



February 2006

BRIEFING

FTC announces merger process reforms

Summary

This briefing examines the Federal Trade Commission's announcement of merger process reforms under the Hart-Scott-Rodino Act and provides a summary of the specific proposals to change the "Second Request" process.

The Chairman of the U.S. Federal Trade Commission (FTC), Deborah Platt Majoras, announced a series of proposed changes to the "Second Request" process under the U.S. Hart-Scott-Rodino Act (HSR Act) in February.

Acquisitions notified under the HSR Act are subject to an initial waiting period that may be extended if the FTC issues a "Request for Additional Information", known as a "Second Request". A Second Request is a lengthy and generally very burdensome discovery demand, seeking broad categories of documents, data, and interrogatory responses that relate to the transaction, the parties, and the markets in which they operate. Importantly, a Second Request extends the HSR waiting period until 30 days after both parties have substantially complied with the Second Requests (or 10 days in certain cases, e.g. cash tender offers).

For many years, private parties have complained of the burdens in time and cost of Second Request compliance, and Chairman Majoras recognized that "complying with a Second Request in a significant transaction routinely costs millions of dollars and requires months to respond." The burdens have increased dramatically in recent years, as more and more information is created and stored electronically, and the FTC proposals are offered as a means to "address the increased burden on parties and the [FTC] staff". The FTC proposals apply only to Second Request investigations at the FTC. The U.S. Department of Justice (DOJ), the other U.S. agency with merger review authority, is expected to release Second Request proposals next month.

The FTC's announcement is described as one stage of an ongoing process to reform the U.S. merger review process, and the 16 February announcement focuses exclusively on the Second Request process. Although the FTC has not proposed changes to the HSR Act or the HSR Act rules, the proposed changes are an attempt to formalize certain best practices to be followed by FTC staff in preparing and negotiating the substance of a Second Request and by parties in complying with a Second Request. With the exception of several minor changes, the FTC proposals do not materially change the substance of the "Model Second Request", a standard example of the types of documents and information required in a Second Request response (available at <http://www.ftc.gov/bc/modelguide.htm>).

The proposed changes generally relate to the following aspects of the Second Request process:

- the number of individuals whose files must be searched;
- the time period covered by the document requests;
- the type of empirical data requested and the manner in which it must be provided;
- the production of information from company backup tapes;
- the requirement to produce a privilege log; and
- the use of de-duplication software in electronic document productions.

A summary of the specific proposals follows.

Number of custodians

In responding to a Second Request, parties must determine which individuals will be searched for responsive documents. For Second Request purposes, the chosen individuals are identified as “custodians”. In particularly large mergers or mergers involving competition issues across many relevant product areas, the number of custodians might exceed 50, or many more. The burdens associated with Second Request compliance obviously increase as the number of custodians expands.

The FTC proposal creates a presumption that the FTC will not require a party to search the files of more than 35 employees, provided that the parties:

- submit organizational charts upfront;
- agree to an “initial meeting” and follow-up meetings at the FTC’s request until the FTC agrees on the 35-person custodian list;
- provide descriptions of employee responsibilities as requested by FTC staff;
- agree to an “initial data meeting” and follow-up meetings until the FTC and the parties agree on the data to be produced;
- produce all documents and information in response to the Second Request at least 30 days before formally asserting substantial compliance, or otherwise reach a timing agreement with FTC staff; and
- agree upfront to at least a 60-day discovery period if the FTC challenges the transaction in federal court.

Even if the parties agree to the proposed conditions, the FTC may request authorization from the Director of the FTC Bureau of Competition to expand the custodian list beyond the 35-person presumption. There is no timeline by which the FTC must make its decision on the 35-person custodian list, nor is there a time within which the Bureau Director must make a decision to authorize a broader custodian list.

Two-year relevant time period

The FTC announced that there would be a presumption that the “relevant time period” for a Second Request will be two years, as opposed to three years, which is the current presumption. According to FTC analysis, this change would reduce the number of documents produced by approximately 25 percent. Note that the

two-year presumption applies to the document requests only, and does not apply to data requests. In addition, the FTC staff may lengthen the period at their own discretion in appropriate circumstances.

Empirical data

The FTC proposal attempts to formalize several best practices related to the production of empirical data. The proposal states that the FTC staff will inform the parties of the theories of competitive harm under consideration and will identify the types of data that would be useful in the competitive effects analysis. Parties are encouraged to meet with the FTC staff at an early stage to discuss the data requests and negotiate an agreement that is satisfactory to the FTC staff and potentially less burdensome to the parties. Senior officials at the FTC would be available to meet with the parties if an agreement cannot be reached with the FTC staff.

Backup tapes

The Model Second Request requires parties to produce documents and information from backup tapes to the extent not available in the files of the relevant custodians. The FTC proposal creates a presumption that (i) a party may elect to preserve backup tapes for only two calendar days identified by FTC staff; and (ii) the FTC will require a party to produce documents contained on backup tapes only when responsive documents are not available through other more accessible sources.

Privilege log

The Model Second Request requires parties to produce a detailed privilege log that identifies every document withheld from the Second Request production due to the attorney-client privilege or attorney work-product privilege. Providing a complete privilege log in a Second Request production is ordinarily an enormous task, and the FTC routinely agrees to a conditional waiver of this requirement (e.g. a complete privilege log would not be required if the parties agree to produce a complete privilege log in the event of litigation). The FTC proposal attempts to formalize this established best practice by allowing the parties to produce a partial privilege log (containing only the names of the custodians from whom privileged documents are withheld and the number of documents withheld for each custodian) as long as the

parties agree to certain conditions (e.g. the production of a complete privilege log for a small subset (10 percent) of the custodians and an agreement to produce a complete privilege log in the event of litigation).

Electronic production and de-duplication

Second Request document productions increasingly have been made electronically, and the parties often use service providers that have technology to eliminate duplicate documents from the production (and thereby reduce the cost of the production). The FTC has proposed a new requirement that the parties must receive prior consent from the FTC before eliminating duplicate documents from the Second Request production.

Conclusion

Chairman Majoras announced that these proposals are the result of the first stage of its ongoing review of the merger review process under the HSR Act. Therefore, it is likely that the FTC will consider additional proposals designed to improve the HSR Act process. However, it is noteworthy that the FTC did not state that the Model Second Request is currently too broad in scope; Chairman Majoras explicitly stated that large document and data productions “sometimes are required to protect American consumers.” Accordingly, the proposal does not materially limit the FTC’s ability to request documents and information on the scale of past Second Requests.

The FTC proposals, for the most part, formally establish certain best practices that previously have been implemented at the FTC. As such, the proposals do not materially change the Second Request process in the U.S. However, the proposals establish a baseline from which parties can negotiate these or additional modifications to the standard Second Request. In evaluating the FTC proposals, parties will need to determine, on a case-by-case basis, whether they should accede to one or more of the FTC proposals. For example, in determining whether to take advantage of the 35-person custodian proposal, parties must weigh the timing costs on the front end (i.e. the uncertain time in which the FTC would make a decision on a custodian list) and the back end (i.e. an extra 30 days on the Second Request waiting period, plus an agreed 60-day discovery period if litigation ensues) against the potential benefit of having a narrower search group.

In certain cases (e.g. large, complex mergers with wide-ranging competitive concerns), the FTC proposals might significantly limit the burdens on parties. In other cases, the FTC proposals, including those that extend the Second Request waiting period and require substantial upfront negotiations, might be disfavored where time is of the essence and Second Request compliance can be accomplished on an expedited basis.

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