DOJ Challenges Consummated Merger Following HSR Clearance

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On September 26, 2017, the U.S. Department of Justice filed a federal antitrust complaint seeking partially to unwind Parker-Hannifin Corporation's $4.3 billion acquisition of CLARCOR, Inc.

The case is notable because it was initiated eight months after the expiration of the Hart-Scott-Rodino ("HSR") Act's waiting period, and seven months after the consummation of the transaction. This case is a reminder that HSR "clearance" does not prohibit the government from challenging a transaction, even after it has been consummated, though it is quite rare for the government to do so.[1]

The Merger Review Process

The HSR Act requires that parties to transactions exceeding specified value thresholds make filings with the DOJ and the FTC and observe a statutory waiting period prior to closing the transaction, unless the transaction is covered by one of a number of exemptions. The HSR filing contains basic information regarding the proposed transaction, including certain kinds of business documents (commonly called "4(c) documents") that analyze the transaction with respect to competition, market shares, and the like. After parties submit their HSR filings, the HSR Act prohibits them from consummating the transaction until they observe a waiting period (typically 30 days) during which the government can review the transaction. Unless the government extends the waiting period by requesting additional information (often called a "second request"), the parties are free to close the deal at the expiration of the initial waiting period.

The HSR Act was designed in large part to give the government an opportunity to review (and potentially challenge) transactions *before* consummation, thus avoiding the need to pursue remedies or "unscramble the eggs" after the two businesses have combined.

Significantly, however, the expiration of the HSR waiting period does not constitute government "approval" of the transaction. It simply means that the parties are free to proceed with the closing without violating the HSR Act. Transactions may still be challenged under Section 7 of the Clayton Act after closing. That said, it is unusual for the government to take such a step, and thus it is worth exploring the specific circumstances when such challenges are raised.

The Transaction

According to the DOJ's complaint, in December 2016, "Parker-Hannifin and CLARCOR were the only suppliers of EI-qualified aviation fuel filtration systems and filter elements to U.S. customers."[2] Parker-

[1] The government has challenged a number of transactions that were not subject to HSR filing requirements. It is much less common for the government to challenge a transaction after HSR clearance has been obtained, though it has happened on occasion. For example, in 2004, the FTC filed a complaint against Evanston Northwestern Healthcare Corporation (ENH), alleging that its 2000 merger with Highland Park Hospital was anticompetitive. Similarly, in 2001, the FTC challenged a transaction between Chicago Bridge & Iron Co. (CBI) and Pitt-Des Moines, Inc., almost nine months after the transaction closed.

[2] Complaint, *U.S. v. Parker-Hannifin Corp. and CLARCOR Inc.*, at ¶ 3 (Sept. 26, 2017).

Hannifin sought to acquire CLARCOR for $4.3 billion. The parties submitted their HSR filings in December 2016, and the HSR waiting period expired on January 17, 2017 without the issuance of a second request. The companies closed the deal on February 28, 2017.[3]

The DOJ's Challenge

The key question that arises is not so much why the transaction on its merits might warrant a challenge, but why the challenge came when it did.

In its complaint, the DOJ alleges that the transaction will "substantially lessen competition" in the market for aviation fuel filtration products because Parker-Hannifin would acquire "its only U.S. competitor."[4] Notably, the DOJ alleges that Parker-Hannifin was aware of the potential anticompetitive effects of the acquisition prior to agreeing to the acquisition:

> Just weeks before its $4.3 billion merger was announced, the Vice President of Business Development for Parker-Hannifin's Filtration Group wrote to the President of the Filtration Group, identifying "the notable area of overlap" between the merging parties in "ground aviation fuel filtration." He asked whether Parker-Hannifin should be "forthcoming" about this "aviation antitrust potential." Then, later in that same email, he stated that Parker-Hannifin was "preparing for the possibility that we may have to divest [CLARCOR's] aviation ground fuel filtration" business.[5]

The DOJ seeks an order requiring Parker-Hannifin to divest either CLARCOR's or its own assets in the relevant aviation fuel filtration product markets.[6] The parties no doubt will argue that one basis for denying such equitable relief is that the DOJ had an opportunity to review and challenge the transaction prior to closing, but did not do so. So, a key question likely will be, why did the DOJ not sue earlier to block the merger?

What Happened?

The DOJ has not explained why it did not seek to challenge the Parker-Hannifin transaction prior to expiration of the HSR Act waiting period (or prior to the closing), though it has provided some clues.

It has asserted that "[d]uring the pendency of the department's investigation, Parker-Hannifin failed to provide significant document or data productions in response to the department's requests."[7] However, the Complaint does not allege that the parties violated the HSR Act. Thus, there is no claim that the parties withheld any information or documents that they were required to submit prior to expiration of the waiting period.

According to a press report, a senior DOJ official has stated that the government received a number of complaints from customers, which presumably prompted the post-clearance investigation.[8] The same

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[3] **News Release**, "Parker Acknowledges DOJ Filing Regarding its U.S. Qualified Aviation Ground Fuel Filtration Business" (Sept. 26, 2017) ("Parker-Hannifin News Release").

[4] Complaint at ¶ 5, 50.

[5] *Id.* at ¶ 5.

[6] *Id.* at ¶ 52.

[7] **Press Release**, "Justice Department Files Antitrust Lawsuit Against Parker-Hannifin Regarding the Company's Acquisition of CLARCOR's Aviation Fuel Filtration Business" (Sept. 26, 2017).

[8] Vanderford, Richard, "'Anticompetitive and Illegal' Parker Hannifin Deal Not Shielded by HSR Clearance, DOJ Official Says," MLex (Sept. 28, 2017).

official also suggested that when there is a clear and obvious competitive overlap, parties and their counsel should consider raising the issue affirmatively with the government prior to clearance.[9]

In the end, the simplest explanation may be that the antitrust issue was not spotted during the initial review, and came to light only after customers complained and it became clear (to the DOJ at least) that the concerns were so substantial that they demanded further investigation. The government's statements suggesting that there was something unusual about the transaction and the conduct of the parties may reflect an attempt to alleviate concern that this will be a common occurrence.

Takeaways

- **HSR clearance should still provide comfort.** Although the Parker-Hannifin case no doubt will be cited as a cautionary tale for years to come, it is (and should remain) an outlier. Parties will continue to rely upon HSR clearance as a milestone event, and merger agreements likely will continue to provide that obtaining HSR clearance satisfies a condition to closing.
- **Consider engaging the government affirmatively before or during the HSR waiting period.** In transactions that may raise significant antitrust issues, it is not unusual for parties affirmatively to engage the U.S. antitrust authorities before or during the HSR waiting period to address the issues head on. Getting the process started promptly, rather than waiting for the government to raise concerns during the initial waiting period, can improve the chances of avoiding a second request. Such a proactive approach may, however, prompt an investigation (and delay) that otherwise might not have occurred. Deciding whether to approach the government proactively is a strategic question that companies and their counsel should carefully consider.
- **Post-closing customer complaints can trigger antitrust scrutiny.** Authorities take customer complaints very seriously. Although the government typically seeks out and addresses customer input during the HSR process, this case shows that such complaints can trigger scrutiny even after HSR clearance. Post-closing changes in business practices, such as price increases and aggressive negotiating tactics, can sometimes trigger customer complaints and may prompt government inquiry.

[9] *Id.*

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