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HSR CLEARANCE: SECURITY BLANKET OR FALSE SENSE OF SECURITY FOR MERGING PARTIES?

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"The Division's decision not to challenge a particular transaction is not confirmation that the transaction is competitively neutral or procompetitive."[1]

Credit for the quotation above goes to the Antitrust Division of the U.S. Department of Justice ("DOJ") in its amicus brief filed in the United States Court of Appeals for the Fourth Circuit in *Steves and Sons, Inc. v. Jeld-Wen, Inc.* ("*Steves*"). The Division stated a truth that is often forgotten by merging parties in the glow of their transaction making its way out of the merger review process under the Hart-Scott-Rodino Improvements Act of 1976 ("HSR Act") without an agency challenge. But, as the Division made plain, HSR clearance does not immunize the transaction from later scrutiny from either the antitrust enforcement agencies or, in light of the Fourth Circuit's recent decision affirming the United States District Court for the Eastern District of Virginia's divestiture order in the *Steves* case, from challenges brought by private litigants.

The vast majority of transactions that go through the HSR review process are not challenged by the antitrust enforcement agencies. Agency challenges to consummated transactions that went through the HSR clearance process are exceedingly rare (less rare—but still unusual—are agency challenges to consummated transactions that did not go through HSR review). And, until the *Steves* case, the idea of a successful private challenge to a consummated transaction resulting in a divestiture order was, even if theoretically possible, a risk that could be largely dismissed as non-existent—it had never happened.

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That is why the *Steves* case warrants attention. The divestiture order in *Steves*—now affirmed by the Fourth Circuit, which also denied Jeld-Wen's request for re-hearing *en banc*—makes real the risk, however rare, that private merger enforcement can upend consummated transactions cleared through DOJ or FTC review.[2] In the *Steves* case, the result will be the effective unwinding of a transaction that was nearly nine years post-close. And even if *Steves* is an outlier, merging parties need to understand how it came to pass to avoid a similar fate.

This article begins with brief summaries of the *Steves* case and the HSR merger review process, including some of the factors that informed the antitrust agencies' decisions whether to challenge a transaction. We continue with an exploration of certain deal and industry characteristics that increase the risk of a private merger challenge but that also demonstrate the result in *Steves* is unlikely to be repeated often. The article concludes with some suggestions about how buyers can protect themselves from such a challenge, however rare they may be.

The *Steves* Litigation

In 2012, Jeld-Wen, a manufacturer of both doorskins (decorative coverings of interior molded doors) and molded doors, acquired Craftmaster International, a rival manufacturer of doorskins. The transaction would result in the number of doorskin manufacturers going from three to two. The parties made an HSR filing with the DOJ and the FTC. Following an investigation by the DOJ, it was cleared without challenge. Notably, just prior to the acquisition, Jeld-Wen entered into a long-term supply agreement for doorskins with its customer and competitor for molded doors, Steves & Sons ("S&S"), that included provisions governing the prices Jeld-Wen could charge S&S. The district court described this agreement as "part of [Jeld-Wen's] plan to secure merger approval."[3]

In 2014, Jeld-Wen requested a price increase from S&S that, according to S&S, was not permitted under the 2012 supply agreement, which S&S rejected. Jeld-Wen then gave notice that it would terminate the supply agreement effective September 2021 per the contract terms. In 2016,

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following another investigation by the DOJ prompted by a 2015 complaint from S&S that resulted in no action, S&S sued Jeld-Wen, alleging that the Craftmaster acquisition violated the Clayton Act. The jury delivered a verdict in S&S's favor, and S&S asked the court, among other things, to require Jeld-Wen to divest the facility S&S acquired with Craftmaster. The court granted S&S's request, marking the first time in which a court ordered a divestiture in a private challenge of a merger cleared under the HSR Act, which Congress passed in 1976. S&S appealed, and the Fourth Circuit affirmed the district court's divestiture order.

Factors Influencing HSR Merger Reviews

Prior to the passing of the HSR Act, merging parties were not required to notify the government prior to closing a merger. As a result, the vast majority of government merger challenges were (by default) post-close, creating an uphill battle for the government in court. The balance of hardships typically weighed in favor of the already combined company. This dynamic changed with the passing of the HSR Act, which requires parties to transactions that meet certain thresholds to obtain government clearance before closing.

The vast majority of reportable transactions obtain clearance without any substantive review. Some reportable deals are investigated during the initial 30 days after filing (the "initial waiting period"), or 60 days in the case of a pull-and-refile, and then cleared to close.[4] And only a small percentage of deals result in a formal investigation and issuance of a Second Request.[5] Following a formal investigation, the antitrust agencies have three options: (1) clear the transaction to close; (2) agree with the merging parties on a remedy that addresses competitive concerns about the transaction; or (3) challenge the transaction in court.

As the DOJ pointed out in its amicus brief in *Steves*, there are several factors that the antitrust agencies consider when deciding whether to challenge a transaction, including:

- **Enforcement Priorities.**[6] Enforcement priorities derive from agency and section heads, the presidential administration, Congress, public pressure, and current economic and antitrust scholarship. When deciding how to allocate limited resources, the agencies often give precedence to these priorities over other potential enforcement activities. The current focus on Big Tech and ensuing launch of the Technology Enforcement Division is an example of this factor at work.[7]

- **Potential to Create Unhelpful Precedent.**[8] When the agencies litigate merger challenges they risk creating unhelpful precedent that could hamstring a future enforcement action. Therefore, they consider not only the facts and likely arguments of a particular case, but also how the use of certain facts and structure of certain arguments could have unintended consequences for the agencies' enforcement activities in the future.

- **Litigation Risk.**[9] Finally, and related to the above, the agencies also consider the likelihood of winning in court. Over the years, the agencies' record in court has varied, but the agencies have recently had a strong track record in litigation, in part because of

careful case selection. This factor may deter some merging parties from litigating a government challenge, which may feel like an uphill fight.[10]

- **Agency Resources.**[11] From the outside, it may seem like the agencies have unlimited resources (especially when litigating). But like all aspects of government, they are constrained by annual budgets and attorney headcounts. Leadership at both the DOJ and the FTC have claimed that their budgets are too low and they need more staffing to handle their case volume. Thus, the agencies must constantly evaluate how best to allocate their resources to effectively enforce the antitrust laws.

These factors all relate to the institutional prerogatives of the enforcement agencies. They do not, however, inform whether a transaction violates the Clayton Act,[12] which is why the district court excluded evidence that the DOJ twice chose not to challenge Jeld-Wen's acquisition of Craftmaster.[13] As the Fourth Circuit noted, the evidence of the DOJ's decisions not to challenge the transaction could have misled the jury to infer that the DOJ determined the transaction was lawful. Thus merging parties can only take limited comfort in agency inaction.

While *Steves* reminds us that enforcement agency (in)action does not immunize a transaction from a challenge brought by a private litigant, it also teaches us that there are several, specific characteristics that increase the odds (and likelihood of success) of a private challenge to a transaction.

The Perfect Plaintiff

The institutional prerogatives that influence an enforcement agency's decision to challenge a transaction do not, however, govern or constrain private plaintiffs. There are different constraints on private plaintiffs to be sure—including, not insignificantly, litigation costs that may not be recouped where divestiture is the primary form of relief sought.[14] But existential risks to a plaintiff's business resulting from a consummated merger—risks that the enforcement agencies do not face—are a significant motive to litigate even when the costs to do so are high and the likelihood of recovery is uncertain.

The *Steves* case illustrates some industry and deal characteristics that may make it more likely that a private challenge will emerge post-close. While no single characteristic is determinative, each should be considered in a potential transaction when assessing current and future antitrust risk.

Concentrated Market. A more concentrated market means fewer options for customers after an acquisition of a rival firm. This, in turn, creates an incentive for customers to complain about the transaction to the agencies during a HSR merger review or as a private plaintiff.

The relevant market at issue in *Steves* was highly concentrated prior to the merger.[15] Jeld-Wen's acquisition of Craftmaster reduced the number of suppliers from three to two. As the Fourth Circuit noted, the increase in concentration well exceeded the HHI threshold for S&S to make a *prima facie* showing that the transaction substantially lessened competition. This alone may have given S&S reason to complain given the significant increase in relative concentration and S&S's shrinking supplier options. But soon after the transaction, the only other supplier

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exited the market, leaving S&S with nowhere to turn when Jeld-Wen attempted to raise prices and reduce non-price related services. S&S's inability to turn elsewhere for supply created the existential threat to its business that laid the groundwork for its showing of irreparable harm necessary for injunctive relief in the form of a divestiture order. It goes without saying that not every potential plaintiff will be able to make that same showing.

Customer/Competitor Relationship. Customers that are also competitors have extra incentive to complain (justified or not) about or to challenge a transaction. Normal competitive conduct, when viewed in the context of a customer/competitor relationship, may appear more sinister after an acquisition. In *Steves*, Jeld-Wen was vertically integrated, so it both supplied doorskins to and competed with S&S in the sale of molded doors. But after the acquisition, Jeld-Wen became the only remaining doorskin supplier for S&S while still remaining its competitor in molded doors—a dual role that heightened the conflict between the two.[16]

Failing to Abide by Long-Term Supply Agreements. When merging parties use long-term supply agreements with customers to facilitate HSR clearance, they need to be prepared to abide by those agreements post-closing. The failure (or perceived failure) to live up to those agreements later may turn customers into potential antitrust plaintiffs. In *Steves*, Jeld-Wen entered into a long-term supply agreement with S&S before notifying the DOJ about the transaction. The court believed Jeld-Wen entered into these long-term agreements to "allay concerns about the merger's potential anticompetitive effects."[17] Thus, after the transaction closed, when Jeld-Wen attempted to alter and then cancelled the long-term supply agreement with S&S, it spurned one of the parties it used to "buy" merger peace. Merging parties that use long-term supply agreements in an attempt to temper customer complaints during the HSR review process should be mindful that the risk of a customer complaint or a challenge to the transaction does not end at agency clearance.

Industry Is Not an Agency Focus. A private plaintiff may be more likely to bring a suit in an industry that is not a focus for the agencies, or where there are concerns about under-enforcement by the government. As noted above, several factors go into the agencies' decisions to investigate and potentially challenge a merger, including agency resources. In *Steves*, despite two investigations, the DOJ never pursued any meaningful enforcement action against Jeld-Wen.[18] S&S could either accept Jeld-Wen's terms or pursue its private antitrust claims against Jeld-Wen.

Private litigation is explicitly authorized by the Clayton Act, allowing plaintiffs to act as private enforcers of federal antitrust law.[19] As a result, the agencies' lack of enforcement activity in an industry incentives private litigants to fill the enforcement gap. Thus, while a lack of agency interest is often viewed as a blessing for aspiring merger partners, it does not necessarily foreclose private plaintiffs.

Post-Close Conduct. The facts that gave rise to S&S' complaint reveal the most significant lesson from the case. According to the Fourth Circuit's opinion, after the 2012 acquisition and after Jeld-Wen's successful efforts to obtain customer support for the transaction, Jeld-Wen

took actions inconsistent with its pre-transaction treatment of customers like S&S in violation of its long-term supply agreement with S&S. For example, Jeld-Wen provided notice of price increases unavailable under the supply agreement, lowered the quality of its products, and tightened its reimbursement policy for defective product. When Jeld-Wen gave notice it was terminating the long-term supply agreement in 2014, it effectively shut out S&S from the only available supply of a critical input—driving S&S to bring litigation. Each of these actions weighed against Jeld-Wen at trial where it fought to defend a transaction that, based on traditional HHI analysis, substantially increased concentration in the relevant market.

The record in the Fourth Circuit and district court opinions also highlight the litigation off-ramps that the parties did not take. That is, after S&S notified Jeld-Wen about its potential antitrust suit, Jeld-Wen appears to have done little to settle the dispute. Did the DOJ's multiple closed investigations or the historical lack of divestiture orders in private merger cases convince Jeld-Wen that it faced little or no risk of a court order unwinding the transaction? In hindsight, a benefit future buyers have, the risk was real and may have been avoidable.

Finally, though not a factor that makes a private challenge more likely, the structure of the challenged transaction can increase the likelihood of a divestiture order if a private litigant prevailed in its merger challenge. For several years, the antitrust agencies have been moving away from conduct remedies that govern the behavior of the combined company post-close for some period of time, favoring instead structural remedies such as divestitures. The Fourth Circuit's opinion in the *Steves* case provides support for this approach by calling out the difficulties enforcers face in managing behavioral remedies.[20] Post-close, however, it can be difficult to "unscramble the egg" once the buyer and seller have combined their operations. But, transactions that result in a wholly-owned subsidiary or the acquisition of standalone facilities are better candidates for a preferred post-closing structural remedy to address anticompetitive harm. In *Steves*, Jeld-Wen acquired a standalone production plant that operated (with capital improvements) fairly independent from the rest of Jeld-Wen. This transaction structure made it more palatable for the district court to order divestiture. While any divestiture will be messy, the court in *Steves* felt confident enough to cleave off the acquired plant to remedy the alleged anticompetitive conduct.[21]

How Do I Protect Myself?

Steves is a cautionary tale that buyers and their counsel can use as a reference for putting protections in place to minimize the still limited risk of a private challenge to a transaction that has cleared DOJ or FTC review. Though it is impossible to eliminate all risk of such a challenge, below are a few ways buyers can minimize the possibility of the *Steves* outcome.

Pre-Signing Risk Assessment. Where there is potential antitrust risk, merging parties often perform a pre-signing risk assessment. This assessment, however, generally focuses on the risk of a government challenge, not a private challenge. Post-*Steves*, merging parties should consider the likelihood of a private challenge post-close, using the characteristics described above as a starting point for this analysis. Sellers

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may be reluctant to perform this analysis since the risk of a post-close challenge will be borne solely by the buyer. But assessing the possibility of a private challenge is not overly burdensome and, likely, incremental to the assessment of the risk of a government challenge. For example, counsel and the parties should consider the expected reaction of customers and competitors to the deal, including the alternative sources of supply.

Merger Agreement. Where there is a risk of a government challenge to the transaction, merger agreements often include protections for both buyers and sellers—both of which can be harmed if the transaction does not obtain HSR clearance to close. Protections built into merger agreements related to post-close challenges are far less common, largely because the seller may not have any interest in the combined business. Sellers are not likely to agree to additional antitrust protections for the buyer in the merger agreement to cover this risk, *e.g.*, express indemnification for such a challenge, or to a reduction in purchase price that reflects the risk of such a challenge because private merger enforcement is rare, and likely will continue to be rare post-*Steves*. In addition, sellers will be wary of any obligation that arises from the buyer's post-transaction conduct (as in the *Steves* case). In other words, since the buyer is in control post-closing, it may have the ability to avoid or cause the litigation. Moreover, any additional antitrust protections in the merger agreement could risk the unintended consequence of piquing the interest of the reviewing antitrust agency.

Nevertheless, where the buyer determines the risk of a challenge is particularly high, the buyer could try to negotiate language in the seller's "Litigation" representation and warranty in the merger agreement that covers actions that threaten not just consummation of the transaction, but the transaction itself. If the buyer can show the seller had (or should have had) knowledge of a threat of private antitrust enforcement, it could rely on a breach of this representation and warranty as indemnification for defending the private merger challenge. Establishing the seller's actual or constructive knowledge of risk, however, is easier said than done. Though the seller's participation in a pre-signing risk assessment of a private challenge to the deal would be helpful evidence of such knowledge. And, of course, the buyer's ability to recover ultimately will depend on whether the seller still exists post-close in some form.

Post-Close Conduct. The most important—and perhaps easiest—thing a buyer can do to avoid a private challenge to the transaction post-close is to moderate post-close conduct. The lesson from the *Steves* case is that HSR clearance should not lull a buyer into thinking a transaction is immune from challenge down the line post-consummation. If the buyer or seller enters into a long-term supply agreement with a customer to assuage concerns about the transaction, it should not be just for "show." If down the road, the buyer needs to alter the agreement, it should confer with antitrust counsel before doing so, especially if market dynamics have changed since the signing of the long-term supply agreement. The company should conduct a careful evaluation of the increased antitrust risk from abandoning such an agreement and weigh that risk against the business objectives. Separately, it would not be surprising to see customers use *Steves* as leverage to get (and keep) better terms from merging parties in any negotiations around long-

term supply agreements leading up to a transaction or in discussions about renewing such agreements post-closing. Again, the buyer should confer with antitrust counsel should such demands be made.

Conclusion

The *Steves* case makes real the threat of litigants obtaining divestiture orders through private enforcement of the Clayton Act. That threat, though, is still limited and unlikely to affect the vast majority of transactions. Nonetheless, it cannot be ignored entirely. Buyers should not view an enforcement agency's decision not to challenge a transaction as a "free pass" to do what they like post-close. There may not be additional protections available (or agreeable) for the buyer to put in the merger agreement to limit its exposure to a post-close private merger challenge. But there is work the buyer and its counsel can do to assess the risk of private merger enforcement pre-signing, and moderate its conduct post-close to minimize that risk.

The views and opinions set forth herein are the personal views or opinions of the authors; they do not necessarily reflect views or opinions of the law firm with which they are associated.

ENDNOTES:

[1]Brief for the United States of America as Amicus Curiae in Support of Appellee Steves and Sons, Inc., at *15.

[2]Transactions that fall below HSR thresholds or are exempt under HSR rules are not reportable and in the vast majority of cases, are never reviewed by one of the antitrust agencies prior to close. These transactions also are vulnerable to challenge post-consummation by a private plaintiff or government entity.

[3]*Steves & Sons, Inc. v. JELD-WEN, Inc.*, 345 F. Supp. 3d 614, 630 (E.D. Va. 2018).

[4]In 2019, 74.2% of deals requested early termination and the FTC granted 73.5% of these requests, equating to approximately 54.5% of all deals receiving early termination. *Hart-Scott-Rodino Annual Report*, Federal Trade Commission Bureau of Competition & U.S. Department of Justice Antitrust Division (2019) at 6 (hereinafter "HSR Report"), *available at* https://www.ftc.gov/system/files/documents/reports/federal-trade-commission-bureau-competition-department-justice-antitrust-division-hart-scott-rodino/p110014hsrannualreportfy2019.pdf.

[5]In 2019, only 3% of reported transactions resulted in a Second Request. *Id.* at 6.

[6]*Prepared Statement of FTC Commission Acting Chairwoman Rebecca Kelly Slaughter Before the Subcommittee on Antitrust*, The Federal Trade Commission (Mar. 18, 2021) at 5-6 (hereinafter "Slaughter Speech"), *available at* https://www.ftc.gov/system/files/documents/public_statements/1588320/p180101_prepared_statement_of_ftc_acting_chairwoman_slaughter.pdf.

[7]*See FTC's Bureau of Competition Launches Task Force to Monitor Technology Markets*, The Federal Trade Commission (Feb. 26, 2019); *see also Intent to Nominate Lina Khan for Commissioner of the Federal Trade Commission*, The White House (Mar. 22, 2021); *Senator Klobuchar Introduces Sweeping Bill to Promote Competition and Improve Antitrust Enforcement*, Amy Klobuchar (Feb. 4, 2021).

[8]*See Rewriting History: Antitrust Not As We Know It . . . Yet*, Remarks of J. Thomas Rosch before the ABA Antitrust Spring Meeting (Apr. 23, 2010) at 14, *available at* https://www.ftc.gov/sites/default/files/documents/public_statements/rewriting-history-antitrust-not-we-know-it. . . yet/100423rewritinghistory.pdf.

[9]Slaughter Speech at 4.

[10]For example, in 2019, the FTC brought 21 merger enforcement challenges. Of the 21, 10 were the result of proposed consent decrees. Nine were abandoned. HSR Report at 9.

[11]*Steves and Sons, Inc. v. JELD-WEN, Inc.*,

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988 F.3d 690, 714, 2021-1 Trade Cas. (CCH) ¶ 81547 (4th Cir. 2021) (hereinafter "*Steves*"); *Antitrust Division Manual*, The United States Department of Justice (Fifth Ed.) at III-7, *available at* https://www.justice.gov/atr/file/761166/download.

[12]Section 18 of the Clayton Act (15 U.S.C.A. § 18) specifically prohibits "acquisition [whose effect] may be substantially to lessen competition, or to tend to create a monopoly."

[13]*Steves* at 713-15.

[14]The Clayton Act does, however, permit the recovery of "reasonable attorney's fee[s]" for a prevailing plaintiff. 15 U.S.C.A. § 4304.

[15]*Steves* at 699-701.

[16]*Id.*

[17]*Steves* at 700.

[18]*Id.* at 700, 702.

[19]15 U.S.C.A. § 18.

[20]*Steves* at 706, 720-21.

[21]*Steves* at 721.

DELAWARE COURT ENJOINS AN "EXTREME" STOCKHOLDER RIGHTS PLAN

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On February 26, 2021, Vice Chancellor Kathaleen S. McCormick of the Delaware Court of Chancery permanently enjoined a stockholder rights plan—or so-called "poison pill"—with a 5% trigger[1] that The Williams Companies, Inc. ("Williams" or the "Company") adopted at the beginning of the COVID-19 pandemic. In a lengthy post-trial opinion,[2] Vice Chancellor McCormick reviewed the rights plan under the *Unocal* standard and determined that the members of the Williams board of directors breached their fiduciary duties by adopting it, rendering it unenforceable.

The decision is a reminder that although rights plans remain an important tool, boards of directors should carefully consider and evaluate them before adoption based on a company's particular facts and circumstances.

Background

On March 19, 2020, the Williams board of directors adopted a one-year stockholder rights plan in response to the severe decline of Williams' stock price resulting from plummeting oil prices and the unprecedented COVID-19 pandemic, and concerns about opportunistic activist stockholders acquiring a substantial position in the Company.[3] In the press release announcing the adoption of the rights plan, Williams noted that the rights plan "is intended to enable all Williams stockholders to realize the full potential value of their investment in the company and to protect the interests of the company and its stockholders by reducing the likelihood that any person or group gains control of Williams through open market accumulation or other tactics (especially in recent volatile markets) without paying an appropriate control premium."