PRESENTATION TO FTC ON DEVELOPMENT AND MAINTENANCE OF ACCOUNTING AND FINANCIAL RECORDS AND DATA AS RELATED TO THE MERGER INVESTIGATION

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Outline Relating to the Use of Accounting and Financial Data for Expert Economic or Financial Analyses in FTC Merger Cases

- **Overview**
    - Neither the FTC nor the merging parties are "the enemy" and it is in the best interest of both sides to be forthright and to share concerns and theories throughout the merger review process so that they may be adequately addressed
    - Expert analyses cannot anticipate and address every potential concern; thus, expert analyses must be provided early to the FTC in order to allow sufficient time for sharing of all underlying data and analyzing all economic or financial issues
- **Best practices on way for FTC to ask for information**
    - My experience at the FTC was that underlying support provided by merging parties for expert analyses was often incomplete or, at best, inadequate to allow for a complete understanding of the basis for, and shortcomings of, expert analyses
        - Notwithstanding that the H-S-R Second Request asks for virtually all information and documents underlying an expert analysis, in many cases it has not proven sufficient in providing the substantiation necessary to fully assess the reliability of the expert analysis
            - The Second Request typically asks for identification of all experts and consultants retained by merging firms, and requests all documents and data provided to such experts and consultants
            - The Second Request also asks for all instructions, programs and other documents necessary to use and interpret finished analyses or data used in such analyses
            - The Second Request, however, lacks the "roadmap" (explanation and walk-through of all facets of the analysis) to understanding the supporting data and underlying assumptions
                - Often, an understanding of the expert analysis is limited by lack of knowledge of the chronology, hierarchy, priority

and source of the documents underlying the analysis or the methodology used in the analysis

- Investigational hearings and depositions, by their very nature, are adversarial even if conducted in the most cooperative vein; thus, they seldom serve as a means of providing the level of substantiation needed by the FTC to "verify" expert reports and analyses

- The 1997 "Revised Section 4 of the Horizontal Merger Guidelines" ("Efficiency Amendment") has helped remedy this problem for expert reports on efficiency claims by providing a "roadmap" to merging parties on what is needed to support their claims

  - A comparison of the *Staples* case (1997) and the *Heinz* case (2001) shows the sharp contrast between a well-substantiated efficiency claim and one that is not well-substantiated

    - *Staples* was inadequate despite the submission of many documents to the second request and to subsequent discovery requests

    - *Heinz* had far fewer relevant documents, but was well-substantiated

- Language in the Efficiency Amendment offers sound guide and added standard for documentation that should be provided to FTC as support for economic and financial analyses

  - Efficiency Amendment essentially calls for information and documentation *independent of the second request* and effectively says that asserted efficiencies that are not adequately substantiated will be dismissed by the Commission in assessing the competitive effects of the merger

    - Efficiency Amendment requires sufficient substantiation to allow the FTC by practical means to verify the claims or assertions

  - Severe time constraints imposed by H-S-R process make it imperative, and should serve as an incentive, for merging parties to provide an adequate level of substantiation so that expert analyses are properly credited in evaluating the proposed merger

    - Expert analyses, especially econometric studies, take substantial time and effort to develop and are frequently done by merging parties prior to a H-S-R filing

- Certainly, it is unreasonable to expect the FTC to evaluate the reliability of such expert studies between the initial H-S-R filing and the date of issuance of a second request

- But even after issuance of a second request, with its longer time frame for review, such an evaluation is extremely difficult, and almost always requires substantial cooperation between the merging parties and the FTC

    - By its nature, the FTC merger investigation is adversarial, thus making it difficult to obtain the level of cooperation needed to properly evaluate and credit expert reports

- If Second Request and other discovery processes available to the Commission staff have not resulted in production of documents and information necessary to enable staff to judge the reliability of expert analyses, something more is needed

- I believe that it makes sense to impose (formally or informally) the "standard" of the Efficiency Amendment upon all categories of expert analyses

- **Best practices on way for merging parties to gather and compile information**

    - With respect to expert analyses, the burden and cost of production by the merging parties is relatively small if documents and information underlying expert analyses have already been gathered or developed as basis for expert analyses undertaken by merging parties or their retained consultants

        - Keep in mind that it took a lot of time to develop the expert analysis, and merging parties cannot expect the FTC to assess such analyses in the relatively short H-S-R time frame and lacking a comparable level of support and cooperation given by the merging parties to the retained experts who developed the analysis

    - With respect to accounting and financial documents, in general, an inherent problem in defining and competitively assessing the "relevant" antitrust market(s) is the availability of accounting and financial data specific or exclusive to such markets

        - Appropriate documents might be identified in advance of the second request

            - Between initial H-S-R filing and deadline for issuance of second request, FTC might request, and merging parties might provide, controllers and financial officers for interviews or investigational

hearings to determine extent to which relevant accounting and financial information exists

- Companies maintain books and records in accordance with their reporting requirements and decision-making needs

- With respect to decision-making needs, there is a balance between the cost of capturing information and the benefits of having access to such information

- Communications between the FTC and personnel at the merging parties with knowledge about financial and accounting systems could allow for cutback of document requests in the second request

  - Cutbacks in the Second Request may best be done, however, after issuance, as part of negotiating modifications

- Before or after the second request issues, the FTC could identify the specific accounting and financial information it is seeking and merging parties could respond in letter or written narrative of what is and is not available (could limit to those reviewed by senior level managers or decision-makers)

- The merging parties have the opportunity to negotiate modifications to the second request

  - As Casey Triggs of the FTC stated in an article he wrote a few years ago on the H-S-R second request process:

    - "On any given day in the Federal Trade Commission 601 Pennsylvania Avenue offices, counsel for merging parties meet with staff attorneys from the Bureau of Competition seeking modifications to narrow the scope of second requests…"

  - The Second Request itself encourages discussion of possible modifications with FTC staff

    - The merging parties can comply with the second request through a "rolling production", which could demonstrate without full compliance that the merger is beneficial or at least competitively benign

    - Risky in that the H-S-R time frame for completing the investigation does not apply until certification of full compliance with the second request

- Finally, the second request might be limited through stipulation between FTC and merging parties of certain aspects of the case

    - The second request might be limited by stipulation of market measurement such as market shares and the appropriate share measure (sales, production, capacity, etc)

        - Stipulation on measures of an alleged market, such as sales, production or capacity figures, still allows for evidence and argument that the market is improperly defined

        - Such stipulation still allows evidence of entry and competitive effects

    - Stipulation at the outset that an efficiency claim or failing company/*General Dynamics* argument will not be offered

        - Could serve to significantly limit the scope of the second request, but also imposes significant constraint or possible foreclosure of evidence and arguments relevant to competitive effects

    - Stipulations present a real danger (both to the Commission and merging parties) that valid arguments and relevant evidence are precluded from subsequent consideration

        - Experienced antitrust counsel may have done a sufficient antitrust assessment before the H-S-R filing to allow for informed stipulations, but less experienced counsel may be endangering their client's position by entering into early stipulations aimed at reducing the burden of complying with the second request

        - Valid positions on various aspects of the antitrust inquiry are sometimes formed or developed later rather than earlier during the Commission's investigation and stipulations made at the outset of the investigation can void relevant evidence

        - Thus, stipulation to avoid document production may not be in the best interest of either merging parties or the Commission

    - In recent years, the Commission seems inclined to rely on actual evidence, including production of documents under the second request, rather than stipulation of substantive antitrust issues