The Metropolitan Corporate Counsel®

www.metrocorpcounsel.com

Volume 19, No. 12 December 2011

M&A And Antitrust: Present Challenges And Future Opportunities

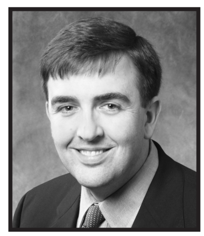
The Editor interviews ***David J. D'Urso,*** *Partner in Akin Gump's Corporate Practice and* ***Anthony W. Swisher****, Partner in the firm's Antitrust Practice.*

Editor: What is the current environment for M&A involving U.S. companies, either as acquirers or as acquisition targets? In what industry sectors do you see the greatest M&A activity?

D'Urso: Despite the fact that we are not technically in a recession (two consecutive quarters of negative growth), the economic environment has not supported M&A activity in the United States or globally during the past year. Besides slowing economic activity worldwide, there have been several factors that have depressed domestic M&A activity: (i) continuing concerns about the health of the European Monetary Union; (ii) downgrades to the world's sovereign debt (including the downgrade by S&P of the United States' debt); (iii) a very volatile stock market; and (iv) a high unemployment rate coupled with population growth outpacing job creation.

However, not all of the factors are negative. During the last few years, companies have focused on reducing costs and expenses. Their cost-cutting has generated a lot of cash, which is available for acquisitions. In addition, interest rates are quite low, and this is an important factor in financing M&A transactions. The Federal Reserve has stated that it intends to keep interest rates low through 2012. This should support M&A activity once uncertainty wanes. In addition, consumer spending seems to be improving. So, not all of the news is necessarily negative.

David J. D'Urso



Anthony W. Swisher

The sectors that are seeing the greatest M&A activity are clearly technology, health care and energy. Technology will continue to be important because it is a means for efficiency and cost savings. Health care obviously is showing a fair amount of activity because of the graying U.S. population. Energy continues to be a hot area because of the global demand for energy resources.

Editor: Is financing a significant concern in M&A transactions? What types of leverage multiples are lenders willing to finance? How does this compare to prior years?

D'Urso: Financing is available for the right companies and transactions. Although there has been less M&A activity than expected, there has been a meaningful increase in the volume of senior debt issued in 2011 as compared to 2010. Senior debt loan volume of $319 billion has already been issued, surpassing senior debt financing issued in 2010 by 36 percent.

The yields that lenders are receiving in consideration for their loans have increased. However, the yields are lower than they were during the peak of the credit crisis in 2008, but not as favorable to the borrower as in 2005/2006 at the height of the M&A boom.

Senior lenders are also willing to finance more of a transaction – requiring an equity contribution for M&A transactions of approximately 38 percent. In 2008 and 2009, equity contribution as a percentage of purchase price was closer to 45 to 50 percent. In addition, leverage multiples for middle market LBOs are approximately four and a quarter times EBITDA – about 1x higher leverage than in 2009.

Editor: What is the impact on private equity transactions of current economic variables?

D'Urso: In the earlier part of 2011, the volume of private equity transactions seemed to be improving, especially in middle market transactions. However, over the course of the third quarter and into the fourth quarter, deal volume slowed due to general uncertainty about the economy generated by the items I identified earlier. This is otherwise stalling favorable supply and demand dynamics for private equity M&A. There is an abundance of uncommitted capital on the books of private equity sponsors, making them good potential buyers. Plus, there is an aging portfolio of companies owned by sponsors that need to be sold in the near term in order to comply with the terms of the sponsors' fund documents. There is also good financing available because lenders are willing to finance more of the purchase price and provide better leverage ratios.

Editor: How have macroeconomic circumstances affected the terms of the

Please email the interviewees at ddurso@akingump.com or aswisher@akingump.com with questions about this interview.

transaction documents? Are indemnities longer? Are escrows and holdbacks longer?

D'Urso: M&A documentation in private transactions has been tighter and better from the buyer's perspective, with the buyer receiving more robust representations and warranties and stronger covenants. However, the economic aspects of transaction documents seemed to have remained constant recently. For example, the average size of indemnity escrows as a percentage of the purchase price is still between seven to eight percent of transaction value, and the escrow period is still between 15 to 18 months. Indemnity caps continue to be approximately 10 percent of purchase price, and indemnity baskets are in the eight-tenths percent range, with most baskets being deductibles and not "triggers." All of these terms are generally consistent with terms from the past several years. Buyers have been more successful in getting better representations, warranties and covenants; but indemnities, caps, baskets and escrows are no worse for sellers than in prior years.

Editor: Where are U.S. antitrust enforcers placing primary emphasis in terms of issues and industry sectors?

Swisher: The enforcement priorities largely mirror overall deal activity mentioned earlier – high tech, energy, but a particular emphasis has been health care. Both the DOJ and the FTC have been very active in health care markets, including the provider space, health insurers and pharmaceuticals. Recently, DOJ has brought actions involving a health plan in Montana and challenged Blue Cross/Blue Shield's use of most-favored-nation clauses in Michigan.[1] The FTC just completed an enforcement action in a merger involving two companies in the health care information management space, and it continues to be very active in so-called reverse payment cases in pharmaceutical transactions. Much of the agencies' activity may be driven by health care reform and the changes in the industry.

Editor: In general, are decisions of U.S. courts in antitrust matters becoming less plaintiff-friendly?

Swisher: Overall, I would say no. Certainly there is no question that there was a spate of very high-profile Supreme Court decisions in recent years that favored defendants – cases such as *Trinko*, *Twombly* dealing with conspiracy pleading standards and *Leegin,* which applied the rule of reason to RPM (resale price maintenance) agreements. But, more recently, the Supreme Court came down with the *American Needle* case that went against the defendants.

Supreme Court decisions receive a lot of press, but lower court decisions have not necessarily become more defendant-friendly. In a very recent example in the merger context, the DOJ sued to challenge the H&R Block/TaxACT merger and was successful in federal district court here in D.C. in blocking that merger.

Editor: What are the key determinants of possible monopoly power for a given company? What additional burdens are placed on a company that becomes legitimately dominant, i.e., not via anticompetitive means? What specific conduct might trigger antitrust action against dominant companies?

Swisher: The classic statement of market power is the ability to raise prices and exclude competitors. How do you determine if a firm has that ability? As a practical matter, the key determinant of market power in most cases is going to be market share, a relatively concrete factor that courts and enforcers can get their hands around.

The obvious question is: how much market share is enough to provide market power? Unfortunately, there is no easy answer. Back in the 1940s, Judge Learned Hand in the Alcoa case laid out the famous dictum – a 90 percent share was enough, two-thirds share may be enough, one-third share is probably not enough – and those remain pretty good rules of thumb.

There is no bright line. Any given case is going to require you to dig into the specifics of the industry involved. In terms of additional burdens placed on challenging a firm that has market power, a monopolization claim requires some claim of exclusionary conduct in addition to just a large market share.

One of the great conundrums of antitrust law is what exactly constitutes exclusionary conduct. The recent Supreme Court cases I mentioned have pared back the definition of what constitutes exclusionary conduct. In *Trinko*, for example, the Supreme Court said if you violate a regulatory requirement, it doesn't necessarily mean that you've automatically also violated Section 2 of the Sherman Act. In *LinkLine*, a case dealing with a "price squeeze" theory, the Court said if you're pricing above your cost, you're not engaged in predatory pricing, and you don't have any duty to deal with your competitors – we're not going to find you liable for a price squeeze even if your conduct makes it difficult for your rivals to compete.

In general, a monopolist should be able to identify some legitimate business rationale for its conduct. If a firm's conduct makes no economic sense except for its tendency to disadvantage or exclude its rivals, then it's increasing its antitrust risk. Also, if a firm has an established course of dealing with its rivals and suddenly changes that course of dealing, it could be opening itself up to a potential antitrust claim. This change in course was mentioned by the Court in the *Trinko* case as it applied to *Aspen Skiing,* a situation where there had been a longstanding course of dealing that was presumably profitable that suddenly changed to the disadvantage of competitors.

Editor: What is the current status and impact of global implementation of laws that adopt provisions similar to Hart-Scott-Rodino?

Swisher: Following in the wake of U.S. adoption of Hart-Scott-Rodino**,** pre-merger notification regimes have expanded tremendously over recent years. When I first started doing antitrust merger work about 15 years ago, it was the unusual deal that required a non-U.S. filing; now it's the opposite. It's the unusual deal that doesn't at least require you to think about whether a non-U.S. filing might be required.

We've seen filing regimes throughout Europe, the individual member states of the EU, as well as in the EU itself. We've seen pre-merger notification regimes in numerous countries in Asia and South America. Firms with any kind of international scope that are considering a merger now really need to factor in possible international filings when they're doing their due diligence and considering possible regulatory approvals.

Editor: How important to U.S. enforcers is convergence of foreign jurisdictions, including developing countries, with Hart-Scott-Rodino and U.S. enforcement priorities? Where does the U.S. fit in the spectrum of enforcement vis-à-vis encouraging business growth?

Swisher: Convergence is important to the enforcers on a policy level. The FTC and the DOJ are in a continuing dialogue with their counterparts around the world about the appropriate standards to apply to particular types of cases.

On a more practical, day-to-day level, in my experience, the U.S. agencies are, in a specific matter, going to apply the U.S. standards, and if they happen to conflict with those of another jurisdiction so be it. They're engaged in a mutual education effort with other jurisdictions and would certainly like to see convergence, but, as a practical matter, in a given case it's not going to necessarily play a major role.

As to business growth, I don't think the agencies really view antitrust enforcement as a function of encouraging business growth. Rather, their focus is on whether the merger or the conduct in question is likely to substantially reduce competition. I do think business growth is aided when you have a degree of transparency and certainty in enforcement activities. This goes back to the point that David raised that certainty helps to drive deals, specifically, and economic activity, more generally. On the certainty and transparency front, the agencies score very high relative to other jurisdictions. They deserve credit for articulating the standards they're going to apply and then applying them in a rigorous fashion. Having competent, professional enforcers and having a degree of predictability allow you to make an informed assessment of the antitrust risk surrounding a particular deal.

Editor: There have been occasions where U.S. enforcement and EU enforcement have differed markedly. In some cases, the EU has come down harder. Is that still the case?

Swisher: There have been some high-profile matters where that has been the case, and there is not perfect convergence certainly between the U.S. and the EU. You see it not only in the agencies, but in the courts as well.

A relatively recent example is the price squeeze matter that I mentioned earlier. The U.S. Supreme Court struck down the price squeeze claim in *LinkLine*. Yet, at almost the same time, the EU upheld what they called a margin squeeze claim on similar facts in the *Deutsche Telekom* case. So, there are still areas where there is not convergence. However, the trend is probably moving towards convergence as the U.S. and the EU both become more rigorous in applying economic principles and the ongoing dialogue among their enforcers continues.

Editor: Does another country's degree of convergence with U.S. antitrust law play into due diligence? How and why?

Swisher: Certainly to the degree that you're facing different standards in different jurisdictions, you need to take those into account. As a practical matter you have to take a lowest common denominator approach. If you have a deal that is going to have antitrust trouble in one jurisdiction, it doesn't matter if you're going to sail through in another jurisdiction.

I had a deal not too long ago where we knew we were going to need to divest some assets in the EU. When we went to the DOJ, we said, look, we're going to have to divest these assets to satisfy the EU, so we can just take them off the table. This actually helped streamline the process with the DOJ.

Editor: How has the domestic and global recession and uncertainties affecting particular areas such as the Euro Zone impacted the volume and magnitude of M&A deals? What does the future hold?

D'Urso: The uncertainty in Euro Zone countries about their ability to deal with their sovereign debt has negatively impacted M&A activity not only in Europe, but also in the U.S. deal flow – both quality and quantity – will improve as greater certainty returns. Unemployment should improve as well, as the economy continues to grow. The interest rate environment is going to be positive for M&A over the next 12 months.

Editor: How does the presence of significant intellectual property affect the strategy of M&A?

D'Urso: Intellectual property has certainly been a driver of M&A activity over the last year. The global dispute between Samsung and Apple with respect to the IP used in their handsets and their tablets illustrate how companies have been using courts to gain market share, and one of the key aspects of pursuing that course of action is having the right intellectual property to be able to bring claims of infringement. Nortel Networks recently sold its remaining patent portfolio in an auction that generated an incredible amount of interest from the biggest players in the tech industry. The bankruptcy auction resulted in sale proceeds of more than $4 billion. This was indicative of the value of IP in today's marketplace for maintaining market share in various industries and in the global market. There are many strategic investors that are looking at M&A transactions to improve their patent portfolio. For example, consider Google's acquisition of Motorola.

---

[1] See Akin Gump MCC article, "Federal Court Explains Denial Of Motion To Dismiss In 'Most Favored Nations' Clause Decision" October, 2011, p. 31.