

# Fried Frank Antitrust & Competition Law Alert<sup>®</sup>



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## Department of Justice Challenges Consummated \$5M Merger

On March 8, 2010, the Antitrust Division of the Department of Justice (the "DOJ") and nine states announced a settlement in their challenge of Election Systems & Software Inc.'s ("ES&S") \$5 million acquisition of Premier Election Solutions, Inc. and PES Holdings, Inc. ("Premier"). At the time of the transaction in September 2009, ES&S and Premier were the two largest suppliers of voting equipment systems in the US, with approximately 70 percent market share combined. The settlement follows a DOJ investigation that was initiated notwithstanding that the transaction was not subject to the reporting requirements of the Hart-Scott-Rodino ("HSR") Antitrust Improvements Act of 1976.<sup>1</sup> To address the competitive concerns raised by the transaction, ES&S agreed to divest certain Premier assets and to accept other obligations and restrictions with respect to its business.

*ES&S/Premier* exemplifies a trend of active investigative and enforcement efforts against consummated transactions of all sizes, including transactions that are not reportable under the HSR Act. In recent years, the number of enforcement actions involving non-reportable transactions has increased at both agencies.<sup>2</sup> *ES&S/Premier* also illustrates some of the difficulties in crafting remedies in consummated transactions where the target has already been fully integrated.

### Background

Following the passage of the Help America Vote Act ("HAVA") in 2000, state and local jurisdictions have sought to replace traditional mechanical voting systems (e.g., lever and punch card machines) with new electronic voting systems for which HAVA provided funding. ES&S and

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<sup>1</sup> The HSR Act requires the submission of a filing and observation of a waiting period before consummation of an acquisition of voting securities, assets or non-corporate interests which satisfy certain thresholds, including a size-of-transaction threshold (\$65.2 million at the time of the ES&S/Premier transaction). The value of the Premier transaction (\$5 million) was far below the HSR size-of-transaction threshold and therefore was not HSR-reportable.

<sup>2</sup> In fiscal year 2009, the DOJ issued seven Civil Investigative Demands in "non-HSR investigations" compared to just two in fiscal year 2008. Prior to *ES&S/Premier*, in January 2010, the DOJ filed suit challenging Dean Foods' consummated (and non-HSR reportable) \$35 million acquisition of Foremost Farms. The DOJ is requesting that Dean Foods divest all the assets acquired from Foremost. The Federal Trade Commission ("FTC") increased enforcement actions involving non-reportable transactions from two in fiscal year 2007 to nine in fiscal year 2008 and six in fiscal year 2009. The FTC recently received a favorable ruling in its action before an Administrative Law Judge against Polypore International, Inc. ("Polypore"). The FTC had brought an administrative action against Polypore's acquisition of Microporous L.P. based on concerns in a number of battery separator markets.

Premier were the two largest providers of voting equipment systems in the United States prior to the Premier transaction. The transaction was not reviewed by the DOJ prior to closing as it was not reportable under the HSR Act. Shortly after closing, ES&S integrated the Premier business into its own. Although the transaction was not HSR-reportable, there were public complaints and, in December 2009, the DOJ opened an investigation. Transactions that are not subject to the HSR Act reporting requirements are still subject to the substantive antitrust laws (principally, Section 7 of the Clayton Act) and may still be investigated by the DOJ, the FTC, or state attorneys general.

According to the DOJ, ES&S and Premier had 70 percent market share combined, were each other's closest competitors, and had engaged in vigorous price competition in their bidding activities. There were three other companies in the market, but none were capable of acting as a competitive constraint on the combined *ES&S/Premier* as they were limited by factors such as a lack of a full product line, inadequate certification, a limited record of proven equipment, and, in at least one case, inadequate financing. DOJ asserted that without Premier, the combined firm would have had reduced incentives to compete aggressively and thus the deal would have resulted in higher prices and reduced quality in electronic voting systems for local and state jurisdictions.

The proposed settlement contains a number of divestiture requirements. ES&S must divest, to a buyer to be approved by the DOJ, the following: (1) all the intangible assets – including intellectual property and trademarks – related to the Premier voting equipment system products, including assets in development at the time of the acquisition; (2) Premier's tangible assets including all tooling and fixed assets related to the production, assembly and repair of these products; and (3) inventory and parts. In addition, ES&S has agreed to license ballot marking technology to enable the buyer to serve disabled customers, and provide the buyer with supply and transition services.

There are other less common settlement provisions reflecting the fact that ES&S had already "dismantled" the Premier business. For example, to avoid disruption to customers (state and local jurisdictions), the DOJ did not require that ES&S divest existing customer contracts. The buyer will have the exclusive rights to offer Premier equipment to existing customers for new installations (including replacements for 50 percent or more of a customer's installed equipment). Both ES&S and the buyer will be allowed to compete to provide services for existing customer systems, thereby giving existing customers the option to switch. Further, ES&S will be required to waive any existing contractual provisions that might prevent or hinder the buyer from competing for such business.

### **Implications**

*ES&S/Premier* is one of a number of recent cases where the antitrust agencies have challenged a consummated transaction, including transactions that are not reportable under the HSR Act. It serves as an important reminder that companies should evaluate and consider the potential antitrust risks in advance of any transaction regardless of the value of the deal.

The matter also illustrates the complexities of devising an appropriate remedy where the target is no longer a separate and independent business. Here, there was no freestanding Premier

business to be divested. As the DOJ noted in its Competitive Impact Statement, given the circumstances, it was not able to resolve its competitive concerns by unwinding the transaction. The Premier business units responsible for sales, product design and development, and voting equipment system certification were dismantled and most of the Premier employees of these units had been terminated. While the settlement does require ES&S to provide some additional IP rights and a supply agreement to allow the buyer time to establish its own manufacturing facilities, the settlement allows ES&S to retain and continue to serve certain Premier customers in light of sensitivities with respect to the impact of a divestiture on the administration of upcoming primaries and general elections. *ES&S/Premier* demonstrates the need for, and the interest of the antitrust agencies in, seeking remedies that are tailored to specific circumstances to address competitive concerns in consummated transactions.<sup>3</sup>

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<sup>3</sup> *ES&S/Premier* stands in contrast to other actions, such as *Chicago Bridge*, where the FTC ordered – and the Fifth Circuit Court of Appeals affirmed – an acquirer (Chicago Bridge) in a litigated merger action to divest all assets obtained in its acquisition of Pitt-Des Moines. Although Chicago Bridge had already fully integrated the acquired assets, the FTC required Chicago Bridge to create two stand alone divisions capable of competing – each fully, equally, and independently engaged in all aspects of the relevant business – and to sell one of those divisions at no minimum price. See *Chicago Bridge & Iron Co. N.V. v. F.T.C.*, 534 F.3d 410 (5th Cir. 2008); *Chicago Bridge & Iron Co.*, 138 F.T.C. 1024 (2004). Of course, *Chicago Bridge* was a litigated case that involved a larger transaction (\$84 million).

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