LATHAM & WATKINS

Client Alert
Commentary

Latham & Watkins Antitrust & Competition Practice September 29, 2017 | Number 2216

DOJ Files Unusual Suit to Unwind a Consummated Merger: 3 Lessons

The suit of a merger that had already cleared HSR review serves as a reminder that parties should not assume clearance confers immunity from scrutiny.

Update:

On September 26, 2017, the US Department of Justice's Antitrust Division (DOJ) sued to unwind Parker-Hannifin Corporation's (Parker's) consummated acquisition of CLARCOR Inc. (CLARCOR) on the ground the transaction created a monopoly in the US market for aviation fuel filtration systems and filter elements, in violation of Section 7 of the Clayton Act. DOJ's complaint demands divestitures sufficient to replace CLARCOR's pre-acquisition position in the marketplace, among other relief.[1]

Notably, Parker's US$4.3 billion acquisition of CLARCOR had already cleared US antitrust review under the Hart-Scott-Rodino Antitrust Improvements Act (HSR Act). According to company filings and press reports, Parker announced the proposed acquisition on December 1, 2016; the parties submitted the required HSR Act merger notification filings with DOJ and the Federal Trade Commission (FTC) shortly thereafter, triggering the statutory 30-day review period; then the HSR Act waiting period expired on January 17, 2017, without further action by either agency. After similarly clearing antitrust review in Germany and Austria, Parker closed the deal on February 28, 2017.

While DOJ and the FTC both investigate (and potentially challenge) a number of consummated mergers every year, those investigations almost always involve deals that were exempt from or otherwise not reportable under the HSR Act rules. Here, however, and *far more unusually*, DOJ has challenged a transaction that previously cleared HSR review.[2] DOJ has neither explained why this transaction cleared HSR review in early 2017 without incident nor what prompted its subsequent investigation, although press reports suggest the investigation resulted from post-closing customer complaints. DOJ also has not explained why it filed a lawsuit at this time, although the press release accompanying DOJ's complaint indicates that the parties' failure to provide sufficient documents and data or satisfactory commitments to "hold separate" the CLARCOR business was a factor.[3]

Takeaways:

Regardless of how DOJ's case plays out on the merits, or how the merger parties defend or resolve the matter, this development is an important reminder that "clearance" under the HSR process only provides M&A parties comfort that they have complied with merger control regulations. Clearance does not mean the transaction is immune from substantive antitrust scrutiny, and if the antitrust enforcement agencies form a concern about the matter, they can commence an investigation at any time. Here are three quick takeaways from the DOJ's challenge:

1. The HSR Act is a screening process, not a "jurisdictional" test.

In the US, the fact that a transaction is not subject to HSR review or that it has gone through HSR review and cleared without incident does not immunize the transaction from antitrust scrutiny going forward. The fundamental purpose of the HSR Act is to solve a mechanical problem: it gives the antitrust authorities an opportunity to review mergers that fit within certain parameters before the mergers occur, so that the agencies can intervene effectively when necessary, without needing to try and "unscramble the eggs" after closing. HSR review is a process borne out of the fact that the original law that prohibits anticompetitive mergers (the Clayton Act of 1914) failed to include a mechanism for detecting problematic transactions before they took place. Importantly, however, the HSR Act did not override the Clayton Act or narrow its jurisdiction, so transactions that are not subject to HSR — and even transactions that go through and clear HSR review — may still be prohibited at a later date if regulators determine that the transactions may substantially lessen competition or tend to create monopolies.

For parties pursuing transactions that may raise antitrust sensitivities, then, the lesson is that it remains critically important for deal certainty to have a well-thought-out, substantive antitrust defense of the deal. In transactions where HSR notification is required, clearing the HSR waiting period provides important comfort that the regulatory requirements have been met, but clearance does not immunize the substance of the transaction or the parties from later scrutiny.

2. The antitrust agencies focus on deal substance, not size.

Both DOJ and the FTC have demonstrated that they are willing to challenge a big deal (here, a US$4.3 billion combination) over an antitrust issue in a relatively small line of business (here, a business representing about US$20 million in revenue — less than 0.5% of deal value — according to press accounts). While sometimes counter-intuitive to business executives, the fact that a deal is "mostly complementary" is not a defense if part of the deal raises competition concerns. As both DOJ and the FTC have made clear through their enforcement programs, if a deal substantially lessens competition or tends to create a monopoly in a meaningful area of commerce, the agencies' mandate is to protect consumers from that anti-competitive effect, regardless of whether the alleged harm is occurring in the context of a much larger and otherwise unproblematic deal.

For parties pursuing competitively sensitive strategic transactions, the lesson is to focus their antitrust analysis and strategy on each of the antitrust-sensitive parts of the deal, regardless of the relative size of that business, and to avoid the temptation to blur over issues that are "too small to matter."

3. In a strategic transaction, investigations can occur at any time.

As a general matter, when thinking about the risks that attach to an antitrust-sensitive transaction, parties tend to think in terms of "detection risk" (that is, the risk that anyone will notice the strategic issues in the deal at all); "investigation risk" (that is, the risk that an antitrust agency will conduct an extended investigation of the deal); and "closing risk." (that is, the risk that a reviewing agency ultimately will seek to block or unwind the deal).

Evaluating and understanding all three of these categories of antitrust deal risks is, of course, important for a company that is pursuing a strategic transaction. Almost always, if a deal is detected and reviewed through the HSR process, the parties can take comfort that the merits of the deal pass muster, and they may proceed to closing without incident. For transactions in which the detection risk is low (either because HSR is not required or because the parties have cleared HSR), the parties nonetheless should continue to manage any potential investigation risks and closing risks in a way that best positions the parties to anticipate and address possible substantive antitrust concerns, in the event that some aspect of the deal does become of interest to the agencies. This effort never really expires and may include reaching out to customers to try and avoid complaints about the transaction (or at least to identify what concerns customers are expressing). In some cases, the effort may also include affirmatively reaching out to the antitrust authorities to discuss the transaction rather than "laying low" and hoping the deal goes unnoticed.

For parties pursuing competitively sensitive strategic transactions, it is important to recognize that every deal is different, and the appropriate strategy for one deal may not fit another deal. In every strategic deal, the parties will benefit from anticipating where they face the most risk of scrutiny from the antitrust agencies, and identifying the best way to manage those risks at any point in the deal's life cycle.

If you have questions about this *Client Alert*, please contact one of the authors listed below or the Latham lawyer with whom you normally consult:

[Lawrence E. Buterman]
lawrence.buterman@lw.com
+1.212.906.1264
New York/Washington, D.C.

[Jason D. Cruise]
jason.cruise@lw.com
+1.202.637.1033
Washington, D.C.

[Michael G. Egge]
michael.egge@lw.com
+1.202.637.2285
Washington, D.C.

[Joshua N. Holian]
joshua.holian@lw.com
+1.415.391.0600
San Francisco

[Hanno F. Kaiser]
hanno.kaiser@lw.com
+1.415.395.8856
San Francisco

[Amanda P. Reeves]
amanda.reeves@lw.com
+1.202.637.2183
Washington, D.C.

[Karen E. Silverman]
karen.silverman@lw.com
+1.415.395.8232
San Francisco

[E. Marcellus Williamson]
marc.williamson@lw.com
+1.202.637.2200
Washington, D.C.

[Farrell J. Malone]
farrell.malone@lw.com
+1.202.637.1024
Washington, D.C.

You Might Also Be Interested In

Latham Launches We've Got Washington Covered Resource Center

Class Action Defendants Likely to Benefit if House Bill Becomes Law

Tracking Global Merger Control Changes for 2017

How to Pass the New German Merger Control Size-of-Transaction Test

---

Endnotes

---

[1] DOJ Complaint, available at *https://www.justice.gov/opa/press-release/file/999266/download*.

[2] For a summary of which transactions are subject to the HSR Act, *see* *https://m.lw.com/thoughtLeadership/annual-hsr-threshold-adjustments-announced*.

[3] DOJ Press release, available at *https://www.justice.gov/opa/pr/justice-department-files-antitrust-lawsuit-against-parker-hannifin-regarding-company-shttps://www.justice.gov/opa/pr/justice-department-files-antitrust-lawsuit-against-parker-hannifin-regarding-company-s*.