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BEST PRACTICES

Trustbuster, Heal Thyself

Antitrust officials are big proponents of efficiency—until it comes to their own merger review processes.

By Joe Sims

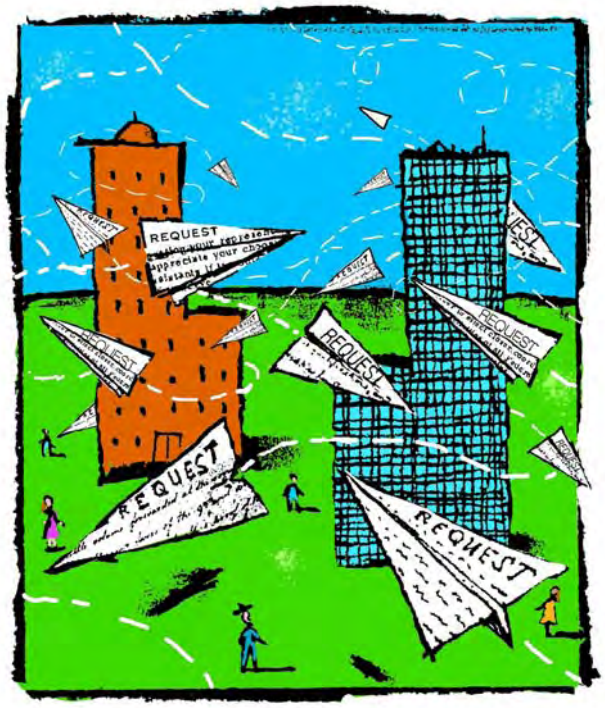
MERGER REVIEW IS APPROACHING A crossroads. Broad demands for information by federal antitrust agencies, combined with widespread use of electronic documents, is about to cause the system to collapse. As Federal Trade Commission chairman Deborah Platt Majoras recognized in May in announcing a "soup to nuts" review of the FTC's merger review processes, the agencies are going to have to adapt—or become increasingly less effective.

The most frequent complaint about merger enforcement in the United States is not about rules, or even how those rules are applied. It's about the review process, which has become steadily more burdensome. In an M&A transaction, time is critical—every day that a deal does not close delays the realization of business benefits, and in some cases may heighten the risk of the deal's unraveling. So time, not money, is really the critical element here, even though the cost of merger reviews is spiraling. (Not long ago, spending $1 million on a merger review would have been typical. Today it is common to spend several million dollars—sometimes tens of millions—producing paper and electronic files for antitrust officials.)

Clearly, the process is out of control, and electronic communication stands to make it worse. At some companies, 85–90 percent of all documents are now electronic. Such documents are more typically retained, and for longer periods, than paper documents. As a result, the volume of potentially responsive material—e-mail, word processing documents, spreadsheets, slide presentations, and databases—is skyrocketing. Just two years ago, the average amount of electronic information collected from the typical person in one of our antitrust merger investigations was less than one gigabyte; today, it is four gigabytes—the equivalent of about 300,000 pages of paper, or more than 150 boxes of paper documents. And because both the FTC and the antitrust division have lots of economists—and economists have never seen a database they would not like to review—the agencies' data demands are exploding.

The increase in electronic documents has practical implications for companies, but it is about to have a big impact on the antitrust agencies as well. Since the enactment of the Hart-Scott-Rodino Antitrust Improvements Act in 1976, merger review has been a highly regulatory process. Parties to a transaction file a form and various documents with the FTC and the antitrust division. Then one of the agencies is assigned to investigate, which it typically does by issuing a massive subpoena (known as a Second Request). The HSR Act prohibits the parties from closing the transaction until at least 30 days after they have fully complied with the subpoena. The effect is an automatic injunction for 90–180 days (or longer, since the 30-day limit is frequently extended). The agency can use the time to review the materials that are produced, interview customers and competitors, conduct economic analyses, and generally prepare to challenge the transaction if necessary.

At least, that was the way it used to work. In the old paper



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world, it took a long time to pull documents from several hundred employees' files, review the documents for relevance and privilege, process them, box them up, and transport them to the agency. The cost is staggering; most Second Requests today cost at least $3 million.

But it is about to get much worse, not just for the parties but also for the agencies. The volume of material is increasing exponentially, which means higher costs. But for those companies willing to spend the money, this does not necessarily mean more time is required to collect and produce these materials. In fact, as the percentage of paper materials steadily decreases, the ability to rapidly collect and search large volumes of materials is improving. Hard drives can be copied quickly, and then reviewed with the use of software that can search not only for words and dates but also for context. Where in the past more than 100 lawyers would spend months reviewing thousands of boxes of documents, now a fraction of that number can review a larger volume of materials five to ten times faster.

Because companies want to minimize interference with their ongoing business, the general practice in responding to Second Requests is to make quick and broad pulls from employee files, and then carefully review the resulting volumes to find responsive documents. Our experience is that 80–90 percent of documents collected and reviewed turn out to be nonresponsive. Given that, the ability to review electronic materials quickly and efficiently with software is an enormous time-saver. In fact, soon the parties to a transaction won't even bother to try to negotiate limitations on the typical unreasonably broad Second Request. Instead, they will just pull the (mostly electronic) documents, run software-assisted reviews, and rapidly produce a very large volume of materials.

Majoras—a former partner at my firm, Jones Day—identified this issue as a big risk for the agencies, and she was right. Today the agencies use the six to 12 months that most productions require to conduct their investigation. Tomorrow that time simply won't exist, because even massive productions will be completed much more quickly. Today, there is no incentive for an agency to send a narrowly focused Second Request, or even to agree to reasonable modifications, since helping the parties comply more quickly means less time for an investigation. Tomorrow a broad Second Request will continue to produce a big response, but it will come very quickly, and it will hurt the agency by burying it (and the really useful materials) in an avalanche of irrelevance.

How should the agencies deal with this new reality? I believe they should discard the notion that a proper merger investigation requires looking under every rock. Any experienced merger lawyer will tell you (and agency officials will privately confirm) that the percentage of really useful information for merger analysis to be found deep in the bowels of big companies is very small. These are not fraud or criminal price-fixing investigations, where a sales or marketing person's activities may well be highly relevant. In a merger investigation, the issues are market definition, entry, innovation, and competitive presence. At most companies these issues are identified and dealt with at relatively high levels. That is where the investigation should be focused, not on hundreds of low-level employees.

This approach would require a cultural change at the agencies, where the search for "hot documents" often seems to take priority over more analytical evaluation. (For one thing, judges find such documents easier to comprehend than econometric analyses.) But it would require another change, too. One reason that the agencies want to search everywhere for useful documents is that they have come to think and behave like regulatory agencies rather than law enforcement entities. They believe that to make their decisions, they need to have all the information they would want in any subsequent litigation. This confuses what should be a decision to seek a review by a judge into a decision on the merits. The agencies think they are deciding whether a merger should be approved—after all, they are the experts!—and the fact that they have to go before a judge is an annoyance. But the fact is that the agencies are simply prosecutors; they decide which mergers to challenge. It's the courts that decide which mergers will be blocked.

Before the HSR Act gave government the power to temporarily enjoin a merger by merely issuing a subpoena, merger litigation was like any other litigation—the agencies would decide, usually o n pretty limited information, that a transaction should be challenged. The agency would file a complaint, after which there would be discovery based on the regular civil rules. The HSR Act gave the agencies an ability to get much more discovery than a judge would normally allow, and they have taken full advantage. They seek all the information they could possibly want (and more than most judges would permit) just in case of litigation, even though the vast majority of matters never go to court. The result is a "litigation discovery tax" on everyone so the agencies can be fully prepared for the few times a year they actually litigate.

A shorter, more focused investigation would leave ample time and room for appropriate additional discovery if and when a merger is challenged. Since litigation is rare, the result would be enormous savings—potentially in the hundreds of millions of dollars—for parties to the vast majority of transactions that are not challenged, and no additional time or burden for the few that are.

The question is whether the agencies can adjust to this new electronic world. Majoras's statements suggest that she understands the problem, but after more than 30 years of frustration with the agencies over this process, guarded optimism is about the best I can muster. It would be nice to see the antitrust agencies, so properly concerned about efficiencies when they analyze a merger, apply that concern to their own process.

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