Antitrust Alert

It Is Not Over Until It's Over: Antitrust Risks in Unreported Small Acquisitions

March 10, 2010

BY TYLER A. BAKER AND MARK S. OSTRAU

Fenwick
FENWICK & WEST LLP

On March 9, 2009, the Antitrust Division of the Department of Justice ("DOJ") announced that it had brought suit against Election Systems & Software, Inc. ("ES&S") to challenge its acquisition in September of 2009 of Premier Election Solutions Inc. ("Premier") from Diebold, Inc. At the same time, the DOJ filed a settlement agreement with ES&S that requires the divestiture of the assets of Premier in order to restore competition in the market for voting equipment systems in the United States. There are several lessons from this enforcement action that apply to companies in other markets.

ES&S acquired Premier for $5 million in cash and 70% of certain receivables. The purchase price fell below the reporting thresholds of the Hart-Scott-Rodino ("HSR") Antitrust Improvements Act of 1976. As a result ES&S was not required to and did not report the transaction prior to closing. Rather, ES&S moved immediately to integrate Premier into its existing operations, with the result that Premier no longer exists as an independent, free-standing company. One of the reasons for the HSR reporting requirements was to give the DOJ and the Federal Trade Commission a chance to review and, if necessary, challenge proposed mergers before closing. The reason is obvious: if the eggs are already scrambled, it is often difficult to restore competition. While this concern is undoubtedly true, this case shows that the enforcement agencies will challenge mergers even after closing and integration.

The DOJ defined the relevant market as voting equipment systems in the United States. For this purpose, a voting equipment system is the integrated collection of customized hardware, software, firmware, and associated services used to electronically record, tabulate, transmit, and report votes in an election.

Within the market as defined, ES&S was the largest competitor, and Premier was the second largest. Together they constituted 70% of the market. Moreover, the DOJ concluded that many customers viewed the two companies as their first and second choices. Assuming that these allegations are correct, it is hardly surprising that the DOJ concluded that the merger would harm competition. That conclusion follows easily from the resulting market concentration. In addition, the fact that the two companies were viewed by many customers as the closest competitors could justify a challenge under the "unilateral effects" theory even if the combined market share were smaller.

Because Premier had already been folded into ES&S, a simple order of divestiture was impossible. Premier as a viable operating entity no longer exists. But the DOJ was not dissuaded by those facts. Under the settlement agreement, ES&S is required to divest what remains of Premier in terms of physical assets and intellectual property to a qualified purchaser who can use them to compete. In addition, ES&S is required to take various other affirmative steps to give the acquirer the ability to compete. For example, ES&S must forego the enforcement of non-competition and other covenants that would restrict present or former employees of Premier to work for the acquirer. Similarly, ES&S must provide a transition services agreement to assist the acquirer for six months and a transition supply agreement to provide necessary supplies for up to two years. In the event that an acquirer satisfactory to the DOJ is not found within 60 days, the DOJ will appoint a trustee to find a suitable acquirer, with the costs to be borne by ES&S. All in all, ES&S is stuck with many onerous obligations designed to undo its hastily consummated deal.

There is a certain irony in this situation. The vast majority of large mergers that must be reported under the HSR requirements do not, in fact, create any competitive harm. The HSR reporting thresholds reflect the assumption that transactions that do not reach those thresholds are unlikely to harm competition. Yet, some markets are small, whether because they are very local or for other reasons. Mergers in such markets, as in this case, may create competitive problems even though they are not large enough to be reported. In fact, the DOJ and FTC have challenged a number of small transactions over the last several years involving markets ranging from highly-sophisticated software to horseshoe nails.

This case illustrates clearly that the risk of having to sell-off assets previously acquired—often at a price well below what was initially paid—is something to be analyzed early in the consideration of any transaction that may raise antitrust concerns. Doing so will give the buyer the opportunity to manage that risk appropriately through a variety of actions including careful drafting of acquisition agreements, getting informal feedback from the government enforcers on the likelihood of a problem, and/or taking other preemptive curative action (in a better negotiating position) to address possible concerns.

In conclusion, don't assume that because there is no HSR notification required that you are home free. Both the DOJ and the FTC have been quite willing to investigate deals below those thresholds. This is simply the latest example. Similarly, don't assume that because the deal is closed and the assets thoroughly integrated that you are safe. As this case shows, the enforcement agencies are willing to impose the substantial costs of a mistake on the acquirer. Most small acquisitions are unlikely to create problems, but some do. Especially where the deal combines close competitors, it is worth getting antitrust advice before proceeding.

For further information, please contact:

Tyler A. Baker, Co-Chair, Antitrust and Unfair Competition Group
tbaker@fenwick.com, 650.335.7624

Mark S. Ostrau, Co-Chair, Antitrust and Unfair Competition Group Group
mostrau@fenwick.com, 650-335-7269