that have previously been approved by the Delaware Supreme Court include, among others, arm’s-length negotiation, board deliberation without conflicts of interest, buyer due diligence and receipt of confidential information about the target’s value and extraction of multiple price increases, with the absence of post-signing bidders an indicator particularly emphasized by the Delaware Supreme Court.<sup>6</sup>

The Court found that Panera’s sale process was sufficiently reliable to make deal price persuasive evidence of fair value, noting, among evidence of other indicia, the following: the two increases in JAB’s offer price even though JAB had previously insisted it would not offer more than \$299 per share; the extensive public information about the company available to JAB given the company’s transparency and other confidential information provided to JAB; and no appearance of other potential bidders, particularly in light of a leak. The Court found that Panera’s routine deal protections, together with the “unremarkable conclusion that no bidders emerged in the face of nonpreclusive deal protections” through a 104-day period between signing and closing, would seem to survive enhanced scrutiny.<sup>7</sup>

● **Pre-Signing Market Check:** The Court noted that when “directors possess a body of reliable evidence with which to evaluate the fairness of a transaction, they may approve that transaction without conducting an active survey of the market”<sup>8</sup> or using traditional value-maximizing tools, such as an auction, provided that the board “must possess an impeccable knowledge of the company’s business.”<sup>9</sup> Outreach to logical buyers is a key indicator of reliability,<sup>10</sup> and the Court concluded that the Panera Board led outreach to all logical buyers (*i.e.*, Starbucks and JAB), highlighting the Panera Board’s “impeccable knowledge of the market in the pre-signing phase.”<sup>11</sup>

● **Termination Fee:** The Court noted that Panera’s 3% termination fee “falls on the low end of the range” presented by other deals (referencing deals



with 2.27%, 3.5% and 3.9% termination fees).<sup>12</sup>

- **“No-Shop”:** The Court described Panera’s “no-shop” with a fiduciary out and matching rights as differing little from that of other deals with protections held by Delaware courts to satisfy enhanced scrutiny.<sup>13</sup> The Court also noted that the absence of a “go-shop” did not affect the reliability of Panera’s outreach.<sup>14</sup>

- **Passive Post-Signing Market Check:** The Court noted that the duration of Panera’s passive post-signing market check “falls in the middle” of other examples (pointing to deals with 50 days, 126 days and 153 days between signing and closing) and provided sufficient time for a topping bid to appear.<sup>15</sup>

The Court also addressed the petitioners’ contention that weaknesses in Panera’s pre-signing process undermined the deal price’s reliability. The petitioners pointed to the Panera Board’s alleged failure to oversee the negotiations led by Shaich, but the Court concluded that the board “exercised active oversight,”<sup>16</sup> with Shaich operating on the Panera Board’s instructions, with the assistance of outside counsel.<sup>17</sup> Another primary allegation by the petitioners was that Shaich’s personal conflicts undermined the process and that he had left value on the table given his desire to retire and his dislike of running a public company. In response, the Court extensively discussed Shaich’s “deep” commitment to realizing value for Panera<sup>18</sup> and his tenure with Panera, including the fact that he had “repeatedly prioritized the Company’s success over his preferred professional trajectory,”<sup>19</sup> which indicated that his personal interests did not undermine the sale process. The petitioners also raised a secondary contention that Shaich was apathetic on price because he wanted to liquidate and diversify his assets upon closing a transaction, which the Court disregarded given the absence of evidence.<sup>20</sup> The Court recognized Shaich as the deal’s lead negotiator who was intent on obtaining the highest price possible and whose deep understanding

of the market contributed to the robustness of the sale process, noting that “[t]he market and the restaurant industry both recognize Shaich as a visionary.”<sup>21</sup>

Having established that the deal price was a persuasive metric of fair value in the case, the Court deducted a reasonable estimate of merger-specific synergistic gains from the deal price, which amounted to \$11.56 of cost and tax synergies per share.<sup>22</sup> Based on this valuation method, the Court found that the fair value of Panera’s common stock at the time of the merger was \$303.44 and, as a result, that petitioners obtained more than fair value.<sup>23</sup>

Panera sought a refund of the amount of the deducted synergies, but the Court concluded that it could not order a refund since it is not explicitly provided for by Section 262 of the DGCL.<sup>24</sup> Pursuant to Section 262(h) of the DGCL, a surviving corporation seeking to decrease the amount of interest that could accrue in an appraisal suit may prepay petitioners an amount in cash,<sup>25</sup> and upon such prepayment, interest accrues only on the sum of (1) any difference between such amount and the fair value of the shares determined by the court and (2) any interest accrued to date unless paid at that time.<sup>26</sup> The Court concluded that any prepayment in excess of the judicially determined fair value of the shares is not a remedy available under the statute, and the prepayment agreement here did not provide any contractual right to claw-back overpayments, as some others have done.<sup>27</sup> The Court described prepayment under the DGCL as “a business decision, made with knowledge of the company’s sale process that is superior to the stockholder’s, and with counsel’s prediction of how long the litigation may take and how much interest may accrue.”<sup>28</sup>

### Implications

A few notable takeaways from the Delaware Court of Chancery’s decision in *Panera* include the following:

- In its assessment, the Court emphasized the Panera Board’s deep knowledge in the pre-

signing phase of the company—including its valuation metrics, performance and projections—and of the market. This reaffirms the need for boards of directors to develop a strong record of their attention to the company’s performance and market over time, rather than solely in the context of considering a particular transaction.

- Boards of directors engaged in a sales process should continue to develop a record of a robust deal process, which may be equally important in any appraisal proceeding or in any fiduciary litigation.
- Prepayment of the deal price is a business decision to be made by companies after weighing various factors regarding the appraisal action, and upon electing prepayment, companies may want to consider stipulating claw-back rights so that they may recover any amount of the prepayment that may be judicially determined to exceed the fair value of the appraisal shares.
- In its discussion of deal protections, the Court noted that it “has recently posited that deal price is persuasive evidence of fair value, even with a limited pre-signing outreach, if the merger agreement’s deal protections are sufficiently open to permit a post-signing passive market check in line with what decisions have held is sufficient to satisfy enhanced scrutiny.”<sup>29</sup> The referenced recent decision currently is on appeal to the Delaware Supreme Court, which may provide further guidance on process sufficiency in appraisal proceedings moving forward.

#### ENDNOTES:

<sup>1</sup>*In re Appraisal of Panera Bread Company*, C.A. No. 2017-0593-MTZ (Del. Ch. Jan. 31, 2020).

<sup>2</sup>*Id.* at 22.

<sup>3</sup>*Id.* at 33.

<sup>4</sup> *Id.* at 37.

<sup>5</sup>*Id.* at 52 (quoting *In re Appraisal of Stillwater Min. Co.*, 2019 WL 3943851, at \*21 (Del. Ch. Aug. 21, 2019) (citing *Dell, Inc. v. Magnetar Glob. Event Driven Master Fund Ltd.*, 177 A.3d 1, 21 (Del. 2017); *DFC Glob. Corp. v. Muirfield Value P’rs, L.P.*, 172 A.3d 346, 366-67 (Del. 2017))).

<sup>6</sup>*Id.* at 53-54.

<sup>7</sup>*Id.* at 61 (n.385).

<sup>8</sup>*Id.* at 68 (quoting *Barkan v. Amsted Indus., Inc.*, 567 A.2d 1279, 1287 (Del. 1989)).

<sup>9</sup>*Id.* (quoting *In re OPENLANE, Inc. S’holders Litig.*, 2011 WL 4599662, at \*5 (Del. Ch. Sept. 30, 2011)).

<sup>10</sup>*Id.* at 63 (citing *Dell, Inc. v. Magnetar Glob. Event Driven Master Fund Ltd.*, 177 A.3d 1, 35 (Del. 2017)).

<sup>11</sup>*Id.* at 69.

<sup>12</sup>*Id.* at 61-62 (n.385 (citing *C & J Energy Servs., Inc. v. City of Miami Gen. Emps.*, 107 A.3d 1049, 1063 (Del. 2014); *In re Dollar Thrifty Shareholder Litigation*, 14 A.3d 573, 592-93, 614-16 (Del. Ch. 2010); and *In re PLX Tech. Inc. S’holders Litig.*, 2018 WL 5018535, at \*2, \*26-27, \*44, \*55 (Del. Ch. Oct. 16, 2018))).

<sup>13</sup>*Id.*

<sup>14</sup>*Id.* at 69.

<sup>15</sup>*Id.* at 61-62 (n.385 (citing *C & J Energy*, 107 A.3d 1049, 1063; *Dollar Thrifty*, 14 A.3d 573, 592-93, 614-16; and *PLX*, 2018 WL 5018535, at \*2, \*26-27, \*44, \*55)).

<sup>16</sup>*Id.* at 71.

<sup>17</sup>*Id.* at 27-28, 73. Panera and its Board were represented by Sullivan & Cromwell LLP.

<sup>18</sup>*Id.* at 88.

<sup>19</sup>*Id.* at 87.

<sup>20</sup>*Id.* at 85 (n.504).

<sup>21</sup>*Id.* at 5.

<sup>22</sup>*Id.* at 102-103.

<sup>23</sup>*Id.* at 125.

<sup>24</sup>*Id.* at 129.

<sup>25</sup>*Id.* at 126 (citing 8 *Del. C.* § 262(h)).

<sup>26</sup>8 *Del. C.* § 262(h).

<sup>27</sup>*Panera*, C.A. No. 2017-0593-MTZ, at 127 (citing *Artic Invs. LLC v. Medivation, Inc.*, C.A. No. 2017-0009-JRS, D.I. 20 at 5 (Del. Ch. Mar. 6, 2016)).

<sup>28</sup>*Id.* at 130 (n.704).

<sup>29</sup>*Id.* at 61 (n.385 (citing *In re Appraisal of Stillwater Min. Co.*, 2019 WL 3943851, at \*24-30 (Del. Ch. Aug. 21, 2019))).

## THE CORONAVIRUS AND M&A: EARLY SCENARIOS

As of press time for this issue of *The M&A Lawyer*, 109,000 cases of SARS-CoV-2, aka COVID19 or “coronavirus,” had been confirmed worldwide and stocks had posted their worst weekly decline since 2008. A year that had begun with a feeling of modest economic optimism was suddenly looking at the prospect of a global pandemic with the potential to send the global economy into recession.

What impact could a coronavirus pandemic have on ongoing and prospective mergers and acquisitions? It’s fair to say that it’s simply too soon to tell at this point. But looking at China’s initial response to the pandemic and how that has affected deals may shed light on some potential issues in the months ahead.

On February 26, *The M&A Lawyer* talked to Friedemann Thomma, a partner in the San Francisco office of Venable LLP, and head of Venable’s international tax practice, who has extensive contacts with Chinese firms. Thomma was relatively optimistic that the coronavirus panic in the markets could prove to be a short-lived “one off” event, but added this greatly depends on how the situation plays out worldwide over the next month or so.

“This is not the first time we’ve seen these type of events, such as SARS [in 2002-2003],” he said. “Whenever we have such events it obviously has an impact on prospective deals. But I’ve yet to see a deal that was already in motion that got derailed.”

A key M&A-related issue in China at the time of this interview was that the mandatory quarantines had essentially shut down the Chinese economy for over a month. “I have clients in China and everyone is home

right now. They literally cannot go to work, everyone’s in their apartments, they have to get a special permit,” Thomma said. “So obviously that’s a particular problem when trying to get a deal done. That’s granular. If they were working on a deal, they now cannot produce the financials—it’s not practical.”

“We have several deals that aren’t proceeding and it’s a wait-and-see approach,” he added. “But it’s not that the buyer and seller are having concerns, it’s just that it’s practically impossible to proceed right now. Due diligence is all but impossible—you are not going to get that data. A lot of things—bank approvals, etc.—have more or less stopped.”

Thomma emphasized that the situation still felt more like a pause rather than being something that could seriously deflate Chinese M&A in 2020. “Will the deals eventually get done? Absolutely,” he said. “In the M&A context I think it’ll be a blip.”

Looking at cross-border deals in progress, one merger with the potential to be affected by the Chinese business shutdown is the announced union of Mylan NV and Upjohn, slated to close later this year. Upjohn (currently a division of Pfizer Inc.) is based in Shanghai and roughly 20% of its revenues come from the sales of such drugs as Viagra and Zoloft to the Chinese market.

In an SEC filing in late February, Mylan said “the extent to which the coronavirus impacts the Upjohn Business’ operations will depend on future developments, which are highly uncertain and cannot be predicted, including new information which may emerge concerning the severity of the coronavirus and the actions to contain the coronavirus or treat its impact, among others.”

### Due Diligence, MAC Questions

The Chinese situation has demonstrated that due diligence can be hindered in the event of a quarantine on the scale of China’s and Northern Italy’s. While the use of virtual data rooms to share critical documents should

mostly keep a deal's negotiations on track, there's still a solid chance that some unforeseen event—say, a mandated closing of a government or regulatory office—could forcibly extend a due diligence period. While normally such a delay shouldn't be a major issue, should it be the acquisition of a distressed seller, for example, a substantial freeze in due diligence could result in the seller's condition deteriorating beyond expected predictions before the deal finally closes.

Which leads to the question: could a buyer try to invoke a MAC clause as a means to walk away from a deal or to renegotiate a deal's terms? There are reports that M&A clients have indeed begun quietly asking their lawyers about MAC options, in particular for China-related deals. But the market consensus is that any coronavirus-related issue will not trigger a MAC. These clauses mostly serve to protect buyers from material adverse changes that are specific to the seller's business, not from changes affecting all sorts of businesses on a global scale.

And there are multiple precedents that invoking an unforeseen political or environmental change won't trigger a MAC. Take the UK Takeover Panel's rejection in 2001 of WPP's claim that it shouldn't be forced to honor its agreement to buy Tempus Group Plc because Tempus' performance had deteriorated after the 9/11 attacks. Further, sellers would fight hard before conceding a MAC tied to any virus-related changes to their business. If anything, lawyers expect to see some explicit coronavirus-related carveouts to MAC clauses appear in the next few months.

The coronavirus tumult comes as M&A has been muted so far in the first quarter. At the end of February, global announced transaction volume was down about 26%, at \$387.4 billion, according to Refinitiv, while U.S. announced deals were down 52%, at \$144.8 billion. Global announced private equity M&A transactions is also substantially less than last year's volume at this point. The decline is in part a question of size: there haven't been any substantially large acquisitions so far in 2020. U.S. private equity, for example, hasn't

posted a transaction above \$10 billion as of the end of February.

## PAYROLL TAX CONSIDERATIONS IN MERGERS AND ACQUISITIONS

*By Keith Durkin*

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Post-closing payroll tax reporting requirements are a common issue after the merger or consolidation of entities. Clients need guidance on how to properly report payroll taxes after a merger or acquisition and how to efficiently structure their payroll tax reporting after the merger or acquisition.

### Post-Closing Reporting Requirements

Revenue Procedure 2004-53 provides thorough guidance on payroll tax reporting requirements after a statutory merger or consolidation or any other acquisition qualifying under the "predecessor-successor rules" set forth in Treasury Regulation 31.3121(a)(1)-1(b). Acquisitions qualifying under the predecessor-successor rules are those in which a successor employer (a) acquires substantially all the property used in a trade or business of another employer or in a separate unit of a trade or business of a predecessor, and (b) in connection with and directly after the acquisition during the same calendar year, employs individuals who immediately before the acquisition were employed in the trade or business of the predecessor.

Employees transferred pursuant to an asset sale acquisition or a type C reorganization would qualify under the predecessor-successor rules. Revenue Procedure 2004-53 sets forth two payroll tax reporting methods after an acquisition qualifying under the predecessor-successor rules: (a) the standard method and (b) the alternative method.

### *Standard Method*

With the standard method, the selling entity (or predecessor) performs all reporting duties for the wages paid up until the date of acquisition. Subsequent to that date, the purchasing entity reports the wages it pays. This means the employees receive two Form W-2s, Wage and Tax Statement, in the year of acquisition—one from the purchasing entity and one from the selling entity—similar to a short taxable year filing. The employees transferred to the purchasing entity must provide the purchasing entity a new Form W-4, Employee's Withholding Certificate, as applicable. If the selling entity is discontinuing operations, then it must file a final Form 941, Employer's Quarterly Federal Tax Return, and is required to issue expedited W-2s to the former employees. Expedited is defined in the Revenue Procedure as the earlier of (a) on or before the Form 941 filing date or (b) within 30 days after the written request of an employee or 30 days after final wage payments, whichever is later in this latter scenario.

### *Alternative Method*

With the alternative method, the selling entity is released from reporting wages for the entire acquisition year. Instead, the purchasing entity is responsible for filing W-2s for the entire year. The selling entity transfers all W-4s to the purchasing entity and the purchasing entity is required to submit those forms to the Internal Revenue Service (IRS). These forms can be electronically transferred between the entities. The alternative method applies only to employees transferred between the two entities. If one or more employees are not transferred, then the selling entity must file a Form 941 and issue W-2s for those employees who have not been transferred, as set forth in the standard method.

Generally, the totals on the W-2s will equal the totals reported on Form 941. If the alternative method is elected, then there will be a difference shown on the purchasing entity's W-2s and its own filed Form 941. The purchasing entity reconciles these differences by

filing a Schedule D to Form 941 explaining the discrepancies and disclosing the acquisition. Schedule D is a special schedule supplement to Form 941, titled Report of Discrepancies Caused by Acquisitions, Statutory Mergers, or Consolidations. The purchasing entity files Schedule D with Form 941 for the first quarter of the calendar year after the year of the acquisition. For example, if an acquisition occurs in the third quarter of 2020, then Schedule D would be filed in the first quarter of 2021. Filing Schedule D is important because it will prevent a notice (SSA-L-93-SM) being sent by the Social Security Administration notifying the employer of W-2 discrepancies.

Acquisitions through statutory mergers or consolidations are governed by Revenue Ruling 62-60, which is further amplified by Revenue Procedure 2003-54. Revenue Ruling 62-60 and Revenue Procedure 2003-54 require utilization of the alternative method in statutory mergers or consolidations. This means the acquiring entity is responsible for issuing one W-2 to the employees and then completing and attaching Schedule D to Form 941 in the first quarter of the year after the acquisition to disclose discrepancies between Form 941 and the W-2s. If an acquired entity is filing a final Form 941 as a result of a statutory merger, then it should also file a Schedule D with the final Form 941 and explain any discrepancies between the W-2s and the final Form 941.

### **Post-Closing Structure**

Most attorneys advise clients to operate separate businesses as separate entities and manage ownership through parent entities. Splitting operating businesses into separate affiliated entities provides creditor protection, protects tax attributes and can assist in qualifying for tax incentives. Accordingly, many mergers and acquisitions end with a confusing and complex corporate ownership chart, with employees employed by separate subsidiary entities. Without any planning, this means each separate subsidiary entity must file its own payroll tax forms, issue W-2s and generally comply with all payroll tax reporting obligations. Requiring

each separate subsidiary to fulfill its own payroll tax reporting obligations is inefficient and costly and can be circumvented by designating a member of the affiliated group as a “common pay agent” or “3504 agent.”

Internal Revenue Code § 3504 authorizes the use of a common pay agent. Treasury Regulation § 31.3504-1 allows an entity (the applying entity) to file a Form 2678, Employer/Payer Appointment of Agent and designate an affiliate or its owner as its agent to (a) pay wages or compensation to some or all of the employees of the applying entity, (b) prepare and file employment tax forms on behalf of the applying entity, (c) prepare Forms W-2 on behalf of the applying entity, and (d) make federal tax deposits and other federal tax payments on behalf of the applying entity. A common pay agent, however, cannot file Form 940, Employer’s Annual Federal Unemployment (FUTA) Tax Return, which remains the obligation of the applying entity.

A common pay agent cannot be designated retroactively and must be filed for at least 60 days prior to the requested effective date. It is best for clients to designate a common pay agent commencing on the first of a year in order to reduce the administrative burden. The IRS sends an approval letter to the designated common pay agent and the applying entity.

Once approved, the agent is then required to file one Form 941 return for each tax return period (a) reporting the wages and employment taxes on the wages paid to its own employees and (b) the wages and employment taxes on the wages paid by the agent to the employees of each applying entity on whose behalf it is acting. This Form 941 return is referred to as the “aggregate return.” The agent must complete an allocation schedule and attach it to the aggregate return. The allocation schedule sets forth the name and employer identification number (EIN) of each applying entity for whom the agent is authorized to act and it allocates the wages, taxes and payments reported on the aggregate return to each applying entity.<sup>1</sup> The agent is required to maintain records identifying all the wages paid by the agent on behalf of an applying entity to an employee of the ap-

plying entity. Correspondingly, the applying entity is required to maintain records identifying all the wages paid by the agent to the applying entity’s employees. The reciprocal record-keeping obligations are imposed on the agent and the applying entity because each of them assumes responsibility for any unpaid employment taxes of the applying entity. The agent files and provides each applying entity employee one Form W-2. The agent’s EIN is entered in the spaces provided for the employer’s EIN on the W-2. The name of the agent, followed by “Agent for [name of employer],” is entered in the space designated for the employer’s name on the W-2. Last, the agent can process an applying entity’s payment of supplemental wages to an employee if the applying entity checks the box labeled “For ALL employees/payees/payments” on the Form 2678 the agent files.

### Conclusion

Payroll tax considerations are an overlooked consideration in merger and acquisition transactions. Clients often have post-closing questions regarding payroll tax reporting requirements and structural issues. Anticipating and effectively resolving these questions strengthen client relationships by helping them reduce payroll tax administrative costs generated by the acquisition and operation of separate businesses.

### ENDNOTES:

<sup>1</sup>The IRS has designated Schedule R, Allocation Schedule for Aggregate Return Filers, for Form 941 as the allocation schedule to attach to an aggregate Form 941.

## CONSUMMATED MERGERS: OPTIONS FOR RESURRECTING A LOST COMPETITOR

By Ian Conner

*Ian Conner is the director of the Bureau of Competition at the Federal Trade Commission. This is excerpted and adapted from remarks that he gave at the GCR Live 9th Annual Antitrust Law Leaders Forum in Miami on February 8, 2020.*

Over the past several months, the Commission has moved aggressively against anticompetitive conduct in a range of industries and under varied, and often novel, theories . . . Two of these recent cases targeted acquisitions of nascent competitors,<sup>1</sup> another action in the pharmaceutical space targeted an anticompetitive scheme to prevent entry by a nascent or any other competitor,<sup>2</sup> another transaction was abandoned after FTC staff raised labor and downstream service concerns,<sup>3</sup> while other cases focused on more familiar antitrust theories.<sup>4</sup> Even as we push forward with innovative theories, we still bring bread-and-butter cases to stop significant competitors in an industry from merging.

While finding and stopping anticompetitive conduct and mergers is the primary goal of the Commission's antitrust enforcement actions, just as important is how we fix those antitrust violations. Remedies are crucial because they are where the abstract theoretical and analytical work of antitrust meets the real world. There is a current perception in some corners that antitrust is, or should become, a cure-all. At the same time, others argue that antitrust is moribund and should be overhauled. I think the truth is that antitrust law is neither a blunt instrument nor a relic from a bygone era: rather it is far more like a chisel, useful to target a specific set of illegal conduct that distorts the competitive marketplace. And, just as important, is the remedial effort, seeking to restore the competitive dynamics—the vigor, the innovation, and the market opportunity—that the anticompetitive conduct stifled. Antitrust is a great set of tools for solving real compet-

itive problems that harm real consumers in real markets. When antitrust succeeds in making the world a more competitive and innovative place, it does so with remedies.

Today I want to address some misperceptions about the Commission's remedial powers in competition cases. My main message is that the Commission relies on a variety of different tools to design a remedy that fixes the competitive problems in each case. The Commission has honed these tools over 100 years of practice, and we use them every day as part of our enforcement work. In fact, our expertise in constructing custom-made remedies for complex cases is one of the Commission's flagship advantages as an antitrust enforcer. And we are not deterred by the potential difficulty in crafting a remedy; and we will bring a case when it's the right thing to do even though restoring competition may be difficult. This is true for both conduct matters and for acquisitions, whether they affect small segments of the economy or significant industries. Our two guiding principles in enforcement are stop the conduct and restore competition. Sometimes we cannot fully un-ring the bell, but we will do our best.

I [will focus] on remedies crafted by the Commission in a voluntary consent or following administrative litigation pursuant to Part 3 of our Rules of Practice.

Let's start with a couple of fundamentals. The Commission's authority to write its own orders derives from Section 5(b) of the FTC Act,<sup>5</sup> which gives the Commission a pretty expansive remedial toolbox. Section 5(b) talks on its face about orders to "cease and desist" from unlawful practices, but our remedies frequently do more than simply bring specific ongoing conduct to an end (or command that past conduct not be repeated). Commission orders are not limited to simply stopping past violations. In the words of the Supreme Court: "If the Commission is to attain the objectives Congress envisioned, it cannot be required to confine its road block to the narrow lane the transgressor has traveled; it must be allowed effectively to close all roads to the

prohibited goal, so that its order may not be by-passed with impunity.”<sup>6</sup>

There are limits, of course. The remedial provisions must bear a reasonable relation to the violation charged—that is, the need for the remedial provision must be supported by the record and bear a nexus to the illegal conduct.<sup>7</sup> Commission orders also must avoid unreasonable overbreadth and impermissible vagueness: needless to say, respondents should be able to understand and comply with their obligations.<sup>8</sup> Respondents in contested Part 3 matters routinely seek federal court review of Commission orders, as is their right under the FTC Act.<sup>9</sup> So respondents enjoy both substantive and procedural protections, which they routinely exercise.

The Supreme Court has recognized that the FTC is an expert body with wide latitude to design remedies.<sup>10</sup> The Commission’s remedial flexibility is critical if the Commission is going to be able to solve complex real-world problems in complex real-world markets. Courts remind us that the means of monopolization are myriad,<sup>11</sup> and we have learned over more than a hundred years that there are often countless ways for companies to impose the same harm by different means. So a remedy that can be easily evaded or subverted is really no remedy at all.

Often, delay in achieving justice accrues to the benefit of the offender. Respondents often continue to reap the benefits of their harmful merger or conduct until it is affirmatively stopped through entry of a final order. Delay also may undermine the remedial options available to the Commission. So we aim to act swiftly, as well as accurately, when we seek a remedy for anticompetitive problems.

### Consummated Mergers

My first category of special cases is consummated mergers. It’s important to remember that until Congress required premerger notification for some transactions in the late 1970s, nearly all merger enforcement actions involved consummated mergers.

To put it another way, between 1890 and 1978, merger review was primarily structured as a consummated merger review. Section 7 in both its 1914 and 1950 versions had consummated transactions primarily in mind. This made merger review a tricky affair for all the familiar reasons: assets were scrambled, effective structural relief was hard to come by, and competitive harm continued during what was often lengthy litigation.

All this made merger control a weak constraint on anticompetitive deals until Congress introduced the Hart-Scott-Rodino premerger notification system in 1976, which greatly improved the agencies’ ability to prevent competitive harm from mergers.<sup>12</sup> But not all acquisitions are subject to premerger notification, and sometimes acquisitions are challenged after they have been notified and cleared by the agencies. When the Commission challenges transactions that are anticompetitive but consummated, it must frame a remedy that reflects that reality and the challenges that come with it.

For many reasons, it may be hard to resurrect a competitor or form a new player that is able to exert the same competitive intensity that the target would have provided, but for the merger in question. The recent Remedy Study noted that the Commission may face significant challenges in crafting a remedy for a consummated merger, especially if the acquired business has been merged and its assets combined with those of the acquiring firm.

But the challenges here can come not only from “scrambled” assets, but also from lost business relationships: customers may have chosen new suppliers, employees may have left or taken different positions, suppliers may no longer be available for needed inputs. And degraded assets cause other challenges: machinery may have been actively destroyed or intellectual property may not have been properly upgraded. The companies may have shared confidential business information, knowhow, trade secrets, or proprietary data that were key to the competitive significance of



the acquired firm. Additionally, the passage of time may have resulted in the loss of brand or reputational cachet. In order to restore competition, the Commission will have to consider all of the factors that determine competitive success in the affected market, all the ways in which competition has declined since the transaction; and so on. Nevertheless, even when it is hard and may require assets and services beyond those acquired, breakup of the merged company to reestablish competition is still the most likely remedy for a consummated merger.

Parties can mitigate these problems and sometimes avoid them altogether if they refrain from integrating or diminishing the value of acquired assets during the Commission's investigation. For example, a hold separate agreement, or a letter commitment to refrain from integration, may help to preserve divestiture options, and retain relationships with key employees and trading partners that are important for the competitive viability of the target. The scope of the necessary hold separate (or similar measure) may be relatively modest: depending on the nature of the transaction and any competitive concerns, the relevant assets for this kind of exercise may be only a few business units or product lines, leaving the rest of the integration to proceed unaffected.<sup>13</sup> Parties should recognize that it may be in their interests to agree to this kind of arrangement early on in an investigation; without this agreement and with continued integration, the remedy may become more far-reaching to address the loss of competition.

The Commission will seek to unwind a merger when it's the best way to restore competition, as it did recently in *In re Otto Bock*.<sup>14</sup> After an administrative trial, the Commission found that Otto Bock's 2017 acquisition of Freedom removed from the market a firm that had directly competed against Otto Bock and other suppliers of microprocessor prosthetic knees by offering low prices and attractive promotions to prosthetic clinic customers to win sales. The Commission found that anticompetitive effects from the acquisition have already occurred, and that the acquisition is likely to

cause future anticompetitive effects through higher prices and less innovation for amputee patients and prosthetic clinic customers. The Commission ordered a complete divestiture of the Freedom business; the Order has been stayed pending appeal.

In some cases, particularly where parties don't operate the acquired assets as a separate and ongoing business, simply unwinding the deal may not be enough to restore the competition that would have existed but for the challenged transaction. For example, this might be the case when an acquired firm was on a trajectory of growth; when the acquired assets have not been vigorously developed in the way that an independent firm would have developed them; when the acquired assets have become dependent on the acquirer. In cases like these, the Commission may order divestiture of assets beyond those acquired, for instance by requiring additional assets from the acquiring firm, or acquired assets that are used in other markets. In both *Chicago Bridge*<sup>15</sup> and *Polypore*<sup>16</sup>—two consummated mergers in which appellate courts upheld the Commission's remedial approach—the Commission's orders included assets outside the relevant market of competitive concern because those assets were necessary to ensure competitive viability in the relevant market and ensure that the buyer could effectively compete against the strong incumbent in the market. Where the acquired assets or business units would be viable with some improvement, the Commission may require the Respondent to update or restore the assets before divesting them.<sup>17</sup>

In some cases, and particularly when dealing with data, it may be possible to both retain and divest an asset: databases, for example, can be copied, with one copy divested and one retained.<sup>18</sup>

Regardless of which assets are divested, I want to emphasize how important it is that we find a strong buyer for divested assets. This is true in every merger divestiture, but it is especially true with consummated mergers where we may very well not have a standalone business to divest, and much may turn on how the buyer

plans to support and use the divested assets. This was a key finding from the Remedy Study,<sup>19</sup> and it's hard to overstate the importance of finding the type of buyer that can compete with vigor in the post-merger market. Our Compliance Division has world-leading expertise in assessing potential divestiture buyers, and we take that exercise very seriously.

Behavioral relief may also have some role to play in reestablishing competition, particularly when the acquired assets are not viable. At a minimum, agreements that enable a merged firm to further restrain competition—in ways that go beyond the effects of the merger—are likely to be an obvious casualty of our remedy. For example, in 2013, the Commission charged Charlotte Pipe with acquiring its only U.S. competitor three years earlier for \$19 million and destroying that firm's production equipment. As part of their merger deal, the companies had also executed a confidentiality and non-compete agreement that prevented the seller of the assets and its employees from competing against Charlotte Pipe for six years. Without the option of divesting assets, the Commission prohibited Charlotte Pipe from enforcing the confidentiality and non-compete provisions of the merger agreement so as to allow the seller and its employees to enter the market to compete against Charlotte Pipe.<sup>20</sup>

However, behavioral relief required to stand up a new competitor may go beyond—and perhaps far beyond—simply requiring that the merged firm give up the power to enforce anticompetitive agreements. In addition, we may require the merged firm to affirmatively engage in behaviors, or enter into agreements to license assets and provide other competitive resources to new entrants. These obligations are not unique to consummated mergers and are often included in non-consummated merger remedies as well in the scope of a transfer services agreement, third party consents, and sharing of certain assets or support functions for a period of time. The breadth of additional relief that may be considered include obligations to provide inputs, distribution, access or other rights, data, or supply of

products and services to one or more entrants on specified terms or a non-discriminatory basis for some period of time. It could also impose obligations to change existing trading relationships (such as those with customers or employees) in order to facilitate switching to competitors and entrants.<sup>21</sup> What matters here is ensuring the viability of new entry sufficient to restore the lost competition, and what that will require will vary significantly from one case to another.

Here's a good example. In 2013, Graco, Inc. bought its two closest competitors and reduced competition in the North American market for fast set equipment. Not only had it fully integrated the assets, it had also raised barriers to entry by taking steps to ensure that its distributors would distribute only Graco's products. As part of its remedy, the Commission required Graco to provide a license to certain competitively significant technology to a company run by former employees of the acquired firm. In addition, the Order required Graco to affirmatively change a number of its business practices, including prohibiting it from requiring exclusivity for distributors or their customers.<sup>22</sup>

The bottom line is that we can, and do, go beyond divestitures when that's what is needed to solve the competitive problem. We have often done so in the past, and you can expect us to continue to do so in future.

### Dealing with IP

We have learned over many years that remedies can present special concerns or complexities when the acquired assets include intellectual property rights. Generally, the Commission treats IP rights like anything else: if they're part of a business unit, they will be treated for remedy purposes like any other competitively important asset. However, intellectual property also has value because it contains the right to exclude and can be monetized through licensing. When divesting intellectual property rights, the Commission seeks to provide a divestiture buyer with the full value of that intellectual property, including value from rights to exclude and rights to license. In consummated transac-

tions, however, the merged company may have diminished the value of these rights by incorporating acquired patented technology into its own products. The Commission recognizes that in this type of situation, permitting a firm to retain a limited license to the technology it is divesting may be appropriate to avoid disruption to competition and consumers.<sup>23</sup>

Merger remedies involving IP rights sometimes call for creative solutions involving complementary remedial provisions. A good example is the 2002 order entered in our MSC Software Corporation matter.<sup>24</sup>

In that case, MSC had made two unreported acquisitions that gave it a monopoly in the market for advanced versions of the “Nastran” engineering simulation software. The acquisitions eliminated two smaller competitors—Universal Analytics, Inc. and Computerized Structural Analysis and Research—that sold competing advanced versions of Nastran. All three versions were derived from a single, more basic, public domain software product. Because of the close family relationship between the three products, customers could switch more readily among their respective products, making them particularly close competitors and giving MSC reason to target its two smaller rivals for acquisition.

Our remedy required MSC not only to divest the IP it had acquired from UAI and CSAR, but also to give the divestiture buyer a clone copy of its current advanced Nastran software, including the source code with a perpetual, worldwide, royalty-free, and non-exclusive license to the most up-to-date version of its own Nastran software. This reflected the reality that MSC had improved its own product, including by taking features from the UAI and CSAR versions, but it had not improved the other two products in the way that an independent competitor would have done. The Commission concluded that “[d]ivestiture of the acquired assets alone would not restore the competitive conditions that existed before the acquisitions (the status quo ante), because the 3-year old UAI and CSAR

codes are no longer as commercially viable as they were when MSC acquired them.”<sup>25</sup>

The Commission’s order also required MSC to provide affirmative assistance to the new competitor for a transitional period. The Commission ordered MSC to provide, for example, customer files and support logs; access to its personnel, information, and training; and the opportunity to hire key MSC personnel, especially programmers and customer support engineers. MSC was also required to maintain interoperability with the buyer’s software for three years, including maintaining its file formats so that customers could switch to the software supplied by the divestiture buyer.

The MSC remedy also provides a helpful illustration of a point I made earlier: when acquired assets have not been competitively maintained or developed by the merged firm - effectively left to rot or back-burnered while the acquirer’s original product is kept competitive - then simply pulling the half-rotten assets out again will likely not solve the problem. That can be a particular concern in software markets, where products develop rapidly and frequent updates may be necessary, and back-burnering in this context can lead to the rapid devaluation of acquired IP. When this happens, the Commission may require the merged firm to update the relevant software before divesting it, and to provide updates post-divestiture for a short time.<sup>26</sup>

IP rights may be center-stage in cases dealing with nascent or potential competition. As the Commission explained in testimony before the Senate Antitrust Subcommittee last fall, the acquisition of the assets—including IP rights—of an emerging or nascent competitor may harm competition, violating Section 7 of the Clayton Act and/or Section 2 of the Sherman Act (via Section 5 of the FTC Act). In such cases, IP rights may play a key role in the competitive story, and may form an important part of any divestiture or other remedy.

For example, in 2017, the FTC charged that Questcor

had illegally maintained its monopoly in the United States for a drug called Acthar that treated infantile spasms and other conditions. Outside of the United States, another drug, Synacthen, was sold in direct competition with Acthar. Questcor (later acquired by Mallinckrodt) bought the U.S. rights to Synacthen, outbidding several other companies for those development rights. The anticompetitive effects of this conduct were substantial because it eliminated the possibility that a competitor to an extraordinarily expensive life-saving drug would emerge but for the acquisition, and, according to the complaint, Questcor had no legitimate business purpose for buying Synacthen other than elimination of a nascent competitor. In a Stipulated Injunction, the Commission ordered the defendants to grant to a divestiture buyer a royalty-free license to develop Synacthen.

I mentioned earlier that remedies may need to go beyond divestiture and impose affirmative obligations to ensure that competition is fully restored. This can be a heightened concern in cases where the remedy involves a transfer of IP rights and other technology: in particular, the transitional period may need to be carefully managed in order to protect the divestiture buyer from interference by the merged firm. Appropriate provisions might include licensing requirements, covenants not to sue the divestiture buyer for IP infringement, or whatever else is necessary to create a safety net to ensure that the effectiveness of the divestiture is not undermined by sharp practice after the fact. These types of provisions are not unique to consummated mergers, but are often employed in non-consummated transactions or other remedies involving the transfer or spin-off of assets.

#### ENDNOTES:

<sup>1</sup>*In re Illumina Inc.*, Dkt. 9387 (complaint Dec. 17, 2019; dismissed Jan. 6, 2020), <https://www.ftc.gov/enforcement/cases-proceedings/1910035/matter-illumina-inc-pacific-biosciences-california-inc>; and *In re Edgewell Pers. Care*, Dkt. 9390 (complaint Feb. 3, 2020), <https://www.ftc.gov/enforcement/cases-proceedings/191-0147/edgewell-personal-care-company-harry-s-inc>.

<sup>2</sup>*FTC and State of New York v. Vyera Pharmaceuticals, LLC et al*, No. 20-cv-00706 (S.D. N.Y. Jan. 21, 2020), <https://www.ftc.gov/enforcement/cases-proceedings/161-0001/vyera-pharmaceuticals-llc>.

<sup>3</sup>Statement of the FTC Chairman Regarding Announcement that Aveanna Healthcare and Maxim Healthcare Services have Terminated Their Acquisition Agreement (Jan. 30, 2020), <https://www.ftc.gov/news-events/press-releases/2020/01/statement-ftc-chairman-regarding-announcement-aveanna-healthcare>.

<sup>4</sup>*In re Post Holdings, Inc.*, Dkt. 9388 (complaint Dec. 2019; dismissed Jan. 16, 2020), <https://www.ftc.gov/enforcement/cases-proceedings/191-0128/post-holdings-inc-matter>; *In re Axon Enterprise, Inc.*, Dkt. 9389 (complaint Jan. 3, 2020), <https://www.ftc.gov/enforcement/cases-proceedings/1810162/axonvievu-matter>;

<sup>5</sup>15 U.S.C.A. § 45(b).

<sup>6</sup>*FTC v. Ruberoid Co.*, 343 U.S. 470, 473 (1952).

<sup>7</sup>*FTC v. Nat'l Lead Co.*, 352 U.S. 419, 428 (1957).

<sup>8</sup>*N. Tex. Specialty Physicians v. FTC*, 528 F.3d 346, 371 (5th Cir. 2008) (order provision requiring physicians' group to both deal and refuse to deal struck down as overly broad and inconsistent).

<sup>9</sup>15 U.S.C.A. § 45(c).

<sup>10</sup>*Jacob Siegel Co. v. FTC*, 327 U.S. 608, 613 (1946); *FTC v. Nat'l Lead Co.*, 352 U.S. at 428.

<sup>11</sup>*United States v. Microsoft Corp.*, 253 F.3d 34, 58 (D.C. Cir. 2001).

<sup>12</sup>Antitrust Modernization Commission, Report at 158 (April 2007) ("the existing premerger review system under the HSR Act is achieving its intended objectives of providing a more effective means for challenging mergers raising competitive concerns before their consummation and protecting consumers from anticompetitive effects."), <http://govinfo.library.unt.edu/amc/>; see also "Reflections on 20 Years of Merger Enforcement under the Hart-Scott-Rodino Act," remarks of Bill Baer before The Conference Board, Washington, D.C. Oct. 29, 1996, <https://www.ftc.gov/public-statements/1996/10/reflections-20-years-merger-enforcement-under-hart-scott-rodino-act>.

<sup>13</sup>Just as with proposed mergers, it is possible that only certain of the acquired firm's business lines overlap with the acquiring firm's such that targeted divestitures would be sufficient, leaving the merged firm with some acquired assets that do not create competitive concerns. See, e.g., *In re Airgas, Inc.*, C-4029

(final order Dec. 18, 2001) (divestiture of two nitrous oxide plants and related assets acquired as part of a larger acquisition), <https://www.ftc.gov/enforcement/cases-proceedings/0010040/airgas-inc-matter>; *In re Service Corp. Internat'l*, C-3959 (final order June 30, 2000)(divested one of two acquired funeral homes to restore competition in Roswell, New Mexico), <https://www.ftc.gov/enforcement/cases-proceedings/981-0108/service-corporation-international-matter>.

<sup>14</sup>*In re Otto Bock HealthCare N.A.*, Dkt. 9378 (opinion and final order issued Nov. 6, 2019), <https://www.ftc.gov/enforcement/cases-proceedings/171-0231/otto-bock-healthcarefreedom-innovations>.

<sup>15</sup>*Chicago Bridge & Iron Company v. Federal Trade Commission*, 534 F.3d 410 (5th Cir. 2008).

<sup>16</sup>*Polypore Internat'l v. Federal Trade Commission*, 686 F. 3d 1208 (11th Cir. 2012).

<sup>17</sup>*In re Dun & Bradstreet Corp.*, Dkt. 9342 (final order Sept. 10, 2010), <https://www.ftc.gov/enforcement/cases-proceedings/091-0081/dun-bradstreet-corporation-matter>.

<sup>18</sup>*In re Solera Holdings, Inc.*, C-4415 (final order Oct. 24, 2013), <https://www.ftc.gov/enforcement/cases-proceedings/121-0165/solera-holdings-inc>.

<sup>19</sup>Remedy Study at 24 (in most cases, “respondents proposed buyers that were familiar with the market, dealt with many of the same customers and suppliers, had developed thoughtful business plans with realistic financial expectations and sufficient backing, and were well received by market participants.”).

<sup>20</sup>*In re Charlotte Pipe and Foundry*, C-4403 (final order May 15, 2013), <https://www.ftc.gov/enforcement/cases-proceedings/1110034/charlotte-pipe-foundry-company-et-al>.

<sup>21</sup>*In re TALX Corp.*, C-4228 (final order Aug. 8, 2008), <https://www.ftc.gov/enforcement/cases-proceedings/061-0209/talx-corporation-matter>. See also *In re Renown Health*, C-4366 (final order Dec. 4, 2012)(order lifted non-compete clauses for certain cardiologists, allowing them to realign with other health care groups), <https://www.ftc.gov/enforcement/cases-proceedings/1110101/renown-health-matter>; *In re CentraCare Health System*, C-4594 (final order Jan. 9, 2017), <https://www.ftc.gov/enforcement/cases-proceedings/161-0096/centracare-health-system>.

<sup>22</sup>*In re Graco, Inc.*, C-4399 (final order Apr. 18, 2013), Analysis to Aid Public Comment, [https://www.ftc.gov/sites/default/files/documents/federal\\_register\\_notices/graco-inc.analysis-agreement-containing-consent-order-aid-public-comment-proposed-consent-agreement/130424gracofrn.pdf](https://www.ftc.gov/sites/default/files/documents/federal_register_notices/graco-inc.analysis-agreement-containing-consent-order-aid-public-comment-proposed-consent-agreement/130424gracofrn.pdf).

[ent/130424gracofrn.pdf](https://www.ftc.gov/sites/default/files/documents/federal_register_notices/graco-inc.analysis-agreement-containing-consent-order-aid-public-comment-proposed-consent-agreement/130424gracofrn.pdf).

<sup>23</sup>See *Aspen Tech, Inc.*, Dkt. 9310 (final order issued Dec. 21, 2004; modified Aug. 25, 2009)(Respondent used the acquired IP in its product so the license to buyer was non-exclusive as to IP used in Respondent’s products.), <https://www.ftc.gov/enforcement/cases-proceedings/021-0153/aspen-technology-inc-matter>.

<sup>24</sup>*In re MSC Software Corp.*, Dkt. 9299 (final order Nov. 1, 2002), <https://www.ftc.gov/enforcement/cases-proceedings/0010077/mscsoftware-corporation>.

<sup>25</sup>MSC Analysis to Aid Public Comment, <https://www.ftc.gov/sites/default/files/documents/cases/2002/08/mscsoftwareanalysis.htm>.

<sup>26</sup>See *In re Automatic Data Processing*, Dkt. 9282 (final order Oct. 24, 1997)(Para. IV requires ADP to update software for three years no later than when it pushes updates to its own customers), [https://www.ftc.gov/sites/default/files/documents/cases/1997/10/autoinfo\\_0.htm](https://www.ftc.gov/sites/default/files/documents/cases/1997/10/autoinfo_0.htm). See also *FTC v. The Hearst Trust*, No. 1:01-cv-00734 (D.D.C. Stipulated Order Nov. 9, 2001)(merged firm did not maintain acquired database; Respondent required to divest acquired business, and provide access to its own information database for 3 years.), <https://www.ftc.gov/sites/default/files/documents/cases/2001/11/heardststip.pdf>.

## FROM THE EDITOR

### New Moves in the Antitrust/Tech Dance

Last month, the Federal Trade Commission issued Special Orders to some of the largest technology firms in the U.S.—Alphabet Inc. (Google), Amazon.com, Apple Inc., Facebook Inc. and Microsoft Corp.—to provide information about prior, smaller acquisitions that they didn't report to the antitrust agencies under the Hart-Scott-Rodino Act, including “terms, scope, structure, and purpose of transactions that each company consummated between Jan. 1, 2010 and Dec. 31, 2019,” as per the FTC's statement.

The orders require the five tech companies to offer the Commission information on their corporate acquisition strategies, voting and board appointment agreements, agreements to hire key personnel from other companies, and relevant non-compete agreements. Further, the companies are required to divulge information related to post-acquisition product development and pricing, including whether and how they integrated acquired assets and how they treat acquired data.

“If during this study we see transactions that were problematic, all our options are on the table and it is conceivable we can initiate enforcement action with those deals,” FTC Chairman Joseph Simons said in a call with reporters after the orders were announced.

The FTC cited Section 6(b) of the FTC Act, which authorizes it to conduct wide-ranging studies without a specific law enforcement purpose. As per the FTC's statement, the orders “will help the FTC deepen its understanding of large technology firms' acquisition activity, including how these firms report their transactions to the federal antitrust agencies, and whether large

tech companies are making potentially anticompetitive acquisitions of nascent or potential competitors that fall below HSR filing thresholds and therefore do not need to be reported to the antitrust agencies.”

This marks the culmination of a few recent trends, with the origin of the orders lying in the FTC's 2018 Hearings on Competition and Consumer Protection in the 21st Century. It also represents a rare point of unity on the political map. Both Republican and Democratic politicians have called for greater regulation of the leading tech players, and all five Commissioners voted to approve issuing the orders.

And the FTC's move comes while Attorney General William Barr is reportedly taking a more prominent role in the Department of Justice's antitrust probes into the big tech companies, centralizing oversight and, in some cases, sidelining Assistant Attorney General Makan Delrahim. Barr is seen by some antitrust analysts as potentially taking a harder line against the tech firms, citing his past statements and his role as a lawyer for GTE in persuading the European Commission in 1998 to require MCI to divest its internet business before it could merge with WorldCom. That said, Barr also was critical of the DOJ's 2017 attempt to block the merger of AT&T and Time Warner, arguing that Delrahim's positions “that the alleged harms from this merger and his inexplicable . . . rejection of remedies short of extreme divestitures were the product not of a well-versed substantive analysis, but rather political.”

Chris O'Leary

Managing Editor

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