Antitrust Client Advisory

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Federal Trade Commission Announces Reforms to Second Request Process

On February 16, Federal Trade Commission (FTC or the Commission) Chairman Deborah Platt Majoras issued an official statement titled "Reforms to the Merger Review Process." The 31-page statement – the first in what reportedly will be a series of statements – is the product of a year-long effort by the Commission's Merger Process Task Force. The announced reforms aim to address a perennial concern of merger lawyers and the business community: the increasing cost, time, and burden associated with "second request" compliance.

EXECUTIVE SUMMARY

By officially adopting long-standing best practices, such as limiting both the number of employees and the number of years from which responsive documents are sought, the Commission hopes to substantially streamline the second request process. However, given the inherent uncertainty of individual negotiations with staff, as well as filing parties' potential wariness regarding certain mandatory concessions, a substantial track record of application likely will be needed before the true impact of the FTC's reforms can be fairly assessed.

The most significant reforms set forth in the FTC statement are:

- A presumption that the size of the employee search group will be limited to 35 individuals (provided that the filing parties are willing to agree to certain mandatory concessions);
- A presumption that the relevant time period for which most responsive materials must be produced will be limited to two years;
- A presumption that filing parties will be required to preserve backup tapes for only two calendar days, combined with a presumption that production of the responsive documents preserved therein will only be required when they are not available through other, more accessible sources; and
- A modification to the standard second request instructions that would permit filing parties to produce a partial privilege log for the majority of the employees in the search group, while still requiring them to produce a complete privilege log for a subset of those employees (five employees, or 10 percent of the total number of employees searched, whichever is greater).

SECOND REQUESTS AND THE HART-SCOTT-RODINO PROCESS

Pursuant to the Hart-Scott-Rodino Antitrust Improvements Act (HSR Act), parties to transactions of a specified size must notify the FTC and the Antitrust Division of the Department of Justice (DOJ or Antitrust Division) of their intention to consummate a merger or acquisition. In order to give the enforcement agencies time to evaluate the potential competitive impact of the deal, the parties must wait at least until the expiration of an "initial waiting period"

ate the potential competitive impact of the deal, the parties must wait at least until the expiration of an "initial waiting period" (usually 30 days) before completing the transaction. After the initial 30-day waiting period has expired, if the agencies still have concerns about the transaction, a "second request" is issued, which typically requires the parties to produce voluminous amounts of documents and data. Second requests are relatively rare – according to the FTC, 95 percent of reportable transactions are cleared without one – but the Commission still manages to issue almost two dozen a year, with the Antitrust Division issuing a comparable number.

THE FTC REFORMS

The FTC statement acknowledges that, since passage of the HSR Act in 1978, the cost and burden associated with second request compliance has increased dramatically. The Commission offers two explanations for this trend. First, the standards for reviewing transactions have changed significantly. Today, the enforcement agencies rely much less on structural indicators than they did in 1978, and much more on fact-intensive direct market analyses. Second, advances in information technology have resulted in companies producing and retaining a substantially larger number of documents.

To address the resulting information overload, the FTC statement establishes a series of key presumptions regarding second request compliance, including the presumption that Commission staff will:

(1) limit the number of employees required to provide information in response to a second request, provided the party complies with specified conditions;

(2) reduce the time period for which a party must provide documents in response to the second request;

(3) allow a party to preserve far fewer backup tapes and produce documents on those tapes only when responsive documents are not available through more accessible sources; and

(4) significantly reduce the amount of information parties must submit regarding documents they consider to be privileged.

The first presumption is the most important, as the FTC explained that the number of employees required to provide information, or the "search group," is one of the most important determinants of the total cost of compliance with a second request. The reform therefore establishes a presumption that the search group will be limited to 35 employees per filing party. In order to qualify for the presumption, a party must:

(1) provide staff with the organization charts (or equivalent materials) and with specified additional information and access to its employees;

(2) produce the materials responsive to the second request 30 days before formally certifying substantial compliance (or enter into a mutually acceptable timing agreement); and

(3) if the FTC challenges the transaction, agree to propose to the court jointly with the FTC a scheduling order that contains at least a 60-day discovery period.

The presumption is based on the FTC's coclusion that for most transactions, 35 employees per party is likely to be sufficient.

However, the FTC made clear that there is no one-size-fits-all search group, and that the FTC will be able to use a larger or smaller search group when appropriate. For example, the FTC noted that larger search groups would likely be needed in mergers of firms with retail gasoline operations in many geographic markets, and in mergers that implicated a large number of product markets.

If the FTC staff determines that a larger search group is needed, the reform provides that the staff may request that the Director of the Bureau of Competition authorize staff to exceed the presumptive limit. In order to preserve flexibility, there is no specific time limit regarding how quickly the Bureau Director must decide whether to authorize a larger search group. The affected party will have the right to meet or confer with the Bureau Director or a Deputy Director before the Director decides whether to authorize staff to exceed the presumptive level.

The reforms contain other provisions that should reduce the costs of producing quantitative data in response to second requests as well. They also include several changes to definitions and instructions that will eliminate certain production requirements.

IMPACT ON THE MERGER REVIEW PROCESS

The FTC's reforms appear to be a step in the right direction, and could reduce the cost and burden associated with second request compliance significantly. The FTC's own statement acknowledges that, under the current system, parties often spend millions of dollars to collect and review responsive materials, and that second request investigations can take as long as six to nine months. Given the strong relationship between the cost of second request compliance and both search group size and length of responsive time period, the reforms targeting these areas could improve both statistics dramatically. The move to a search group of 35, from the current practice of 50 to 100, and a responsive time period of two years, from the current practice of three or four (the Model Second Request recommends at least three), is not mere tinkering, but a real and substantial shift.

However, the true impact of the FTC's reforms is likely to be determined by three key questions, all of which have yet to be answered:

Will filing parties accept the significant concessions that the FTC's reforms require?

In order to qualify for the presumption that investigating staff will limit the size of the search group to 35 employees, filing parties must agree to:

- produce all responsive materials 30 days prior to certifying "substantial compliance;" and
- allow 60 days of pre-trial discovery if the FTC decides to challenge the transaction.

These requirements may not represent substantial changes from current practice, as it is common to give staff more time at the end of the review if they ask for it and discovery often takes more than 60 days. However, each establishes a baseline from which negotiations over further extensions will commence. Consequently, each could potentially result in longer reviews or more extended discovery.

Will the FTC's investigational staff remain

committed to implementing the reforms?

The FTC statement is clear that, by adopting presumptions rather than firm rules, the Merger Process Task Force sought to avoid a one-size-fits-all approach. Indeed, the statement expressly contemplates that, despite the reforms, in exceptional cases investigational staff might search the files of more than 35 employees, or request documents for more than a two-year period. While the desire to preserve flexibility is understandable, the potential flaw in this approach is that, in many ways, every case in which a second request is issued is an "exceptional" case. As the FTC's own data confirms, only 5% of reportable transactions result in a second request, yet 44% to 78% of the transactions in this narrow slice of the pie ultimately result in some form of enforcement action. Thus, absent a sustained commitment by the staff, coupled with the development of consistent practices, one can easily envision a regulatory environment in which departures from the Commission's limiting presumptions become the norm rather than the exception.

Will the DOJ follow the FTC's lead?

Notably, the merger process reform statement was issued by the FTC alone, rather than as a joint statement by the FTC and the DOJ. Whether this represents a rift of small or large proportions remains to be seen. Public statements by Antitrust Division officials suggest general approval of the FTC approach but the failure of the two agencies to reach consensus remains a concern. Furthermore, to the extent this disagreement suggests a growing divergence in the enforcement agencies' merger review practices, it is likely to focus additional attention on the "clearance" process, whereby responsibility for review of a particular transaction is granted to one agency or the other.

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