FTC RESCINDS 2020 VERTICAL MERGER GUIDELINES, REPORTS ON NON-HSR REPORTED ACQUISITIONS BY MAJOR TECH COMPANIES AND SETS AMBITIOUS ENFORCEMENT AGENDA

September 29, 2021

I. Executive Summary

On September 15, 2021, on a 3–2 party-line vote, the U.S. Federal Trade Commission ("FTC") rescinded its prior approval of the 2020 Vertical Merger Guidelines issued jointly with the U.S. Department of Justice ("DoJ"). Rescission of the 2020 guidelines, often criticized for excessively tolerant and lenient treatment of Merger and Acquisition ("M&A") activity between companies vertically integrated in their supply chain (as opposed to horizontal competitors), was not a joint action with the DoJ, nor did it reinstate the 1984 guidelines the 2020 version had replaced, leaving M&A parties without guidance as to how the FTC will handle vertical M&A review going forward, and whether the DoJ is still applying the 2020 guidelines even in the wake of the unilateral FTC rescission.

Also on September 15, the FTC issued a report on acquisitions by leading technology companies from 2010-2019 made without pre-transaction notification pursuant to the Hart-Scott-Rodino Act ("HSR"), codified as section 7A of the Clayton Act (the "September 15 Report"). HSR requires the parties to certain qualifying acquisitions of voting securities or assets of the acquired party to notify the FTC and DoJ of the transaction and await the expiration of a mandatory waiting period prior to the closing. The September 15 Report was the result of FTC special orders issued to the technology companies in February 2020, well before the change of presidential administrations.

Then, in a September 22, 2021 publicly disseminated memorandum to FTC commissioners and staff (the "September 22 Memorandum"), newly appointed Biden administration FTC Chairperson Lina M. Khan set out an ambitious agenda aimed at integrating the Commission's Antitrust (Competition) and Consumer Protection regulatory and enforcement mandates and instituting reforms to police more aggressively M&A activity and even common commercial contracting techniques that have injurious effects on competition and consumer choice.

These actions collectively have a common theme: the inauguration of an era of more aggressive and less lenient antitrust policing by the FTC of M&A and related activity for anti-competitive behavior and effects. All M&A parties need to take account of the new FTC posture in their transaction structuring.

II. Background

We reported earlier this month on the FTC Competition Bureau's issuance of a warning to M&A parties not to seek to avoid HSR pre-merger notification filings by structuring transactions to retire seller/target debt in place of paying cash consideration ("FTC Issues Warning on Use of Debt Retirement to Avoid HSR Filings," September 17, 2021), and earlier this year on the FTC for the first time *lowering* instead of raising the annually-adjusted HSR notification qualifying monetary thresholds relating to the size of the transaction and size of the parties ("Federal Trade Commission Lowers 2021 Hart-Scott-Rodino Reporting Thresholds," February 4, 2021). Both advisories are available at Kurtin PLLC Whitepapers and Advisories. Those actions were early warning shots in a new FTC policy posture under the Biden administration to reverse years, and arguably decades, of increasing reluctance to aggressively use the antitrust laws to police M&A activity and resulting industry consolidation. With the FTC's September 2021 rescission of the 2020 Vertical Merger Guidelines, the September 15 Report and the policy priorities set forth in the September 22 Memorandum, that campaign now begins in earnest, and all M&A parties should be aware of and make provision for the new paradigm and regulatory enforcement posture in planning and structuring transactions.

III. The September FTC Actions

a. The 2020 Vertical Merger Guidelines Rescission

The FTC's unilateral rescission of the 2020 Vertical Merger Guidelines on a party-line vote (three Democratic-appointed Commissioners voting for rescission, two Republican-appointed Commissioners voting against), was stated to be to prevent the industry or judicial reliance on the 2020 guidelines, due to their being based on "unsound economic theories…unsupported by the law or market realities," as well as being in contravention to the Clayton Act's language in its approach to market efficiencies and the allegedly pro-competitive benefits of mergers, which, the FTC states, are not recognized by the statute as a defense to an unlawful merger or in economic reality (see FTC Sept. 15 press release and links to individual Commissioner statements here). The FTC states that it will work with the DoJ to update the merger guidance to better reflect market realities, and provide better guidance on transactions that are likely unlawful.

b. The September 15 Report on non-HSR Reported Technology Company Acquisitions

The September 15 Report (a full copy of the Report is available here), launched in February 2020 by issuance of FTC special orders pursuant to s. 6(b) of HSR to five leading technology companies, each of which is among the largest U.S. companies by market capitalization: Alphabet/Google, Amazon, Apple, Facebook and Microsoft, analyzed 616 transactions (excluding hiring and patent acquisitions) valued at or above $1 million between 2010 and 2019 that were not reported under HSR. The key findings were:

- 94 of the 616 transactions exceeded the HSR size-of-person and/or size-of-transaction reporting thresholds. Subject to some regulatory exemptions built into HSR, most or all of these transactions should presumptively have been reported.

- In 36% of the 616 transactions, the acquirer assumed debt or liabilities as part of the acquisition consideration, making clear that assumption of debt was a significant method and component of paying acquisition consideration. In three of those transactions, had the debt or liability assumption been paid as cash, the transaction would have tipped over the HSR size-of-transaction reporting thresholds, in addition to the 94 transactions already above the thresholds.

- More than 79% of the transactions used deferred or contingent consideration to founders and key employees of the acquired companies, with little variation among the five responding companies, making clear that deferred or contingent compensation to founders and key employees was a significant method and component of paying acquisition consideration.

- More than 75% of the transactions included non-compete clauses for founders and key employees of the acquired companies, making clear that non-compete clauses were, along with deferred or contingent compensation, a significant technique for incentivizing founders and key employees to remain with the acquired company.

- 65% of the transactions were between $1 million and $25 million. The number of transactions in each of five size-of-transaction tranches, ranging from $1 million and $5 million and ending at between $50 million and the HSR size-of-transaction threshold, trended upward during the 2010-2019 period.

- Asset acquisitions and control (i.e., change of voting security control or other control) transactions were the most common in each size-of-transaction range, with control the most common type of transaction above $5 million and higher value transactions likely to be control acquisitions.

- 400 of the 616 transactions overall, approximately two-thirds, and approximately two-thirds of the acquired entities in each size-of-transaction range, were of domestic (U.S.) companies.

- In up to 295 of the 616 transactions, over 39%, the acquired companies were less than five years old when acquired.

- More than half of the acquired companies had between 1 and 10 non-sales employees, with size-of-transaction in correlation with number of non-sales employees.

- The total number of transactions per calendar year among the five responding tech companies during the 2010-2019 time period ranged from 43 in 2012 to 79 in 2014.

c. The September 22 Memorandum

In the September 22 Memorandum (a full copy of the Memorandum is available here), Chairperson Khan sets out a wide range of policy goals to integrate the FTC's antitrust and consumer protection missions and address a surge in M&A activity and resultant industry consolidation and concentration, including "facially illegal transactions," and "take-it-or-leave-it" contract terms that she states are injurious to enterprises and consumers alike. The influence of the September 15 Report findings on the September 22 Memorandum is clear throughout. The implications of the strategic approach and policy priorities set out in the September 22 Memorandum, if implemented, are enormous, as follows:

- Strategic Approach

  - The need for a "holistic approach…recognizing that antitrust and consumer protection violations harm workers and independent businesses as well as consumers." Khan asserts the need to focus on power asymmetries and unlawful practices resulting from and enabled by those imbalances.

- The need for an orientation to targeting enforcement efforts on root causes rather than one-off effects.

- The need for a more rigorous and empirical driven approach to understanding market behaviors and business practices, focusing on an interdisciplinary approach to remedy information asymmetries.

- The need to be forward-looking in anticipation of problems and swift in the initiation of remedial action on both the antitrust and consumer protection sides of the FTC's mandate, including attentiveness to new technologies, innovations and industries and checking anticompetitive conduct that would cause markets to tip and targeting unfair practices before that conduct becomes widely adopted.

- The need to democratize the FTC itself and ensure that it is in tune with real problems facing Americans in their daily lives.

- Policy Priorities

  - The need to address "rampant consolidation" and resulting market domination, requiring strengthening the FTC's merger enforcement capability and focusing on market-dominant firms, where lack of competition makes unlawful conduct more likely.

  - The need to prioritize allocation of resources, citing particular concern that market power is an increasingly systemic national problem and the surge in M&A activity as likely to lead to greater and greater market domination absent a vigilant and assertive FTC enforcement posture. Khan cites the prospective project to revise the FTC merger guidelines in collaboration with the DoJ, as an opportunity to implement a new merger review framework to close gaps between theory and practices and put in place a more effective and empirically grounded enforcement regime.

  - The September 22 Memorandum also sets a broader policy priority to deter unlawful transactions, citing the rate at which companies propose facially illegal transactions as straining FTC resources.

- The need to address dominant market intermediaries and extractive business models that hike fees, dictate terms, and increase market power while outsourcing risk, liability and costs. Khan mentions in particular the growing role of private equity and other investment vehicles as potentially distorting ordinary market incentives, stripping productive capacity and facilitating unfair competition and consumer protection violations.

- The need to target "take-it-or-leave-it" contract terms, sometimes called "contracts of adhesion," as a type of unfair competition or deceptive practice between market dominant parties and their counterparties while masquerading as freely negotiated contracts between parties of equal bargaining power. Khan mentions non-compete clauses, repair restrictions and exclusionary clauses as the types of contract provisions increasingly abused and to be addressed.

- Operational Objectives.

  - First, the need to integrate the traditionally separate antitrust/competition and consumer protection "siloes" to improve oversight, coordination and staff training and experience.

  - Second, the need to expand the FTC's regional footprint to better connect with American communities and improve the agency's talent pool by recruitment nationwide into regional offices.

  - Third, the need to broaden institutional skills to ensure that the FTC staff is fully grasping developing and rapidly changing market realities, especially as the economy becomes increasingly digitized, including bringing on to staff technologists, financial analysts and experts from other disciplines. Khan mentions with admiration the more interdisciplinary approach taken by international counterparts and her desire to learn from their experience and practices.

IV. Takeaways

Chairperson Khan took up her post earlier this year with a progressive, activist and trust-busting reputation based in large part on a celebrated 2017 Yale Law Journal article, "Amazon's Antitrust Paradox," in which she argued that traditional American antitrust thinking, focused on keeping

consumer prices down, was inadequate to explain or confront the anticompetitive effects of "platform" businesses like Amazon. Khan proposed alternative frameworks, such as traditional common carrier or public utility-like status and duties for companies like Amazon.

The series of September acts, including rescission of the 2020 Vertical Merger Guidelines, release of the September 15 Report, and the September 15 Memorandum clearly influenced by the Report's findings show a clear intention to re-energize and integrate the FTC's antitrust/competition and consumer protection missions, particularly in the area of M&A review and enforcement under a reworked HSR. M&A parties who have gotten sloppy and complacent on the regulatory/enforcement front are going to have to wake up.

In the area of consumer protection, not only is Khan's linkage to antitrust and market consolidation and domination a wake-up call, but her singling out of the increasing use of "contracts of adhesion" and other "take-it-or-leave-it" terms between parties of unequal bargaining power noteworthy. It stands to be an interesting and dynamic time in the M&A, antitrust and consumer protection worlds. Parties structuring and negotiating transactions in the new environment will need to be more vigilant and less complacent about the implications.

Owen D. Kurtin