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Antitrust merger review costs and acquirer lobbying

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ABSTRACT

Documenting the US antitrust review process for M&As in rich detail, we unveil that regulatory costs and risks are significant and that mitigating these risks via lobbying by acquirers may benefit shareholders. Our results show that an adverse antitrust review outcome leads to a decline of 2.8% in acquirer firm value. Further, we show that lobbying before deal announcements is associated with more favorable review outcomes. Finally, higher pre-announcement lobbying is valued by shareholders, especially in horizontal deals and deals with a larger expected change in market concentration, which have higher antitrust concerns. However, this positive value effect of lobbying applies only in firms with strong corporate governance. Our results highlight the role of political connections and lobbying for corporate investments when facing regulatory costs and risks.

1. Introduction

In 2011, AT&T proposed to acquire T-Mobile USA in a $39-billion deal.[1] The proposed merged company would take a 43% share in the wireless market, which raised concerns with the Antitrust Division in the Department of Justice (DOJ). The DOJ eventually blocked the deal, and AT&T stock price dropped by 4% on the DOJ announcement. In addition, AT&T had to pay a reverse breakup fee of around $4.2 billion (almost 10% of its market value) to the target.

All large deals face regulatory costs and risks during the antitrust merger review process.[2] Although acquiring firms in successful deals avoid paying termination fees, they may need to offer asset divestitures or restrictive agreements to address antitrust concerns. Such negotiated concessions are costly because they reduce projected deal synergies. In addition, the regulatory process gives rise to indirect costs associated with increased interim uncertainty (Bhagwat et al., 2016).[3] This paper investigates the costs and risks associated with the antitrust review process and how they may motivate acquirer firms to directly influence regulators through lobbying around deal announcements.

Our paper starts with a rich description of the antitrust review process. We collect detailed information on this process for 370

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[1] http://money.cnn.com/2011/09/01/technology/att_tmobile_lawsuit/

[2] According to the 2011 Hart-Scott-Rodino (HSR) Annual Report reported by the Federal Trade Commission (FTC) and the DOJ (http://www.ftc.gov/os/2012/06/2011hsrreport.pdf) as much as 40% of all large merger deals with deal value larger than $1 billion in 2011 were reviewed in detail and over 15% received a Second Request.

[3] "Companies in a number of recent mergers have been waiting upward of a year or longer for a final verdict, and some deals have fallen apart because of government concerns… As time passes, merging firms can become increasingly worried about completing a deal. They have to ensure financing remains in place, and that can cost money. They can begin to lose employees nervous about the future, as well as customers." See "U.S. Antitrust Reviews of Mergers Get Longer," WSJ, June 7, 2015.

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merger transactions above $100 million during the period from 2008 to 2014. Pursuant to the Hart-Scott-Rodino (HSR) Act of 1976, both the acquirer and the target submit their premerger filings to antitrust agencies shortly after the public announcement of the deal and wait a statutory period of 30 days for their review outcome. For favorable antitrust review outcomes, merging firms clear the antitrust review at the end of the waiting period (Natural Expiration, 139 deals), or antitrust agencies terminate the period even before the end of the waiting period (Early Termination, 138 deals). Deal failure risk associated with these deals is low – only 6% of them are later withdrawn and abandoned. In addition, a group of 31 firms receive an Early Termination or Natural Expiration decision after having withdrawn and refiled their HSR premerger documents to allow antitrust agencies extra time to review their case. We label them Pull&Refile. While maintaining a 6% withdrawal rate, Pull&Refiles prolong the deal completion time by 29 percentage points. Antitrust agencies initiate a full-scale investigation into the antitrust nature of 62 deals and request extensive additional information, a so-called Second Request. Out of the 62 deals with a Second Request, 24 deals are Challenged with a complaint filed against the merging parties, while 38 deals stay Unchallenged and achieve clearance to proceed without a filed complaint. Second Requests, both Challenged and Unchallenged, face substantially higher regulatory costs and risks. The antitrust agencies consider Challenged Second Requests as anticompetitive and, therefore, question sources of potential benefits from these mergers. However, Unchallenged Second Requests also face high costs associated with extra filing requests and longer time to deal completion. Second Requests take on average 237 days from announcement to completion, while it takes only 98 days to complete deals with favorable outcomes. Also, 19% of deals with Second Requests fail in comparison to the 6% for the favorable outcomes. We believe this detailed classification of antitrust review outcomes contributes to the understanding of the review process and associated costs and risks.

The antitrust review process is closely followed by the stock market. For the acquirers, receiving a Second Request is associated with a significant negative 2.8% abnormal return, while Early Terminations and Natural Expirations exhibit insignificant announcement abnormal returns. This is an economically sizeable market adjustment that reflects increased costs and risks of complying with Second Requests. Moreover, we show that the negative market reaction is more pronounced for deals for which the market imputed a higher probability of deal completion at the time of announcement and for deals with higher antitrust concerns.

Next, we explore acquirer lobbying activities before and after merger announcements and their link with antitrust review outcomes. We focus on lobbying because it is the main channel through which firms influence regulators and legislators. Corporate lobbying also has an advantage of being regularly reported on a quarterly basis and of being the largest part of corporate political activities (Kerr et al., 2014). Our analysis suggests that higher acquirer lobbying is associated with more favorable review outcomes and this relationship is mostly driven by long-term lobbying patterns rather than changes in lobbying immediately before deal announcements.

The last part of our analysis explores the value implications of lobbying for M&A deals. We show that the market recognizes the value of lobbying as means to manage regulatory costs and risks: acquirer and target-acquirer combined deal announcement abnormal returns are significantly higher for firms with higher disclosed pre-announcement lobbying. A one-standard-deviation increase in lobbying expenditure, reported over four quarters before the deal public announcement, increases the acquirer and combined abnormal returns by 1.3% and 2.3%, respectively. Further analysis reveals that the positive value consequence of lobbying applies only for deals with higher antitrust concerns. Lobbying also increases the (perceived) probability of deal completion at the deal announcement. Importantly, lobbying positively impacts acquirer returns only when it is likely to be used for the benefit of shareholders (in firms with strong corporate governance) rather than to pursue empire building behavior (in firms with weak corporate governance).

Our paper's contribution to the literature is threefold. First, it contributes to the literature on the impact of regulatory risks on individual firms and on their M&A activities. Regulatory risks are documented, for example, through negative value consequences of European regulator interventions in announced business combinations (Aktas et al., 2004). We add to this literature by describing in detail the antitrust review process and its outcomes. Our contribution is in showing that the antitrust review process takes substantially longer for deals with Second Requests and that Second Requests increase the probability of withdrawal even if they are not officially challenged. Mehta et al. (2017) also study antitrust review outcomes, but only for completed deals. Moreover, we contribute to the literature by measuring the direct impact on shareholder wealth around the revelation of antitrust review outcomes and showing that the value loss for Second Requests, especially for deals with antitrust concerns, is up to a half of their announcement synergy gains. Previous studies document a negative effect of regulatory enforcement on the probability of future mergers in the same industry,[4] but we document the existence of regulatory costs and risks at the firm level when receiving a Second Request. Given our results that regulatory risks in M&As have substantial economic consequences, we also contribute to the recent research on interim uncertainty (Bhagwat et al., 2016).

Second, we contribute to the growing literature concerning the impact of political economy on corporate finance. Recently, Akey (2015) shows a positive causal relationship between firm political donations to winning candidates and firm value, which suggests that corporate political donations are effective in influencing policy decisions and represent an investment in valuable political capital.[5] Corporate lobbying is the largest and most common form of corporate political activity with total expenditures far outnumbering contributions to political action committees. Cao et al. (2018) shows a positive relationship between corporate lobbying and firm performance, but only for growth firms. However, Kerr et al. (2014) argue that corporate lobbying is highly persistent, which is a result of high costs of setting up lobbying operations and of the fact that benefits from lobbying increase with experience.

[4] Clougherty and Seldeslachts (2012)and Seldeslachts et al. (2009).

[5] Other references include, for example, Goldman et al. (2008), Cooper et al. (2010), and Amore and Bennedsen (2013).