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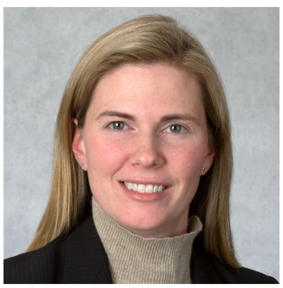
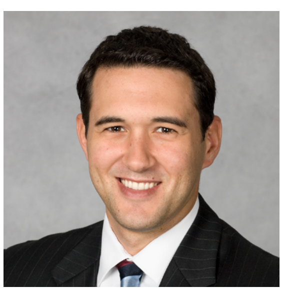
Don’t Let Your Antitrust Guard Down: Non-Reportable Transactions May Be Scrutinized

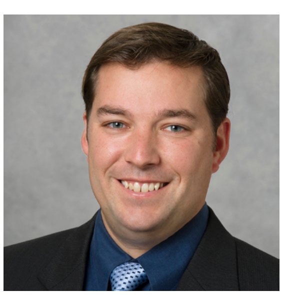
Determining that a planned corporate transaction is exempt from the requirements of the Hart-Scott-Rodino Act (“HSR Act”) can happily save a bundle in filing fees but it does not insulate the transaction from scrutiny by antitrust regulators. An HSR Act filing is required only if the proposed transaction meets certain monetary thresholds but all transactions are subject to potential challenge under the Sherman Act and the Clayton Act.[1]



Florence A. Crisp
Associate



Joseph A. Farside, Jr.
Associate



Robert D. Coulter
Associate

When the HSR filing thresholds are met, the transacting parties are required to submit a filing that provides basic information about the transaction, including the geographic and product markets in which the parties do business, in order to enable federal antitrust authorities to analyze the proposed transaction – prior to its consummation – for potential violations of section 7 of the Clayton Act. Section 7 prohibits transactions that may substantially lessen competition.

Although non-reportable transactions get to skip the HSR filing, they are not immune from antitrust review. The antitrust enforcers pay close attention to press reports regarding non-reportable transactions and also often receive calls from customers and/or competitors regarding alleged anticompetitive impacts of non-reportable transactions (e.g., post-acquisition price increases or supply decreases). Recently, the Antitrust Division of the U.S. Department of Justice and the Federal Trade Commission each brought court actions seeking to undo previously completed transactions that had not met the HSR filing threshold. The FTC case targets Ovation Pharmaceuticals, Inc.’s acquisition of the rights to the only product that currently competes with an Ovation drug that is used to treat serious heart defects in premature babies. Ovation’s post-transaction price increase (allegedly a 1300% increase) triggered concern and led to the FTC’s investigation and subsequent court action. Similarly, a post-transaction price increase appears to have triggered DOJ scrutiny following Microsemi Corporation’s acquisition of the assets of its former competitor, Semicoa, Inc. Although the transaction did not meet the HSR filing threshold, the DOJ took an interest when Microsemi raised prices on defense-certified transistors following the transaction. In each case, the agency seeks a court order requiring the acquiring party to sell the acquired assets, purportedly to restore competition that was allegedly lessened as a result of the transaction. In the Ovation case, the FTC also seeks disgorgement of allegedly illegal profits.

Such investigations are not new. In recent years, Edwards Angell Palmer & Dodge LLP has successfully defended clients in two post-closing investigations of transactions that had not met the HSR reporting threshold. Shortly after Genzyme Corporation’s 2001 acquisition of Novazyme Pharmaceuticals, Inc., the FTC launched an investigation focused on the transaction’s likely impact on what is sometimes referred to in antitrust circles as the “innovation” market. At the time of the acquisition, Genzyme and Novazyme were two of only a few companies actively developing enzyme replacement therapies for the very rare Pompe disease. Although neither had even begun clinical trials of their respective potential products, the FTC expressed concern that the merger would adversely affect competition in the market to develop a treatment for this disease. The FTC closely examined Genzyme's behavior post-acquisition, looking for evidence of reduced research and development spending or a slower development pace for either competing therapy. Ultimately, Edwards Angell Palmer & Dodge was able to persuade the FTC that the transaction was not likely to lessen competition, and the FTC voted to close its investigation without taking any action. See Genzyme Corporation/Novazyme Pharmaceuticals, Inc., F.T.C. Closing Letter, File No. 021 0026 (Jan. 13, 2004). A copy of the FTC's press release and links to statements by Commissioners regarding the decision to close the investigation can be found at http://www.ftc.gov/opa/2004/01/genzyme.shtm.

Similarly, following its non-reportable licensing of patents and a line of control system design software, EAPD client The MathWorks, Inc. was investigated by the DOJ. A settlement was reached pursuant to which MathWorks retained the acquired patents but sold the acquired software to a third party.

These four investigations highlight several key points:

- First, it is the acquirer that is usually left with the burden of defending a post-closing investigation and, potentially, effecting a costly remedy in the form of divesting the very assets it acquired in the challenged transaction. Because non-reportable transactions do not have to await HSR review prior to closing, the acquirer in a questioned non-reportable transaction is often left to consider how it might "unscramble the eggs" after it has already incorporated the new assets and personnel into its own operations. The risk of a post-closing investigation should be taken into consideration in drafting transaction documents. Depending on the transaction, acquirers may want to include some type of protection for the investigation contingency.
- Second, post-closing investigations typically (and not surprisingly) examine the post-closing conduct of the transacting parties closely for any signs of harm to competition, whether in the form of price increases, exclusionary conduct, or actions taken to eliminate the development of actual or potential competitive technologies. While price increases may seem like a quick way to increase profits, such a move may be short-sighted and extremely risky. An acquirer should seek advice from antitrust counsel to determine whether post-closing actions are likely to be seen as evidence of a potential lessening of competition by federal, state, or foreign antitrust regulators. Caution must also be used in the creation of any documents during the negotiation of the transaction concerning the potential market impact of the transaction including the likely ability to increase prices, decrease output, or otherwise gain competitive leverage post-transaction.
- Third, issues of potential interest to the FTC and DOJ may not always be apparent when deals are negotiated and closed, particularly in transactions involving innovative intellectual property. Careful attention to lurking antitrust issues and a full understanding of the risks involved in a proposed transaction are extremely important, particularly when antitrust clearance is not mandated by the HSR Act. Undoing a closed transaction is almost always more costly than not entering into a transaction that is not cleared by the reviewing agency. While the lack of an HSR filing may tempt some transacting parties to dispense with further analysis of antitrust issues, giving in to such temptation is not advisable. Antitrust issues identified early in the process are much easier to address than those that come to light after closing.
- Fourth, a successful defense requires not only a thorough understanding of antitrust law, but also the technology or science involved in the transaction and the economics of the relevant marketplace.

Post-transaction investigations may not always be bad news, however. Such investigations can present opportunities for other companies in the affected industry. In some instances, actual or potential competitors of the transacting parties benefit from a settlement or judgment requiring the acquirer's divestiture of assets. Although competitors are frequently found to lack standing to challenge a transaction directly, competitors can – and do – voice their concerns about transactions in their industries to the FTC and the DOJ. Furthermore, market participants other

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than the transacting parties are frequently called upon, either formally or informally, to provide information, documents, or testimony to the investigating agency. Seeking the advice of experienced antitrust counsel is always prudent when such requests are received; without careful consideration and a thorough understanding of the issues involved in an investigation, companies risk drawing attention to their own conduct and missing out on strategies that may work to their own benefit.

In sum, while the news that an HSR filing is not required may make closing a corporate transaction easier and faster, it does not mean that the deal will escape antitrust scrutiny. Whether prompted by their own investigations, concerned consumers, or a complaining competitor, the FTC and DOJ have a clear history of investigating transactions that fall below the HSR threshold. (Similarly, state attorneys general and foreign antitrust regulators may also investigate smaller transactions, particularly if the transaction affects a market within the regulator's jurisdiction.) Early and careful analysis of antitrust issues raised by a transaction can help companies avoid costly and time-consuming investigations later. Similarly, thoughtful analysis of the antitrust impact of a non-reportable transaction by a competitor may present opportunities that could work to the advantage of other businesses competing in the same market.

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1 The HSR Act generally prohibits (1) an acquiring person from acquiring voting securities or assets valued at more than $260.7 million and (2) an acquiring person with total assets or annual net sales in excess of $130.3 million from acquiring more than $65.2 million in aggregate total amount of the voting securities or assets of an acquired person with annual net sales or total assets of $13 million or more (if target is not engaged in manufacturing, only the "asset" test applies) without first complying with the Act's filing requirements.

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Ruth T. Dowling, Partner, Co-Chair of Antitrust Group	617.239.0657	rdowling@eapdlaw.com
Patricia A. Sullivan, Partner, Co-Chair of Antitrust Group	401.276.6437	psullivan@eapdlaw.com

Edwards Angell Palmer & Dodge

111 Huntington Avenue
Boston, MA 02199
Tel 617.239.0100
Fax 617.227.4420
eapdlaw.com