VIII. MERGERS AND ACQUISITIONS

A. Overview

The third of antitrust's three great pillars—alongside the rule against agreements in restraint of trade and the rule against monopolization—is the prohibition of anticompetitive mergers and acquisitions. The enforcement of this prohibition, often known as "merger control," constitutes a huge part of the day-to-day work of the antitrust agencies (and of many antitrust lawyers!).

The basic legal standard for mergers and acquisitions is found in Section 7 of the Clayton Act, 15 U.S.C. § 18:

> No person engaged in commerce or in any activity affecting commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital and no person subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of another person engaged also in commerce or in any activity affecting commerce, where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly.

As we saw in Chapter I, the Clayton Act was enacted in 1914 to reinforce the Sherman Act. Section 7 of the Clayton Act was directly aimed at mergers and acquisitions, and it was amended in 1950 to close some loopholes in the earlier statutory language.[606] And while the Clayton Act is today the primary statute under which merger challenges are litigated, it did not displace the applicability of the Sherman Act to transactions. Thus, an agreement to merge with, or acquire, another firm can constitute a restraint of trade in violation of Section 1 of the Sherman Act, and an anticompetitive acquisition by a monopolist can constitute monopolization in violation of Section 2.[607]

To determine whether a proposed or completed ("consummated" or "closed") merger violates Section 7, courts and agencies start by evaluating the economic relationship between the merging parties (usually just the "parties"). Theories of competitive concern can generally be described as either "horizontal" theories, relating to a relationship of actual or potential competition between the parties, or "vertical" theories, relating to the fact that the parties are actually or potentially active at different levels of the same supply chain, or are suppliers of complements. Some mergers present neither horizontal nor vertical concerns: for example, a shoe manufacturer merging with a supplier of fruit. Those mergers—which are sometimes known as "conglomerate" deals—usually do not raise competitive concerns, although they might be concerning for other reasons.[608] And some mergers

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606 The Celler-Kefauver Amendments of 1950 clarified, among other things, that Section 7 is not only focused on competition "between" the parties (and thus can address vertical concerns), and that it applies to asset transactions, rather than only stock transactions. (Can you see why the "asset loophole" was a serious problem?) For some history and context, *see*, *e.g.*, M.A. Adelman, *The Antimerger Act, 1950–60*, 51 Am. Econ. Rev. 236, 236 (1961); Milton Handler & Stanley D. Robinson, *A Decade of Administration of the Celler-Kefauver Antimerger Act*, 61 Colum. L. Rev. 629 (1961); Note, *Section 7 of the Clayton Act: A Legislative History*, 52 Colum. L. Rev. 766 (1952).

607 *See*, *e.g.*, United States v. Grinnell Corp., 384 U.S. 563 (1966) (analyzing acquisitions under Section 2); Complaint, United States v. Booz Allen Hamilton Holding Corp., Case No. 1:22-cv-01603 (D. Md. filed June 29, 2022) (challenging proposed merger as a violation of Section 7 and the merger agreement as a violation of Section 1).

608 Some scholars have pointed out that such transactions may raise concerns on other grounds: for example, by making a company so large that it acquires great political influence, or by threatening national security when it would place key industries under the control of non-U.S. actors. But in the modern era courts and antitrust agencies have generally not regarded these concerns as a matter for antitrust analysis, with some very specific exceptions. For a cross-section of discussions from various periods in this transition, *see*, *e.g.*, OECD, Note by the United States, *Conglomerate Effects of Mergers*, DAF/COMP/WD(2020)7 (June 2020); Thomas B. Leary, *Antitrust Scrutiny of a Pure Conglomerate Merger: The* Ovation Case, ANTITRUST (Summer 2009) 74; Eleanor M. Fox, *GE/Honeywell: The U.S. Merger that Europe Stopped—A Story of the Politics of Convergence* in Eleanor M. Fox & Daniel A. Crane (eds.), ANTITRUST STORIES (2007); Deputy Asst. Att'y Gen. William J. Kolasky, U.S. Dept. of Justice Antitrust Division, *Conglomerate Mergers and Range Effects: It's A Long Way from Chicago to Brussels* (speech of November 9, 2001); Donna E. Patterson & Carl Shapiro, *Transatlantic Divergence in* GE/Honeywell: *Causes and Lessons*, ANTITRUST (Fall 2001) 18; Michael Pertshuk & Kenneth M. Davidson, *What's Wrong With Conglomerate Mergers?* 48 Fordham L. Rev. 1 (1979); Joseph P. Bauer, *Challenging Conglomerate Mergers Under Section 7 of the Clayton Act: Today 's Law and Tomorrow's Legislation*, 68 B.U.L. Rev. 199 (1978); Donald F. Turner, *Conglomerate Mergers and Section 7 of the Clayton Act*, 78 Harv. L. Rev. 1313 (1965). *See also* Robert H. Lande & Sandeep Vaheesan, *Preventing the Curse of Bigness Through Conglomerate Merger Legislation*, 52 Ariz. St. L. J. 75 (2020). Other legal processes, like CFIUS review, regulate mergers on non-competition grounds. *See generally* Chapter I (discussing visions of the goals of antitrust).

present both horizontal *and* vertical concerns: for example, if the parties are active at different levels of the chain but one is also a potential entrant into the other's market.

Horizontal merger analysis is usually motivated by either, or both, of two basic concerns. The first concern is that the loss of head-to-head competition between the parties will, by creating or increasing market power, allow the merged firm to unilaterally increase its own prices, or to inflict some equivalent form of harm such as reduced quality, generating so-called "unilateral anticompetitive effects." (The effects are "unilateral" in that the merged firm will have the ability and incentive to inflict harm "unilaterally," without having to coordinate with other market participants.) The second concern is that by changing the structure of the market, and particularly by increasing its concentration (*i.e.*, leaving a smaller number of competitively significant firms controlling more of the market), the merger may encourage or facilitate tacit (or even explicit) collusion among the remaining participants, generating so-called "coordinated anticompetitive effects." The concepts of concentration and tacit collusion are described in more detail in Chapter II.

Vertical mergers can raise competitive concerns too. The primary concern here is usually "foreclosure": the prospect that the merged firm might have the ability and incentive to limit rivals' access to important inputs, distribution, customers, or complements in ways that would harm competition overall. Another concern is that a vertical merger might give the merged firm access to confidential information about its competitors (such as capacity constraints or input costs) that could lead to a reduction in the intensity of competition by diminishing rivals' incentives to compete. A third concern is that a vertical merger could increase the likelihood of coordination between the participants in a market (just as in a horizontal case). A vertical merger could do this, for example, by increasing market participants' symmetry—that is, the extent to which their incentives are similar—or by changing the incentives of a business that has previously been a particularly vigorous and disruptive competitor. A merger involving sellers of complements may also create the ability and incentive to foreclose rivals through bundling or tying, though this theme is not prominent in modern enforcement practice.

As a class, horizontal mergers are more likely to raise competitive concerns than are vertical deals, for two main reasons. The first is that there is by definition at least some competition between the parties before a horizontal deal, which the merger eliminates by putting both parties under common ownership. The second is that vertical transactions, compared to horizontal ones, are particularly likely to bring certain kinds of benefits, including reductions in the transaction costs of dealing between downstream and upstream divisions (because it is typically less costly to coordinate within a firm than between firms) that can lead to lower prices. Some of these are cost savings that we associate broadly with "the theory of the firm."[609] In addition, a vertical merger may generate beneficial incentive effects that arise from the imperative to maximize profits across the integrated company rather than at each stage of the process individually.[610] However, this can be overstated. Not all horizontal mergers are harmful, and not all vertical mergers are benign. There is some controversy today over whether agencies and scholars have historically been too quick to assume that vertical transactions are beneficial overall, and that those benefits are shared with consumers. The empirical evidence is limited and ambiguous.[611]

Horizontal mergers have often been litigated, and as a result there is a healthy jurisprudence of merger law that fleshes out the circumstances under which a horizontal merger will be unlawful. But these are overwhelmingly lower-court decisions: the Supreme Court has not rendered a substantive merger decision since 1975.[612] Vertical mergers, by contrast, have been litigated less often in the modern era, although recent years have seen an

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[609] R.H. Coase, *The Nature of the Firm*, 4 Economica 386 (1937).

[610] *See infra* § VIII.D.2 (discussing the elimination of double marginalization).

[611] *See*, *e.g.*, Marissa Beck & Fiona Scott Morton, *Evaluating the Evidence on Vertical Mergers*, 59 Rev. Indus. Org. 273 (2021); James C. Cooper, Luke M. Froeb, Dan O'Brien, & Michael G. Vita, *Vertical Antitrust Policy as a Problem of Inference*, 23 Int'l J. Indus. Org. 639 (2005); Francine Lafontaine & Margaret Slade, *Vertical Integration and Firm Boundaries: The Evidence*, 45 J. Econ. Lit. 629 (2007); Timothy Bresnahan and Jonathan Levin, *Vertical Integration and Market Structure* in Robert Gibbons & John Roberts (eds.) THE HANDBOOK OF ORGANIZATIONAL ECONOMICS (2013); Paul L. Joskow, *Vertical Integration*, in Claude Ménard & Mary M. Shirley (eds.), HANDBOOK OF NEW INSTITUTIONAL ECONOMICS (2008).

[612] *See* United States v. Citizens and Southern Nat'l Bank, 422 U.S. 86 (1975); see also FTC v. Phoebe Putney Health Sys., Inc., 568 U.S. 216 (2013) (analyzing state action defense to a hospital merger).

enforcement surge beginning with DOJ's challenge to AT&T / Time Warner deal, and continuing with challenges to deals like United / Change, Microsoft / Activision, Illumina / Grail, and Tempur Sealy / Mattress Firm.

Most litigated merger cases focus on effects on competition among sellers. But, at least in principle, merger law equally protects competition among purchasers, including purchasers of labor.[613] Thus, a merger that has the effect of reducing competition among purchasers of products or services—*i.e.*, a merger that tends to create a *monopsony*—can be unlawful, even in the absence of sell-side effects.[614] In 2022, the Department of Justice successfully challenged a high-profile proposed merger between publishers Penguin Random House and Simon & Schuster on just such a theory.[615]

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Merger control is an unusual component of antitrust in several ways. First, in practice, most sizeable mergers are usually analyzed *ex ante*—that is, before the merger is consummated—thanks to the Hart-Scott-Rodino ("HSR") Act, which requires prior notification of many proposed mergers and acquisitions to the agencies before closing, so that the agencies have an opportunity to analyze the transaction, and challenge it if appropriate. Thus, whereas most Sherman Act challenges to anticompetitive conduct typically involve challenges to past or ongoing actions by a defendant, and usually require a court to decide whether those actions do or did in fact harm competition, merger challenges most commonly require a court to *predict* whether a proposed merger or acquisition will harm competition if it goes ahead. Merger cases can involve sharp clashes of view between opposing economic or industry experts with different predictions of how the transaction will affect competition, or between economic expert evidence and lay testimony and documents. Different courts will form different views about the best guide to the relevant "commercial realities."[616] The *ex ante* footing of much merger review and merger litigation often means a heavy emphasis on certain kinds of evidence: predictive tools (such as economic modeling), the internal documents of merging parties, and the expectations of customers, suppliers, and competitors.

This prospective focus reveals a difficult puzzle in Section 7 law: what exactly Congress meant when it prohibited transactions of which the effect "may be" substantially to lessen competition, or to tend to create a monopoly. The Court emphasized in *Brown Shoe* that Congress chose the phrase "*may be*" in order to capture incipient harms to competition, and that "probability" of harm, not certainty, was the correct threshold.[617] Some modern courts and the HMGs have focused on whether harm is "probable," while other courts have used language suggesting a lower

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[613] *See*, *e.g.*, C. Scott Hemphill & Nancy L. Rose, *Mergers that Harm Sellers*, 127 Yale L.J. 2078 (2018).

[614] *See*, *e.g.*, United States v. Pennzoil Co., 252 F. Supp. 962, 985 (W.D. Pa. 1965) ("[T]he merger of Pennzoil and Kendall will substantially lessen competition in the purchase of Penn Grade crude in the Penn Grade crude producing area."). *See also*, *e.g.*, Statement of the FTC Chairman Regarding Announcement that Aveanna Healthcare and Maxim Healthcare Services Have Terminated Their Acquisition Agreement (Jan. 30, 2020) (noting that both patients *and nurses* would continue to benefit from competition following the abandonment of the proposed transaction).

[615] United States v. Bertelsmann SE & Co. KGaA, 646 F. Supp. 3d 1 (D.D.C. 2022).

[616] *See*, *e.g.*, FTC v. Thomas Jefferson Univ., 505 F. Supp. 3d 522, 553 (E.D. Pa. 2020) ("[T]he Government relies on econometrics and insurer testimony to prove the propriety of its proposed Philadelphia Area market. But it has not shown that the market corresponds with commercial realities and it thus cannot pass the HMT."); United States v. AT&T Inc., 310 F. Supp. 3d 161, 222 (D.D.C. 2018) ("[The] opinion by Professor Shapiro runs contrary to all of the real-world testimony during the trial from those who have actually negotiated on behalf of vertically integrated companies."); FTC v. Swedish Match, 131 F. Supp. 2d 151, 161–62 (D.D.C. 2000) (rejecting economic expert evidence provided by both plaintiff and defendants, and relying instead on lay testimony and documents for market definition analysis).

[617] Brown Shoe Co. v. United States, 370 U.S. 294, 317–18 (1962) ("[A] keystone in the erection of a barrier to what Congress saw was the rising tide of economic concentration, was its provision of authority for arresting mergers at a time when the trend to a lessening of competition in a line of commerce was still in its incipiency. Congress saw the process of concentration in American business as a dynamic force; it sought to assure the Federal Trade Commission and the courts the power to brake this force at its outset and before it gathered momentum."); *id.* at 323 & n.39 (indicating that "Congress used the words 'may be substantially to lessen competition' (emphasis supplied), to indicate that its concern was with probabilities, not certainties . . . Mergers with a probable anticompetitive effect were to be proscribed by this Act," and quoting a Senate Report indicating that the language "may be" "would not apply to the mere possibility but only to the reasonable probability of the [proscribed] effect"). *See also* Doha Mekki, *Remarks at Mercatus Center Second Annual Antitrust Forum* (Jan. 26, 2023) ("Congress prohibited any merger whose effect 'may be'—and those words, 'may be,' are critical—substantially to lessen competition. Does that mean we prohibit more mergers than we would need to if we had a crystal ball that perfectly predicted the future? Of course. There is nothing radical about that approach. That was Congress's design.").

threshold.[618] Courts have expressed some frustration with the lack of clarity around the meaning of the "may be" standard, and its interaction with the plaintiff's obligation to prove liability by a preponderance of the evidence.[619] Adding to the puzzle, the independent meaning of the phrase "tend to create a monopoly" remains very far from clear.[620] At least in principle—and setting aside the question of whether the "tend to create a monopoly" language might create room for new law—some courts seem to understand Section 7 to provide that a merger that is 51% likely to cause a "substantial"[621] lessening of competition is (absent defenses) unlawful, while a merger that is 49% likely to cause a much greater harm to competition is not unlawful.[622] As we shall see below, this approach has been criticized.

Despite the focus on prediction during an HSR review, Section 7 is equally applicable to consummated deals. Thus, an agency or a private plaintiff can sue to unwind—that is, break up—a deal that has already closed, even if that transaction was notified to the agencies pursuant to HSR.[623] (There is some controversy over whether and when such *ex post* challenges represent wise policy: we will talk about this when we examine the HSR process in Chapter XI.)

A second distinctive feature of merger control law is the central role of agency guidelines, which are not binding law but which have considerable practical influence. While agency guidelines are occasionally a focus of attention in conduct cases,[624] they are virtually always front and center in merger analysis. In particular, the various

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[618] *See*, *e.g.*, HMGs § 1 ("Most merger analysis is necessarily predictive, requiring an assessment of what will likely happen if a merger proceeds as compared to what will likely happen if it does not."); United States v. AT&T, Inc., 916 F.3d 1029, 1038 (D.C. Cir. 2019) (noting the government's burden "of showing that the proposed merger *is likely* to increase [the merged firm's] bargaining leverage") (emphasis added); United States v. Baker Hughes Inc., 908 F.2d 981, 984 (D.C. Cir. 1990) ("Section 7 involves probabilities, not certainties or possibilities."); Hospital Corp. of America v. FTC, 807 F.2d 1381 (7th Cir. 1986) ("Section 7 does not require proof that a merger or other acquisition has caused higher prices in the affected market. All that is necessary is that the merger create an appreciable danger of such consequences in the future"); Yamaha Motor Co., Ltd. v. FTC, 657 F.2d 971, 977 (8th Cir. 1981) ("[W]ould Yamaha, absent the joint venture, probably have entered the U.S. outboard-motor market independently, and would this new entry probably have increased competition more than the joint venture did? We stress the word 'probably' in this formulation of the issue, because the question under Section 7 is not whether competition was actually lessened, but whether it 'may be' lessened substantially."); United States v. H&R Block, Inc., 833 F.Supp.2d 36 (D.D.C. 2011) (quoting authorities stating that a plaintiff must show a merger is "reasonably likely to cause anticompetitive effects," that this is a matter of "probabilities, not certainties," and that an "appreciable danger" of effects suffices); FTC v. Steris Corp., 133 F.Supp.3d 962, 966 (N.D. Ohio 2015) ("The FTC asserts that the acquisition of an actual potential competitor violates Section 7 if (1) the relevant market is highly concentrated, (2) the competitor "probably" would have entered the market, (3) its entry would have had pro-competitive effects, and (4) there are few other firms that can enter effectively. . . . [T]he Court directed counsel to focus their attention at the hearing on the second prong of the actual potential entrant doctrine, i.e., whether, absent the acquisition, the evidence shows that Synergy probably would have entered the U.S. contract sterilization market by building one or more x-ray facilities within a reasonable period of time."). Daniel A. Crane, *Antitrust Antitextualism*, 96 Notre Dame L. Rev. 1205, 1242–55 (2021); Richard M. Steuer, *Incipiency*, 31 Loyola Consumer L. Rev. 155 (2019).

[619] *See*, *e.g.*, United States v. Bertelsmann SE & Co. KGaA, Case No. CV-21-2886, 2022 WL 16748157, at *10 n.15 (D.D.C. Nov. 7, 2022) ("In *United States v. AT&T, Inc.*, the D.C. Circuit described the Section 7 standard of proof as follows: The government must show that the proposed merger is likely to substantially lessen competition, which encompasses a concept of reasonable probability. The parties dispute the meaning of this language. The defendants argue that *AT&T* requires the government to prove that a merger is likely to cause substantial harm to competition, not only that harm may occur. The government points to *AT&T*'s explanation that this standard encompasses a concept of reasonable probability, arguing that *AT*&T requires something less than what the defendants propose [and specifically an "appreciable danger" standard]. The root of these competing formulations may be uncertainty over how the government's preponderance-of-the-evidence burden interacts with Section 7's already probabilistic standard; combined, the two standards require the government to prove by a preponderance of the evidence that the effect of a challenged merger or acquisition may be substantially to lessen competition. Like the district court in *AT&T*, this Court need not further toil over discerning or articulating the daylight, if any, between 'appreciable danger,' 'probable,' 'reasonably probable,' and 'likely' as used in the Section 7 context. The selection of any of the competing permutations is not outcome-determinative in this case.") (cleaned up).

[620] *See*, *e.g.*, Jonathan Kanter, Asst. Att'y Gen., U.S. Dept. of Justice Antitrust Division, *Remarks to the New York State Bar Association Antitrust Section* (Jan. 24, 2022) ("The second prong [of Section 7]—["]or tend to create a monopoly["]—has often been given less emphasis. No longer: we intend to remain faithful to the plain language of the Clayton Act."); Rebecca Kelly Slaughter, *Storming the Concentration Castle: Antitrust Lessons from* The Princess Bride (remarks of Mar. 31, 2022).

[621] Brown Shoe Co. v. United States, 370 U.S. 294, 321 (1962) (noting that Congress provided "no definite quantitative or qualitative tests by which enforcement agencies could gauge the effects of a given merger to determine whether it may 'substantially' lessen competition or tend toward monopoly").

[622] *See*, *e.g.*, FTC v. Steris Corp., 133 F. Supp. 3d 962, 966 (N.D. Ohio 2015).

[623] 18 U.S.C. § 18a(i)(1) (HSR does not bar subsequent action); FTC v. Facebook, Inc., 581 F. Supp. 3d 34, 57 (D.D.C. 2022).

[624] However, such guidelines do exist. *See*, *e.g.*, U.S. Dept. of Justice Antitrust Division & FTC, ANTITRUST GUIDELINES FOR BUSINESS ACTIVITIES AFFECTING WORKERS (January 2025); U.S. Dept. of Justice & FTC, ANTITRUST GUIDELINES FOR THE LICENSING OF INTELLECTUAL PROPERTY (January 2017).

iterations of Merger Guidelines ("MGs") (first issued in 1968 and revised in 1982, 1984, 1992, 1997, 2010, 2020, and 2023) have long played a central role in modern merger practice: including in the agencies' own evaluation of whether to challenge a proposed transaction, and in the courts' adjudication of merger cases, where the Guidelines have often been cited as persuasive authority by litigants and courts.[625] The most recent version of the Guidelines was issued in 2023, and the change from 2010 to 2023 has prompted a flurry of commentary: some critical, some supportive. [626]

This chapter is intended to introduce some of the central issues, and a sprinkling of the key cases, in merger analysis. It will necessarily be a brief overview: merger control is a vast topic. We will proceed as follows. In Section B we will look at some central themes in horizontal merger analysis, including the role of the HMGs and the main theories of competitive harm. In Section C we will venture into the realm of vertical mergers, examining the main theories of harm and some core economic principles. In Section D we will consider some important defenses specific to merger cases, including the role of efficiencies as well as the so-called "failing firm" defense. (We will meet some more defenses and immunities that may apply to mergers in Chapter IX.) In Section E we will briefly meet merger remedies.

NOTES

1) Businesses undertake mergers and acquisitions for many different reasons. How many can you think of?
2) Sometimes mergers and acquisitions—or, conversely divestitures or "sell-offs"—are a centerpiece of a change in corporate strategy. Can you identify examples from your everyday experience?
3) In light of what you already know about Sections 1 and 2, was the Clayton Act's separate merger-control provision really necessary? Could Sections 1 and 2 have done an adequate job of policing transactions?
4) Should we have a "conduct review" process for proposed business conduct under Sections 1 and 2?

B. Horizontal Mergers

Horizontal mergers—that is, mergers between, or acquisitions of, actual or potential competitors[627]—have been a core concern of antitrust law for a long time. Indeed, some of the earliest antitrust cases dealt with what we would now call corporate concentrations: a term that embraces mergers (unions between two entities) and acquisitions (the purchasing of one "target" entity by a "parent" entity), as well as certain kinds of joint ventures.[628] In this section we will examine the basic framework through which courts approach the assessment of horizontal mergers.

1. The Merger Guidelines and the Structural Presumption

Merger law, just like the rest of antitrust law, is elaborated and developed through judicial interpretation of Congressional statutes. But because many of the most significant merger challenges are brought not by private plaintiffs but by government enforcers, and particularly the federal agencies,[629] the analytical approach taken by

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[625] *See generally* Daniel Francis, *Revisiting The Merger Guidelines: Protecting An Enforcement Asset*, Comp. Pol'y Int'l (Nov. 2022).

[626] *See*, *e.g.*, Sean Sullivan (ed.), THE 2023 U.S. MERGER GUIDELINES (2024); Herbert Hovenkamp, *The 2023 Merger Guidelines: Law, Fact, and Method*, 65 Rev. Indus. Org. 39 (2024); Steven Salop, *Assessing the Advances Made on Vertical Mergers in the Final Merger Guidelines*, PROMARKET (Dec. 20, 2023).

[627] For a refresher on the concept of "potential competition," *see* Chapter II. Some joint ventures—that is, cooperative projects between entities—may also involve mergers or acquisitions. U.S. Dept. of Justice & FTC, ANTITRUST GUIDELINES FOR COLLABORATIONS AMONG COMPETITORS (April 2000) 5 ("The Agencies treat a competitor collaboration as a horizontal merger in a relevant market and analyze the collaboration pursuant to the Horizontal Merger Guidelines if appropriate, which ordinarily is when: (a) the participants are competitors in that relevant market; (b) the formation of the collaboration involves an efficiency-enhancing integration of economic activity in the relevant market; (c) the integration eliminates all competition among the participants in the relevant market; and (d) the collaboration does not terminate within a sufficiently limited period by its own specific and express terms.").

[628] For some early cases, *see*, *e.g.*, N. Sec. Co. v. United States, 193 U.S. 197 (1904); United States v. Am. Tobacco Co., 221 U.S. 106 (1911); United States v. E.I. Du Pont De Nemours & Co., 188 F. 127, 129 (C.C.D. Del. 1911); United States v. Union Pac. R. Co., 226 U.S. 61 (1912); United States v. U.S. Steel Corp., 251 U.S. 417 (1920).

[629] *But see* Kevin Hahm, Ryan Phair, Carter Simpson & Jack Martin, *Recent Private Merger Challenges: Anomaly or Harbinger?*, 35 ANTITRUST 90 (Summer 2021) (emphasizing importance of private merger litigation).

the expert agency staff is immensely influential in practice. And the agencies explain their analytical approach, which is informed by the underlying law, in public Merger Guidelines. The Merger Guidelines are used routinely by agency staff and private attorneys to guide their analytical work, and are often cited by courts as persuasive authority.[630] Recent interventions have raised some tricky questions about the extent to which the guidelines should attempt to guide the development of the law, reflect its current state, and/or merely state agency analytical practices.[631]

In broad terms, merger analysis often—though not always—involves some basic steps: (1) threshold classification of whether the relevant competitive concerns are horizontal, vertical, or both; (2) definition of one or more relevant markets; (3) calculation of market shares and market concentration in the relevant market(s); (4) analysis of competitive effects; (5) analysis of whether new entry into the market, or expansion by existing competitors, may provide additional competitive pressure that could discipline the merged firm and prevent competitive harm; (6) determination of whether the merger would result in procompetitive efficiencies or other benefits that would reduce or eliminate harms; and finally (7) the assessment of defenses, including but not limited to the so-called "failing firm" defense. This is not a rigid framework, and not every step is necessary in every case. But it is a good outline of the key issues on which, in practice, agencies often focus when analyzing a merger, and on which courts often focus when adjudicating a merger case.

In practice, an important starting point in the determination of whether a horizontal merger will violate Section 7 is the application of the so-called "structural presumption," after a market has been defined. This is the principle that mergers that significantly increase market concentration (*i.e.*, the extent to which that market is dominated by a few large firms) may be presumed to be anticompetitive, such that the burden of proof shifts to the defendant to rebut the *prima facie* case that the structural change establishes. For a refresher on the concept of market "concentration," look back at Chapter II.

The structural presumption is grounded in a landmark Supreme Court merger case: *Philadelphia National Bank* (colloquially just "*PNB*"), in which the Court endorsed the inference of competitive harm from an increase in concentration.

United States v. Philadelphia Nat'l Bank

374 U.S. 321 (1963)

Justice Brennan.

[1] The Philadelphia National Bank and Girard Trust Corn Exchange Bank are, respectively, the second and third largest of the 42 commercial banks with head offices in the Philadelphia metropolitan area, which consists of the City of Philadelphia and its three contiguous counties in Pennsylvania. The home county of both banks is the city itself; Pennsylvania law, however, permits branching into the counties contiguous to the home county, and both banks have offices throughout the four-county area. PNB, a national bank, has assets of over $1,000,000,000, making it (as of 1959) the twenty-first largest bank in the Nation. Girard[,] a state bank[,] is a member of the FRS and is insured by the FDIC; it has assets of about $750,000,000. Were the proposed merger to be consummated, the resulting bank would be the largest in the four-county area, with (approximately) 36% of the area banks' total assets, 36% of deposits, and 34% of net loans. It and the second largest (First Pennsylvania Bank and Trust

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630 For a great historical overview, *see* Hillary Greene, *Guideline Institutionalization: The Role of Merger Guidelines in Antitrust Discourse*, 48 Wm. & Mary L. Rev. 771 (2006). *See also*, *e.g.*, FTC v. Hackensack Meridian Health, Inc., 30 F.4th 160, 167 (3d Cir. 2022) ("We begin our analysis with the Merger Guidelines."); Steves & Sons, Inc. v. JELD-WEN, Inc., 988 F.3d 690, 704 (4th Cir. 2021) ("While courts aren't bound by the Guidelines, they're a helpful tool, in view of the many years of thoughtful analysis they represent, for analyzing mergers.") (internal quotation marks, citation, and ellipses omitted); FTC v. Sanford Health, 926 F.3d 959, 964 (8th Cir. 2019) (quoting HMGs); United States v. AT&T, Inc., 916 F.3d 1029, 1032 (D.C. Cir. 2019) (citing then-operative vertical merger guidance); United States v. Anthem, Inc., 855 F.3d 345, 349 (D.C. Cir. 2017) (pointing out that "the court is not bound by, and owes no particular deference to, the Guidelines" but "considers them a helpful tool, in view of the many years of thoughtful analysis they represent, for analyzing proposed mergers").

631 *See*, *e.g.*, Comments of Open Markets Institute et al. re Draft Merger Guidelines, Regulations.gov Comment ID FTC-2023-0043-1502 (Sept. 18, 2023); Daniel Francis, *Revisiting the Merger Guidelines: Protecting an Enforcement Asset*, Comp. Pol'y Int'l (Nov. 2022); James Keyte, *New Merger Guidelines: Are the Agencies on a Collision Course with Case Law?* ANTITRUST (Fall 2021) 49; K. Sabeel Rahman & Lina Khan, *Restoring Competition in the U.S. Economy*, in Nell Abernathy, Mike Konczal & Kathryn Milani, UNTAMED: HOW TO CHECK CORPORATE FINANCIAL, AND MONOPOLY POWER (June 2016) 18.

Company, now the largest) would have between them 59% of the total assets, 58% of deposits, and 58% of the net loans, while after the merger the four largest banks in the area would have 78% of total assets, 77% of deposits, and 78% of net loans.

[2] The present size of both PNB and Girard is in part the result of mergers. Indeed, the trend toward concentration is noticeable in the Philadelphia area generally, in which the number of commercial banks has declined from 108 in 1947 to the present 42. Since 1950, PNB has acquired nine formerly independent banks and Girard six; and these acquisitions have accounted for 59% and 85% of the respective banks' asset growth during the period, 63% and 91% of their deposit growth, and 12% and 37% of their loan growth. During this period, the seven largest banks in the area increased their combined share of the area's total commercial bank resources from about 61% to about 90%.

[3] In November 1960 the boards of directors of the two banks approved a proposed agreement for their consolidation under the PNB charter. . . . Such a consolidation is authorized, subject to the approval of the Comptroller of the Currency, by [12 U.S.C. § 2157.] But under the Bank Merger Act of 1960, [12 U.S.C. § 1828(c)], the Comptroller may not give his approval until he has received reports from the other two banking agencies and the Attorney General respecting the probable effects of the proposed transaction on competition. All three reports advised that the proposed merger would have substantial anticompetitive effects in the Philadelphia metropolitan area. However, on February 24, 1961, the Comptroller approved the merger. . . . [H]e reasoned that "since there will remain an adequate number of alternative sources of banking service in Philadelphia, and in view of the beneficial effects of this consolidation upon international and national competition it was concluded that the over-all effect upon competition would not be unfavorable." He also stated that the consolidated bank "would be far better able to serve the convenience and needs of its community by being of material assistance to its city and state in their efforts to attract new industry and to retain existing industry." The day after the Comptroller approved the merger, the United States commenced the present action. No steps have been taken to consummate the merger pending the outcome of this litigation.

[4] The Government's case in the District Court relied chiefly on statistical evidence bearing upon market structure and on testimony by economists and bankers to the effect that, notwithstanding the intensive governmental regulation of banking, there was a substantial area for the free play of competitive forces; that concentration of commercial banking, which the proposed merger would increase, was inimical to that free play; that the principal anticompetitive effect of the merger would be felt in the area in which the banks had their offices, thus making the four-county metropolitan area the relevant geographical market; and that commercial banking was the relevant product market. The defendants, in addition to offering contrary evidence on these points, attempted to show business justifications for the merger. They conceded that both banks were economically strong and had sound management, but offered the testimony of bankers to show that the resulting bank, with its greater prestige and increased lending limit, would be better able to compete with large out-of-state (particularly New York) banks, would attract new business to Philadelphia, and in general would promote the economic development of the metropolitan area.[10]

[5] Upon this record, the District Court held that: . . . even assuming that s 7 is applicable and that the four-county area is the relevant market, there is no reasonable probability that competition among commercial banks in the area will be substantially lessened as the result of the merger; . . . since the merger does not violate s 7 of the Clayton Act, a fortiori it does not violate s 1 of the Sherman Act; [and] the merger will benefit the Philadelphia metropolitan area economically. [. . .]

[6] We think that the four-County Philadelphia metropolitan area, which state law apparently recognizes as a meaningful banking community in allowing Philadelphia banks to branch within it, and which would seem roughly to delineate the area in which bank customers that are neither very large nor very small find it practical to do their banking business, is a more appropriate "section of the country" in which to appraise the instant merger than any

[10] There was evidence that Philadelphia, although it ranks fourth or fifth among the Nation's urban areas in terms of general commercial activity, ranks only ninth in terms of the size of its largest bank, and that some large business firms which have their head offices in Philadelphia must seek elsewhere to satisfy their banking needs because of the inadequate lending limits of Philadelphia's banks . . . .

larger or smaller or different area. We are helped to this conclusion by the fact that the three federal banking agencies regard the area in which banks have their offices as an "area of effective competition." Not only did the FDIC and FRB, in the reports they submitted to the Comptroller of the Currency in connection with appellees' application for permission to merge, so hold, but the Comptroller, in his statement approving the merger, agreed: "With respect to the effect upon competition, there are three separate levels and effective areas of competition involved. These are the national level for national accounts, the regional or sectional area, and the local area of the City of Philadelphia and the immediately surrounding area."

[7] Having determined the relevant market, we come to the ultimate question under s 7: whether the effect of the merger "may be substantially to lessen competition" in the relevant market. Clearly, this is not the kind of question which is susceptible of a ready and precise answer in most cases. It requires not merely an appraisal of the immediate impact of the merger upon competition, but a prediction of its impact upon competitive conditions in the future; this is what is meant when it is said that the amended s 7 was intended to arrest anticompetitive tendencies in their incipiency. Such a prediction is sound only if it is based upon a firm understanding of the structure of the relevant market; yet the relevant economic data are both complex and elusive. And unless businessmen can assess the legal consequences of a merger with some confidence, sound business planning is retarded. So also, we must be alert to the danger of subverting congressional intent by permitting a too-broad economic investigation. And so in any case in which it is possible, without doing violence to the congressional objective embodied in s 7, to simplify the test of illegality, the courts ought to do so in the interest of sound and practical judicial administration. This is such a case.

[8] We noted in *Brown Shoe Co.* that the dominant theme pervading congressional consideration of the 1950 amendments (to s 7) was a fear of what was considered to be a rising tide of economic concentration in the American economy. This intense congressional concern with the trend toward concentration warrants dispensing, in certain cases, with elaborate proof of market structure, market behavior, or probable anticompetitive effects. Specifically, we think that a merger which produces a firm controlling an undue percentage share of the relevant market, and results in a significant increase in the concentration of firms in that market is so inherently likely to lessen competition substantially that it must be enjoined in the absence of evidence clearly showing that the merger is not likely to have such anticompetitive effects.

[9] Such a test lightens the burden of proving illegality only with respect to mergers whose size makes them inherently suspect in light of Congress' design in s 7 to prevent undue concentration. Furthermore, the test is fully consonant with economic theory. That competition is likely to be greatest when there are many sellers, none of which has any significant market share, is common ground among most economists, and was undoubtedly a premise of congressional reasoning about the antimerger statute.

[10] The merger of appellees will result in a single bank's controlling at least 30% of the commercial banking business in the four-county Philadelphia metropolitan area. Without attempting to specify the smallest market share which would still be considered to threaten undue concentration, we are clear that 30% presents that threat. Further, whereas presently the two largest banks in the area (First Pennsylvania and PNB) control between them approximately 44% of the area's commercial banking business, the two largest after the merger (PNB-Girard and First Pennsylvania) will control 59%. Plainly, we think, this increase of more than 33% in concentration must be regarded as significant.

[11] Our conclusion that these percentages raise an inference that the effect of the contemplated merger of appellees may be substantially to lessen competition is not an arbitrary one, although neither the terms of s 7 nor the legislative history suggests that any particular percentage share was deemed critical. The House Report states that the tests of illegality under amended s 7 "are intended to be similar to those which the courts have applied in interpreting the same language as used in other sections of the Clayton Act." Accordingly, we have relied upon decisions under these other sections in applying s 7. In *Standard Oil Co. of Cal. & Standard Stations v. United States*, [337 U.S. 293 (1949)], this Court held violative of s 3 of the Clayton Act exclusive contracts whereby the defendant company, which accounted for 23% of the sales in the relevant market and, together with six other firms, accounted for 65% of such sales, maintained control over outlets through which approximately 7% of the sales were made. In *Federal Trade Comm'n v. Motion Picture Adv. Serv. Co.*, [344 U.S. 392 (1953)], we held unlawful, under s 1 of the Sherman Act and s 5 of the Federal Trade Commission Act, rather than under s 3 of the Clayton Act,

exclusive arrangements whereby the four major firms in the industry had foreclosed 75% of the relevant market; the respondent's market share, evidently, was 20%. In the instant case, by way of comparison, the four largest banks after the merger will foreclose 78% of the relevant market. . . . Doubtless these cases turned to some extent upon whether by the nature of the market there is room for newcomers. . . . But they remain highly suggestive in the present context, for as we noted in *Brown Shoe Co.*, integration by merger is more suspect than integration by contract, because of the greater permanence of the former. The market share and market concentration figures in the contract-integration cases, taken together with scholarly opinion . . . support, we believe, the inference we draw in the instant case from the figures disclosed by the record.

[12] There is nothing in the record of this case to rebut the inherently anticompetitive tendency manifested by these percentages. There was, to be sure, testimony by bank officers to the effect that competition among banks in Philadelphia was vigorous and would continue to be vigorous after the merger. We think, however, that the District Court's reliance on such evidence was misplaced. This lay evidence on so complex an economic-legal problem as the substantiality of the effect of this merger upon competition was entitled to little weight, in view of the witnesses' failure to give concrete reasons for their conclusions.

[13] Of equally little value, we think, are the assurances offered by appellees' witnesses that customers dissatisfied with the services of the resulting bank may readily turn to the 40 other banks in the Philadelphia area. In every case short of outright monopoly, the disgruntled customer has alternatives; even in tightly oligopolistic markets, there may be small firms operating. A fundamental purpose of amending s 7 was to arrest the trend toward concentration, the tendency to monopoly, before the consumer's alternatives disappeared through merger, and that purpose would be ill-served if the law stayed its hand until 10, or 20, or 30 more Philadelphia banks were absorbed. This is not a fanciful eventuality, in view of the strong trend toward mergers evident in the area; and we might note also that entry of new competitors into the banking field is far from easy.

* * *

Note the decisive move in paragraph 8 of the extract: "a merger which produces a firm controlling an undue percentage share of the relevant market, and results in a significant increase in the concentration of firms in that market is so inherently likely to lessen competition substantially that it must be enjoined in the absence of evidence clearly showing that the merger is not likely to have such anticompetitive effects."

In reading this, it may be helpful to recall from Chapter II that the Court's observation in paragraph 9 of the *PNB* extract that "competition is likely to be greatest when there are many sellers, none of which has any significant market share" is actually more controversial than it sounds. The relationship between concentration and competition is the subject of a rich literature: in some cases, more concentration can indeed mean that tacit collusion will be the outcome; in others, an increase in market concentration is compatible with intense competition. Indeed, as you may remember from Chapter I, at the time that *PNB* was decided, much antitrust economics was heavily influenced by the "structuralist" or "structure-conduct-performance" perspective, a set of views which centrally held that concentration in a market strongly implied harm to competition.[632] That view eventually lost ground to evidence that the relationship between competition and concentration was more complex, and that a more concentrated market did not necessarily indicate competitive trouble as opposed to, for example, the effects of certain kinds of efficiencies and economies.[633] Today the role of structure is controversial:

[632] *See supra* § I.E.3. (discussing the mid-20th century ascendancy of structuralism).

[633] *See*, *e.g.*, Leonard W. Weiss, *The Structure-Conduct-Performance Paradigm and Antitrust*, 127 U. Pa. L. Rev. 1104 (1979). *But see*, *e.g.*, Richard Schmalensee, *Inter-Industry Studies of Structure and Performance,* in Richard Schmalensee & Robert D. Willig (eds.), 2 HANDBOOK OF INDUSTRIAL ORGANIZATION (1989) 976 (noting relationship between concentration and prices).

some call for a return to more structuralist perspectives,[634] while others deeply criticize structure's remaining role.[635]

But even if economists no longer broadly agree that the fact of a concentrated market means that something is amiss, they generally do agree that a horizontal merger that will significantly increase market concentration will often be harmful, justifying a structural presumption of illegality.[636] (Even this, however, is not uncontroversial.[637]) As an article co-authored by 25 academic former chief economists from the FTC and DOJ recently put it:

> Economists widely agree that, absent sufficient efficiencies or other offsetting factors, mergers that increase concentration substantially are likely to be anticompetitive. The reason is that economic theory indicates that competition among firms leads to lower prices. The joint profit of any two competitors is higher if they both raise price, yet neither would do so unilaterally because it would simply lose sales to the competitor. A merger between competitors aligns incentives such that price increases or output restrictions can be implemented profitably, to the detriment of consumers and (often) total welfare.
>
> Economic theory also indicates that the magnitude of these adverse price effects tends to be larger, holding everything else equal, the larger is the increase in concentration caused by the merger.[638]

Of course, *PNB* did not explain at what level of concentration, or increase in concentration, the presumption of illegality would apply. Today, the presumption is fleshed out and specified in the Merger Guidelines. The presumption centrally relies on the Herfindahl-Hirschman Index ("HHI") measure of concentration. If you need a refresher on HHIs, look back at Chapter II.

The 2023 Merger Guidelines mark an interesting change in the way the structural presumption is described. From 1982 until the 2023 revisions, the Merger Guidelines defined the structural presumption by reference to market concentration metrics: namely, post-merger HHI and the increase in HHI caused by the transaction ("delta HHI"). In the 2023 document, the agencies articulated an additional path, based primarily on the market share

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634 *See*, *e.g.*, K. Sabeel Rahman & Lina Khan, *Restoring Competition in the U.S. Economy*, in Nell Abernathy, Mike Konczal & Kathryn Milani, UNTAMED: HOW TO CHECK CORPORATE FINANCIAL, AND MONOPOLY POWER (June 2016) 20 (proposing that the next Administration should "reassert the centrality of market structure to competition analysis—namely, the idea that how a market is structured directly implicates its competitiveness. A mainstay of antitrust thinking for much of the last century, this foundational idea has since fallen into disuse.").

635 *See*, *e.g.*, Louis Kaplow, RETHINKING MERGER ANALYSIS (2024) 145 (emphasizing that, because "concentration" is a feature of an analytical choice about market definition, "[t]here is no such thing as higher concentration, ceteris paribus[.]").

636 *See*, *e.g.*, Herbert J. Hovenkamp & Carl Shapiro, *Horizontal Mergers, Market Structure, and Burdens of Proof*, 127 Yale L.J. 1996, 2001 (2018); John Kwoka, *The Structural Presumption and The Safe Harbor in Merger Review: False Positives or Unwarranted Concerns?*, 81 Antitrust L.J. 837 (2017) (discussing theoretical and empirical foundations).

637 *See*, *e.g.*, Louis Kaplow, *Replacing the Structural Presumption*, 84 Antitrust L.J. 565, 566 (2022) ("[T]he structural presumption is fundamentally flawed because of its own internal illogic, its sharp conflict with the economic analysis of anticompetitive effects, and the unintelligibility of its associated legal framework. The structural presumption's failure even as a preliminary screening device a fortiori renders it unsound as a basis for actual decision-making. It is therefore necessary to replace the structural presumption—and dangerous to extend and enshrine it as currently proposed."); Douglas H. Ginsburg & Joshua D. Wright, Philadelphia National Bank: *Bad Economics, Bad Law, Good Riddance*, 80 Antitrust L.J. 377, 380 (2015) ("The point is not that 30 percent is an outdated threshold above which to presume adverse effects upon competition; rather, it is that market structure is an inappropriate starting point for the analysis of likely competitive effects. Market structure and competitive effects are not systematically correlated."); ABA Section of Antitrust Law, *Comments, HMG Revision Project* (June 4, 2010) 4 ("[T]he Section urges the Agencies to remove the presumption of illegality keyed to the level and increase in the HHI. The presumption does not reflect how the Agencies conduct investigations, is not theoretically warranted, and could be misinterpreted by other countries thereby undercutting international efforts to promulgate solid merger analysis principles."); *see also* John Harkrider, *Proving Anticompetitive Impact: Moving Past Merger Guidelines Presumptions*, 2005 Colum. Bus. L. Rev. 317 (2005).

638 Nathan Miller et al., *On The Misuse of Regressions of Price on the HHI in Merger Review*, 10 J. Antitrust Enforcement 248 (2021).

of the merged firm, that they would view as sufficient to establish the presumption.[639] So far, courts have cited the share-based presumption favorably.[640]

Merger Guidelines § 2.1

Guideline 1: Mergers Raise a Presumption of Illegality When They Significantly Increase Concentration in a Highly Concentrated Market.

[1] Market concentration and the change in concentration due to the merger are often useful indicators of a merger's risk of substantially lessening competition. In highly concentrated markets, a merger that eliminates a significant competitor creates significant risk that the merger may substantially lessen competition or tend to create a monopoly. As a result, a significant increase in concentration in a highly concentrated market can indicate that a merger may substantially lessen competition, depriving the public of the benefits of competition.

[2] The Supreme Court has endorsed this view and held that "a merger which produces a firm controlling an undue percentage share of the relevant market, and results in a significant increase in the concentration of firms in that market, is so inherently likely to lessen competition substantially that it must be enjoined in the absence of [rebuttal] evidence." In the Agencies' experience, this legal presumption provides a highly administrable and useful tool for identifying mergers that may substantially lessen competition.

[3] An analysis of concentration involves calculating pre-merger market shares of products within a relevant market . . . . The Agencies assess whether the merger creates or further consolidates a highly concentrated market and whether the increase in concentration is sufficient to indicate that the merger may substantially lessen competition or tend to create a monopoly.

[4] The Agencies generally measure concentration levels using the Herfindahl-Hirschman Index ("HHI").[12] The HHI is defined as the sum of the squares of the market shares; it is small when there are many small firms and grows larger as the market becomes more concentrated, reaching 10,000 in a market with a single firm. Markets with an HHI greater than 1,800 are highly concentrated, and a change of more than 100 points is a significant increase.[13] A merger that creates or further consolidates a highly concentrated market that involves an increase in the HHI of more than 100 points is presumed to substantially lessen competition or tend to create a monopoly. The Agencies also may examine the market share of the merged firm: a merger that creates a firm with a share over thirty percent is also presumed to substantially lessen competition or tend to create a monopoly if it also involves an increase in HHI of more than 100 points.

Indicator	Threshold for Structural Presumption
Post-merger HHI	Market HHI greater than 1,800 AND Change in HHI greater than 100
Merged Firm's Market Share	Share greater than 30% AND Change in HHI greater than 100

[639] Some courts had previously indicated the validity of a share-based presumption. *See*, *e.g.*, Cmty. Publishers, Inc. v. DR Partners, 139 F.3d 1180, 1184 (8th Cir. 1998) ("high combined market shares" enough to presume illegality); United States v. Oracle Corp., 331 F. Supp. 2d 1098, 1110 (N.D. Cal. 2004) ("Under *Philadelphia Nat Bank*, a post-merger market share of 30 percent or higher unquestionably gives rise to the presumption of illegality."); FTC v. Swedish Match, 131 F. Supp. 2d 151, 166 (D.D.C. 2000) ("[T]he [*PNB*] Court specifically held that a post-merger market share of thirty percent triggers the presumption.").

[640] FTC v. Kroger Co., No. 3:24-CV-00347, 2024 WL 5053016, at *15 (D. Or. Dec. 10, 2024); FTC v. Cmty. Health Sys., Inc., 736 F. Supp. 3d 335, 369 (W.D.N.C. 2024), *opinion vacated on other grounds, appeal dismissed sub nom.* FTC v. Novant Health, Inc., No. 24-1526, 2024 WL 3561941 (4th Cir. July 24, 2024); *see also* FTC v. Tapestry, Inc., 755 F. Supp. 3d 386, 457–58 (S.D.N.Y. 2024) (applying a share-based presumption but grounding it in cases, not the 2023 Merger Guidelines).

[12] The Agencies may instead measure market concentration using the number of significant competitors in the market. This measure is most useful when there is a gap in market share between significant competitors and smaller rivals or when it is difficult to measure shares in the relevant market.

[13] Thus, the HHI for a market of five equal firms is 2,000 ($5 \times 20^2 = 2{,}000$) and for six equal firms is 1,667 ($6 \times 16.67^2 = 1{,}667$).

[5] When exceeded, these concentration metrics indicate that a merger's effect may be to eliminate substantial competition between the merging parties and may be to increase coordination among the remaining competitors after the merger. This presumption of illegality can be rebutted or disproved. The higher the concentration metrics over these thresholds, the greater the risk to competition suggested by this market structure analysis and the stronger the evidence needed to rebut or disprove it.

* * *

Previous merger guidelines described the presumption in different ways:

- The 1968 Guidelines, issued by DOJ alone, stated the concentration test as follows:
    - if the sum of the shares of the four largest firms in the market (the "four-firm concentration ratio" or "CR4") was 75% or more, DOJ would "ordinarily challenge" transactions between: (a) an acquiring firm of share >4% and an acquired firm of >4%; (b) an acquiring firm of >10% and an acquired firm of >2%; or (c) an acquiring firm of share >15% and an acquired firm of >1%;
    - if the sum of the shares of the four largest firms in the market (the "four-firm concentration ratio" or "CR4") was less than 75%, DOJ would "ordinarily challenge" transactions between: (a) an acquiring firm of share >5% and an acquired firm of >5%; (b) an acquiring firm of share >10% and an acquired firm of >4%; (c) an acquiring firm of share >15% and an acquired firm of >3%; (d) an acquiring firm of share >20% and an acquired firm of >2%; and (e) an acquiring firm of share >25% and an acquired firm of >1%; and
    - if a market showed a "significant trend toward increased concentration," defined as a situation in which "the aggregate market share of any grouping of the largest firms in the market from the two largest to the eight largest has increased by approximately 7% or more of the market over a period of time extending from any base year 5-10 years prior to the merger," DOJ would "ordinarily challenge any acquisition, by any firm in a grouping of such largest firms showing the requisite increase in market share, of any firm whose market share amounts to approximately 2% or more."
- The 1982 Guidelines, issued by DOJ alone,[641] introduced the hypothetical monopolist test into the Guidelines.[642] They switched from CR4 to HHI and stated:
    - if the post-merger HHI was below 1000, DOJ would be "unlikely" to challenge the transaction;
    - if the post-merger HHI was between 1000 and 1800, DOJ would be "unlikely" to challenge the merger if the transaction increased the HHI by less than 100 points, but "more likely than not" to challenge the merger if the transaction increased the HHI by more than 100 points; and
    - if the post-merger HHI was above 1800, DOJ would be "unlikely" to challenge the merger if the transaction increased the HHI by less than 50 points, would review other factors if the transaction increased the HHI by between 50 and 100 points, but would be "likely" to challenge the merger if the transaction increased the HHI by more than 100 points.
    - The 1982 Guidelines also contained a "leading firm proviso": "the Department is likely to challenge the merger of any firm with a market share of at least 1 percent with the leading firm in the market, provided that the leading firm has a market share that is at least 35 percent and is approximately twice as large as that of the second largest firm in the market."
- The 1984 Guidelines retained the 1982 concentration thresholds. The 1984 Guidelines also expressed a modified version of the leading firm proviso, pegging it to a 35% market share without the additional "approximately twice as large" requirement.

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641 For contemporaneous perspectives, *see* William F. Baxter, *New Merger Guidelines: A Justice Department Perspective*, 51 Antitrust L.J. 287 (1982); William F. Smith, *Changing Enforcement Policy*, 51 Antitrust L.J. 95 (1982); Thomas J. Campbell, *New Merger Guidelines: A Federal Trade Commission Perspective*, 51 Antitrust L.J. 295, 297 (1982); Donald I. Baker & William Blumenthal, *The 1982 Guidelines and Preexisting Law*, 71 Calif. L. Rev. 311 (1983).

642 For commentary on this change and its aftermath, *see* Barry C. Harris & Joseph J. Simons, *Focusing Market Definition: How Much Substitution Is Necessary?*, 12 Research in L. & Econ. 207 (1989); Joseph J. Simons & Michael A. Williams, *The Renaissance of Market Definition*, Antitrust Bull. 799 (1993).

- The 1992 Guidelines were issued jointly by DOJ and the FTC,[643] dropped the leading firm proviso, and stated:
    - if the post-merger HHI was below 1000, the transaction would be "unlikely" to have adverse effects;
    - if the post-merger HHI was between 1000 and 1800, a transaction that increased the HHI by less than 100 points would be "unlikely" to have adverse effects, and a transaction that increased the HHI by more than 100 points would "potentially raise significant competitive concerns" based on other factors;
    - if the post-merger HHI was above 1800, a transaction that increased the HHI by less than 50 points would be "unlikely" to have adverse effects, a transaction that increased the HHI by more than 50 points would "potentially raise significant competitive concerns" based on other factors, and a transaction that increased the HHI by more than 100 points would be presumed "likely to create or enhance market power or facilitate its exercise," with such presumption rebuttable by a showing that other factors make this concern unlikely.
    - Note the transition in the 1992 guidelines from a statement of enforcement intentions to an analytical presumption about economic effects!
- The 1997 Guidelines retained the 1992 concentration thresholds.
- The 2010 Guidelines raised the concentration thresholds,[644] and stated:
    - if the transaction increased the HHI by less than 100 points, it would be "unlikely" to have adverse effects;
    - if the post-merger HHI was below 1500, the transaction would be "unlikely" to have adverse effects;
    - if the post-merger HHI was between 1500 and 2500, a transaction that increased the HHI by more than 100 points would "potentially raise significant competitive concerns and often warrant scrutiny";
    - if the post-merger HHI was above 2500, a transaction that increased the HHI by between 100 and 200 points would "potentially raise significant competitive concerns and often warrant scrutiny," and a transaction that increased the HHI by more than 200 points would be presumed "likely to enhance market power," with such presumption rebuttable by "persuasive evidence" showing that the merger is unlikely to enhance market power.

"Delta HHIs"

The so-called "delta HHI"-—that is, the *increase* in HHI resulting from a proposed transaction—is very important in merger analysis. As you can see from the MG extract above, if a transaction results in a post-merger HHI above 1,800 and a "delta HHI" above 100, it will be *presumed* likely to enhance market power. This is a critical threshold in practice. And recent economic work has suggested that deltas may be much more important than absolute concentration levels in screening for the risk of harm from a merger.[645]

A hot tip: if you want to calculate the delta HHI resulting from a transaction without calculating full HHIs for the market as a whole—either because you don't want to go through the trouble of that calculation or because you don't have share data for other market participants—you can still do so. *The delta HHI is equal to twice the product of the premerger market shares of the two merging firms.* Bonus points for proving this algebraically!

[643] For contemporaneous perspectives, *see* Charles A. James, *Overview of the 1992 Horizontal Merger Guidelines*, 61 Antitrust L.J. 447 (1993); Thomas B. Leary, *The Essential Stability of Merger Policy in the United States*, 70 Antitrust L.J. 105 (2002) (including 1997 revisions).

[644] For contemporaneous perspectives, *see* Christine A. Varney, *An Update on the Review of the Merger Guidelines*, Remarks for the Horizontal Merger Guidelines Review Project's Final Workshop (Jan. 26, 2010); Dennis W. Carlton, *Revising the Horizontal Merger Guidelines*, 6 J. Comp. L. & Econ. 619 (2010).

[645] Volker Nocke & Michael D. Whinston, *Concentration Thresholds for Horizontal Mergers*, 112 Am. Econ. Rev. 1915, 1946 (2022).

The presumption, once established, can be rebutted by other evidence.[646] Such evidence, for example, could involve a showing that the market shares are poorly correlated to the parties' real competitive position, or that harm is unlikely in light of evidence regarding entry by new firms, expansion by existing ones, or efficiencies arising from the transaction.[647]

The seminal modern case on the operation of the structural presumption in merger litigation is the D.C. Circuit's 1990 decision in *Baker Hughes*.[648] In that case, then-Judge Clarence Thomas, joined by then-Judge Ruth Bader Ginsburg, laid out the burden-shifting framework that guides modern merger analysis. In the process, he reviewed the changes in merger adjudication since the 1960s, and highlighted the disconnect between the Court's early merger cases (including decisions like *Von's Grocery* and *Pabst Brewing*) and the approach that had emerged by 1990, which still prevails today.

United States v. Baker Hughes Inc.

908 F.2d 981 (D.C. Cir. 1990)

Judge Thomas.

[1] Appellee Oy Tampella AB, a Finnish corporation, through its subsidiary Tamrock AG, manufactures and sells hardrock hydraulic underground drilling rigs ("HHUDRs") in the United States and throughout the world. Appellee Baker Hughes Inc., a corporation based in Houston, Texas, owned a French subsidiary, Eimco Secoma, S.A. (Secoma), that was similarly involved in the HHUDR industry. In 1989, Tamrock proposed to acquire Secoma.

[2] The United States challenged the proposed acquisition, charging that it would substantially lessen competition in the United States HHUDR market in violation of section 7 of the Clayton Act, 15 U.S.C. § 18. In December 1989, the government sought and obtained a temporary restraining order blocking the transaction. In February 1990, the district court held a bench trial and issued a decision rejecting the government's request for a permanent injunction and dismissing the section 7 claim. The government immediately appealed[.] . . .

[3] The basic outline of a section 7 horizontal acquisition case is familiar. By showing that a transaction will lead to undue concentration in the market for a particular product in a particular geographic area, the government establishes a presumption that the transaction will substantially lessen competition. The burden of producing evidence to rebut this presumption then shifts to the defendant. If the defendant successfully rebuts the presumption, the burden of producing additional evidence of anticompetitive effect shifts to the government, and merges with the ultimate burden of persuasion, which remains with the government at all times. [. . .]

[4] By presenting statistics showing that combining the market shares of Tamrock and Secoma would significantly increase concentration in the already highly concentrated United States HHUDR market, the government established a prima facie case of anticompetitive effect.[3] The district court, however, found sufficient evidence that the merger would not substantially lessen competition to conclude that the defendants had rebutted this prima

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[646] *See*, *e.g.*, United States v. General Dynamics Corp., 415 U.S. 486 (1974); United States v. Baker Hughes Inc., 908 F.2d 981 (D.C. Cir. 1990); *see also* U.S. Dept. of Justice & FTC, MERGER GUIDELINES (2023) § 3. For some thoughtful discussions of the status and function of the presumption's operation, *see* Sean P. Sullivan, *What Structural Presumption?: Reuniting Evidence and Economics on the Role of Market Concentration in Horizontal Merger Analysis*, 42 J. Corp. L. 403 (2016); Steven C. Salop, *The Evolution and Vitality of Merger Presumptions: A Decision-Theoretic Approach*, 80 Antitrust L.J. 269 (2015).

[647] Herbert J. Hovenkamp & Carl Shapiro, *Horizontal Mergers, Market Structure, and Burdens of Proof*, 127 Yale L.J. 1996, 1997 (2018) ("Generally, [parties rebut the presumption] by making one of three showings: first, that the proposed market is poorly defined or that market shares exaggerate the merger's anticompetitive potential; second, that entry into the market will discipline any price increase; or third, that the merger produces offsetting efficiencies sufficient to keep prices at premerger levels or otherwise counteract any anticompetitive effects").

[648] For another influential case in which the structural presumption was central (but in which, unlike *Baker Hughes*, the government plaintiff prevailed largely on the basis of structural evidence), *see* FTC v. H.J. Heinz Co., 246 F.3d 708 (D.C. Cir. 2001).

[3] From 1986 through 1988, Tamrock had an average 40.8% share of the United States HHUDR market, while Secoma's share averaged 17.5%. In 1988 alone, the two firms enjoyed a combined share of 76% of the market. (The district court inaccurately calculated this figure as 66%.) The acquisition thus has brought about a dramatic increase in the Herfindahl-Hirschman Index (HHI)—a yardstick of concentration—for this market. The Department of Justice's [1984] Merger Guidelines characterize as "highly concentrated" any market in which the HHI exceeds 1800. This acquisition has increased the HHI in this market from 2878 to 4303.

facie case. The government did not produce any additional evidence showing a probability of substantially lessened competition, and thus failed to carry its ultimate burden of persuasion.

[5] In this appeal, the government assails the court's conclusion that the defendants rebutted the prima facie case. Doubtless aware that this court will set aside the district court's findings of fact only if they are clearly erroneous, the government frames the issue as a pure question of law, which we review de novo. The government's key contention is that the district court, which did not expressly state the legal standard that it applied in its analysis of rebuttal evidence, failed to apply a sufficiently stringent standard. The government argues that, as a matter of law, section 7 defendants can rebut a prima facie case only by a clear showing that entry into the market by competitors would be quick and effective. Because the district court failed to apply this standard, the government submits, the court erred in concluding that the proposed acquisition would not substantially lessen future competition in the United States HHUDR market.

[6] We find no merit in the legal standard propounded by the government. It is devoid of support in the statute, in the case law, and in the government's own [1984] Merger Guidelines. Moreover, it is flawed on its merits in three fundamental respects. First, it assumes that ease of entry by competitors is the only consideration relevant to a section 7 defendant's rebuttal. Second, it requires that a defendant who seeks to show ease of entry bear the onerous burden of proving that entry will be "quick and effective." Finally, by stating that the defendant can rebut a prima facie case only by a clear showing, the standard in effect shifts the government's ultimate burden of persuasion to the defendant. Although the district court in this case did not expressly set forth a legal standard when it evaluated the defendants' rebuttal, we have carefully reviewed the court's thorough analysis of competitive conditions in the United States HHUDR market, and we are satisfied that the court effectively applied a standard faithful to section 7. Concluding that the court applied this legal standard to factual findings that are not clearly erroneous, we affirm the court's denial of a permanent injunction and its dismissal of the government's section 7 claim. [. . .]

[7] It is a foundation of section 7 doctrine, disputed by no authority cited by the government, that evidence on a variety of factors can rebut a prima facie case. These factors include, but are not limited to, the absence of significant entry barriers in the relevant market. In this appeal, however, the government inexplicably imbues the entry factor with talismanic significance. If, to successfully rebut a prima facie case, a defendant must show that entry by competitors will be quick and effective, then other factors bearing on future competitiveness are all but irrelevant. The district court in this case considered at least two factors in addition to entry: the misleading nature of the statistics underlying the government's prima facie case and the sophistication of HHUDR consumers. These non-entry factors provide compelling support for the court's holding that Tamrock's acquisition of Secoma was not likely to lessen competition substantially. We have concluded that the court's consideration of these factors was crucial, and that the government's fixation on ease of entry is misplaced.

[8] Section 7 involves probabilities, not certainties or possibilities. The Supreme Court has adopted a totality-of-the-circumstances approach to the statute, weighing a variety of factors to determine the effects of particular transactions on competition. That the government can establish a prima facie case through evidence on only one factor, market concentration, does not negate the breadth of this analysis. Evidence of market concentration simply provides a convenient starting point for a broader inquiry into future competitiveness; the Supreme Court has never indicated that a defendant seeking to rebut a prima facie case is restricted to producing evidence of ease of entry. Indeed, in numerous cases, defendants have relied entirely on non-entry factors in successfully rebutting a prima facie case. [. . .]

[9] The district court's analysis of this case is fully consonant with precedent and logic. The court reviewed the evidence proffered by the defendants as part of its overall assessment of future competitiveness in the United States HHUDR market. As noted above, the court gave particular weight to two non-entry factors: the flawed underpinnings of the government's prima facie case and the sophistication of HHUDR consumers. The court's consideration of these factors was not only appropriate, but imperative, because in this case these factors significantly affected the probability that the acquisition would have anticompetitive effects.

[10] With respect to the first factor, the statistical basis of the prima facie case, the court accepted the defendants' argument that the government's statistics were misleading. Because the United States HHUDR market is

minuscule, market share statistics are volatile and shifting, and easily skewed. In 1986, for instance, only 22 HHUDRs were sold in the United States. In 1987, the number rose to 43, and in 1988 it fell to 38. Every HHUDR sold during this period, thus, increased the seller's market share by two to five percent. A contract to provide multiple HHUDRs could catapult a firm from last to first place. The district court found that, in this unusual market, at any given point in time an individual seller's future competitive strength may not be accurately reflected. While acknowledging that the HHUDR market would be highly concentrated after Tamrock acquired Secoma, the court found that such concentration in and of itself would not doom competition. High concentration has long been the norm in this market. For example, only four firms sold HHUDRs in the United States between 1986 and 1989. Nor is concentration surprising where, as here, a product is esoteric and its market small. Indeed, the trial judge found that concentration has existed for some time in the United States HHUDR market but there is no proof of overpricing, excessive profit or any decline in quality, service or diminishing innovation.

[11] The second non-entry factor that the district court considered was the sophistication of HHUDR consumers. HHUDRs currently cost hundreds of thousands of dollars, and orders can exceed $1 million. These products are hardly trinkets sold to small consumers who may possess imperfect information and limited bargaining power. HHUDR buyers closely examine available options and typically insist on receiving multiple, confidential bids for each order. This sophistication, the court found, was likely to promote competition even in a highly concentrated market.

[12] The government has not provided us with any reason to suppose that these findings of fact are unsupported in the record or clearly erroneous. We thus accept them as correct. These findings provide considerable support for the district court's conclusion that the defendants successfully rebutted the government's prima facie case. Because the defendants also provided compelling evidence on ease of entry into this market, we need not decide whether these findings, without more, are sufficient to rebut the government's prima facie case. [. . .]

[13] The district court in this case discussed a number of considerations that led it to conclude that entry barriers to the United States HHUDR market were not high enough to impede future entry should Tamrock's acquisition of Secoma lead to supracompetitive pricing. First, the court noted that at least two companies, Cannon and Ingersoll-Rand, had entered the United States HHUDR market in 1989, and were poised for future expansion. Second, the court stressed that a number of firms competing in Canada and other countries had not penetrated the United States market, but could be expected to do so if Tamrock's acquisition of Secoma led to higher prices. Because the market is small, it is inexpensive to develop a separate sales and service network in the United States. Third, these firms would exert competitive pressure on the United States HHUDR market even if they never actually entered the market. Finally, the court noted that there had been tremendous turnover in the United States HHUDR market in the 1980s. Secoma, for example, did not sell a single HHUDR in the United States in 1983 or 1984, but then lowered its price and improved its service, becoming market leader by 1989. Secoma's growth suggests that competitors not only can, but probably will, enter or expand if this acquisition leads to higher prices. The district court, to be sure, also found some facts suggesting difficulty of entry, but these findings do not negate its ultimate finding to the contrary. [. . .]

[14] The government argues that the court erred by failing to require the defendants to make a "clear" showing. The relevant precedents, however, suggest that this formulation overstates the defendants' burden. We conclude that a "clear" showing is unnecessary, and we are satisfied that the district court required the defendants to produce sufficient evidence.

[15] The government's "clear showing" language is by no means unsupported in the case law. In the mid-1960s, the Supreme Court construed section 7 to prohibit virtually any horizontal merger or acquisition. At the time, the Court envisioned an ideal market as one composed of many small competitors, each enjoying only a small market share; the more closely a given market approximated this ideal, the more competitive it was presumed to be.

[16] This perspective animated a series of decisions in which the Court stated that a section 7 defendant's market share measures its market power, that statistics alone establish a prima facie case, and that a defendant carries a heavy burden in seeking to rebut the presumption established by such a prima facie case. The Court most clearly articulated this approach in *Philadelphia Bank*:

> Th[e] intense congressional concern with the trend toward concentration [underlying section 7] warrants dispensing, in certain cases, with elaborate proof of market structure, market behavior, or probable anticompetitive effects. Specifically, we think that a merger which produces a firm controlling an undue percentage share of the relevant market, and results in a significant increase in the concentration of firms in that market, is so inherently likely to lessen competition substantially that it must be enjoined in the absence of evidence clearly showing that the merger is not likely to have such anticompetitive effects.

[17] *Philadelphia Bank* involved a proposed merger that would have created a bank commanding over 30% of a highly concentrated market. While acknowledging that the banks could in principle rebut the government's prima facie case, the Court found unpersuasive the banks' evidence challenging the alleged anticompetitive effect of the merger.

[18] In *United States v. Von's Grocery Co.*, [384 U.S. 270 (1966)], the Court further emphasized the weight of a defendant's burden. Despite evidence that a post-merger company had only a 7.5% share of the Los Angeles retail grocery market, the Court, citing anticompetitive "trends" in that market, ordered the merger undone. The Court summarily dismissed the defendants' contention that the post-merger market was highly competitive. . . . Noting that the market was marked at the same time by both a continuous decline in the number of small businesses and a large number of mergers, the *Von's Grocer*y Court predicted that, if the merger were not undone, the market "would slowly but inevitably gravitate from a market of many small competitors to one dominated by one or a few giants, and competition would thereby be destroyed."

[19] Although the Supreme Court has not overruled these section 7 precedents, it has cut them back sharply. In [*United States v. General Dynamics*, 415 U.S. 486 (1974)], the Court affirmed a district court determination that, by presenting evidence that undermined the government's statistics, section 7 defendants had successfully rebutted a prima facie case. In so holding, the Court did not expressly reaffirm or disavow *Philadelphia Bank*'s statement that a company must "clearly" show that a transaction is not likely to have substantial anticompetitive effects. The Court simply held that the district court was justified, based on all the evidence, in finding that no substantial lessening of competition occurred or was threatened by the acquisition.

[20] *General Dynamics* began a line of decisions differing markedly in emphasis from the Court's antitrust cases of the 1960s. Instead of accepting a firm's market share as virtually conclusive proof of its market power, the Court carefully analyzed defendants' rebuttal evidence. These cases discarded *Philadelphia Bank*'s insistence that a defendant "clearly" disprove anticompetitive effect, and instead described the rebuttal burden simply in terms of a "showing." Without overruling *Philadelphia Bank*, then, the Supreme Court has at the very least lightened the evidentiary burden on a section 7 defendant.

[21] In the aftermath of *General Dynamics* and its progeny, a defendant seeking to rebut a presumption of anticompetitive effect must show that the prima facie case inaccurately predicts the relevant transaction's probable effect on future competition. The more compelling the prima facie case, the more evidence the defendant must present to rebut it successfully. A defendant can make the required showing by affirmatively showing why a given transaction is unlikely to substantially lessen competition, or by discrediting the data underlying the initial presumption in the government's favor.

[22] By focusing on the future, section 7 gives a court the uncertain task of assessing probabilities. In this setting, allocation of the burdens of proof assumes particular importance. By shifting the burden of producing evidence, present law allows both sides to make competing predictions about a transaction's effects. If the burden of production imposed on a defendant is unduly onerous, the distinction between that burden and the ultimate burden of persuasion—always an elusive distinction in practice—disintegrates completely. A defendant required to produce evidence "clearly" disproving future anticompetitive effects must essentially persuade the trier of fact on the ultimate issue in the case—whether a transaction is likely to lessen competition substantially. Absent express instructions to the contrary, we are loath to depart from settled principles and impose such a heavy burden.

[23] Imposing a heavy burden of production on a defendant would be particularly anomalous where, as here, it is easy to establish a prima facie case. The government, after all, can carry its initial burden of production simply by presenting market concentration statistics. To allow the government virtually to rest its case at that point, leaving

the defendant to prove the core of the dispute, would grossly inflate the role of statistics in actions brought under section 7. The Herfindahl-Hirschman Index cannot guarantee litigation victories. Requiring a "clear showing" in this setting would move far toward forcing a defendant to rebut a probability with a certainty.

[24] The appellees in this case presented the district court with considerable evidence regarding the United States HHUDR market. The court credited the evidence concerning the sophistication of HHUDR consumers and the insignificance of entry barriers, as well as the argument that the statistics underlying the government's prima facie case were misleading. This evidence amply justified the court's conclusion that the prima facie case inaccurately depicted the probable anticompetitive effect of Tamrock's acquisition of Secoma. Because the government did not produce sufficient evidence to overcome this successful rebuttal, the district court concluded that it is not likely that the acquisition will substantially lessen competition in the United States either immediately or long-term. The government has given us no reason to reverse that conclusion.

[25] For the foregoing reasons, the judgment of the district court is

Affirmed.

The Shape of a Merger Case: The Burden-Shifting Framework

After *Baker Hughes*, the rough shape of a merger case can be thought of as follows. (*Baker Hughes* itself dealt with a horizontal merger, but an equivalent burden-shifting framework governs vertical deals.[649]) This is an analytical framework, not a procedural one: these steps do not correspond to successive stages in litigation. But they are often used to structure the formulation or presentation of a legal analysis or a judicial opinion.

Plaintiff's affirmative case. First, a plaintiff must demonstrate an affirmative or *prima facie* case of illegality. This is most readily done by showing that the structural presumption is satisfied, but plaintiffs almost invariably adduce other evidence suggestive of competitive harm at this stage too (supporting a coordinated-effects theory, unilateral-effects theory, or both). Note that, while the core logic of the structural presumption is a close fit with coordinated-effects theories, it can be used to discharge the plaintiff's affirmative burden in pure unilateral-effects cases too.[650]

Defendant's rebuttal case. Second, the defendant can present a rebuttal case, including evidence tending to undermine the applicability or force of the structural presumption; evidence suggesting that the theory or theories of harm are misfounded; evidence that entry or expansion, or the countervailing power of trading partners, will preclude competitive concerns; or other evidence of any kind tending to indicate that the merger will not be anticompetitive. (This may include evidence related to efficiencies to the extent that they tend to exclude the possibility of competitive harm.) The weight of the defendant's rebuttal burden is a function of the strength of the plaintiff's affirmative case: a more compelling *prima facie* case requires a more persuasive rebuttal.

Analysis of defenses in the strict sense. The defendant may also present any defenses in the strict sense, such as the "failing firm" defense, or those grounded in other doctrines like the "state action" defense that we will meet in Chapter IX.

Finally, the plaintiff has the ultimate burden of persuading a factfinder that the transaction is unlawful.

NOTES

1) In light of what you can tell from the decision, does *PNB* involve a merger that would raise concerns today?
2) Why was the *PNB* Court so dismissive of customer testimony?
3) The court in *Baker Hughes* indicated that it is "easy to establish a prima facie case" by "presenting concentration statistics," and that as a result a prima facie case built on concentration should be relatively easy to rebut. How would you defend that view? How would you criticize it?

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649 *See*, *e.g.*, ProMedica Health System, Inc. v. FTC, 749 F.3d 559, 570 (6th Cir. 2014).

650 *See infra* note 697 and accompanying text.

4) Why is a merger that significantly increases market concentration presumed to be anticompetitive? Should the strength of this presumption vary from one market to another?
5) How do you think the antitrust agencies determined the concentration levels at which the structural presumption would apply? Why do you think the presumptions have changed over time?
6) Are the guidelines binding on courts? What is the source of their authority? Are they binding on agencies?
7) Most agency merger litigations are in practice brought at concentration levels materially above the structural presumption.[651] Why do you think this is? Does it imply a problem: and, if so, what is it?
8) What would you want to know, or evaluate, in order to determine whether the structural presumptions are set at the "right" level? What values or concerns should be weighed in determining what the "right" level is?
9) Should the presumption be made irrebuttable?
10) Jonathan Baker and Carl Shapiro have written that, in the years between *Philadelphia National Bank* and *Baker Hughes*, "the emphasis in merger enforcement has shifted . . . from proving market concentration to telling a convincing story of how the merger will actually lead to a reduction in competition. Put simply, market definition and market shares have become far less important relative to proof of competitive effects."[652] Assuming that this is correct, do you think it is a good or bad development?

2. Competitive Effects Theories in Horizontal Merger Cases

A horizontal merger may give rise to competitive concerns in at least two ways: by creating "unilateral" competitive effects through the reduction of competition between the parties, or by creating "coordinated" competitive effects through facilitating tacit (or explicit) collusion among the market participants.

a) Unilateral Effects Theories

"Unilateral" anticompetitive effects arise when, as a result of the loss of head-to-head competition between the two parties to a horizontal merger, the merged firm can "unilaterally" raise its prices, lower quality or output, or otherwise change its behavior in harmful ways as a result of the lost competitive pressure. This kind of harm, which was explicitly described in the merger guidelines for the first time in 1992, and then given expanded treatment and emphasis in the 2010 version, is a central concern when the parties are particularly close competitors in a market with differentiated products or services before the transaction.[653] In principle, unilateral-effects analysis is not dependent on the bounds of a relevant market definition, as the focus is on direct competitive interactions between the parties—indeed, nothing in a unilateral-effects theory of harm turns on market concentration or a market definition—but as noted above in practice market definition is important in virtually every merger case.[654]

Merger Guidelines § 2.2

Guideline 2: Mergers Can Violate the Law When They Eliminate Substantial Competition Between Firms.

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[651] For some related data and discussion, *see* John Kwoka, *The Structural Presumption and The Safe Harbor in Merger Review: False Positives or Unwarranted Concerns?* 81 Antitrust L.J. 837, 867–71 (2017); Malcolm B. Coate, *Benchmarking the Upward Pricing Pressure Model with Federal Trade Commission Evidence*, 7 J. Comp. L. & Econ. 825, 834 tbl. 2 (2011).

[652] Jonathan B. Baker & Carl Shapiro, *Reinvigorating Horizontal Merger Enforcement*, in Robert Pitofsky (ed.) HOW CHICAGO SCHOOL OVERSHOT THE MARK: THE EFFECT OF CONSERVATIVE ECONOMIC ANALYSIS ON U.S. ANTITRUST (2008) 238.

[653] *See generally* Gregory Werden & Luke Froeb, *Unilateral Competitive Effects of Horizontal Mergers*, in Paolo Buccirossi (ed.), HANDBOOK OF ANTITRUST ECONOMICS (2007); Jonathan B. Baker, *Unilateral Competitive Effects Theories in Merger Analysis*, ANTITRUST (Spring 1997) 21. The 1992 and 1997 guidelines listed coordinated effects first, and unilateral effects second; the 2010 guidelines switched the order. The 2010 guidelines are widely understood to have helped to invigorate unilateral-effects enforcement. *See*, *e.g.*, Carl Shapiro & Howard Shelanski, *Judicial Response to the 2010 Horizontal Merger Guidelines*, 58 Rev. of Ind. Org. 51, 66 ("The 2010 Guidelines gave unilateral effects much more prominent and detailed treatment than did the 1992 Guidelines. It is not by accident that the 2010 Guidelines flipped the order of the 1992 Guidelines and discussed unilateral effects [first] before addressing coordinated effects second."); *id.* at 67 (noting "[t]he increased use of unilateral effects theories by the agencies after 2010").

[654] In upholding the FTC's challenge to the Kroger / Albertson's supermarket merger, the district court stated: "Courts recognize that a merger that eliminates head-to-head competition between close competitors can result in a substantial lessening of competition." FTC v. Kroger Co., No. 3:24-CV-00347, 2024 WL 5053016, at *17 (D. Or. Dec. 10, 2024) (citing FTC v. Sysco Corp., 113 F. Supp. 3d 1, 61 (D.D.C. 2015)). The court noted defendants' argument that "undue market concentration" must also be proved to establish a *prima facie* case, but declined to resolve that argument as the FTC had also made such a showing. *See also supra* note 177 and accompanying text (discussing the role of market definition in Section 7 cases).

[1] A merger eliminates competition between the merging firms by bringing them under joint control. If evidence demonstrates substantial competition between the merging parties prior to the merger, that ordinarily suggests that the merger may substantially lessen competition. Although a change in market structure can also indicate risk of competitive harm, an analysis of the existing competition between the merging firms can demonstrate that a merger threatens competitive harm independent from an analysis of market shares.

[2] Competition often involves firms trying to win business by offering lower prices, new or better products and services, more attractive features, higher wages, improved benefits, or better terms relating to various additional dimensions of competition. This can include competition to research and develop products or services, and the elimination of such competition may result in harm even if such products or services are not yet commercially available. The more the merging parties have shaped one another's behavior, or have affected one another's sales, profits, valuation, or other drivers of behavior, the more significant the competition between them.

[3] The Agencies examine a variety of indicators to identify substantial competition. For example:

[4] *Strategic Deliberations or Decisions.* The Agencies may analyze the extent of competition between the merging firms by examining evidence relating to strategic deliberations or decisions in the regular course of business. For example, in some markets, the firms may monitor each other's pricing, marketing campaigns, facility locations, improvements, products, capacity, output, input costs, and/or innovation plans. This can provide evidence of competition between the merging firms, especially when they react by taking steps to preserve or enhance the competitiveness or profitability of their own products or services.

[5] *Prior Merger, Entry, and Exit Events.* The Agencies may look to historical events to assess the presence and substantiality of direct competition between the merging firms. For example, the Agencies may examine the competitive impact of recent relevant mergers, entry, expansion, or exit events.

[6] *Customer Substitution.* Customers' willingness to switch between different firms' products is an important part of the competitive process. Firms are closer competitors the more that customers are willing to switch between their products. The Agencies use a variety of tools . . . to assess customer substitution.

[7] *Impact of Competitive Actions on Rivals.* When one firm takes competitive actions to attract customers, this can benefit the firm at the expense of its rivals. The Agencies may gauge the extent of competition between the merging firms by considering the impact that competitive actions by one of the merging firms has on the other merging firm. The impact of a firm's competitive actions on a rival is generally greater when customers consider the firm's products and the rival's products to be closer substitutes, so that a firm's competitive action results in greater lost sales for the rival, and when the profitability of the rival's lost sales is greater.

[8] *Impact of Eliminating Competition Between the Firms.* In some instances, evidence may be available to assess the impact of competition from one firm on the other's actions, such as firm choices about price, quality, wages, or another dimension of competition. . . .

[9] *Additional Evidence, Tools, and Metrics.* The Agencies may use additional evidence, tools, and metrics to assess the loss of competition between the firms. Depending on the realities of the market, different evidence, tools, or metrics may be appropriate.

Merger Guidelines § 4.2

Evaluating Competition Among Firms

[1] Evidence commonly analyzed to show the extent of substitution among firms' products includes: how customers have shifted purchases in the past in response to relative changes in price or other terms and conditions; documentary and testimonial evidence such as win/loss reports, evidence from discount approval processes, switching data, customer surveys, as well as information from suppliers of complementary products and distributors; objective information about product characteristics; and market realities affecting the ability of customers to switch. [. . .]

Considerations When Terms Are Set by Firms

[2] The Agencies may use various types of evidence and metrics to assess the strength of competition among firms that set terms to their customers. Firms might offer the same terms to different customers or different terms to different groups of customers.

[3] Competition in this setting can lead firms to set lower prices or offer more attractive terms when they act independently than they would in a setting where that competition was eliminated by a merger. When considering the impact of competition on the incentives to set price, to the extent price increases on one firm's products would lead customers to switch to products from another firm, their merger will enable the merged firm to profit by unilaterally raising the price of one or both products above the premerger level. Some of the sales lost because of the price increase will be diverted to the products of the other firm, and capturing the value of these diverted sales can make the price increase profitable even though it would not have been profitable prior to the merger. [. . .]

Considerations When Terms Are Set Through Bargaining or Auctions

[4] In some industries, buyers and sellers negotiate prices and other terms of trade. In bargaining, buyers commonly negotiate with more than one seller and may play competing sellers off against one another. In other industries, sellers might sell their products, or buyers might procure inputs, using an auction. Negotiations may involve aspects of an auction as well as aspects of one-on-one negotiation. Competition among sellers can significantly enhance the ability of a buyer to obtain a result more favorable to it, and less favorable to the sellers, compared to a situation where the elimination of competition through a merger prevents buyers from playing those sellers off against each other in negotiations.

[5] Sellers may compete even when a customer does not directly play their offers against each other. The attractiveness of alternative options influences the importance of reaching an agreement to the negotiating parties and thus the terms of the agreement. A party that has many attractive alternative trading partners places less importance on reaching an agreement with any one particular trading partner than a party with few attractive alternatives. As alternatives for one party are eliminated (such as through a merger), the trading partner gains additional bargaining leverage reflecting that loss of competition. A merger between sellers may lessen competition even if the merged firm handles negotiations for the merging firms' products separately.

[6] Thus, qualitative or quantitative evidence about the leverage provided to buyers by competing suppliers may be used to assess the extent of competition among firms in this setting. Analogous evidence may be used when analyzing a setting where terms are set using auctions, for example, procurement auctions where suppliers bid to serve a buyer. If, for some categories of procurements, certain suppliers are often among the most attractive to the buyer, competition among that group of suppliers is likely to be strong. [. . .]

Considerations When Firms Determine Capacity and Output

[7] In some markets, the choice of how much to produce (output decisions) or how much productive capacity to maintain (capacity decisions) are key strategic variables. When a firm decreases output, it may lose sales to rivals, but also drive up prices. Because a merged firm will account for the impact of higher prices across all of the merged firms' sales, it may have an incentive to decrease output as a result of the merger. The loss of competition through a merger of two firms may lead the merged firm to leave capacity idle, refrain from building or obtaining capacity that would have been obtained absent the merger, lay off or stop hiring workers, or eliminate pre-existing production capabilities. A firm may also divert the use of capacity away from one relevant market and into another market so as to raise the price in the former market. The analysis of the extent to which firms compete may differ depending on how a merger between them might create incentives to suppress output.

[8] Competition between merging firms is greater when (1) the merging firms' market shares are relatively high; (2) the merging firms' products are relatively undifferentiated from each other; (3) the market elasticity of demand is relatively low; (4) the margin on the suppressed output is relatively low; and (5) the supply responses of non-merging rivals are relatively small. Qualitative or quantitative evidence may be used to evaluate and weigh each of these factors. [. . .]

Considerations for Innovation and Product Variety Competition

[9] Firms can compete for customers by offering varied and innovative products and features, which could range from minor improvements to the introduction of a new product category. Features can include new or different product attributes, services offered along with a product, or higher-quality services standing alone. Customers value the variety of products or services that competition generates, including having a variety of locations at which they can shop.

[10] Offering the best mix of products and features is an important dimension of competition that may be harmed as a result of the elimination of competition between the merging parties.

[11] When a firm introduces a new product or improves a product's features, some of the sales it gains may be at the expense of its rivals, including rivals that are competing to develop similar products and features. As a result, competition between firms may lead them to make greater efforts to offer a variety of products and features than would be the case if the firms were jointly owned, for example, if they merged. The merged firm may have a reduced incentive to continue or initiate development of new products that would have competed with the other merging party, but post-merger would "cannibalize" what would be its own sales. A service provider may have a reduced incentive to continue valuable upgrades offered by the acquired firm. The merged firm may have a reduced incentive to engage in disruptive innovation that would threaten the business of one of the merging firms. Or it may have the incentive to change its product mix, such as by ceasing to offer one of the merging firms' products, leaving worse off the customers who previously chose the product that was eliminated. For example, competition may be harmed when customers with a preference for a low-price option lose access to it, even if remaining products have higher quality. [. . .]

[12] Innovation may be directed at outcomes beyond product features; for example, innovation may be directed at reducing costs or adopting new technology for the distribution of products.

Analytical Methods for Mergers: Diversions, UPP, and Merger Simulation

Economists use a variety of tools to assess the strength of competition between merging parties and to predict effects caused by the merger.[655] As a lawyer, you will not be expected to be a master of intricate econometrics! But it may be helpful to have a basic sense of the nature and function of some of the tools that are commonly used to think in an organized way about unilateral effects. Each of the tools described here is best thought of, and used, as one form of evidence and analysis among many.[656]

Diversion Ratios

"Diversion ratios" are often used as one measure of the intensity of head-to-head competition between two firms. These are important in practice, so it is worth making sure you have absorbed the idea.[657] A diversion ratio is measured from one firm to another: thus, in merger between Firm A and Firm B we might calculate a diversion ratio from A to B, and separately calculate the diversion ratio from B to A. The diversion ratio from A to B is the proportion of customers who, when switching away from A, do or would turn to B.

For example, suppose that we were considering a merger between two supermarkets: SuperStore (a general supermarket) and BakeryFirst (a supermarket that particularly focused on high-end baked goods), in an area where there were two other supermarkets: GeneralStores and OKStuff. The diversion ratio from SuperStore to BakeryFirst would be the proportion of users switching away from SuperStore (because it increased its prices, reduced its opening hours, closed altogether, etc.) who turned to BakeryFirst. Thus, if X% of customers (or customer dollars) switching away from SuperStore would go to BakeryFirst rather than GeneralStores or OKStuff, or rather than not purchasing at all, the diversion ratio from SuperStore to BakeryFirst would be X%.

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655 *See*, *e.g.*, Nathan H. Miller & Gloria Sheu, *Quantitative Methods for Evaluating the Unilateral Effects of Mergers*, 58 Rev. Indus. Org. 143 (2021); Gregory J. Werden, *Unilateral Competitive Effects of Horizontal Mergers I: Basic Concepts and Models*, in ABA Section of Antitrust Law, 2 ISSUES IN COMPETITION LAW AND POLICY (2008).

656 *See*, *e.g.*, Carl Shapiro, *The 2010 Horizontal Merger Guidelines: From Hedgehog to Fox in Forty Years*, 77 Antitrust L.J. 49 (2010).

657 *See*, *e.g.*, FTC v. Swedish Match, 131 F. Supp. 2d 151, 169 (D.D.C. 2000) ("High margins and high diversion ratios support large price increases, a tenet endorsed by most economists.").

Note that diversions may be "asymmetrical": the ratio from A to B may be very different from the ratio from B to A. In the example above, suppose that BakeryFirst is an expensive store with a great baked-goods selection but limited offerings in other areas, and that it therefore attracts customers who prefer higher-priced, higher-quality baked goods, and who care a bit less about other product lines. Suppose also that BakeryFirst and SuperStore were geographically close to one another, with GeneralStores and OKStuff located somewhat further away, and that BakeryFirst was the only supermarket that focused on high-quality baked goods to the exclusion of other things.

Under those circumstances, we could imagine that the diversions from BakeryFirst to SuperStore might be fairly high (because customers who cannot shop at BakeryFirst—and who will therefore have to shop at a generalist supermarket—probably prefer a nearby store to one located further away), while diversions from SuperStore to BakeryFirst might be much lower (because SuperStore's existing customers may not want to shop at a more expensive, bakery-focused store, and might prefer to travel a bit further to reach a similarly generalized supermarket).

As this example illustrates, diversions can be a helpful data point in building an overall picture of the shape of head-to-head competition between two firms, particularly when there is some product and/or geographic differentiation in the market. Of course, diversions can be difficult to calculate: in some cases, there may be actual evidence of how customers actually responded in the past when one party has experienced a price increase, output reduction, or service interruption, allowing diversions to be measured directly. In other cases, sources like customer surveys, customer testimony, win/loss records, or qualitative industry evidence may help to illuminate substitution practices. In still other cases, diversion ratios might have to be inferred, including from market shares. The analytical value of diversion ratios in such cases may be rather small, particularly in differentiated markets. (Can you see why?)

The Concept of Upward Pricing Pressure and GUPPIs

Diversion ratios are a key input into the calculation of "upward pricing pressure" ("UPP") arising from a proposed transaction.[658] The core idea is fairly simple. When a merger combines two competing firms, it changes the effects of a price increase on the profit derived from the firm's separate products or services. Before the merger, a price increase means fewer sales of the product or service in question, but higher margins on the sales that are made at the higher price. A merger with a competing firm changes things a little because some of those lost sales will be lost to the *other* merging party: meaning that the "lost" sale is in fact "recaptured" by the merged firm. As a result, a price increase that would not have been profitable before the merger (because of lost sales) may be profitable for the merged firm (because some of the lost sales are recouped by the merging firm). We can thus think of a merger between competitors as creating "upward pressure" on prices. Of course, if the merger *also* generates efficiencies (which we will discuss later in this chapter), those efficiencies will create some *downward* pressure on prices. The balance of the two effects will determine the direction in which the merger will affect prices.

Sometimes lawyers and economists will use the "Gross Upward Pricing Pressure Index" ("GUPPI") to get a raw sense of how much upward pressure a merger might create (before allowing for countervailing efficiencies, reactions of other market participants, resulting entry, repositioning by other suppliers, impact on prices of other products supplied by the firms, innovation effects, or anything else). In a merger between the supplier of product 1 and the supplier of product 2, the GUPPI on product 1 can be calculated in a simple way by multiplying (the diversion ratio from product 1 to product 2) by (the percentage profit margin on product 2) and then by (the price of product 2 divided by the price of product 1). (Note that GUPPI calculation can get much more complicated, but this is the core idea!) In this illustration, the GUPPI is higher when the diversion ratio from product 1 to product 2 is higher (because more lost sales are recouped), when the profit margin on product 2 is high (because the recouped sales on product 2 are valuable), and when the price of product 2 relative to product 1 is high (because the recouped sales on product 2 are valuable relative to the lost sales on product 1).

[658] For a seminal contribution to this tool, *see* Joseph Farrell & Carl Shapiro, *Antitrust Evaluation of Horizontal Mergers: An Economic Alternative to Market Definition*, 10 B.E. J. of Theoretical Econ. (2010).

It is important to understand the GUPPI is a crude measure that does not—and does not attempt to—estimate the *actual* impact a merger will have on prices. The other factors mentioned above, like efficiencies and reactions of market participants, are frequently very important indeed. But it is one way of getting a sense of a transaction's capacity to inflict certain kinds of static price harms. It is also a helpful way of establishing the amount by which the merger would need to reduce the firm's marginal costs in order to have the overall effect of reducing prices (the so-called "CMCR" or compensating marginal cost reduction).

Merger Simulation

Merger simulation involves creating an economic model of a market, based on information about market demand and market supply, in an effort to predict the competitive conditions that may result from the transaction.

Accurate merger simulation is usually a demanding exercise, requiring granular information about the market. Its utility is, among other things, a function of the quality of the inputs—including the quality of data and the accuracy of models—and a function of the aptness of particular economic modeling tools to reflect the way the relevant industries and markets actually work.

In practice, building a strong merger case—regardless of the theory of harm—almost invariably requires more than just an impressive structural case built on high market shares. This is for at least three reasons. First, there often is no single "correct" way to calculate a market share, so parties often argue over how this should be done, and parties' market-share arguments may be subject to some plausible criticism and doubt. Second, courts generally expect (and often require) robust qualitative support from some combination of: (1) economic expert evidence; (2) customers who are willing to credibly testify that they anticipate adverse effects from the merger; and (3) ordinary-course documents showing the parties' competitive significance. Third, in a unilateral effects case in particular, the structural presumption is at best a very imperfect proxy for the core story of harm. The structural presumption is based on market-wide statistics; the unilateral theory of harm zooms in on the competitive interactions between the parties. Thus, in principle, a unilateral effects case has nothing to do with market definition in the traditional sense.

Staples / Office Depot II—the second successful FTC effort to block the acquisition of Office Depot by Staples[659]—showcases *both* the difficulties of calculating a market share *and* the importance of the three main types of qualitative evidence. It also underscores the value, to a plaintiff in a merger trial, of the parties' internal documents![660]

After the *Staples* extract, we will take a briefer look at the district court's thorough analysis of unilateral effects in the DOJ's challenge to the H&R Block / TaxAct transaction. As in *Staples*, the court's conclusion was buttressed by multiple alternative forms of evidence, including some of the forms of analysis described above.

FTC v. Staples, Inc. ("Staples / Office Depot II")

190 F. Supp. 3d 100 (D.D.C. 2016)

Judge Sullivan.

[1] There is overwhelming evidence in this case that large [business-to-business, or "B-to-B"] customers constitute a market that Defendants could target for price increases if they are allowed to merge. Significantly, Defendants themselves used the proposed merger to pressure B-to-B customers to lock in prices based on the expectation that they would lose negotiating leverage if the merger were approved. See, e.g., PX05236 (ODP) at 001 ("This offer is time sensitive. If and when the purchase of OfficeDepot is approved, Staples will have no reason to make this offer."); PX05249 (ODP) at 001 ("[The merger] will remove, your ability to evaluate your program with two

659 The quest continued. *See* Lauren Hirsch, *Staples returns to Office Depot with a $1 billion offer for its consumer business*, N.Y. TIMES (June 4, 2021), https://www.nytimes.com/2021/06/04/business/staples-office-depot-deal.html; Ben Unglesbee, *After much mulling, Office Depot owner rejects both sale and split*, RETAIL DIVE (June 22, 2022), https://www.retaildive.com/news/after-much-mulling-office-depot-owner-rejects-sale-and-split/625844/.

660 For another case in which extensive qualitative evidence played a key role, look at the Department of Justice's challenge to Bazaarvoice/PowerReviews. DOJ assembled a compelling deck, linked here, filled with internal documents in support of their successful effort to block the deal. Highlights included documents describing "our only meaningful competitor," "our only real current competitor," and "Literally, no other competitors." Hard to get much better than that.

competitors. There will only be one."); PX05514 (ODP) at 003 ("Today, the FTC announced 45 days for its final decision. You still have time! You would be able to leverage the competition, gain an agreement that is grandfathered in and drive down expenses!").

[2] Having concluded that Plaintiffs have carried their burden of establishing that the sale and distribution of consumable office supplies to large B-to-B customers in the United States is the relevant market, the Court now turns to an analysis of the likely effects of the proposed merger on competition within the relevant market. If the FTC can make a prima facie showing that the acquisition in this case will result in a significant market share and an undue increase in concentration in the relevant market, then a presumption is established that the merger will substantially lessen competition. The burden is on the government to show that the merger would produce a firm controlling an undue percentage share of the relevant market that would result in a significant increase in the concentration of firms in that market.

[3] The Plaintiffs can establish their prima facie case by showing that the merger will result in an increase in market concentration above certain levels. Market concentration is a function of the number of firms in a market and their respective market shares. The Herfindahl-Hirschmann Index ("HHI") is a tool used by economists to measure changes in market concentration. HHI is calculated by "summing the squares of the individual firms' market shares," a calculation that "gives proportionately greater weight to the larger market shares." An HHI above 2,500 is considered "highly concentrated"; a market with an HHI between 1,500 and 2,500 is considered "moderately concentrated"; and a market with an HHI below 1,500 is considered "unconcentrated". A merger that results in a highly concentrated market that involves an increase of 200 points will be presumed to be likely to enhance market power. {*Eds.: These levels reflect the then-applicable 2010 Horizontal Merger Guidelines.*}

Concentration in the sale and distribution of consumable office supplies to large B-to-B customers

[4] Dr. Shapiro estimated Defendants' market shares by using data collected from Fortune 100 companies. During the data collecting process, 81 of the Fortune 100 companies responded with enough detail to be used in Dr. Shapiro's sample. . . . .

[5] Defendants' market share of the Fortune 100 sample as a whole is striking: Staples captures 47.3 percent and OfficeDepot captures 31.6 percent, for a total of 79 percent market share. The pre-merger HHI is already highly concentrated in this market, resting at 3,270. Put another way, Staples and OfficeDepot currently operate in the relevant market as a duopoly with a competitive fringe. If allowed to merge, the HHI would increase nearly 3,000 points, from 3,270 to 6,265. This market structure would constitute one dominant firm with a competitive fringe. Staples' proposed acquisition of OfficeDepot is therefore presumptively illegal because the HHI increases more than 200 points and the post-merger HHI is greater than 2,500.

[6] Defendants make several arguments in opposition to Dr. Shapiro's market share methodology and calculation. Defendants argue that: . . . the Fortune 100 sample overstates Defendants' actual market share; . . . and (3) Dr. Shapiro underestimates leakage, inflating Defendants' market shares. However, despite significant time spent cross-examining Dr. Shapiro with regard to his methodology, Defendants produced no expert evidence during the hearing to rebut that methodology. Moreover, it is significant that Defendants' final 100-page brief devotes only seven paragraphs to challenging Dr. Shapiro's market share calculations.

[7] Defendants' first argument in opposition to Dr. Shapiro's focus on the Fortune 100 is that his failure to take a sample of the other approximate 1100 companies in the relevant market is error because it results in dramatically inflated market shares. Dr. Shapiro conceded that the data he analyzed is imperfect because it does not include all large B-to-B customers. However, Dr. Shapiro was confident that there is no reason to believe the market shares are biased when it comes to estimating the market shares of Staples and OfficeDepot. To test whether his analysis of the Fortune 100 might have overstated Defendants' market shares because the Fortune 100 companies are especially large, Dr. Shapiro measured the market share of the top half of his sample separate from the bottom half. The range of spending on consumable office supplies among the companies analyzed in Dr. Shapiro's analysis is vast: from less than $200,000 per year on the low end, to more than $33 million per year on the high end. The combined market share for Defendants is seventy-nine percent among the top half of the Fortune 100 and eighty-

nine percent among the bottom half. Thus, Dr. Shapiro states that he is confident that the market shares for Staple[s] and OfficeDepot . . . are not overstated.

[8] Defendants' second challenge relating to the Fortune 100 sample focuses on the fact that only eighty-one of the 100 companies responded with enough data to be included in Dr. Shapiro's analysis. Defendants argue that the nineteen omitted are the most likely to purchase supplies from vendors other than Staples and OfficeDepot. Defendants highlight Costco as an example, a company that charges each department with procuring its own office supplies, whether from Costco or other vendors. The fact that Costco is able to purchase office supplies from Costco itself makes that company's procurement of office supplies an anomaly. Because Defendants did not present a case, they do not provide the Court with an analysis of the nineteen Fortune 100 companies excluded from Dr. Shapiro's analysis to show that their exclusion skewed Defendants' market shares in a way favorable to Plaintiffs. Antitrust economists rely on data from third parties through surveys, and therefore the measure of market shares is normally imperfect. . . . For all of these reasons, and in view of the absence of expert testimony offered by the Defendants, the Court is persuaded that Dr. Shapiro's analysis of the Fortune 100 represents a reasonable and reliable approximation of the Defendants' market share. [. . .]

[9] Finally, Defendants contend that Dr. Shapiro did not adequately account for "leakage" in his market share analysis. Leakage refers to unreported discretionary employee purchases of office supplies. Dr. Shapiro requested an estimate of leakage from the Fortune 100. Of the eighty-one companies included in his market-share analysis, twenty-six reported on leakage. Twelve of the twenty-six indicated that leakage spend was de minimis or immaterial. In these cases, Dr. Shapiro assumed that one percent of the companies' spend on office supplies was leakage.

[10] Testimony from fact witnesses during the hearing made it clear that even the largest companies in the world are either not concerned enough about leakage to track it or do not have a reliable way of tracking it. These same companies have tremendous incentive to ensure that their employees spend on contract. . . .

[11] For all of these reasons, the Court is confident that Dr. Shapiro accounted for any impact leakage has on Defendants' market shares in this case.

[12] Plaintiffs have met their burden of showing that the merger would result in undue concentration in the relevant market of the sale and distribution of consumable office supplies to large B-to-B customers in the United States. The relevant HHI would increase nearly 3,000 points, from 3,270 to 6,265. These HHI numbers far exceed the 200 point increase and post-merger concentration level of 2,500 necessary to entitle Plaintiffs to a presumption that the merger is illegal. The Court rejects Defendants' arguments in opposition to Dr. Shapiro's market analysis for the reasons discussed in detail . . . supra. Nevertheless, to strengthen their prima facie case, Plaintiffs presented additional evidence of harm, which the Court analyzes next.

Plaintiffs' evidence of additional harm

[13] Sole reliance on HHI calculations cannot guarantee litigation victories. Plaintiffs therefore highlight additional evidence, including bidding data ("bid data"), ordinary course documents, and fact-witness testimony. This additional evidence substantiates Plaintiffs' claim that this merger, if consummated, would result in a lessening of competition.

[14] Mergers that eliminate head-to-head competition between close competitors often result in a lessening of competition. Plaintiffs' evidence supports the conclusion that Defendants compete head-to-head for large B-to-B customers.

1. Bidding Data

[15] Dr. Shapiro analyzed five sets of bid data including: (1) Defendants' win-loss data; (2) data on Defendants' top wins and top losses; and (3) Fortune 100 bid data. Defendants often bid against each other for large B-to-B contracts.

[16] The bid data also shows that Defendants win large B-to-B customer bids more frequently than other bidders. The B-to-B contract market accounts for approximately thirty-five percent of Defendants' sales. . . . Staples CEO

Mr. Sargent describes the B-to-B contract business as a "cornerstone" of Staples' business. In fact, seventy-eight percent of OfficeDepot bid losses are to Staples. Similarly, eighty-one percent of Staples' bid losses were to OfficeDepot. Defendants compete aggressively for the others' business, exemplified by Staples' 2014 "Operation Take Share," a campaign that sought to capture some of OfficeDepot's market share.

2. Ordinary Course Documents

[17] Defendants' own documents created in the ordinary course of their business show that Defendants view themselves as the most viable office supply vendors for large businesses in the United States. See, e.g. PX04082 (SPLS) at 029 ("[T]here are only two real choices for them. Us or Them."); PX04042 (SPLS) at 024; PX05311 (ODP) at 001. Not surprisingly, Defendants view themselves as each other's fiercest competition. See, e.g., PX04322 (SPLS) at 001 (identifying only OfficeDepot as "Key Competitor[ ]"); PX04414 (SPLS) at 008 ("For core office supplies we often compare ourselves to our most direct competitor, ODP"); PX05229 (ODP) at 149 (stating that Staples is OfficeDepot's "[t]oughest and most aggressively priced national competitor.").

[18] Defendants consistently compete head-to-head with each other to win large B-to-B contracts. For example, in early 2015, HPG began negotiations with Staples. Staples' initial price reduction was retracted until OfficeDepot was invited to bid. Pitting Defendants against each other, HPG received substantial price concessions from both. In November 2014, Staples increased its up-front payment to [redacted text] to $[redacted text] to prevent [redacted text] from switching to OfficeDepot. In March 2014, [redacted text] engaged the Defendants in multiple rounds of bidding. Ultimately, OfficeDepot could not meet the six percent core list savings necessary to win the contract from Staples.

3. Fact Witness Testimony

[19] Large B-to-B customers view Defendants as their best option for nationwide sale and delivery of consumable office supplies. See e.g. Hrg Tr. 225:25-226:5 (AEP: "Q: And after OfficeDepot and Staples, what's the—what's the next best option after that? A: Then we're in trouble. We don't have a good—I don't think we have a good option after that."); 1205:17-20 (Best Buy "Q: So today Best Buy has a contract with OfficeDepot. Who does Best Buy consider to be its next best option for general office supplies and copy paper? A: Staples."); 1938:14-1939:18 (HPG "There's two nationally capable office supply vendors, from our perspective. One is Staples and one is Depot. And they control, roughly—when I say control, they own 80 percent of the market in terms of revenue."); 361:2-21, 373:9-15; 492:3-7 (McDonalds' noting its consideration of Staples and OfficeDepot, but ultimately did not invite Staples to submit an RFP because the company was able to "recognize immediate savings" by not going through an expensive bid process.); 1018:1-13 (Select Medical, a company that contracts with OfficeDepot, testified that it has concerns about the merger going through because "I believe it's important to have that competition to be able to properly service our national footprint, our national presence, and to also be able to provide the best possible pricing."). This testimony shows that absent OfficeDepot, large B-to-B customers would lose tremendous leverage and likely have to pay higher prices for consumable office supplies.

[20] This additional evidence strengthens Plaintiffs' claim that harm will result in the form of loss of competition if Staples is permitted to acquire OfficeDepot.

CASENOTE: United States v. H & R Block, Inc.

833 F. Supp. 2d 36 (D.D.C. 2011)

You may remember *H & R Block*—DOJ's challenge to the proposed acquisition of TaxACT by H & R Block ("HRB")—from Chapter III, where we considered some of the market definition challenges. In that case, DOJ advanced both unilateral and coordinated effects theories, and triggered the structural presumption by showing that the deal would increase HHI by around 400, resulting in a post-acquisition HHI of almost 4,700(!).

The court began its analysis by explaining that unilateral anticompetitive effects arise "if the acquiring firm will have the incentive to raise prices or reduce quality after the acquisition, independent of competitive responses from other firms." The court quoted a framework from an earlier case, FTC v. CCC Holdings, Inc., 605 F. Supp. 2d 26, 68 (D.D.C. 2009): "Unilateral effects in a differentiated product market are likely to be profitable under the

following conditions: (1) the products must be differentiated; (2) the products controlled by the merging firms must be close substitutes, i.e., a substantial number of the customers of one firm would turn to the other in response to a price increase; (3) other products must be sufficiently different from the products offered by the merging firms that a merger would make a small but significant and non-transitory price increase profitable for the merging firm; and (4) repositioning [by existing competitors to defeat anticompetitive effects] must be unlikely."

DOJ's unilateral case rested on considerable evidence of head-to-head competition between HRB and TaxACT. This included evidence that "HRB has lowered its [digital do-it-yourself] DDIY prices to better compete with free online products, the category pioneered by TaxACT, and has directly considered TaxACT's prices in setting its own prices. HRB has also determined the nature of its free offerings in response to competitive activity from TaxACT. The government also points to HRB documents that appear to acknowledge that TaxACT has put downward pressure on HRB's pricing ability." The court concluded that "[f]rom all of this evidence, and the additional evidence discussed in this opinion, it is clear that HRB and TaxACT are head-to-head competitors."

DOJ's position was supported by economic expert analysis. DOJ's expert had calculated that, if customer diversions were proportional to market share, diversions from HRB to TaxACT would be at least 14% and those from TaxACT to HRB would be at least 12%. Considering the parties' respective profit margins, DOJ's merger simulations suggested that the merged firm would increase TaxACT's price by 10.5–12.2% and HRB's price by 2.2–2.5%. Defendants raised various objections to these simulations (including the inputs to the economics model as well as to the model itself).

In response, the court emphasized that, while the government's quantitative analysis was necessarily imprecise, it was a helpful data point among others: "The Court finds that the merger simulation model used by the government's expert is an imprecise tool, but nonetheless has some probative value in predicting the likelihood of a potential price increase after the merger. The results of the merger simulation tend to confirm the Court's conclusions based upon the documents, testimony, and other evidence in this case that HRB and TaxACT are head-to-head competitors, that TaxACT's competition has constrained HRB's pricing, and that, post-merger, overall prices in the DDIY products of the merged firms are likely to increase to the detriment of the American taxpayer."

The merging parties offered some additional arguments in an effort to rebut DOJ's case: a couple of these are particularly important. First, the parties pointed to the fact that TaxACT had promised to maintain its current prices for three years as a guarantee against harm from the deal. But the court closed the door firmly on this kind of good-behavior remedy. "[T]his type of guarantee cannot rebut a likelihood of anticompetitive effects in this case. Even if TaxACT's list price remains the same, the merged firm could accomplish what amounts to a price increase through other means. For example, instead of raising TaxACT's prices, it could limit the functionality of TaxACT's products, reserving special features or innovations for higher priced, HRB-branded products. The merged firm could also limit the availability of TaxACT to consumers by marketing it more selectively and less vigorously."

Second, the parties pointed to evidence suggesting that a third player—the market leader, Intuit, which offered the popular TurboTax product—was a closer competitor to each of the merging parties than the other party. But the court was again unmoved, given the evidence of direct competition between HRB and TaxACT on both pricing and features: "[t]he fact that Intuit may be the closest competitor for both HRB and TaxACT also does not necessarily prevent a finding of unilateral effects for this merger."

Staples / Office Depot II and *H&R Block* demonstrate some ways in which additional evidence can reinforce the structural presumption. But in other cases, it can work the other way: additional evidence can *undermine* the structural presumption and allay competitive concerns. *Baker Hughes*, discussed above, was just such a case. *General Dynamics*, which we will meet later in this chapter, was another.[661] A more recent example was the state AGs' challenge to the *Sprint / T-Mobile* merger: in that case, a combination of efficiencies evidence, a remedy negotiated by the DOJ (which the state AG plaintiffs did not accept as sufficient), and a "flailing firm" argument operated to

[661] *See infra* § VIII.D.3.

defeat the presumption. We will talk about efficiencies and flailing firms later in this chapter, and will consider remedies below, as well as in Chapters XI and XII.

In general, consistent with the teachings of *Baker Hughes*, the stronger the structural case gets—that is, the higher the post-merger concentration HHI measure and the higher the increase in concentration caused by the deal (the so-called "delta HHI")—the less additional evidence courts or agencies will require from a plaintiff.[662] In *Heinz*, as we will see in a moment, the structural case seems to have stood virtually alone to discharge the plaintiff's burden.

Merger cases, like virtually all antitrust cases, are heavily driven by their own contexts and circumstances. This means that merger investigations and litigations are evidence-driven, discovery-heavy affairs, as agencies and courts work to understand the workings of competition in each relevant market. A merger can give rise to unilateral anticompetitive effects: even if neither party is the market leader; even if other firms are also close competitors of the merging parties; and even if the competition between the parties occurs higher up the distribution chain than the level at which end-consumers make their purchases. All three of these factors were at issue in the *Heinz* case (colloquially, the "Baby Foods" litigation). In *Heinz*, the merging parties—Heinz and Beech-Nut—were #2 and #3 in the market but, due to supermarket retailing practices, they were very seldom competing side-by-side on the same shelf. Instead they competed for the so-called "second position" on the shelf, alongside the market leader, Gerber, which was carried virtually everywhere. The district court denied the FTC's motion for a preliminary injunction to block the deal during an administrative challenge.[663] But, as the D.C. Circuit concluded on appeal, the deal was still unlawful, given the brands' robust competition to get onto the supermarket shelf in the first place.[664]

FTC v. H.J. Heinz Co.

246 F.3d 708 (D.C. Cir. 2001)

Judge Henderson.

[1] Four million infants in the United States consume 80 million cases of jarred baby food annually, representing a domestic market of $865 million to $1 billion. The baby food market is dominated by three firms, Gerber Products Company, Heinz and Beech-Nut. Gerber, the industry leader, enjoys a 65 per cent market share while Heinz and Beech-Nut come in second and third, with a 17.4 per cent and a 15.4 per cent share respectively. The district court found that Gerber enjoys unparalleled brand recognition with a brand loyalty greater than any other product sold in the United States. Gerber's products are found in over 90 per cent of all American supermarkets.

[2] By contrast, Heinz is sold in approximately 40 per cent of all supermarkets. Its sales are nationwide but concentrated in northern New England, the Southeast and Deep South and the Midwest. Despite its second-place domestic market share, Heinz is the largest producer of baby food in the world with $1 billion in sales worldwide. Its domestic baby food products with annual net sales of $103 million are manufactured at its Pittsburgh, Pennsylvania plant, which was updated in 1991 at a cost of $120 million. The plant operates at 40 per cent of its production capacity and produces 12 million cases of baby food annually. Its baby food line includes about 130 SKUs (stock keeping units), that is, product varieties (e.g., strained carrots, apple sauce, etc.). Heinz lacks Gerber's brand recognition; it markets itself as a "value brand" with a shelf price several cents below Gerber's.

[3] Beech-Nut has a market share (15.4%) comparable to that of Heinz (17.4%), with $138.7 million in annual sales of baby food, of which 72 per cent is jarred baby food. Its jarred baby food line consists of 128 SKUs. Beech–Nut manufactures all of its baby food in Canajoharie, New York at a manufacturing plant that was built in 1907 and began manufacturing baby food in 1931. Beech–Nut maintains price parity with Gerber, selling at about one penny less. It markets its product as a premium brand. Consumers generally view its product as comparable in

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662 *See*, *e.g.*, United States v. Anthem, Inc., 855 F.3d 345, 349–50 (D.C. Cir. 2017) ("The more compelling the prima facie case, the more evidence the defendant must present to rebut it successfully, but because the burden of persuasion ultimately lies with the plaintiff, the burden to rebut must not be unduly onerous.") (internal quotation marks omitted).

663 FTC v. H.J. Heinz Co., 116 F.Supp.2d 190 (D.D.C. 2000).

664 For a similar transaction that abandoned after an FTC challenge, *see* Complaint, In the matter of Post Holdings, Inc., FTC Dkt. No. 9388 (filed Dec. 19, 2019).

quality to Gerber's. Beech-Nut is carried in approximately 45 per cent of all grocery stores. Although its sales are nationwide, they are concentrated in New York, New Jersey, California and Florida.

[4] At the wholesale level Heinz and Beech-Nut both make lump-sum payments called "fixed trade spending" (also known as "slotting fees" or "pay-to-stay" arrangements) to grocery stores to obtain shelf placement. Gerber, with its strong name recognition and brand loyalty, does not make such pay-to-stay payments. The other type of wholesale trade spending is "variable trade spending," which typically consists of manufacturers' discounts and allowances to supermarkets to create retail price differentials that entice the consumer to purchase their product instead of a competitor's.

a. Prima Facie Case

[5] Merger law rests upon the theory that, where rivals are few, firms will be able to coordinate their behavior, either by overt collusion or implicit understanding, in order to restrict output and achieve profits above competitive levels. Increases in concentration above certain levels are thought to raise a likelihood of interdependent anticompetitive conduct. Market concentration, or the lack thereof, is often measured by the Herfindahl-Hirschmann Index (HHI).

[6] Sufficiently large HHI figures establish the FTC's prima facie case that a merger is anti-competitive. The district court found that the pre-merger HHI score for the baby food industry is 4775—indicative of a highly concentrated industry. The merger of Heinz and Beech-Nut will increase the HHI by 510 points. This creates, by a wide margin, a presumption that the merger will lessen competition in the domestic jarred baby food market. Here, the FTC's market concentration statistics are bolstered by the indisputable fact that the merger will eliminate competition between the two merging parties at the wholesale level, where they are currently the only competitors for what the district court described as the second position on the supermarket shelves. Heinz's own documents recognize the wholesale competition and anticipate that the merger will end it. Indeed, those documents disclose that Heinz considered three options to end the vigorous wholesale competition with Beech-Nut: two involved innovative measures while the third entailed the acquisition of Beech-Nut. Heinz chose the third, and least pro-competitive, of the options.

[7] Finally, the anticompetitive effect of the merger is further enhanced by high barriers to market entry. The district court found that there had been no significant entries in the baby food market in decades and that new entry was difficult and improbable. This finding largely eliminates the possibility that the reduced competition caused by the merger will be ameliorated by new competition from outsiders and further strengthens the FTC's case.

[8] As far as we can determine, no court has ever approved a merger to duopoly under similar circumstances.

b. Rebuttal Arguments

[9] [. . .] The appellees first contend, and the district court agreed, that Heinz and Beech-Nut do not really compete against each other at the retail level. Consumers do not regard the products of the two companies as substitutes, the appellees claim, and generally only one of the two brands is available on any given store's shelves. Hence, they argue, there is little competitive loss from the merger.

[10] This argument has a number of flaws which render clearly erroneous the court's finding that Heinz and Beech-Nut have not engaged in significant pre-merger competition. First, in accepting the appellees' argument that Heinz and Beech-Nut do not compete, the district court failed to address the record evidence that the two do in fact price against each other, and that, where both are present in the same areas, they depress each other's prices as well as those of Gerber even though they are virtually never all found in the same store. This evidence undermines the district court's factual finding.

[11] Second, the district court's finding is inconsistent with its conclusion that there is a single, national market for jarred baby food in the United States. The Supreme Court has explained that "[t]he outer boundaries of a product market are determined by the reasonable interchangeability of use [by consumers] or the cross-elasticity of demand between the product itself and substitutes for it." [Brown Shoe Co. v. United States, 370 U.S. 294, 325 (1962).] The definition of product market thus focuses solely on demand substitution factors, i.e., that consumers regard

the products as substitutes. By defining the relevant product market generically as jarred baby food, the district court concluded that in areas where Heinz's and Beech-Nut's products are both sold, consumers will switch between them in response to a small but significant and nontransitory increase in price (SSNIP). The district court never explained this inherent inconsistency in its logic nor could counsel for the appellees explain it at oral argument.

[12] Third, and perhaps most important, the court's conclusion concerning pre-merger competition does not take into account the indisputable fact that the merger will eliminate competition at the wholesale level between the only two competitors for the "second shelf" position. Competition between Heinz and Beech-Nut to gain accounts at the wholesale level is fierce with each contest concluding in a winner-take-all result. The district court regarded this loss of competition as irrelevant because the FTC did not establish to its satisfaction that wholesale competition ultimately benefitted consumers through lower retail prices. The district court concluded that fixed trade spending did not affect consumer prices and that the FTC's assertion that the proposed merger will affect variable trade spending levels and consumer prices is at best, inconclusive. Although the court noted the FTC's examples of consumer benefit through couponing initiatives, the court held that it was impossible to conclude with any certainty that the consumer benefit from such couponing initiatives would be lost in the merger.

[13] In rejecting the FTC's argument regarding the loss of wholesale competition, the court committed two legal errors. First, as the appellees conceded at oral argument, no court has ever held that a reduction in competition for wholesale purchasers is not relevant unless the plaintiff can prove impact at the consumer level. Second, it is, in any event, not the FTC's burden to prove such an impact with "certainty." To the contrary, the antitrust laws assume that a retailer faced with an increase in the cost of one of its inventory items will try so far as competition allows to pass that cost on to its customers in the form of a higher price for its product. Section 7 is, after all, concerned with probabilities, not certainties.

* * *

Although a unilateral effects case presupposes that meaningful competition would occur between the parties absent the transaction, merger enforcement does *not* depend on the conclusion that the parties are literally one another's closest or nearest competitors. The 2010 Horizontal Merger Guidelines said this explicitly, in language that did not survive into the 2023 version: "A merger may produce significant unilateral effects for a given product even though many more sales are diverted to products sold by non-merging firms than to products previously sold by the merger partner."[665]

Read the following FTC blog post, which emphasizes this point, and then take a look at a summary of the Oracle / PeopleSoft decision, which pre-dates the invigoration of unilateral effects enforcement in the 2010 Horizontal Merger Guidelines. Do you think Oracle / PeopleSoft would come out the same way today? Should it?

Stephen Mohr, The closest competitor is not the only competitor

FTC Competition Matters Blog (Dec. 9, 2019)

More and more, merging parties argue that their merger does not raise competition concerns because they are not each other's closest competitors. Parties have advanced this argument even in markets where there will be only two or three remaining firms post-transaction, including the merged firm. This argument is not new, and it often misunderstands merger analysis.

For any merger involving direct competitors—firms that are actively bidding against one another or vying for the same customers—the key question is whether the elimination of competition between the merging parties increases opportunities for anticompetitive unilateral or coordinated conduct in the post-merger market. While removal of

[665] U.S. Dept. of Justice & FTC, HORIZONTAL MERGER GUIDELINES (2010) § 6.1. *See also*, *e.g.*, FTC v. Kroger Co., No. 3:24-CV-00347, 2024 WL 5053016, at *19 (D. Or. Dec. 10, 2024) ("[A] merger need not be solely between the two largest competitors to eliminate substantial head-to-head competition and result in anticompetitive effects."); United States v. Anthem, Inc., 236 F. Supp. 3d 171, 216 (D.D.C. 2017) ("The acquired firm need not be the other's closest competitor to have an anticompetitive effect; the merging parties only need to be close competitors."), *aff'd*, 855 F.3d 345 (D.C. Cir. 2017); United States v. H & R Block, Inc., 833 F. Supp. 2d 36, 83 (D.D.C. 2011) ("The fact that [a third party] may be the closest competitor for both [the merging parties] . . . does not necessarily prevent a finding of unilateral effects for [a challenged] merger.").

the closest competitor likely eliminates the most significant source of competitive pressure on the merging firm, the Bureau's analysis does not end merely because the merging parties are not each other's most intense rivals. Instead, the Bureau routinely examines mergers that do not involve the two closest competitors in a market because a merger that removes a close (though not closest) competitor also may have a significant effect on the competitive dynamics in the post-merger market—that is, it too may "substantially lessen competition" in violation of Section 7. This is consistent with the discussion in the [Merger Guidelines] regarding competition between differentiated products, and is especially true if the acquired firm plays the role of a disruptor or innovator in the market. These firms often punch above their weight, having an out-sized impact on market dynamics despite a small market share.

For more recent real world guidance, merging parties need look no further than two of the Commission's recent merger challenges: *In re CDK Global, Inc. (CDK)* and *In re Otto Bock HealthCare North America, Inc. (Otto Bock)*. Last year, the Commission challenged the proposed merger of CDK and Auto/Mate, providers of dealer management systems for car dealerships. As the Commission stated in its Complaint, CDK and Reynolds & Reynolds were the two dominant players in the U.S. market, while Auto/Mate was an "innovative, disruptive challenger" that engaged in aggressive pricing. Although Auto/Mate was far from being CDK's closest competitor, the Commission nonetheless determined that Auto/Mate was poised to become an even stronger competitive threat in the future and that existing, current competition between the parties understated the most likely anticompetitive effects of this transaction. After the Commission issued a complaint and authorized staff to seek a PI, the parties abandoned their transaction.

Even more illuminating is this year's Commission Opinion analyzing Otto Bock's acquisition of Freedom Innovations, two manufacturers of microprocessor prosthetic knees (MPKs). [In the matter of Otto Bock Healthcare North America, 2019-2 Trade Cases ¶ 80,990, 2019 WL 6003207 (F.T.C. Nov. 1, 2019)] Similar to Auto/Mate, Freedom was a smaller, but more innovative and aggressive competitor than the two larger prosthetic manufacturers, Otto Bock and Össur. Otto Bock argued that the transaction was unlikely to result in competitive harm because Össur, not Freedom, was its closest competitor. The Commission disagreed, emphasizing in its Opinion that, "a merger can cause unilateral effects even if the merging products are not each other's closest competitors" and noting that it is sufficient if "a significant fraction of the customers purchasing that product view products formerly sold by the other merging firm as their next-best choice"—and that a "significant fraction . . . need not approach a majority." Applying this principle, the Commission found sufficient evidence of closeness of competition because Otto Bock and Freedom competed vigorously before the merger and, at the time of the acquisition, Freedom was preparing to introduce a new MPK that it expected would take significant share away from Otto Bock.

As the *CDK* and *Otto Bock* matters demonstrate, parties that continue to focus on showing that the merging firms are not each other's closest competitor may be ignoring the full analysis necessary to convince the Bureau and the Commission that the merger does not raise competitive concerns. Because that fact is not dispositive, counsel should address all the ways in which the parties are important competitive constraints on each other (or other market participants) such that the merger, by removing this constraint, would allow the merged firm to raise prices, reduce quality, reduce innovation, or coordinate more effectively with remaining competitors. Merger review is not so myopic as to dismiss the impact of all but the closest competitor.

CASENOTE: United States v. Oracle Corp.

331 F. Supp. 2d 1098 (N.D. Cal. 2004)[666]

Oracle / PeopleSoft involved the proposed merger of two major suppliers of enterprise software, including software for financial management and for human resources management. DOJ brought the challenge on a unilateral-

[666] For a perspective from one of the lead lawyers, see Commissioner J. Thomas Rosch, *Lessons Learned from* United States v. Oracle Corp., *Remarks for Antitrust in the High Tech Sector: Mergers, Enforcement, and Standardization* (Jan. 31, 2012); for contemporary commentary, *see* Roundtable, *Unilateral Effects Analysis After* Oracle, ANTITRUST (Spring 2005) 8; R. Preston McAfee, David S. Sibley, and Michael A. Williams, *Oracle's Acquisition of PeopleSoft:* U.S. v. Oracle (July 2007), https://vita.mcafee.cc/PDF/Oracle.pdf. For the DOJ's closing argument slides, see https://www.justice.gov/atr/case-document/closing-argument-presentation.

effects theory, arguing that Oracle and PeopleSoft were close competitors despite the presence of an important third competitor, SAP.

DOJ introduced a variety of factual evidence that Oracle and PeopleSoft were important head-to-head competitors. This included internal documents, such as a "win/loss analysis" indicating that, in the first quarter of 2003, Oracle lost to PeopleSoft 37 percent of the time when the two were in competition, while Oracle lost to SAP only 15 percent of the time the two competed. One Oracle internal document explicitly stated that "PeopleSoft is our Number # 1 competitor and SAP is our Number # 2 competitor." DOJ also presented witness testimony, including that of a SAP executive who testified that SAP "has had to deal with perceptions that [its software] is too costly and difficult to implement." And five customers of enterprise software testified that they had eliminated SAP for the final round of a procurement process, leaving Oracle and PeopleSoft competing head-to-head for their business.

In addition, DOJ's expert, Professor McAfee, conducted a regression analysis indicating that "when Oracle competes against PeopleSoft for the sale of Oracle's E–Business Suite, the consumer obtains a 9.7 percent greater discount than when Oracle competes against no one in selling the suite."

But Judge Walker was unconvinced, holding that "the plaintiffs have wholly failed to prove the fundamental aspect of a unilateral effects case[.]" The problem, he concluded, was that "they have failed to show a 'node' or an area of localized competition between Oracle and PeopleSoft. In other words, plaintiffs have failed to prove that there are a significant number of customers . . . who regard Oracle and PeopleSoft as their first and second choices."

None of DOJ's evidence had done the trick. The win/loss data was unpersuasive, the judge concluded, because on a fuller reading that data showed that there was very little distance between the importance of PeopleSoft as a competitor to Oracle and the importance of SAP. In fact, the data disclosed "roughly equal loss ratios." Likewise, the executive testimony about SAP's difficulties was of little weight given clear signs that SAP was a market leader. "SAP is not a 'disadvantaged' and 'troubled' competitor in the United States. If it were, SAP should not be beating Oracle in both [financial management and human resources management] markets and beating PeopleSoft in the [financial management] market." And, while the expert analysis certainly showed that Oracle and PeopleSoft were important competitors, the key question—in Judge Walker's telling—was whether they were close competitors in a part of the market in which SAP was not present. "Simply because Oracle and PeopleSoft often meet on the battlefield and fight aggressively does not lead to the conclusion that they do so in the absence of SAP."

Thus unpersuaded that Oracle and PeopleSoft were particularly important competitive constraints on one another, Judge Walker directed judgment for the merging parties, and the transaction was permitted to close.

Oracle / PeopleSoft was decided in 2004, and it exemplifies a demanding and skeptical approach to unilateral-effects cases that may have deterred enforcers—at least to some extent—from pursuing such theories for a time. Indeed, two former federal enforcers have written that "the court's opinion [in *Oracle / PeopleSoft*] betrays a deep hostility to unilateral effects [theory] that interferes with careful antitrust analysis."[667] The decision seems to have encouraged the drafters of the 2010 Horizontal Merger Guidelines to devote additional space to explaining unilateral-effects analysis. Since 2010, unilateral-effects theories have played an important role in the agencies' enforcement work, and subsequent courts have often been more receptive to them.

NOTES

1) We have seen that courts consider many kinds of evidence—including economic expert analysis, market participant testimony, and ordinary-course documents—as well as information about market shares and market concentration. Which of these do you think are most reliable? Which are least reliable?
2) In practice, courts and agencies often pay particular attention to the views of customers, rather than those of the merging parties or competitors. Why do you think this is? What disadvantages apply to customer testimony as a guide to the likely effects of a merger?

[667] Jonathan B. Baker & Carl Shapiro, *Reinvigorating Horizontal Merger Enforcement*, in Robert Pitofsky (ed.), HOW CHICAGO SCHOOL OVERSHOT THE MARK: THE EFFECT OF CONSERVATIVE ECONOMIC ANALYSIS ON U.S. ANTITRUST (2008) 238.

3) Should the probative weight of parties' internal documents depend on whether they are consistent, or inconsistent, with the parties' arguments at the time of the merger review? How, if at all, should this matter?
4) Nascent competition cases involve a competitor that is already present in the relevant market, but which is still developing. What are the dangers of adopting too lax a standard in connection with acquisitions of nascent competitors? What are the dangers of a too-strict standard?[668]
5) Some have suggested that the acquisitions of potential and nascent competitors might be a particular problem in markets for digital products and services, and that we should have special rules for such markets. How would we test to see whether that is true? What kind of information would we need, and how would we collect it?
6) One major concern for antitrust law and policy is the phenomenon of so-called "serial acquisitions": that is, multiple acquisitions by a firm in the same market, and particularly those such that each individual acquisition may have a small impact on competition but the overall effect may be significant. How do you think Section 7 should treat such practices?
7) Should we have complementary *per se* and "rule of reason" rules for unilateral effects analysis in mergers? How would you define a per se rule for unilateral effects?
8) Do you think a court reviewing the legality of a consummated merger should admit evidence of how the merged firm in fact priced following the deal?

b) Coordinated Effects

"Coordinated" anticompetitive effects arise when a merger or acquisition causes harm by making a market more susceptible to tacit or express coordination.[669] As we saw in Chapter II, tacit collusion is a reduction in competition among firms that realize that it is in their interests to avoid aggressive competition and can sustain strategic interaction to that end. As you may remember from Chapter IV, this kind of behavior is not itself illegal (assuming the participants do not enter into an actual agreement), so merger control is often a critical opportunity to prevent the emergence of concentration levels, and other conditions, that make it more likely.[670]

As you might expect, in coordinated effects cases, courts and agencies pay close attention to the factors that make strategic interdependence particularly likely or particularly harmful. As you will remember from Chapter II, these factors include, among other things: high levels of concentration; transparency of price and other terms among the market participants; mechanisms to punish or retaliate against firms that violate the terms of coordination; symmetry of incentives among the participants; and so on.[671] When circumstances are otherwise—for example, when market participants are many or dissimilarly situated, or when their dealings are not transparent—then the implicit bargain of coordination may be shaky or unsustainable.

As a result, coordinated-effects analysis often focuses on factors that might increase the vulnerability of the market to coordination. Will the merger significantly increase concentration? Will it eliminate a disruptive maverick that has been thwarting efforts at tacit collusion? Will it leave the market more transparent, or the participants' incentives more closely aligned? Will it give coordinators better means of detecting or punishing cheating? And so on.

Merger Guidelines § 2.3

Guideline 3: Mergers Can Violate the Law When They Increase the Risk of Coordination.

[1] The Agencies determine that a merger may substantially lessen competition when it meaningfully increases the risk of coordination among the remaining firms in a relevant market or makes existing coordination more stable or effective. Firms can coordinate across any or all dimensions of competition, such as price, product features, customers, wages, benefits, or geography. Coordination among rivals lessens competition whether it

668 *Compare*, *e.g.*, C. Scott Hemphill & Tim Wu, *Nascent Competitors*, 168 U. Penn. L. Rev. 1879 (2020), *with* John M. Yun, Bruce H. Kobayashi, Abbott B. Lipsky, Alexander Raskovich, & Joshua D. Wright, *Potential and Nascent Competition in Merger Review: Global Antitrust Institute Comment on the DOJ-FTC Request for Information on Merger Enforcement* (April 2022).

669 On the economics of coordination, *see* George J. Stigler, *A Theory of Oligopoly*, 72 J. Pol. Econ. 44 (1961).

670 *See supra* § IV.B.

671 *See supra* § II.H.

occurs explicitly—through collusive agreements between competitors not to compete or to compete less—or tacitly, through observation and response to rivals. Because tacit coordination often cannot be addressed under Section 1 of the Sherman Act, the Agencies vigorously enforce Section 7 of the Clayton Act to prevent market structures conducive to such coordination.

[2] Tacit coordination can lessen competition even when it does not rise to the level of an agreement and would not itself violate the law. For example, in a concentrated market a firm may forego or soften an aggressive competitive action because it anticipates rivals responding in kind. This harmful behavior is more common the more concentrated markets become, as it is easier to predict the reactions of rivals when there are fewer of them.

[3] To assess the extent to which a merger may increase the likelihood, stability, or effectiveness of coordination, the Agencies often consider three primary factors and several secondary factors. The Agencies may consider additional factors depending on the market.

2.3.A. Primary Factors

[4] The Agencies may conclude that post-merger market conditions are susceptible to coordinated interaction and that the merger materially increases the risk of coordination if any of the three primary factors are present.

[5] *Highly Concentrated Market.* By reducing the number of firms in a market, a merger increases the risk of coordination. The fewer the number of competitively meaningful rivals prior to the merger, the greater the likelihood that merging two competitors will facilitate coordination. Markets that are highly concentrated after a merger that significantly increases concentration (see Guideline 1) {*Eds.: Guideline 1, which expresses the structural presumption, is excerpted above, see § VII.B.1.*} are presumptively susceptible to coordination. If merging parties assert that a highly concentrated market is not susceptible to coordination, the Agencies will assess this rebuttal evidence using the framework described below. Where a market is not highly concentrated, the Agencies may still consider other risk factors.

[6] *Prior Actual or Attempted Attempts [sic] to Coordinate.* Evidence that firms representing a substantial share in the relevant market appear to have previously engaged in express or tacit coordination to lessen competition is highly informative as to the market's susceptibility to coordination. Evidence of failed attempts at coordination in the relevant market suggest that successful coordination was not so difficult as to deter attempts, and a merger reducing the number of rivals may tend to make success more likely.

[7] *Elimination of a Maverick.* A maverick is a firm with a disruptive presence in a market. The presence of a maverick, however, only reduces the risk of coordination so long as the maverick retains the disruptive incentives that drive its behavior. A merger that eliminates a maverick or significantly changes its incentives increases the susceptibility to coordination.

2.3.B. Secondary Factors

[8] The Agencies also examine whether secondary factors demonstrate that a merger may meaningfully increase the risk of coordination, even absent the primary risk factors. Not all secondary factors must be present for a market to be susceptible to coordination.

[9] *Market Concentration.* Even in markets that are not highly concentrated, coordination becomes more likely as concentration increases. The more concentrated a market, the more likely the Agencies are to conclude that the market structure suggests susceptibility to coordination.

[10] *Market Observability.* A market is more susceptible to coordination if a firm's behavior can be promptly and easily observed by its rivals. Rivals' behavior is more easily observed when the terms offered to customers are readily discernible and relatively observable (that is, known to rivals). Observability can refer to the ability to observe prices, terms, the identities of the firms serving particular customers, or any other competitive actions of other firms. Information exchange arrangements among market participants, such as public exchange of information through announcements or private exchanges through trade associations or publications, increase market observability. Regular monitoring of one another's prices or customers can indicate that the terms offered to customers are relatively observable. Pricing algorithms, programmatic pricing software or services, and other

analytical or surveillance tools that track or predict competitor prices or actions likewise can increase the observability of the market.

[11] *Competitive Responses.* A market is more susceptible to coordination if a firm's prospective competitive reward from attracting customers away from its rivals will be significantly diminished by its rivals' likely responses. This is more likely to be the case the stronger and faster the responses from its rivals because such responses reduce the benefits of competing more aggressively. Some factors that increase the likelihood of strong or rapid responses by rivals include: (1) the market has few significant competitors, (2) products in the relevant market are relatively homogeneous, (3) customers find it relatively easy to switch between suppliers, (4) suppliers use algorithmic pricing, or (5) suppliers use meeting-competition clauses. The more predictable are rivals' responses to strategic actions or changing competitive conditions, and the more interactions firms have across multiple markets, the greater the susceptibility to coordination.

[12] *Aligned Incentives.* Removing a firm that has different incentives from most other firms in a market can increase the risk of coordination. For example, a firm with a small market share may have less incentive to coordinate because it has more to gain from winning new business than other firms. The same issue can arise when a merger more closely aligns one or both merging firms' incentives with the other firms in the market. In some cases, incentives might be aligned or strengthened when firms compete with one another in multiple markets ("multi-market contact"). For example, firms might compete less aggressively in some markets in anticipation of reciprocity by rivals in other markets. The Agencies examine these and any other market realities that suggest aligned incentives increase susceptibility to coordination.

[13] *Profitability or Other Advantages of Coordination for Rivals.* The Agencies regard coordinated interaction as more likely to occur when participants in the market stand to gain more from successful coordination. Coordination generally is more profitable or otherwise advantageous for the coordinating firms the less often customers substitute outside the market when firms offer worse terms.

[14] *Rebuttal Based on Structural Barriers to Coordination Unique to the Industry.* When market structure evidence suggests that a merger may substantially lessen competition through coordination, the merging parties sometimes argue that anticompetitive coordination is nonetheless impossible due to structural market barriers to coordinating. The Agencies consider this rebuttal evidence using the framework in Section 3. In so doing, the Agencies consider whether structural market barriers to coordination are so much greater in the relevant industry than in other industries that they rebut the normal presumption of coordinated effects. In the Agencies' experience, structural conditions that prevent coordination are exceedingly rare in the modern economy. For example, coordination is more difficult when firms are unable to observe rivals' competitive offerings, but technological change has made this situation less common than in the past and reduced many traditional barriers or obstacles to observing the behavior of rivals in a market. The greater the level of concentration in the relevant market, the greater must be the structural barriers to coordination in order to show that no substantial lessening of competition is threatened.

* * *

An excellent example of a successful coordinated-effects challenge is our old friend *H&R Block*. In that case, the Department of Justice successfully persuaded the court that the reduction from three to two suppliers of free DIY tax services would give rise to coordinated effects. As in many other coordinated-effects cases, the court gave special attention to whether the merger would eliminate a player that had, before the transaction, been particularly disruptive to oligopolistic behavior. Such firms are sometimes called "mavericks," and their elimination through acquisition can be particularly harmful.[672]

[672] It is not always easy to identify a maverick in practice. *See, e.g.*, Taylor M. Owings, *Identifying a Maverick: When Antitrust Law Should Protect a Low-Cost Competitor*, 66 Vand. L. Rev. 323 (2013); Jonathan B. Baker, *Mavericks, Mergers, and Exclusion: Proving Coordinated Competitive Effects Under the Antitrust Laws*, 77 N.Y.U. L. Rev. 135 (2002).

United States v. H & R Block, Inc.

833 F.Supp.2d 36 (D.D.C. 2011)

Judge Howell.

[1] Having defined the relevant market as [digital do-it-yourself (or "DDIY")] tax preparation products, the Court must next consider the likely effects of the proposed acquisition on competition within that market. The government must now make out its prima facie case by showing that the merger would produce a firm controlling an undue percentage share of the relevant market, and would result in a significant increase in the concentration of firms in that market. Such a showing establishes a presumption that the merger will substantially lessen competition. [. . .]

[2] In this case, market concentration as measured by HHI is currently 4,291, indicating a highly concentrated market under the Merger Guidelines. The most recent measures of market share show Intuit with 62.2 percent of the market, HRB with 15.6 percent, and TaxACT with 12.8 percent. These market share calculations are based on data provided by the IRS for federal tax filings for 2010, the most recent data available.

[3] The defendants argue that market share calculations based exclusively on federal filing data are insufficient to meet the plaintiff's burden in establishing its alleged relevant product market, which includes both federal and state filings. The Court rejects this argument. State tax return products are typically sold as add-ons to or in combination with federal return products and the Court finds that there is little reason to conclude that the market share proportions within the state DDIY segment would be significantly different from federal DDIY. While, as defendants point out, many customers of federal tax return DDIY products do not also purchase state returns, that may be because they live in states without income tax or because their state returns are simple enough to prepare very easily without assistance. A reliable, reasonable, close approximation of relevant market share data is sufficient, however. Further, the defendants' own ordinary course of business documents analyze the market based on IRS federal e-file data, without reference to state filings, even though the defendants' clearly sell state tax return products.

[4] The proposed acquisition in this case would give the combined firm a 28.4 percent market share and will increase the HHI by approximately 400, resulting in a post-acquisition HHI of 4,691. These HHI levels are high enough to create a presumption of anticompetitive effects. Accordingly, the government has established a prima facie case of anticompetitive effects.

[5] Upon the showing of a prima facie case, the burden shifts to defendants to show that traditional economic theories of the competitive effects of market concentration are not an accurate indicator of the merger's probable effect on competition in these markets or that the procompetitive effects of the merger are likely to outweigh any potential anticompetitive effects. [. . .]

[6] Merger law rests upon the theory that, where rivals are few, firms will be able to coordinate their behavior, either by overt collusion or implicit understanding in order to restrict output and achieve profits above competitive levels. The government argues that the elimination of TaxACT, one of the "Big 3" Digital DIY firms will facilitate tacit coordination between Intuit and HRB. Whether a merger will make coordinated interaction more likely depends on whether market conditions, on the whole, are conducive to reaching terms of coordination and detecting and punishing deviations from those terms. Since the government has established its prima facie case, the burden is on the defendants to produce evidence of structural market barriers to collusion specific to this industry that would defeat the ordinary presumption of collusion that attaches to a merger in a highly concentrated market.

[7] The defendants argue the primary reason that coordinated effects will be unlikely is that Intuit will have no incentive to compete any less vigorously post-merger. The defendants assert that the competition between Intuit and HRB's retail stores would be fundamentally nullified if Intuit decided to reduce the competitiveness of TurboTax. Further, defendants contend that Intuit has no incentive to reduce the competitiveness of its free product because it views its free product as a critical driver of new customers. Therefore, the defendants conclude

that if HRB does not compete as aggressively as possible with its post-merger products, it will lose customers to Intuit.

[8] The most compelling evidence the defendants marshal in support of these arguments consists of documents and testimony indicating that Intuit engaged in a series of "war games" designed to anticipate and defuse new competitive threats that might emerge from HRB post-merger. The documents and testimony do indicate that Intuit and HRB will continue to compete for taxpayers' patronage after the merger—indeed, in the DDIY market, they would be the only major competitors. This conclusion, however, is not necessarily inconsistent with some coordination. As the Merger Guidelines explain, coordinated interaction involves a range of conduct, including unspoken understandings about how firms will compete or refrain from competing.

[9] In this case, the government contends that coordination would likely take the form of mutual recognition that neither firm has an interest in an overall "race to free" in which high-quality tax preparation software is provided for free or very low prices. Indeed, the government points to an outline created as part of the Intuit "war games" regarding post-merger competition with HRB that also indicates an Intuit employee's perception that part of HRB's post-merger strategy would be to "not escalate free war: Make free the starting point not the end point for customers." Since, as defendants point out, DDIY companies have found "free" offers to be a useful marketing tool, it is unlikely that free offers would be eliminated. Rather, the government argues, it is more likely that HRB and Intuit may find it in their mutual interest to . . . offer a lower quality free product and maintain higher prices for paid products.

[10] The government points to a highly persuasive historical act of cooperation between HRB and Intuit that supports this theory. After TaxACT launched its free-for-all offer in the [Free File Alliance ("FFA")], Intuit proposed that the firms in the market limit their free FFA offers, a move which TaxACT opposed and which Mr. Dunn [TaxACT's founder] believed was an illegal restraint on trade. HRB, Intuit, and others then joined together and successfully lobbied the IRS for limitations on the scope of the free offers through the FFA—limitations that remain in place today. This action illustrates how the pricing incentives of HRB and Intuit differ from those of TaxACT and it also shows that HRB and Intuit, although otherwise competitors, are capable of acting in concert to protect their common interests.

[11] The defendants also argue that coordinated effects are unlikely because the DDIY market consists of differentiated products and has low price transparency. To the contrary, the record clearly demonstrates that the players in the DDIY industry are well aware of the prices and features offered by competitors. Since DDIY products are marketed to a large swath of the American population and available via the Internet, DDIY firms can easily monitor their competitors' offerings and pricing. The fact that competitors may offer various discounts and coupons to some customers via email hardly renders industry pricing "not transparent," as defendants submit. Moreover, while collusion may, in some instances, be more likely in markets for homogenous products than differentiated products, product differentiation in this market would not necessarily make collusion more difficult.

[12] Other indicia of likely coordination are also present in the DDIY market. Transactions in the market are small, numerous, and spread among a mass of individual consumers, each of whom has low bargaining power; prices can be changed easily; and there are barriers to switching due to the "stickiness" of the DDIY products.

[13] Finally, the Court notes that the merger would result in the elimination of a particularly aggressive competitor in a highly concentrated market, a factor which is certainly an important consideration when analyzing possible anti-competitive effects. The evidence presented at the hearing from all parties demonstrated TaxACT's impressive history of innovation and competition in the DDIY market. Mr. Dunn's trial testimony revealed him to be a dedicated and talented entrepreneur and businessman, with deep knowledge and passion for providing high-quality, low-cost tax solutions. TaxACT's history of expanding the scope of its high-quality, free product offerings has pushed the industry toward lower pricing, even when the two major players were not yet ready to follow—most notably in TaxACT's introduction of free-for-all into the market.

[14] The government presses the argument that TaxACT's role as an aggressive competitor is particularly important by urging this Court to find that TaxACT is a maverick. In the context of antitrust law, a maverick has been defined as a particularly aggressive competitor that plays a disruptive role in the market to the benefit of

customers. The [2010] Merger Guidelines endorses this concept and gives a few examples of firms that may be industry mavericks, such as where one of the merging firms may have the incentive to take the lead in price cutting or a firm that has often resisted otherwise prevailing industry norms to cooperate on price setting or other terms of competition.

[15] The parties have spilled substantial ink debating TaxACT's maverick status. The arguments over whether TaxACT is or is not a "maverick"—or whether perhaps it once was a maverick but has not been a maverick recently—have not been particularly helpful to the Court's analysis. The government even put forward as supposed evidence a TaxACT promotional press release in which the company described itself as a "maverick." This type of evidence amounts to little more than a game of semantic gotcha. Here, the record is clear that while TaxACT has been an aggressive and innovative competitor in the market, as defendants admit, TaxACT is not unique in this role. Other competitors, including HRB and Intuit, have also been aggressive and innovative in forcing companies in the DDIY market to respond to new product offerings to the benefit of consumers.

[16] The government has not set out a clear standard, based on functional or economic considerations, to distinguish a maverick from any other aggressive competitor. At times, the government has emphasized TaxACT's low pricing as evidence of its maverick status, while, at other times, the government seems to suggest that almost any competitive activity on TaxACT's part is a "disruptive" indicator of a maverick. For example, the government claims that most recently, TaxACT continued to disrupt the Digital DIY market by entering the boxed retail software segment of the market, which had belonged solely to HRB and Intuit. Credible evidence at the hearing, however, showed otherwise. . . .

[17] What the Court finds particularly germane for the "maverick" or "particularly aggressive competitor" analysis in this case is this question: Does TaxACT consistently play a role within the competitive structure of this market that constrains prices? The Court finds that TaxACT's competition does play a special role in this market that constrains prices. Not only did TaxACT buck prevailing pricing norms by introducing the free-for-all offer, which others later matched, it has remained the only competitor with significant market share to embrace a business strategy that relies primarily on offering high-quality, full-featured products for free with associated products at low prices.

[18] Moreover, as the plaintiff's expert, Dr. Warren-Boulton, explained, the pricing incentives of the merged firm will differ from those of TaxACT pre-merger because the merged firm's opportunity cost for offering free or very low-priced products will increase as compared to TaxACT now. In other words, the merged firm will have a greater incentive to migrate customers into its higher-priced offerings—for example, by limiting the breadth of features available in the free or low-priced offerings or only offering innovative new features in the higher-priced products.

[19] While the defendants oppose the government's maverick theory, they do not deny that TaxACT has been an aggressive competitor. Indeed, they submit that "that's why H & R Block wants to buy them." HRB contends that the acquisition of TaxACT will result in efficiencies and management improvements that will lead to better, more effective, and/or cheaper H & R Block digital products post-merger that are better able to compete with Intuit. . . . .

[20] Finally, the defendants suggest that coordinated effects are unlikely because of the ease of expansion for other competitors in the market. As detailed above in the Court's discussion of barriers to entry and expansion, the Court does not find that ease of expansion would counteract likely anticompetitive effects.

[21] Accordingly, the defendants have not rebutted the presumption that anticompetitive coordinated effects would result from the merger. To the contrary, the preponderance of the evidence suggests the acquisition is reasonably likely to cause such effects.

* * *

Compare the *H&R Block* analysis with that in the first *Arch Coal* case,[673] in which the court was having none of the FTC's argument that the acquisition by a coal mining company, Arch Coal, of its competitor, Triton, would give rise to coordinated effects. The FTC's case foundered on the court's conclusions that, *first*, the nature of the market was uncongenial to oligopoly effects, and, *second*, the target could not plausibly be described as a "maverick." As you read the following extract, remember that in 2004 the operative Horizontal Merger Guidelines were those issued in 1997, which provided that a merger "potentially raise[d] significant competitive concerns" if the post-merger HHI exceeded 1,800 and the transaction increased the HHI by more than 50 points.

FTC v. Arch Coal, Inc.

329 F. Supp. 2d 109 (D.D.C. 2004)

Judge Bates.

[1] Coal is the primary fuel that produces electric power for residential and business consumers across the United States. It is mined in various regions across the country, in either surface or underground mining operations, after which the coal is transported by rail, truck or barge to electrical generating plants. One-third of the coal produced annually in the United States—over 360 million tons—is produced from large-scale surface mining operations in the Southern Powder River Basin ("SPRB") region of Wyoming. Seven companies operate fourteen mines in the SPRB at this time.

[2] In May of 2003, Arch Coal, Inc. ("Arch"), the owner and operator of two SPRB mines (Black Thunder and Coal Creek) as well as other mining operations across the United States, and New Vulcan Coal Holdings, LLC ("New Vulcan"), the owner of two SPRB mines (North Rochelle and Buckskin), which it operates through its subsidiary Triton Coal Company, LLC ("Triton"), entered into a merger and purchase agreement under which Arch would acquire Triton and its two SPRB mines. . . . Arch subsequently informed the FTC that it intended to divest one of the acquired mines (Buckskin) to Peter Kiewit Sons, Inc. ("Kiewit"), a large company with some mining interests outside the SPRB, and in January 2004 a firm asset purchase agreement was entered by Arch and Kiewit.

[3] . . . The SPRB mines can be divided into three tiers based on coal quality, heat content, and mine location. Tier 1 mines typically produce a high Btu (8600–8900) coal and include the Antelope, Black Thunder, Jacobs Ranch, North Antelope/Rochelle, and North Rochelle mines. Tier 2 mines produce coals ranging from 8300 to 8550 Btu, and include Belle Ayr, Caballo/North Caballo, Coal Creek, and the Cordero Rojo complex. Tier 3 mines produce relatively low Btu coal (7900–8450) and include the Buckskin, Dry Fork, Eagle Butte, Fort Union, Rawhide, and Wyodak mines. {*Eds.: in a footnote, the court explained that "A British Thermal Unit (Btu) is the amount of heat required to raise the temperature of one pound of water one degree Fahrenheit."*}

[4] Seven companies currently operate the fourteen mines in the SPRB. Four companies, each operating a Tier 1 mine, are considered the major producers of SPRB coal: Arch, Triton, Kennecott Energy Co. ("Kennecott"), and Peabody Holding Co. ("Peabody"). Arch operates the Black Thunder and Coal Creek mines; Triton operates the North Rochelle and Buckskin mines; Kennecott operates the Antelope, Jacobs Ranch and Cordero–Rojo mines; and Peabody operates the North Antelope/Rochelle, Caballo, and Rawhide mines. RAG American ("RAG") is another significant producer in the SPRB, but it only operates mines in Tiers 2 and 3 (Belle Ayr and Eagle Butte). Two small mining entities, Western Fuels and Wyodak, generally do not compete for business in the region and, therefore, are not recognized by most customers as feasible supply alternatives to the five larger producers. [. . .]

[5] There are currently five significant producers of SPRB coal: Peabody, Kennecott, Arch, RAG, and Triton. Post-merger, there will still be five significant producers of SPRB coal, with Kiewit replacing Triton as an SPRB producing entity. The percentages of the firms' market shares will change, to be sure, as Arch will acquire the North Rochelle mine and Kiewit will take over only Triton's Buckskin mine. However, Arch will remain third among the five producers.

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[673] For the final (or at least next) chapter of the story, *see* FTC v. Peabody Energy Corp., 492 F. Supp. 3d 865 (E.D. Mo. 2020) ("Arch Coal II") (granting preliminary injunction to block proposed JV between Arch Coal and Peabody that would have created a firm with 68% share and increased HHI from 2,707 to 4,965).

[6] Based on the HHI calculation for the current SPRB coal market, it is highly concentrated. Whether market concentration is measured in terms of practical capacity, loadout capacity, production, or reserves, the post-merger market remains highly concentrated. The post-merger increase in HHI ranges from 49 points to 224 points, depending on which measure is used to calculate market concentration. . . .

[7] . . . The reserves data provided to the Court establish that the current market concentration (HHI) is 2054, and that post-merger it will be 2103, for an increase in HHI of 49. According to the [1997] Merger Guidelines, an increase in HHI of 50 points or more in a post-merger highly concentrated market raises significant competitive concerns. Although the HHI increase calculated on the basis of reserves is only 49, the Merger Guidelines state that: "the numerical divisions suggest greater precision than is possible with the available economic tools and information. Other things being equal, cases falling just above and just below a threshold present comparable competitive issues." Based on reserves, then, the proposed transaction may raise significant competitive concerns—although just barely. [. . .]

[8] [Various alternative measures] of market concentration in the SPRB presented by the parties . . . reflect an increase in HHI ranging from 49 to 224. Considering all these measures of market concentration, therefore, at a minimum the proposed transactions raise significant competitive concerns and if, as the Court believes may be appropriate, one departs from a strictly reserves-based approach . . . because of changes that have occurred in the coal market over the last thirty years, then there may even be a presumption of an anticompetitive increase in market power. Ignoring altogether the other measures of market concentration in favor of an exclusively reserves-based assessment seems unwarranted. The FTC has, therefore, satisfied its prima facie case burden.

[9] Nevertheless, it is important to note that this case is not one in which the post-merger increase in HHI produces an overwhelming statistical case for the likely creation or enhancement of anticompetitive market power. Indeed, the single best available measure of market concentration—reserves—produces an increase in HHI of only 49, which is actually below the level for significant concern in the highly concentrated SPRB market. The [alternative] measure plaintiffs urge . . . only produces an HHI increase of 224. Such HHI increases are far below those typical of antitrust challenges brought by the FTC and DOJ. For example, in *Heinz* the HHI increase was 510 based on a pre-merger HHI of 4775. In *Baker Hughes* the HHI increase was 1425, from 2878 pre-merger to 4303 post-merger. In *Staples* the HHI increase in the several markets under consideration was 2715. And in FTC v. Libbey, Inc., 211 F. Supp. 2d 34, 51 (D.D.C. 2002), the impact of the original merger agreement (used by the court for its analysis) was an HHI increase of 1052. All of these levels of HHI increase dwarf even the highest increase arguably present here. Indeed, between 1999 and 2003, only twenty-six merger challenges out of 1,263 (two percent) occurred in markets with comparable concentration levels to those argued here.

[10] Thus, although the FTC has satisfied its prima facie case burden, the FTC's prima facie case is not strong. Certainly less of a showing is required from defendants to rebut a less-than-compelling prima facie case. Even assuming that the FTC's showing of an increase in HHI, and thus market concentration, warrants a presumption that the transactions will lessen competition, defendants have pointed out the shortcomings of statistics based on capacity or production, rather than on reserves, in providing the best assessment of the proposed merger's likely future effect on competition. Defendants have, therefore, successfully rebutted the presumption that the merger will substantially lessen competition and the Court will proceed to examine the issue of the likely competitive effects of the proposed merger in the relevant market, for which plaintiffs bear the ultimate burden of persuasion. As discussed below, an analysis of the SPRB market confirms that defendants have produced sufficient evidence to further rebut the FTC's prima facie case and that, ultimately, plaintiffs have not carried their burden of persuasion. [. . .]

[11] Plaintiffs [in a merger case] may seek to show that a merger will diminish competition by showing that it will facilitate coordinated interaction. That is, in fact, the thrust of plaintiffs' case here. The Merger Guidelines define coordinated interaction as actions by a group of firms that are profitable for each of them only as a result of the accommodating reactions of the others. This behavior includes tacit or express collusion, and may or may not be lawful in and of itself. Indeed, antitrust policy seeks particularly to inhibit the creation or reinforcement by merger of oligopolistic market structures in which tacit coordination can occur.

[12] A market is conducive to tacit coordination, then, where producers recognize their shared economic interests and their interdependence with respect to price and output decisions. Successful coordination requires two factors: (1) reaching terms of coordination that are profitable to the firms involved and (2) an ability to detect and punish deviations that would undermine the coordinated interaction. Coordination need not be complex or complete—instead, the terms of coordination may be imperfect and incomplete and still result in significant competitive harm. The [1997] Merger Guidelines provide, moreover, that the punishment of deviation will not always be direct and specific: "Credible punishment may not need to be any more complex than temporary abandonment of the terms of coordination by other firms in the market." But "where detection or punishment is likely to be slow, incentives to deviate are enhanced and coordinated interaction is unlikely to be successful." [. . .]

[13] The . . . question . . . is whether . . . coordinated interaction in the form of tacit output reduction is likely to occur in this market as a result of the proposed transactions. [. . .]

a. Interest in Production Discipline

[14] Producers in the SPRB have certainly evinced some past interest in price or production discipline. On April 25, 2000, Irl Engelhardt, Chairman and CEO of Peabody, gave a speech before the Western Coal Transportation Association, a meeting attended by SPRB coal producers and customers, in which he remarked on disciplining production in the coal industry. Engelhardt noted that "[o]ne example [of approaches in the coal industry] is making capital investments to improve productivity and lower costs. Nothing wrong here. Lower costs mean higher margins, right? They do unless the incremental production that results contributes to an oversupply situation." Engelhardt then commented that "[i]f coal producers would use growth in returns as their performance metric, we believe more discipline would be applied to investments that would otherwise lead to oversupply situations." Engelhardt detailed the actions that Peabody was taking to address oversupply in the market:

> Peabody is focusing on profitability and high return investments in the Powder River Basin. Here are some recent steps that they have taken:
>
> > • In early 1999, Peabody suspended the 10-million-ton-per-year Rawhide Mine, one of the most productive mines in the United States;
> >
> > • Also in 1999, the company delayed a 30-million-ton-per-year capacity expansion at North Antelope/Rochelle until margins generate the proper returns; and
> >
> > • In April 2000, it idled a truck/shovel fleet at Caballo, producing 8 million tons per year, until market conditions improve.

[15] A month later, on May 23, 2000, Steven Leer, Chairman and CEO of Arch, addressed the Western Coal Council's 2000 Spring Coal Forum, attended by SPRB coal producers and customers. Leer posed the question "What can we do about oversupply?" His answer was "Produce less coal." In identifying a response to low coal prices, he provided the following information:

> Subliminal Messages
>
> • If you produce it, they will buy it
>
> • Outcome: Prices have suffered
>
> • Solution: Produce less coal.

[16] Leer also identified "produce less coal" as the solution to low prices resulting from the evaporating export market and huge stockpiles.

[17] Plaintiffs view these statements from SPRB producers as strong evidence of the type of production coordination that is likely if Arch's acquisition of Triton is allowed. Defendants have explained, however, that Leer's comments are simply an articulation of Arch's "market driven" business strategy, under which Arch will restrict its production when it believes that, due to oversupply, it cannot obtain returns it considers adequate. This approach is consistent with the accepted business objective of obtaining an adequate rate of return to fund

expansion. Nonetheless, statements of the type made by Leer and Englehardt in 2000 are indicative of possible producer coordination to limit production, and warrant close scrutiny in an assessment of the likelihood of anticompetitive coordination in the SPRB market.

b. Feasibility of Coordinated Interaction

[18] There is evidence that coordination in the SPRB market is feasible. The differences that distinguish coal produced at one SPRB mine from that at another SPRB mine, such as Btu content, sulfur content, moisture and ash content, are similar to differences that distinguish crude oil produced from different wells. Standard adjustments are made in pricing to account for any specific differences that do exist in the coal from different SPRB mines. Furthermore, plaintiffs' expert concluded that the demand for SPRB coal is inelastic, i.e., the elasticity of demand is less than one. This means that a modest price increase in the highly concentrated SPRB market would be very profitable to producers because it would increase revenues, and therefore profits, even before taking into account the additional profits that would be realized from reductions in total costs as a result of any reduction in output.

[19] Barriers to entry into the SPRB coal market increase the likelihood of coordinated interaction. Certainly there are appreciable start-up costs associated with becoming an SPRB coal producer. The small and frequent transactions for SPRB coal also increase the likelihood of coordinated interaction, decrease the incentive to deviate from coordinated interaction, and increase the likelihood that deviations from coordinated interaction will be quickly detected. A typical transaction size in the SPRB coal market is less than one percent of the total market.

[20] Key market information relating to the other competitors in the SPRB coal market is available from numerous sources, which would theoretically permit the sharing of information among producers. These sources include: trade reports and conferences, industry analysts and consultants who publish reports containing annual production, production capacity, and cost-of-production by mine information for the SPRB coal market; governmental filings such as the Form 423 monthly reports required by the Federal Energy Regulatory Commission ("FERC") stating the quantity and quality of coal purchased and the delivered price for each source; coal company announcements that inform the public on market conditions, production costs, mine productivity, and whether a company is gaining an adequate return for its coal; the bidding process which, even though sealed under confidentiality provisions, nevertheless allows some information to be transmitted to producers from customers regarding how their bids compared to other bids from producers; and merger and joint venture negotiations which may allow for limited transfer of certain competitive information between producers.

[21] Given a stated interest by some SPRB producers in production discipline, these general features of the SPRB market would not appear to preclude coordinated interaction having anticompetitive effects. However, even though these factors and conditions make post-merger coordinated activity to limit production in the SPRB market feasible, whether anticompetitive coordination is likely requires closer examination of such factors as the past history of coordinated interaction, the SPRB market structure and dynamics, and the roles of "fringe" or "maverick" producers.

c. Existence of Actual Coordinated Interaction

[22] There is insufficient evidence to conclude that express or even tacit coordination has taken place in the SPRB market. Traditional factors that industrial organization economists consider when assessing the susceptibility of a market to coordinated interaction include whether producers recognize their mutual interest in competing less aggressively and whether producers with incentives to compete less aggressively communicate their intentions to one another. Plaintiffs' expert concluded that he would need to do additional analysis before he could offer conclusive testimony on whether coordinated interaction is occurring in the SPRB coal market. Plaintiffs have not produced sufficient evidence that such coordination to limit production has actually occurred.

[23] Based on a review of the evidence over time, it is unlikely that coordination has taken place in the SPRB, especially since the evidence through which the FTC attempts to show the existence of coordination is focused primarily on 2000 and 2001. The lynchpin of the FTC's position is the comments and actions of Arch with respect to "production discipline." Through 1999, Arch sold coal on an incremental basis, which meant it sold coal for anything more than the cost of producing it. Under what Arch calls its "market driven" approach, however, Arch

will restrict its production when it believes that, due to oversupply, it cannot obtain returns that it considers adequate. On May 17, 2000, Arch announced that it planned to reduce production at its Coal Creek mine by as much as 10 million tons annually. Arch announced that it would no longer expand capacity to keep pace with growing demand for SPRB coal until SPRB price and margin increased to an acceptable level. Arch informed the industry that "moves such as the one we are taking today should have a positive impact on prices," in light of the "supply/demand fundamentals" for SPRB coal.

[24] On May 23, 2000, Arch's CEO Steven Leer drew attention to the fact that "Arch has been conscientious" and illustrated the statement by observing that Arch was idling the Coal Creek mine and had limited expansion at Black Thunder. Jon Kelly of Tuco (a utility) recalled that he found Leer's comments disturbing because there were representatives from Triton, Peabody, and Kennecott in the room. The speech was reported by the trade press to the coal industry as calling for reductions in coal production. . . .

[25] . . . Arch announced in a March 17, 2002 press release that it had recently cut production by seven percent. Arch announced the production cuts in 2002 despite the fact that the cuts would have a negative impact on earnings: "We are committed to being a market-driven producer. We believe it would be a mistake to sell coal into an oversupplied market, at prices that will not provide an adequate return."

[26] Although Arch made public announcements about cutting production and its commitment to being a market-driven producer, other SPRB producers chose not to follow Arch's strategy. [. . .]

[27] [T]here is no evidence that Arch sought to "punish" the producers who declined to restrict production, even if it had the means to do so. According to defendants' expert, public announcements about production made by Peabody, Kennecott, and Arch did not trigger a coordinated output reduction by coal producers, and were instead followed by enhanced output in the SPRB market. The totality of the evidence, then, establishes that although production restrictions were advocated and even practiced by Arch during 2000–2002, and broader coordination by SPRB producers to limit supply was feasible, no express or tacit coordination to limit production has actually occurred among the major SPRB coal producers.

d. Market Structure and Dynamics

[28] That observed conclusion is consistent with an assessment of the SPRB coal market. The structure and dynamics of the SPRB market may permit coordination, but do not make coordination likely. While barriers to entry into the SPRB market exist, and such barriers may facilitate the creation or enhancement of market power or its exercise, a substantial number of firms actively compete in the marketplace. Furthermore, heterogeneity of products and producers limit or impede the ability of firms to reach terms of coordination. The evidence establishes that products in the SPRB market are heterogeneous; SPRB coal is different from one mine to another, and the SPRB mines and coal companies differ in many important respects, including their production costs, cost structures, contractual commitments, level of reserves, and financial viability.

[29] It is true that industry publications make some market information available among producers. However, the information published in those sources is limited, imperfect, and largely unreliable and untimely. Public data on coal pricing, capacity, and production levels are historical, not particularly comprehensive, and tend to lag behind the market by several months, if not more. [. . .]

[30] A market is conducive to tacit coordination where producers recognize their shared economic interests and their interdependence with respect to price and output decisions. Successful coordination requires both that firms reach terms of coordination that are profitable and that they be able detect and punish deviations from the coordinated interaction. In order for producers to be able to coordinate production, they would need a reliable reference point to attain agreement as to a lag in production. Supply and demand estimates in this marketplace, however, have been historically inaccurate and uncertain.

[31] Demand for SPRB coal is not predictable either in the short- or the long-term. The two largest demand drivers for coal consumption are the weather and the economy, and neither can accurately be predicted. Unexpected weather and changes in economic conditions can result in utilities delaying receipt of coal under

contract, advancing receipt of coal, choosing to increase or decrease inventories, or buying and selling coal on the spot market to meet immediate, unanticipated demand. [. . .]

[32] Tacit agreement would also be difficult to coordinate in this marketplace because the terms of agreement would be hard to communicate between producers, even though tacit agreement only requires producers to adopt a uniform strategy that is consistent with less aggressive competition. Moreover, there is no effective mechanism in the SPRB to discipline any producer that would deviate from the terms of coordination. . . . Due to the nature of the confidential bidding and contracting process that gives producers incentives to submit aggressive bids to capture long term contracts, cheating would not be detected until well after the fact, if ever, and any punishment would come well after the fact as well. Such delays in detection or punishment generally mean that deviations are likely and that coordinated interaction is unlikely to succeed. [. . .]

e. Triton as a Market "Maverick"

[33] An important consideration when analyzing possible anticompetitive effects' is whether the acquisition would result in the elimination of a particularly aggressive competitor in a highly concentrated market. For purposes of a coordinated effects analysis, the [1997] Merger Guidelines define a "maverick" firm as one possessing a greater economic incentive to deviate from the terms of coordination than those of its rivals. FTC officials have noted that, in the context of an auction market, to be a maverick a firm must consistently compete aggressively when it bids, causing other firms to bid more aggressively when it is present. The loss of a firm that does not behave as a maverick is unlikely to lead to increased coordination.

[34] The evidence here does not support the proposition that Triton is, or will likely become, a maverick in the SPRB market. Triton is not presently a maverick in the market, particularly not over the last two to three years. Triton's North Rochelle mine is one of the highest cost mines in the SPRB. As a consequence, Triton has been forced to adopt a "last mine standing" sales strategy for its North Rochelle coal. Pursuant to this strategy, Triton bids its North Rochelle coal at a price that covers its cost plus a profit and waits for the market to come to that price as other mines in the SPRB sell out. This strategy is driven for the most part by Triton's debt financing obligations, which require Triton to obtain a sufficient return on its coal sales to meet bank commitments as they come due. Thus, Triton would rarely deviate from the "last mine standing" strategy.

[35] Because of these circumstances, Triton is wholly indifferent to competitors' production levels or their likely uncommitted tonnage in pricing its North Rochelle coal. Triton's goal is not to increase its market share by pricing under its competitors. Rather, Triton seeks to cover its cost and make a profit on each sale by waiting out the competition and obtaining the highest price possible. Given North Rochelle's high cost structure, therefore, Triton has been unable in recent years to be at all competitive on contract bids. The result, the Court concludes, is that Triton does not lead or even influence pricing in the market, does not compete aggressively, and does not have a history of bidding on contracts consistent with the behavior of a maverick in the SPRB market. [. . .]

[36] [P]laintiffs are not likely to succeed on the merits of their claim of a Clayton Act violation based on the novel theory of prospective tacit coordination on production limits.

Unusual Merger Theories: Ovation Pharmaceuticals

Concurring Statement of Commissioner J. Thomas Rosch, Federal Trade Commission v. Ovation Pharmaceuticals, Inc., FTC File No. 081-0156 (Dec. 16, 2008)

From time to time, courts and commentators have advanced unusual theories of harm in horizontal merger cases that do not fit easily into familiar buckets. One example is offered by FTC Commissioner Thomas Rosch in his concurrence in *Ovation*. In that matter, Ovation Pharmaceuticals had acquired the drug NeoProfen from Merck in a deal that the FTC challenged as a violation of Section 7. Commissioner Rosch voted for that complaint, but also expressed his desire to have challenged a separate Ovation acquisition: the purchase of the drug Indocin, designed for premature babies, from Merck.

Commissioner Rosch argued that the investigation showed that, before the deal, Merck had not raised the price of Indocin to monopoly levels because it was subject to "reputational constraints" that could harm sales of its many

other, more profitable, drugs. Specifically: "if [Merck] sold at a monopoly price a product used to treat premature babies, that could damage its reputation and its sales of those more profitable products." But Ovation lacked Merck's larger product portfolio, and so had less (or no!) reputational concerns that would hold it back from monopoly pricing. He pointed to evidence that "after the transaction, Ovation began charging roughly 1300 percent more than the price at which Merck sold the same product." Thus, he concluded, "there is reason to believe that Merck's sale of Indocin to Ovation had the effect of enabling Ovation to exercise monopoly power in its pricing of Indocin, which Merck could not profitably do prior to the transaction." He would accordingly have alleged that the Indocin acquisition violated Section 7. Do you agree that this is or should be a theory of illegality under Section 7?[674] Can you imagine ways in which a defendant might use this argument to defend a deal—and does that change your view?

NOTES

1) If tacit collusion is not unlawful, why should we ban mergers on the ground that they will facilitate it?
2) Think about the proposition that the agencies will be more likely to infer coordinated effects if the market participants previously engaged in *express* collusion. What do you make of that? Is it an improper inference of future guilt based on past (possible?) misconduct? Double punishment for the earlier offense? A sensible response to actual evidence of competition in the market? Something else?
3) At least in principle, a "coordinated effects" theory could specify that the merged firm would engage in per se illegal price fixing as a result of the deal. What kind of circumstances would give rise to that effect?
4) If a merger can be challenged on the theory that the merged firm will have greater ability or incentive to engage in a price-fixing cartel, could it also be challenged on the theory that the merged firm will have the ability and incentive to violate the antitrust laws in other ways, such as by engaging in monopolization? What would a plausible fact pattern for such a claim look like?
5) Many scholars and commentators have suggested that the United States economy is becoming more concentrated.[675] Much of the data that is customarily cited is at the "sector" level rather than market-specific in the antitrust sense. How useful is this: what does it teach us, and what does it not teach? What other information would you want to review to determine whether we have a "concentration problem" in the United States?
6) When we are concerned about coordinated effects, are there remedies that could be imposed as an alternative to blocking the deal? If so, what might they look like? If not, why not?
7) Should we have complementary per se and "rule of reason" rules for coordinated effects analysis in mergers? How would you define a per se rule for coordinated effects?
8) Do you agree with Commissioner Rosch's assessment that a transaction that eliminates or reduces reputational constraints on pricing could violate Section 7? On the flip side of the same issue: should a party be permitted to argue that reputational constraints would prevent or deter a price increase that would otherwise result from a challenged merger?

c) Future Competition: Mergers with Potential and Nascent Competitors

In appropriate circumstances, harm to competition that does not yet exist at the time of the proposed merger, but could or will arise in the future, can form the basis for a merger challenge. As we saw in Chapter II, an entity that does not compete with a particular firm today, but may compete with it in the future, is often called a "potential" competitor. An entity that is a new and minor competitor today, but promises to be a greater threat in future, is often called a "nascent" competitor. It can be hard to win nascent and potential competition merger cases—partly because success requires a plaintiff to prove that the future will be unlike the past in some important ways—but both the law and enforcement practice support bringing them, and they have enjoyed something of a renaissance

[674] *See*, *e.g.*, Jonathan Gleklen, *The Emerging Antitrust Philosophy of FTC Commissioner Rosch*, ANTITRUST 46 (Spring 2009).

[675] Jonathan B. Baker, THE ANTITRUST PARADIGM: RESTORING A COMPETITIVE ECONOMY (2019), Ch. 1; Jan De Loecker & Jan Eeckhout, *The Rise of Market Power and the Macroeconomic Implications*, NBER Working Paper 23687 (Aug. 2017); John Kwoka, MERGERS, MERGER CONTROL, AND REMEDIES (2015); *see also* Carl Shapiro, *Antitrust in a Time of Populism*, 61 Int'l J. Indus. Org. 714 (2018) (noting limits of evidence).

in recent years.[676] The FTC's monopolization complaint against Facebook, for example, alleged harms to both nascent and potential competition from Facebook's acquisitions: specifically, the FTC alleged that Instagram was an existing and growing competitor with Facebook in the personal social networking market (*i.e.*, a nascent competitor), while WhatsApp was established in the mobile messaging market from which it threatened to enter the personal social networking market (*i.e.*, a potential competitor).[677]

When you read potential competition cases, it may be helpful to know that potential competition theories are sometimes broken down into two confusingly named subgroups: (1) "actual potential competition" cases, which frame the harm as the lost possibility that actual horizontal competition might exist in the future if the merger does not occur, following the entry of one firm into the other's market,[678] and (2) "perceived potential competition" cases, which frame the harm as the loss of the disciplining power exerted by market participants' *perception*, before the merger, that such future entry might occur, regardless of whether or not it would actually do so. The perceived potential competition doctrine has been explicitly validated by the Supreme Court; the actual potential competition doctrine has not.[679] Lower courts have generally not doubted the validity of either doctrine.[680]

To see the difference, imagine that, today, the market participants in a relevant market *believe* that, if they increased their prices, Firm X, not currently in the market, would then find it rational to enter the market and compete vigorously, and imagine that this belief currently disciplines their competitive conduct. Imagine further that Firm X itself privately knows that it could not or would not in fact enter. Under those circumstances, Firm X would be a perceived potential competitor, because the perceived threat of entry is exerting competitive discipline, but not an actual potential competitor, because in reality the threat is unfounded.[681]

CASENOTE: United States v. Marine Bancorporation

418 U.S. 602 (1974)

In what is, remarkably, one of the Supreme Court's most recent substantive merger decisions (!), the Court held in *Marine Bancorporation* in 1974 that Section 7 was not violated when the National Bank of Commerce ("NBC")—a national bank with its principal office in Seattle, Washington—acquired Washington Trust Bank ("WTB"), a state bank headquarted in Spokane almost 300 miles from Seattle. DOJ argued that, but for the transaction, NBC

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[676] For some recent nascent and potential competition cases brought by the agencies, *see*, *e.g.*, Complaint, FTC v. Meta Platforms, Inc., Case No. 3:22-cv-04325 (N.D. Cal., filed July 27, 2022); Complaint, United States v. Visa Inc., Case No. 3:20-cv-07810 (N.D. Cal. filed Nov. 5, 2020); First Amended Complaint, FTC v. Facebook, Inc., Case No. 1:20-cv-03590 (D.D.C. filed Aug. 19, 2021); Complaint, In the matter of Illumina, Inc., FTC Dkt. No. 9387 (F.T.C. filed Dec. 17, 2019).

[677] First Amended Complaint, FTC v. Facebook, Inc., Case No. 1:20-cv-03590 (D.D.C. filed Aug. 19, 2021).

[678] For a helpful compilation, *see generally* Bilal Sayyed, *Actual Potential Entrants, Emerging Competitors, and the Merger Guidelines: Examples from FTC Enforcement 1993–2022*, TechFreedom White Paper (Dec. 2022), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4308233.

[679] The potential competition doctrine is grounded in some landmark Supreme Court opinions from the 1960s and 1970s. *See*, *e.g.*, United States v. Marine Bancorporation, Inc., 418 U.S. 602, 624 (1974) (noting that a merger may violate Section 7 on a perceived potential competition theory "if the target market is substantially concentrated, if the acquiring firm has the characteristics, capabilities, and economic incentive to render it a perceived potential de noto entrant, and if the acquiring firm's premerger presence on the fringe of the target market in fact tempered oligopolistic behavior on the part of existing participants in that market," and acknowledging the actual-potential competition theory without adopting it); *id.* at 639 (expressly reserving judgment on the actual potential competition doctrine); United States v. Falstaff Brewing Corp., 410 U.S. 526 (1973) (noting, in what would now be called a perceived potential competition case, that Section 7 covers "the acquisition [of a market participant]by a company not competing in the market but so situated as to be a potential competitor and likely to exercise substantial influence on market behavior," and commenting that "The specific question with respect to this phase of the case is not what Falstaff's internal company decisions were but whether, given its financial capabilities and conditions in the New England market, it would be reasonable to consider it a potential entrant into that market."); *id.* at 559–70 (Marshall, J., concurring) (coining the distinction between an actual potential competitor and a perceived potential competitor, and discussing a variety of related evidentiary concerns); United States v. El Paso Nat. Gas Co., 376 U.S. 651, 659 (1964) (illustrating merging party's competitive "effect . . . merely as a potential competitor").

[680] *See*, *e.g.*, Ginsburg v. InBev NV/SA, 623 F.3d 1229, 1234 (8th Cir. 2010); Tenneco, Inc. v. FTC, 689 F.2d 346, 351 (2d Cir. 1982); Mercantile Texas Corp. v. Bd. of Governors of Fed. Rsrv. Sys., 638 F.2d 1255, 1264 (5th Cir. 1981); FTC v. Meta Platforms Inc.. No. 5:22-cv-04325, 2023 WL 2346238, at *21 (N.D. Cal. Feb. 3, 2023).

[681] Confusingly, this means that the actual potential competitor doctrine is concerned with a mere possible (or "potential") future effect, while the perceived potential competitor doctrine is concerned with a real and ongoing (or "actual") effect. Look: no one promised this stuff was going to make any sense.

would find "an alternative and more competitive means for entering the Spokane market." DOJ also argued that the merger would end the existing "procompetitive influence that the acquiring bank presently exerts over Spokane banks due to the potential for its entry into that market." In other words, DOJ asserted what we would today call actual potential competition *and* perceived potential competition theories. The U.S. District Court for the Western District of Washington dismissed DOJ's complaint, and the government appealed.

The Supreme Court affirmed the district court's opinion. In a majority opinion authored by Justice Powell, the Court reiterated its recognition—at least in principle—of the perceived potential competition doctrine: that is, a theory of harm based on the claim that "the target market is substantially concentrated, . . . the acquiring firm has the characteristics, capabilities, and economic incentive to render it a perceived potential de novo entrant, and . . . the acquiring firm's premerger presence on the fringe of the target market in fact tempered oligopolistic behavior on the part of existing participants in that market."

The Court then considered DOJ's actual potential competition theory. The Court set out two key criteria against which such a claim, assuming its validity, would have to be considered: (1) whether "in fact NBC has available feasible means for entering the Spokane market other than by acquiring WTB"; and (2) whether such means "offer a substantial likelihood of ultimately producing deconcentration of that market or other significant procompetitive effects." In light of this standard, DOJ's claim did not fare well. State-law regulatory barriers made entry difficult, and the theoretical paths to entry suggested by DOJ were unavailing in light of evidence that they either had never been tried in practice, or that they seemed likely to produce entry at such a small scale that it was unlikely to produce "a reasonable prospect of long-term structural improvement or other benefits in the target market." In light of the claim's failure on the facts, the Court pointedly refused to express a view on the legal validity of the theory: "[S]ince the preconditions for [the] theory are not present, we do not reach it, and therefore we express no view on the appropriate resolution of the question[.]"

Finally, the Court circled back to perceived potential competition. Other market participants, the Court explained, could reasonably be assumed to be aware of the barriers that made NBC's entry into the Spokane market implausible. As such, it was not plausible that they lived in competitive fear of NBC's entry. "[I]t is improbable that NBC exerts any meaningful procompetitive influence over Spokane banks by standing in the wings."

With *Marine Bancorp*—and an outcome that seems to owe much to an awfully unpromising evidentiary record—the law of potential-competition mergers passed into the hands of the lower courts, where it has remained ever since.

Yamaha Motor demonstrates a potential competition theory at work in the hands of the Eighth Circuit. In that case, the parties—Yamaha and Brunswick—entered into a joint venture to make outboard motors for boats. They were not actually competing before the deal, as Yamaha was not yet supplying motors in the United States. But the question for the Eighth Circuit was whether Yamaha—which was making and selling outboard motors in most of the rest of the world before entering into the JV—was a sufficiently plausible entrant into the United States to make it an actual potential competitor, and thus make the deal harmful to actual postential competition.

Yamaha Motor Co., Ltd. v. FTC

657 F.2d 971 (8th Cir. 1981)

Judge Arnold.

[1] Brunswick is a diversified manufacturer whose products include recreational items. Brunswick began making outboard motors in 1961, when it acquired what is now called its Mercury Marine Division (Mercury). Brunswick is the second largest seller of outboard motors in the United States. Between 1971 and 1973 its share of the outboard motor market fluctuated between 19.8% and 22.6% by unit volume and between 24.2% and 26% by dollar volume. Brunswick also sells its Mercury outboards in Canada, Australia, Europe, and Japan.

[2] Before entering the joint venture, Brunswick, through Mercury, was considering development of a second line of outboards in an effort to increase its market share. Mariner was to become this second line, which Brunswick hoped would expand the dealer network carrying both the Mercury and Mariner brands.

[3] Yamaha is a Japanese corporation incorporated by Nippon Gakki Company, Ltd. In 1972, it made outboard motors, motorcycles, snowmobiles, and boats. Since 1961, Yamaha has sold snowmobiles, motorcycles, and spare parts to Yamaha International Corporation, a wholly owned subsidiary of Nippon Gakki, which distributes to the United States. In 1972, 40% of Yamaha's total sales were from exports to this country, and 70% of its total production was for export to some country other than Japan. Yamaha manufactures outboard motors through Sanshin Kogyo Company, Ltd., also a Japanese corporation. Since 1969, when Yamaha acquired 60% of Sanshin's stock, Sanshin has produced Yamaha brand outboard motors, and they are sold in most outboard motor markets throughout the world. [. . .]

[4] On November 21, 1972, Brunswick and Yamaha entered into a joint venture under which Brunswick, through Mariner, acquired 38% of the stock of Sanshin. Yamaha's share in Sanshin also became 38%, with the balance of the stock held by others not involved here. Sanshin was to produce outboard motors and sell its entire production to Yamaha. Some of the motors were to be sold by Yamaha under its own brand name, while the rest, physically identical, were to be resold by Yamaha to Mariner, to be marketed by it under the Mariner brand name. [. . .]

[5] The Commission's first ground involves application of a theory known as the "actual potential entrant doctrine." In essence the doctrine, under the circumstances of this case, would bar under s 7 acquisitions by a large firm in an oligopolistic market, if the acquisition eliminated the acquired firm as a potential competitor, and if the acquired firm would otherwise have been expected to enter the relevant market de novo. To put the question in terms applicable to the present case, would Yamaha, absent the joint venture, probably have entered the U.S. outboard-motor market independently, and would this new entry probably have increased competition more than the joint venture did? We stress the word "probably" in this formulation of the issue, because the question under Section 7 is not whether competition was actually lessened, but whether it "may be" lessened substantially. The question arises here, of course, not in the perhaps more common context of an outright acquisition of a competitor that might otherwise have entered, but in the form of acquisition of stock in a jointly owned company, an acquisition that necessarily foreclosed (for the duration of the joint venture) the independent entry of Yamaha, the other joint venturer.

[6] Although the Supreme Court has yet to rule specifically on the validity of the actual-potential-entrant doctrine, it has delineated two preconditions that must be present, prior to any resolution of the issue. First, it must be shown that the alleged potential entrant had available feasible means for entering the relevant market, and second, that those means offered a substantial likelihood of ultimately producing deconcentration of that market or other significant procompetitive effects. On this basis the Commission's decision is amply supported by the evidence.

[7] A finding that the first precondition exists, in essence, establishes whether the firm in question is an "actual potential entrant." It is clear that absent the joint venture, de novo entry into the United States market, in both the low and high horsepower submarkets, was Yamaha's only alternative, unless it was prepared to abandon the United States market altogether, which is most unlikely. There is substantial evidence to support the finding that such entry into the United States market is an attractive alternative. The United States market for outboard engines is the largest and most sophisticated one in the world. In addition, at the time of the agreement, Yamaha was selling substantial numbers of outboard motors in every developed market in the world, except the United States. Yamaha's management had the requisite experience in the production and marketing of outboard motors in areas of the world other than Japan.

[8] There is also evidence that Yamaha had the technology needed to be a viable entrant into the United States market. Yamaha had long been a leader in other parts of the world in production of outboards in the low-horsepower range, and at the time of the agreement was engaged in an ambitious program of development of motors in the high-horsepower range. By 1969 Yamaha had plans to market a 25-horsepower engine in the United States. Engines with 25-horsepower and 55-horsepower ratings were exhibited by Yamaha at the 1972 and 1973 Tokyo boat shows, and the 55-horsepower model was marketed in Japan in 1973 and 1974. Thus Yamaha was close to possessing a "complete line" of models with a wide horsepower range suitable for entry into the United States market.

[9] Brunswick argues that possession of a network of marine dealers to sell and service the outboards was essential, that Yamaha lacked such a network, and that Yamaha was therefore in no position to enter the United States market.

[10] Engines in the high-horsepower range are sold predominantly through dealers, while the low-horsepower models are commonly sold by both dealers and mass merchandisers. The lack of a network of dealers is indeed an obstacle to viable participation in the United States market, but it is probably less so for Yamaha than for others. First, Yamaha, through its sales of motorcycles in the United States, had considerable name recognition. Next, there was evidence that most marine dealers enter into one-year contracts. Thus, recurring opportunities exist for a manufacturer to obtain new dealers. Last, many dealers carry more than one line of outboards, so Yamaha might have been able to persuade established dealers to carry a second line. Sales to mass merchandisers were also available, under the Yamaha brand name or some other brand name. We think the Commission was reasonable in finding that Yamaha had viable opportunities to market its wares effectively in the United States.

[11] As recounted above, the objective evidence of Yamaha's capacity to enter the United States market is substantial. There is also considerable evidence of Yamaha's subjective intent to enter the United States. Prior to the 1972 agreement Yamaha made two less-than-successful attempts to penetrate the United States market. The first attempt came in 1968 when it introduced low-horsepower models into the United States market on a limited scale. This effort failed primarily because the motors were too expensive, and Yamaha's one-cylinder, air-cooled engines were ill-suited to United States consumers, who preferred two-cylinder, water-cooled engines. In 1972 Sears Roebuck & Company offered a 1.5-horsepower Yamaha engine but discontinued the arrangement with Yamaha because the motors proved to be too expensive for Sears customers because of their high quality. These attempts at penetration, coupled with Yamaha's ambitious program to develop high-horsepower models, aimed specifically at the American consumer, indicate a high degree of interest in penetrating the United States market. The 55-h.p. motor that Yamaha exhibited at the 1972 Tokyo boat show was actually being marketed in Japan in 1973. A managing director of Yamaha testified that "with the addition of the 55 horsepower, that is about the time we can go into a developed market like the United States or Canada."

[12] The record amply supports the Commission's finding that Yamaha had the available feasible means for entering the American outboard-motor market. We next inquire whether those means offered a substantial likelihood of ultimately producing deconcentration of the United States market or other significant procompetitive effects. The Commission found that independent entry by Yamaha would certainly have had a significant procompetitive impact. Given the factual context of this case, support for this conclusion is easily found. We start by re-emphasizing the oligopolistic nature of the outboard-motor market in the United States. The top four firms had 98.6% of the dollar volume, and the top two, OMC and Brunswick, controlled 85.0% of the market by dollar volume. Any new entrant of Yamaha's stature would have had an obvious procompetitive effect leading to some deconcentration. Yamaha is a well-established international firm with considerable financial strength. In addition, the Yamaha brand name was familiar to American consumers, and Yamaha had considerable marketing experience in the United States. [. . .]

[13] Accordingly, the record supports the Commission's finding that . . . Yamaha was an actual potential entrant into the United States.

* * *

In *Yamaha Motor*, the plaintiff won, but things are not always so easy in potential-competition cases. In *Steris*, for example, the FTC challenged a merger under similar circumstances—between an in-market incumbent and a threatening entrant—and lost, despite fairly robust evidence of impending entry by the target into the acquirer's market.[682]

Nevertheless, such potential competition cases continue to be brought. The Department of Justice's challenge to the Visa / Plaid transaction is a good example. DOJ filed the following complaint; the parties abandoned the transaction.

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[682] *See FTC v. Steris Corp.*, 133 F.Supp.3d 962 (N.D. Ohio 2015).

Complaint, United States v. Visa Inc. and Plaid Inc.

Case No. 3:20-cv-07810 (N.D. Cal. filed Nov. 5, 2020)

1. Visa is "everywhere you want to be." Its debit cards are accepted by the vast majority of U.S. merchants, and it controls approximately 70% of the online debit transactions market. In 2019, there were roughly 500 million Visa debit cards in circulation in the United States. That same year, Visa processed approximately 43 billion debit transactions, including more than 10 billion online transactions. In 2019, Visa earned over $4 billion from its debit business, including approximately $2 billion from online debit. [. . .]

3. American consumers use debit cards to purchase hundreds of billions of dollars of goods and services on the internet each year. Many consumers buying goods and services online either prefer using debit or cannot access other means of payment, such as credit. Because of its ubiquity among consumers, merchants have no choice but to accept Visa debit despite perennial complaints about the high cost of Visa's debit service.

4. Visa's monopoly power in online debit is protected by significant barriers to entry and expansion. Visa connects millions of merchants to hundreds of millions of consumers in the United States. New challengers to Visa's monopoly would thus face a chicken-and-egg quandary, needing connections with millions of consumers to attract thousands of merchants and needing thousands of merchants to attract millions of consumers. Visa's Chief Financial Officer has acknowledged that building an extensive network like Visa's is "very, very hard to do" and "takes many years of investment," but "[i]f you can do that, then you can have a business [like Visa's] that has a relatively high margin." He explained that entry barriers are so significant that even well-funded companies with strong brand names struggle to enter online debit.

5. Mastercard, Visa's only longstanding rival in online debit services, has a much smaller market share of around 25%. For years, Mastercard has neither gained significant share from Visa nor restrained Visa's monopoly. Mastercard's participation in the online debit market has not translated into lower prices for consumers, and this appears unlikely to change. For example, Visa has long-term contracts with many of the nation's largest banks that restrict these banks' ability to issue Mastercard debit cards. Visa also has hamstrung smaller rivals by either erecting technical barriers, or entering into restrictive agreements that prevent rivals from growing their share in online debit, or both.

6. These entry barriers, coupled with Visa's long-term, restrictive contracts with banks, are nearly insurmountable, meaning Visa rarely faces any significant threats to its online debit monopoly. Plaid is such a threat.

7. Plaid is uniquely positioned to surmount these entry barriers and undermine Visa's monopoly in online debit services. Plaid powers some of today's most innovative financial technology ("fintech") apps, such as Venmo, Acorns, and Betterment. Plaid's technology allows fintechs to plug into consumers' various financial accounts, with consumer permission, to aggregate spending data, look up balances, and verify other personal financial information. Plaid has already built connections to 11,000 U.S. financial institutions and more than 200 million consumer bank accounts in the United States and growing. These established connections position Plaid to overcome the entry barriers that others face in attempting to provide online debit services.

8. While Plaid's existing technology does not compete directly with Visa today, Plaid is planning to leverage that technology, combined with its existing relationships with banks and consumers, to facilitate transactions between consumers and merchants in competition with Visa. Like Visa's online debit services, Plaid's new debit service would enable consumers to pay for goods and services online with money debited from their bank accounts. With this new online debit service, Plaid intended to "steal[] share" and become a "formidable competitor to Visa and Mastercard." Competition from Plaid likely would drive down prices for online debit transactions, chipping away at Visa's monopoly and resulting in substantial savings to merchants and consumers.

9. Visa feared that Plaid's innovative potential—on its own or in partnership with another company—would threaten Visa's debit business. In evaluating whether to consider Plaid as a potential acquisition target in March 2019, Visa's Vice President of Corporate Development and Head of Strategic Opportunities expressed concerns to his colleagues about the threat Plaid posed to Visa's established debit business, observing: "I don't want to be IBM to their Microsoft." This executive analogized Plaid to an island "volcano" whose current capabilities are

just "the tip showing above the water" and warned that "[w]hat lies beneath, though, is a massive opportunity – one that threatens Visa." [. . .]

12. On January 13, 2020, Visa agreed to acquire Plaid in part to eliminate this existential risk and protect its monopoly in online debit. Visa offered approximately $5.3 billion for Plaid, "an unprecedented revenue multiple of over 50X" and the second-largest acquisition in Visa's history. Recognizing that the deal "does not hunt on financial grounds," Visa's CEO justified the extraordinary purchase price for Plaid as a "strategic, not financial" move because "[o]ur US debit business i[s] critical and we must always do what it takes to protect this business."

13. Monopolists cannot have "free reign to squash nascent, albeit unproven, competitors at will." *United States v. Microsoft Corp.*, 253 F.3d 34, 79 (D.C. Cir. 2001). Acquiring Plaid would eliminate the nascent but significant competitive threat Plaid poses, further entrenching Visa's monopoly in online debit. As a result, both merchants and consumers would be deprived of competition that would drastically lower costs for online debit transactions, leaving them with few alternatives to Visa's monopoly prices. Thus, the acquisition would unlawfully maintain Visa's monopoly in violation of Section 2 of the Sherman Act.

14. Visa's proposed acquisition also would violate Section 7 of the Clayton Act, which was "designed to arrest the creation of monopolies 'in their incipiency,'" *United States v. Gen. Dynamics Corp.*, 415 U.S. 486, 505 n.13 (1974), and similarly prohibits a monopolist from bolstering its monopoly through an acquisition that eliminates a nascent but significant competitive threat. The Supreme Court has explained that an acquisition can violate Section 7 when "the relative size of the acquiring corporation ha[s] increased to such a point that its advantage over its competitors threaten[s] to be 'decisive.'" *Brown Shoe Co. v. United States*, 370 U.S. 294, 321 n.36 (1962). Visa already has a decisive market position through its online debit monopoly, and would unlawfully extend that advantage by acquiring Plaid. For the reasons set forth in this Complaint, the proposed acquisition must be enjoined.

CASENOTE: FTC v. Meta Platforms, Inc. ("Meta/Within")

654 F. Supp. 3d 892 (N.D. Cal. 2023)

In 2022, the FTC sued Meta (formerly Facebook) to block its proposed acquisition of Within, a virtual-reality app developer. Meta supplied a set of virtual reality devices (including the "Quest" line of headsets), and also made certain apps that could run on those devices, including Beat Saber, a game in which users smash blocks with laser swords. Within supplied a subscription-based virtual reality service that allowed users to undertake fitness workouts in virtual reality. The FTC's theory was that the acquisition would lead to a loss of potential competition: Meta was an actual potential competitor *and* a perceived potential competitor of Within, because it both could in fact have entered the VR fitness app market and it visibly threatened to do so.

The court agreed with the FTC that there was a "VR dedicated fitness app" market. The court also agreed that that market was highly concentrated—citing *Marine Bancorp* for the proposition that this was a prerequisite for any successful potential-competition claim—whether calculated by revenue, hours spent, or monthly active users. But neither the actual potential competition claim nor the perceived potential competition claim succeeded.

Analyzing the actual potential competition claim, the court held that the FTC was required to show a "reasonable probability"—something *more* than 50%[683]—of entry by Meta, but-for the acquisition. And, while Meta undoubtedly had the necessary "financial and engineering capabilities," it could not currently create fitness content, lacked the studios to film VR workouts, and did not clearly have the necessary incentives to try to enter under its own steam. Moreover, the evidence did not indicate that Meta had considered *de novo* entry to be feasible, nor that any other approach (*e.g.*, a partnership with Peloton) was reasonably probable to work out. And turning to the perceived potential competition claim, the court concluded that the FTC had simply failed to muster sufficient evidence that "Meta's presence did in fact temper oligopolistic behavior or result in any other procompetitive benefits." The mere fact that Within had expressed some concern about unidentified "hypothetical potential entrants" was not enough.

[683] *See also*, *e.g.*, Mercantile Texas Corp. v. Bd. of Governors, 638 F.2d 1255, 1268–69 (5th Cir. 1981).

The failure of the Meta/Within effort has meant another adverse holding on the FTC's potential-competition enforcement docket. Will the FTC's challenge to Facebook's acquisition of WhatsApp fare better?[684]

The protection of future competition is not limited to circumstances like *Yamaha Motor*, *Visa / Plaid*, and *Meta / Within* in which one company is already in the market. In rare cases, competition concerns can arise in markets that do not even exist yet. This was the case, for example, in the FTC's intervention in *Nielsen / Arbitron* in 2013, when the Commission acted to protect competition among cross-platform audience measurement tools, in a market for a service that did not yet exist.[685]

NOTES

1) In principle, a future-competition case could be built on either a coordinated effects theory or a unilateral effects theory. What would be the outline of the story of harm in each case? Why do you think courts don't tend to use the language of unilateral or coordinated effects when talking about these cases? Should they?
2) Some commentators have expressed concerns that an unduly strict approach to nascent and potential competition could have the effect of cutting off an important incentive for investment in startups and, thus, deterring competition; others claim that this concern is overblown.[686] Do you think courts or agencies should consider such second-order impacts of antitrust enforcement: if so, how?
3) In its challenge to Facebook's acquisition of Instagram and WhatsApp, the FTC emphasized the contents of internal documents expressing expectations that the targets presented a serious competitive threat.[687] What are the advantages and disadvantages of such evidence as a guide to the competitive effects of an acquisition?
4) What is the relevance, for competitive analysis, of the documents quoted in paragraph 12 of the *Visa / Plaid* complaint (noting that the deal "does not hunt on financial grounds")?

d) Entry, Repositioning, Expansion, and Countervailing Power

We have already encountered the law and economics of entry barriers in Chapters II and III. But entry can be a particularly important consideration in merger cases. In particular, under certain circumstances, a clear enough prospect of competitive entry—or expansion or repositioning by existing firms—can allay competitive concerns that a transaction would otherwise present. In rare circumstances, courts have sometimes accorded some significance to the idea that buyers may be able to protect themselves from post-merger market power through the exercise of "countervailing power."

Countervailing Buyer Power

Section 8 of the (now withdrawn) 2010 Horizontal Merger Guidelines indicated that, in certain circumstances, the presence of powerful buyers can allay competitive concerns that would otherwise be raised by a transaction: "The Agencies consider the possibility that powerful buyers may constrain the ability of the merging parties to raise prices. This can occur, for example, if powerful buyers have the ability and incentive to vertically integrate upstream or sponsor entry, or if the conduct or presence of large buyers undermines coordinated effects. However, the Agencies do not presume that the presence of powerful buyers alone forestalls adverse competitive effects flowing from the merger. Even buyers that can negotiate favorable terms may be harmed by an increase in market

[684] Complaint, FTC v. Facebook, Case No. 1:20-cv-03590 (D.D.C. Aug. 19, 2021), ¶¶ 107–29.

[685] Statement of the Federal Trade Commission, In the Matter of Nielsen Holdings N.V. and Arbitron Inc., FTC File No. 131 0058 (Sept. 20, 2013) ("The Commission . . . has reason to believe that Nielsen and Arbitron are the best-positioned firms to develop (or partner with others to develop) [the relevant] service.").

[686] *Compare*, *e.g.*, Mark A. Lemley & Andrew McCreary, *Exit Strategy*, 101 B.U.L. Rev. 1 (2021) *with* D. Daniel Sokol, *Vertical Mergers and Entrepreneurial Exit*, 70 Fla. L. Rev. 1357 (2018).

[687] First Amended Complaint, FTC v. Facebook, Inc., Case No. 1:20-cv-03590 (D.D.C. filed Aug. 19, 2021) ¶ 84 (quoting internal document stating: "If Instagram continues to kick ass on mobile or if Google buys them, then over the next few years they could easily add pieces of their service that copy what we're doing now, and if they have a growing number of people's photos then that's a real issue for us."), ¶ 86 (quoting internal document stating "the potential for someone like Apple to use [Instagram] as a foothold."), ¶ 88 (quoting internatl document stating: "If [my analytical] framework holds true, then we should expect apps like Instagram to be able to grow quite large. If it has 15m users now, it might be able to reach 100-200m in the next 1-2 years.").

power. . . . Furthermore, even if some powerful buyers could protect themselves, the Agencies also consider whether market power can be exercised against other buyers."

But this concept was removed from the 2023 version of the Merger Guidelines. This is probably not as much of a change as it might seem: the "power buyer" argument has not usually been much help to merging parties in practice. Moreover, even if one or more buyers in a market hold some buy-side power, additional competitive harm can still result from the creation of market power on the seller side.

Nevertheless, the argument has been accepted by courts in a small number of cases, usually as part of a broader rebuttal showing. One example is DOJ's 1991 challenge to the effort by Archer-Daniels-Midland, an owner and operator of corn wet milling plants, to lease two additional such plants.[688] The transaction triggered the structural presumption (as it then stood), but the district court held that the parties had successfully rebutted the government's case. Noting that "the buying side of the . . . industry is populated by very large and sophisticated purchasers [with] a continuing trend toward increasing concentration on the buying side," the district court concluded that "this consolidation of buying power is an effective means of counteracting any potential market power that might be exercised by sellers." The court pointed out that "[b]uyers have successfully used a variety of tactics to obtain low prices from . . . suppliers, including playing off suppliers against one another, swinging volume back and forth among suppliers, disciplining sellers by cutting them off entirely, successfully insisting on year long or multi-year tolling agreements, and holding out the threat of inducing a new entrant into . . . production." As a result, "[t]here is no question that the size and sophistication of buyers in the . . . industry is a powerful [factor] that strongly mitigates against the possibility of any attempt by . . . suppliers to raise prices anticompetitively." Given additional evidence that coordination would be implausible following the merger, the court concluded that the defendant had successfully rebutted the affirmative case.

Predicting the behavior of third parties in response to post-merger supracompetitive pricing is a tricky business, as we shall see. It is easy for merging parties to claim that other market participants will prevent the merged firm from increasing its prices, but it can be much harder to establish that entry, expansion, or repositioning will be fast enough or significant enough to protect against what would otherwise be harmful effects from a transaction.

Merger Guidelines § 3.2

Entry and Repositioning

[1] Merging parties sometimes raise a rebuttal argument that a reduction in competition resulting from the merger would induce entry or repositioning into the relevant market, preventing the merger from substantially lessening competition or tending to create a monopoly in the first place. This argument posits that a merger may, by substantially lessening competition, make the market more profitable for the merged firm and any remaining competitors, and that this increased profitability may induce new entry. To evaluate this rebuttal evidence, the Agencies assess whether entry induced by the merger would be timely, likely, and sufficient in its magnitude, character, and scope to deter or counteract the competitive effects of concern.

[2] *Timeliness.* To show that no substantial lessening of competition is threatened by a merger, entry must be rapid enough to replace lost competition before any effect from the loss of competition due to the merger may occur. Entry in most industries takes a significant amount of time and is therefore insufficient to counteract any substantial lessening of competition that is threatened by a merger. Moreover, the entry must be durable: an entrant that does not plan to sustain its investment or that may exit the market would not ensure long-term preservation of competition.

[3] *Likelihood.* Entry induced by lost competition must be so likely that no substantial lessening of competition is threatened by the merger. Firms make entry decisions based on the market conditions they expect once they participate in the market. If the new entry is sufficient to counteract the merger's effect on competition, the Agencies analyze why the merger would induce entry that was not planned in pre-merger competitive conditions.

[688] United States v. Archer-Daniels-Midland Co., 781 F.Supp. 1400 (S.D Iowa 1991).

[4] The Agencies also assess whether the merger may increase entry barriers. For example, the merging firms may have a greater ability to discourage or block new entry when combined than they would have as separate firms. Mergers may enable or incentivize unilateral or coordinated exclusionary strategies that make entry more difficult. Entry can be particularly challenging when a firm must enter at multiple levels of the market at sufficient scale to compete effectively.

[5] *Sufficiency*. Even where timely and likely, the prospect of entry may not effectively prevent a merger from threatening a substantial lessening of competition. Entry may be insufficient due to a wide variety of constraints that limit an entrant's effectiveness as a competitor. Entry must at least replicate the scale, strength, and durability of one of the merging parties to be considered sufficient. The Agencies typically do not credit entry that depends on lessening competition in other markets.

[6] As part of their analysis, the Agencies will consider the economic realities at play. For example, lack of successful entry in the past will likely suggest that entry may be slow or difficult. Recent examples of entry, whether successful or unsuccessful, provide the starting point for identifying the elements of practical entry barriers and the features of the industry that facilitate or interfere with entry. The Agencies will also consider whether the parties' entry arguments are consistent with the rationale for the merger or imply that the merger itself would be unprofitable.

* * *

As you might expect, merging parties routinely claim that there are one or more critical entrants poised to leap into the market and reshape competitive conditions. But agencies and courts generally examine these claims skeptically.[689] In two merger challenges we have met already—*Staples / Office Depot II* and *H&R Block / TaxAct*—the parties argued that entry and expansion would be sufficient to allay competitive concerns. In each case the court was unmoved. In particular, *Staples / Office Depot II* demonstrates a recurrent theme in recent merger challenges: merging parties who point to a "big tech" platform as a gamechanging entrant. As Judge Sullivan's opinion makes clear, the mere presence of a big tech platform—even one that has already begun to enter the relevant market—is not automatically enough to eliminate competitive concerns.

FTC v. Staples, Inc. ("Staples / Office Depot II")

190 F. Supp. 3d 100 (D.D.C. 2016)

Judge Sullivan.

{*Eds.: The FTC's prima facie case is covered above.*[690]}

[1] Defendants' sole argument in response to Plaintiffs' *prima facie* case is that the merger will not have anti-competitive effects because Amazon Business, as well as the existing patchwork of local and regional office supply companies, will expand and provide large B-to-B customers with competitive alternatives to the merged entity. Plaintiffs argue that there is no evidence that Amazon or existing regional players will expand in a timely and sufficient manner so as to eliminate the anticompetitive harm that will result from the merger.

[2] The prospect of entry into the relevant market will alleviate concerns about adverse competitive effects only if such entry will deter or counteract any competitive effects of concern so the merger will not substantially harm customers. Even in highly concentrated markets, Plaintiffs' prima facie case may be rebutted if there is ease of entry or expansion such that other firms would be able to counter any discriminatory pricing practices. Defendants

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689 *See*, *e.g.*, FTC v. Swedish Match, 131 F. Supp. 2d 151, 170–71 (D.D.C. 2000) ("The defendants' evidence on entry . . . is not sufficiently persuasive. As discussed above, the evidence shows falling sales volume, increased government regulation, shrinking shelf space, and brand loyalty, all of which will prevent new entry into this market. Demand in the [relevant] market has been declining at a rate of two to three percent per year, a trend which is expected to continue. Thus, there are fewer sales opportunities for new entrants. The steady decline in . . . demand has created excess capacity at . . . production facilities, and existing . . . producers could simply increase production as an effective competitive response to new entrants. [The] consumers are brand loyal, and regulatory restrictions have decreased the producers' ability to advertise their products. New entrants therefore would have a significant, uphill climb to take away market share from the incumbent producers.").

690 *See supra* § VIII.B.2.(a).

carry the burden of showing that the entry or expansion of competitors will be timely, likely and sufficient in its magnitude, character, and scope to deter or counteract the competitive effects of concern. The relevant time frame for consideration in this forward looking exercise is two to three years.

[3] Defendants seize on Amazon's lofty vision for Amazon Business to be the preferred marketplace for all professional, business and institutional customers worldwide to support their contention that Amazon not only wants to take over the office supply industry, but desires to take over the world. Amazon Business may eventually transform the B-to-B office supply space. *See*, *e.g.*, DX05284 at 43 (Mr. Wilson's 2016 presentation in Baltimore: "It's still Day One." Amazon Business plans to "improve with: more selection; an increasing number of produce and business products [sic]; better personalization; a purchasing experience even better tailored for businesses."). The Court's unenviable task is to assess the likelihood that Amazon Business will, within the next three years, replace the competition lost from Office Depot in the B-to-B space as a result of the proposed merger.

[4] Amazon Business has a number of impressive strengths. For example, Amazon Business already enjoys great brand recognition and its consumer marketplace has a reputation as user-friendly, innovative and reliable. Amazon Business' strategy documents also reveal a number of priorities that, if successful, may revolutionize office supply procurement for large companies. . . .

[5] However, several significant institutional and structural challenges face Amazon Business. Plaintiffs point to a long list of what they view as Amazon Business' deficiencies, including, but not limited to: (1) lack of RFP experience; (2) no commitment to guaranteed pricing . . . ; (3) lack of ability to control third-party price and delivery; (4) inability to provide customer-specific pricing; (5) a lack of dedicated customer service agents dedicated to the B-to-B space; (6) no desktop delivery; (7) no proven ability to provide detailed utilization and invoice reports; and (8) lack of product variety and breadth. Although Amazon Business may successfully address some of these alleged weaknesses in the short term, the evidence produced during the evidentiary hearing does not support the conclusion that Amazon Business will be in a position to restore competition lost by the proposed merger within three years.

[6] First, despite entering the office supply business fourteen years ago, large B-to-B customers still do not view Amazon Business as a viable alternative to Staples and OfficeDepot. Moreover, Amazon Business' participation in RFPs has been "limited." Significantly, Amazon Business also has yet to successfully bid to be a large B-to-B customer's primary vendor. . . .

[7] The Court has considered whether Amazon Business' newly energized focus on the B-to-B space could transform the office supply industry for B-to-B customers in such a dramatic way that the RFP process may be "what dinosaurs do" in the future. However, during [the deposition of Vice President of Amazon Business, Prentis Wilson], he testified that Amazon Business does not seek to change the RFP process. During cross-examination, [counsel for Defendants, Diane Sullivan,] addressed this point with Mr. Wilson directly:

> Ms. Sullivan: And anybody that's been watching what's been going on in the world understands that the way the old companies are doing things, running around, trying to get RFPs and a contract is kind of the old world. The new world is going to be procurement officers sitting at their desks using platforms like the one you're developing?
>
> Mr. Wilson: I don't know—I mean, that's maybe one vision of what may happen. We'll see how the technology sort of evolves and where things land.
>
> Ms. Sullivan: But that's your plan, that that's going to be the new world?
>
> Mr. Wilson: Well, our plan is to bring Amazon Business shopping experience to customers. And we would like for them to be able to—to leverage it, and we would like to create a solution that they like.

[8] Mr. Wilson's testimony does not support the conclusion that Amazon Business seeks to make the RFP process obsolete. Defendants did not offer testimony from other industry experts or offer any other credible evidence that the RFP process will become obsolete within the next three years. The evidence before the Court simply does not support a finding that Amazon Business will, within the next three years, either compete for large RFPs in the same way that Office Depot does now, or so transform the industry as to make the RFP process obsolete.

[9] Second, Amazon Business' marketplace model is at odds with the large B-to-B industry. Similar to Amazon's consumer marketplace, half of all sales on Amazon Business are serviced by Amazon directly, while the other half are serviced by third-party sellers. Amazon does not control the price or delivery offered by third-party sellers. Mr. Wilson confirmed that this will not change. Amazon Business' lack of control over the price offered by third-party sellers contributes to Amazon Business' inability to offer guaranteed pricing. . . . [T]he record is devoid of evidence to support the proposition that large business would shift their entire office supply spend to Amazon Business in the next three years.

[10] Finally, although Amazon Business' 2020 revenue projection is an impressive $[redacted text], only [redacted text] percent of that is forecast to come from the sale of office supplies. This level of revenue for office supplies would give Amazon Business only a very small share in the relevant market. . . .

[11] . . . [D]uring Mr. Wilson's testimony about Amazon Business' ability to compete for RFPs, the Court engaged in this exchange:

> THE COURT: So, if one were to predict—if a vice president were to predict five years from now, you'd be in a much better position to respond, just predicting?
>
> THE WITNESS: That's our point, yes.
>
> THE COURT: Right. And that—the strength of that prediction is based upon what?
>
> THE WITNESS: Investment in resources.
>
> THE COURT: Right. And that's something that, I guess from a business point of view, you plan to do?
>
> THE WITNESS: I plan to request the resources.
>
> THE COURT: Right. Because you want to be as successful as you possibly can and compete, right?
>
> THE WITNESS: Absolutely.

[12] Critically, however, when the Court asked whether Mr. Wilson [text redacted in the court's opinion for confidentiality]. This answer, considered in light of Amazon Business' lack of demonstrated ability to compete for RFPs and the structural and institutional challenges of its marketplace model, leads the Court to conclude that Amazon Business will not be in a position to compete in the B-to-B space on par with the proposed merged entity within three years. . . . [I]t would be sheer speculation, based on the evidence, for the Court to conclude otherwise. If Amazon Business was more developed . . . the outcome of this case very well may have been different.

United States v. H & R Block, Inc.

833 F. Supp. 2d 36 (D.D.C. 2011)

Judge Howell.

{*Eds.: DOJ's prima facie case is covered above.*[691]}

[1] Defendants argue that the likelihood of expansion by existing [digital do-it-yourself ("DDIY")] companies besides Intuit, HRB, and TaxACT will offset any potential anticompetitive effects from the merger. Courts have held that likely entry or expansion by other competitors can counteract anticompetitive effects that would otherwise be expected. According to the Merger Guidelines, entry or expansion must be "timely, likely, and sufficient in its magnitude, character, and scope to deter or counteract the competitive effects of concern." Determining whether there is ease of entry hinges upon an analysis of barriers to new firms entering the market or existing firms expanding into new regions of the market. In this case, the parties essentially agree that the proper focus of this inquiry is on the likelihood of expansion by existing competitors rather than new entry into the

[691] *See supra* § VIII.B.2.(b).

market.[28] Since the government has established its prima facie case, the defendants carry the burden to show that ease of expansion is sufficient to fill the competitive void that will result if defendants are permitted to purchase their acquisition target.

[2] In describing the competitive landscape, the defendants note there are eighteen companies offering various DDIY products through the [Free File Alliance ("FFA")]. Most of these companies are very small-time operators, however. The defendants acknowledge this fact, but nevertheless contend that the companies TaxSlayer and TaxHawk are the two largest and most poised to replicate the scale and strength of TaxACT. Witnesses from TaxSlayer and TaxHawk were the only witnesses from other DDIY companies to testify at the hearing. As such, the Court's ease of expansion analysis will focus on whether these two competitors are poised to expand in a way that is "timely, likely, and sufficient in its magnitude, character, and scope to deter or counteract" any potential anticompetitive effects resulting from the merger.

[3] TaxHawk runs five different websites, including FreeTaxUSA.com, that all market the same underlying DDIY product. TaxHawk was founded in 2001, three years after TaxACT, although it has a significantly smaller market share of 3.2 percent. TaxHawk's vice-president and co-founder, Mr. Dane Kimber, testified that the company has the technical infrastructure to grow by five to seven times the number of customers in any given year. TaxHawk's marketing strategy relies substantially on search engine advertising and search term optimization, including by using the FreeTaxUSA.com domain name, which contains the keywords "free" and "tax." Despite having been in business for a decade, its products are functionally more limited than those of Intuit, HRB, and TaxACT in various ways. Although TaxHawk services the forms that cover most taxpayers, its program does not service all federal forms, it excludes two states' forms in their entirety, and it does not service city income tax forms for major cities that have income taxes—notably, New York City. In fact, Mr. Kimber testified that the company would likely need another decade before its DDIY products could fully support all the tax forms. The reason is that TaxHawk is what Mr. Kimber [testified that he] "likes to call a lifestyle company. We like the lifestyle we have as owners. We want our employees to have a life, if you will. I do feel we have the expertise to expand functionality more rapidly, but we choose not to." Mr. Kimber also testified that TaxHawk had suddenly experienced an unprecedented growth rate of over 60 percent since April 2011, but that the company had not done any analysis to attempt to explain this unanticipated (and presumably welcome) growth.

[4] TaxHawk's relaxed attitude toward its business stands in stark contrast to the entrepreneurial verve that was apparent throughout the testimony of Mr. Dunn [founder of TaxACT] and that has been rewarded by the impressive growth of TaxACT over the years. In short, TaxHawk is a very different company from TaxACT. TaxHawk is a small company that has developed a string of search-engine-optimized DDIY websites, which deliver a sufficient income stream to sustain its owners' comfortable lifestyle, without requiring maximal effort on their part. While TaxHawk's decision to prioritize a relaxed lifestyle over robust competition and innovation is certainly a valid one, expansion from TaxHawk that would allow it to compete on the same playing field as the merged company appears unlikely.

[5] After TaxHawk, TaxSlayer is the next largest DDIY competitor, with a 2.7 percent market share. TaxSlayer.com launched in 2003, although the same company started selling a software product to tax professionals several years earlier. TaxSlayer is part of the same corporate family as Rhodes Murphy, a tax firm that provides assisted tax preparation through sixteen retail offices in the Augusta, Georgia area. The company is a family business and James Brian Rhodes, the product manager of TaxSlayer and the son of the company's founder, testified at the hearing. Mr. Rhodes testified that, in the event of an increase in TaxACT's prices or a decrease in its quality, he believes that TaxSlayer is poised and ready to take those customers who would want to go elsewhere for lower prices. TaxSlayer's marketing strategy relies heavily on sponsorship of sporting events, including the Gator Bowl and NASCAR. TaxSlayer typically invests a significant amount of its budget in marketing. For example, TaxSlayer plans to spend $[amount redacted in the court's opinion for confidentiality]

[28] New entrants to the market would not only face all of the barriers to expansion already faced by the existing small firms offering DDIY products, they would also have to develop their own products, including a software platform and a sufficient level of tax expertise. For entry to be considered timely, it typically must occur within approximately two years post-merger. *See* [U.S. Dept. of Justice & FTC,] COMMENTARY ON THE HORIZONTAL MERGER GUIDELINES (2006) at 45–46 (discussing prior [1997] Merger Guidelines § 3.2, which specified that timely entry should occur within two years). It is unlikely that an entirely new entrant to the market could compete meaningfully with the established DDIY firms within that time frame.

on marketing in 2012 based on 2011 revenues of $[amount redacted in the court's opinion for confidentiality]. Despite this high level of marketing spending, TaxSlayer's DDIY market share has not changed substantially since 2006, despite steady growth in TaxSlayer's revenue and number of units sold. Rather, TaxSlayer's growth in unit sales and revenue has come from maintaining the same slice of an expanding pie—the growing DDIY market.

[6] TaxSlayer's stable market share despite its significant marketing expenditure as a proportion of revenue points to what the government considers the key barrier to entry in this market—the importance of reputation and brand in driving consumer behavior in purchasing DDIY products. Simply put, tax returns are highly personal documents that carry significant financial and legal consequences for consumers. Consumers, therefore, must trust and have confidence in their tax service provider. As one of TaxACT's bankers put it a confidential memorandum, tax filers must have confidence that sensitive data is being handled with care and that returns are processed in a secure, error-free and timely manner.

[7] Building a reputation that a significant number of consumers will trust requires time and money. As HRB's former CEO noted, it takes millions of dollars and lots of time to develop a brand. TaxACT's offering memoranda also point to the difficulty in building a brand in the industry as a barrier to competition. In the DDIY industry, the Big Three incumbent players spend millions on marketing and advertising each year to build and maintain their brands, dwarfing the combined spending of the smaller companies. For example, in tax year 2009, Intuit, HRB, and TaxACT collectively spent approximately over $100 million on marketing and advertising. By contrast, TaxSlayer and TaxHawk spent a significantly smaller amount.

[8] Even TaxACT's successful business strategy has been premised on the notion that it cannot outspend Intuit and HRB on marketing. The massive marketing expenditures of the two major DDIY firms create high per customer acquisition costs and limit the easy marketing channels that are open to smaller competitors. Rather than attempting to outspend HRB and Intuit, TaxACT's growth strategy has largely depended on providing great customer service, a great product, and a great customer experience and then relying on word-of-mouth referrals to spread the awareness of the brand. This process is inherently time-consuming and difficult to replicate.

[9] In support of their argument that TaxSlayer and TaxHawk are poised to expand in response to a price increase, the defendants emphasize that these companies are at about the same position in terms of customer base as TaxACT was in 2002, which was the year before it did the Free For All offer on the FFA. The government points out, however, that there are two flaws in this comparison, even assuming that TaxSlayer and TaxHawk were TaxACT's competitive equals. First, while these companies may have a similar number of customers to TaxACT in 2002 in absolute terms, TaxACT's market share at 8 percent was already significantly larger than the market shares of these firms today, despite the fact that TaxACT had been in the market for fewer years.

[10] Second, the DDIY market has matured considerably since 2002, in parallel with the general ripening of various online industries during the past decade. Notably, the pool of pen-and-paper customers has dwindled as DDIY preparation has grown. Thus, the "low hanging fruit" of DDIY customer acquisition may have been plucked. This trend suggests existing market shares may become further entrenched and that growing market share may be even harder, especially because there are barriers to switching from one DDIY product to another. For example, the hearing evidence showed that it is difficult to import prior-year tax return data across DDIY brands. If a taxpayer uses, say, TurboTax or TaxACT in one year, then when the taxpayer returns the next year, the program can automatically import the prior year's data, which is not only convenient but can also help the taxpayer identify useful tax information, such as carry forwards and available deductions. Currently, it is not possible to import much of this data if the taxpayer switches to a competitor's product. Thus, this feature lends a "stickiness" to each particular DDIY product once a customer has used it.

[11] Upon consideration of all of the evidence relating to barriers to entry or expansion, the Court cannot find that expansion is likely to avert anticompetitive effects from the transaction. The Court will next consider whether the evidence supports a likelihood of coordinated or unilateral anticompetitive effects from the merger.

* * *

So what does a *successful* entry showing look like? One such showing was managed by the parties in DOJ's challenge to the acquisition by Waste Management Services of its competitor EMV Ventures.

United States v. Waste Management, Inc.

743 F.2d 976 (2d Cir. 1984)

Judge Winter.

[1] WMI is in the solid waste disposal business. It provides services in twenty-seven states and had revenues of approximately $442 million in 1980. At the time of the acquisition, EMW was a diversified holding company that owned a subsidiary by the name of Waste Resources, which was in the waste disposal business in ten states and had revenues of $54 million in 1980.

[2] WMI and Waste Resources each had subsidiaries that operated in or near Dallas. WMI has one subsidiary, American Container Service ("ACS") in Dallas, and another, Texas Waste Management, in the Dallas suburb of Lewisville. Waste Resources had a Dallas subsidiary called Texas Industrial Disposal, Inc. ("TIDI"). WMI now operates TIDI as a WMI sub. [. . .]

[3] Based on revenue data, Judge Griesa [in the district court below] found that the combined market share of TIDI and ACS was 48.8%. He viewed that market share as prima facie illegal under *United States v. Philadelphia National Bank*, 374 U.S. 321, 364–66 (1963). Agreeing with appellants that entry into the product market is easy—indeed, individuals operating out of their homes can compete successfully "with any other company"—Judge Griesa nevertheless held that proof of ease of entry did not rebut the prima facie showing of illegality. The district court therefore ordered WMI to divest itself of TIDI. Because we conclude that potential entry into the relevant Dallas market by new firms or by firms now operating in Fort Worth is so easy as to constrain the prices charged by WMI's subs, we reverse on the grounds that the merged firm does not substantially lessen competition. [. . .]

[4] WMI does not claim that [the 48.8% combined market share of the parties] is too small a share to trigger the *Philadelphia National Bank* presumption. Rather, it argues that the presumption is rebutted by the fact that competitors can enter the Dallas waste hauling market with such ease that the finding of a 48.8% market share does not accurately reflect market power. WMI argues that it is unable to raise prices over the competitive level because new firms would quickly enter the market and undercut them. [. . .]

[5] . . . [W]e believe that entry into the relevant product and geographic market by new firms or by existing firms in the Fort Worth area is so easy that any anti-competitive impact of the merger before us would be eliminated more quickly by such competition than by litigation. Judge Griesa specifically found that individuals operating out of their homes can acquire trucks and some containers and compete successfully "with any other company." The government's response to this factual finding is largely to the effect that economies of scale are more important than Judge Griesa believed. As with his other findings of fact, however, this one is not clearly erroneous, as there are examples in the record of such entrepreneurs entering and prospering.

[6] In any event, entry by larger companies is also relatively easy. At existing prices most Fort Worth and Dallas haulers operate within their own cities, but it is clear from the record that Fort Worth haulers could easily establish themselves in Dallas if the price of trash collection rose above the competitive level. Although it may be true that daily travel from Fort Worth to Dallas and back is costly, there is no barrier to Fort Worth haulers' acquiring garage facilities in Dallas permitting them to station some of their trucks there permanently or for portions of each week. The risks of such a strategy are low since substantial business can be assured through bidding on contracts even before such garage facilities are acquired, as one Fort Worth firm demonstrated by winning such a contract and then opening a facility in a Dallas suburb. That example can hardly be ignored by WMI or other Dallas haulers (not to mention their customers) in arriving at contract bids. The existence of haulers in Fort Worth, therefore, constrains prices charged by Dallas haulers . [. . .]

[7] Judge Griesa's conclusion that "there is no showing of any circumstances, related to ease of entry or the trend of the business, which promises in and of itself to materially erode the competitive strength of TIDI and ACS" is consistent with our decision. TIDI and ACS may well retain their present market share. However, in view of the findings as to ease of entry, that share can be retained only by competitive pricing. Ease of entry constrains not only WMI, but every firm in the market. Should WMI attempt to exercise market power by raising prices, none of its smaller competitors would be able to follow the price increases because of the ease with which new

competitors would appear. WMI would then face lower prices charged by all existing competitors as well as entry by new ones, a condition fatal to its economic prospects if not rectified.

[8] The government argues that consumers may prefer WMI's services, even at a higher price, over those of a new entrant because of its "proven track record." We fail to see how the existence of good will achieved through effective service is an impediment to, rather than the natural result of, competition. The government also argues that existing contracts bind most customers to a particular hauler and thereby prevent new entrants from acquiring business. If so, they also prevent the price increases until new entrants can submit competitive bids.

[9] Given Judge Griesa's factual findings, we conclude that the 48.8% market share attributed to WMI does not accurately reflect future market power. Since that power is in fact insubstantial, the merger does not, therefore, substantially lessen competition in the relevant market and does not violate Section 7.

CASENOTE: Google/AdMob

FTC File No. 101-0031 (May 21, 2010)

Entry was a critical basis for the FTC's decision to permit Google to acquire the AdMob mobile ad network. In a May 2010 statement, the Commission explained that its unanimous vote to close the merger investigation was "difficult" because "the parties currently are the two leading mobile advertising networks, and the Commission was concerned about the loss of head-to-head competition between them." The Commission's investigation had generated "evidence that each of the merging parties viewed the other as its primary competitor, and that each firm made business decisions in direct response to this perceived competitive threat."

But during the merger review, Apple acquired the #3 mobile ad network, Quattro Wireless. The Commission concluded that: "Apple quickly will become a strong mobile advertising network competitor. Apple not only has extensive relationships with application developers and users, but also is able to offer targeted ads (heretofore a strength of AdMob) by leveraging proprietary user data gleaned from users of Apple mobile devices. Furthermore, Apple's ownership of the iPhone software development tools, and its control over the developers' license agreement, gives Apple the unique ability to define how competition among ad networks on the iPhone will occur and evolve."

The Commission expressed confidence that interplatform competition between Android and iPhone would protect against any effort by the merged firm to exercise market power on Android devices. In particular, because "applications are often made available to consumers in their current low- or no-cost form through advertising provided by mobile ad networks like AdMob," Google would be motivated to keep apps on the Android platform by providing competitive advertising terms. "To the extent Google were to exercise market power on Android after this acquisition, it would risk making Android less competitive against the iPhone and other platforms."

Unfortunately, the predicted competitive pressure from Apple on which the FTC relied so heavily did not take place.[692] What could the agency have done when this became clear?

NOTES

1) Should courts and agencies use the same legal test to assess whether a business should be considered (a) an entrant for the purposes of *reducing* competitive concerns presented by a merger, and (b) a potential competitor for the purposes of *generating* competitive concerns? Should burdens be different? For one perspective, *see* Keith Klovers, Alexandra Keck & Allison Simkins, *Treating Like Cases Alike: The Need for Consistency in the Forthcoming Merger Guidelines*, Comp. Pol'y Int'l (Nov. 2022).
2) Suppose that an agency concludes that the prospect of entry or expansion is sufficient to resolve competitive concerns, allows the merger to close, and the predicted entry or expansion does not occur. Does this mean that the agency was wrong—either factually or legally—in its assessment? When, if at all, should the agency sue?

[692] *See*, *e.g.*, Ragnar Kruse, *The downfall of the walled garden: Here's why iAd failed*, TECHCRUNCH (Mar. 28, 2016).

3) Should the merger guidelines state that a merger will be permitted if the merged firm will face a monopolist supplier or customer? *Compare*, *e.g.*, Tom Campbell, *Bilateral Monopoly in Mergers*, 74 Antitrust L.J. 521 (2007) *with* Jonathan B. Baker, Joseph Farrell, & Carl Shapiro, *Merger to Monopoly to Serve a Single Buyer: Comment*, 75 Antitrust L.J. 637 (2008).

C. Vertical Mergers

Vertical mergers combine firms at different levels of the supply chain (such as an upstream input supplier with a downstream manufacturer that uses the input, or an upstream content creator with a downstream distribution platform), or suppliers of complementary products and services, creating a "vertically integrated" firm.[693]

As we noted at the outset, as a class, these transactions are (generally) somewhat less likely than horizontal mergers to be competitively troubling: because the firms are not in competition, and because there are often efficiencies from integrating different stages of production. As a result, vertical integration may represent a move toward a more efficient way of doing business, with the result that the firm is better able to compete.[694] But individual vertical mergers can and do cause competitive problems, as we shall see, and the agencies have a considerable body of vertical merger enforcement practice.[695] The federal agencies have mounted several efforts to block vertical mergers in recent years, starting with the challenge in 2017 to the AT&T / Time Warner deal.[696]

Courts approach vertical mergers with a burden-shifting framework equivalent to that used for horizontal transactions: a plaintiff must establish a *prima facie* case; the burden then shifts to the defendant to offer rebuttal evidence; and a plaintiff carries the ultimate burden of persuasion.[697] As with the horizontal framework, these steps do not correspond to literal successive stages in litigation. Rather, they are analytical steps, used by courts and others to structure a legal analysis or a judicial opinion.

The most common concern in vertical merger cases is *foreclosure*. The concern is that, post-merger, the integrated firm will use its control over its upstream / downstream division to reduce competition in the downstream / upstream market, by either cutting off rivals entirely or by dealing with them on less favorable terms. For example, a vertical merger that combines a downstream firm with market power in the supply of equipment with an upstream firm with market power in the supply of a key component could enable the merged firm to "foreclose" downstream rivals' access to inputs, or upstream rivals' access to distribution or customers, in ways that might lead to an overall reduction in competition. It may be helpful to see this presented visually:

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693 Virtually all firms are vertically integrated to at least some extent, in that they combine more than one stage of production within the firm. (The very idea of a "production line," in which multiple different processes are applied in sequence, implies that the firm is active in successive stages of production.)

694 *See*, *e.g.*, Oliver E. Williamson, *Economies as an Antitrust Defense: The Welfare Tradeoffs*, 58 Am. Econ. Rev. 18, 32 (1968) ("The logical boundaries of a firm are not necessarily those which have been inherited but rather are defined by the condition that the firm be unable to arrange a transaction internally more cheaply than the market. This is not something which is given once-for-all but depends both on technology and the extent of the market. Thus what may be regarded as 'vertical integration' under a historical definition of an industry might, in many instances, more accurately be characterized as a reorganization into a more efficient configuration. For example, as technology evolves processes that are more fully automated or as demand for a commodity increases sufficiently to warrant continuous processing techniques, combinatorial economies may result by serially linking activities within a single firm that had previously been done in separate specialty firm").

695 *See* FTC, *Commentary on Vertical Merger Enforcement* (Dec. 2020); Steven C. Salop & Daniel P. Culley, *Vertical Merger Enforcement Actions: 1994–2016*, https://scholarship.law.georgetown.edu/facpub/1529/.

696 *See*, *e.g.*, Illumina, Inc. v. FTC, 88 F.4th 1036 (5th Cir. 2023); FTC v. Tempur Sealy Int'l, Inc., No. 4:24-cv-2508, 2025 WL 617735 (S.D. Tex. Feb. 26, 2025); FTC v. Microsoft Corp., 681 F. Supp. 3d 1069 (N.D. Cal. 2023); United States v. UnitedHealth Group Inc., 630 F.Supp.3d 118 (D.D.C. 2022); FTC, Press Release, Statement Regarding Termination of Lockheed Martin Corporation's Attempted Acquisition of Aerojet Rocketdyne Holdings Inc. (Feb. 15, 2022); FTC, Press Release, Statement Regarding Termination of Nvidia Corp.'s Attempted Acquisition of Arm Ltd. (Feb. 14, 2022); United States v. AT&T, Inc., 916 F.3d 1029 (D.C. Cir. 2019).

697 *See*, *e.g.*, Illumina, Inc. v. FTC, 88 F.4th 1036, 1048, 1058 (5th Cir. 2023); United States v. AT&T, Inc., 916 F.3d 1029, 1032 (D.C. Cir. 2019); FTC v. Tempur Sealy Int'l, Inc., No. 4:24-cv-2508, 2025 WL 617735, at *12 (S.D. Tex. Feb. 26, 2025).

Figure 6: Input foreclosure

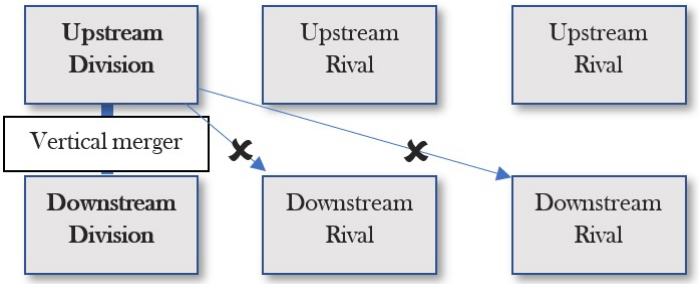
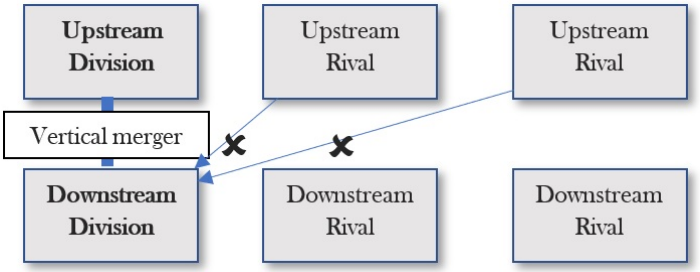


Figure 7: Customer / distribution foreclosure



A vertical merger will not necessarily create a merged firm that will foreclose its rivals: after all, doing so means fewer sales for the foreclosing division. For a foreclosure strategy to have a significant effect on rivals, the foreclosing division must have some degree of market power, or the targets will simply switch to an alternative source of inputs or distribution. And for foreclosure to be attractive, the expected additional profits to the division that competes with the targets of foreclosure must exceed the expected losses from the reduction in sales activity for the foreclosing division. Figuring out whether a merger will create or augment the ability or incentive to engage in harmful foreclosure, and weighing this effect against beneficial ones like cost savings and elimination of double marginalization ("EDM") incentive effects (*i.e.*, price reductions flowing from the integration of upstream and downstream divisions into a single decision-maker[698]) to determine the deal's overall effect, can be complicated.

Foreclosure is not the only way in which a vertical merger could harm competition. A merger that gives the merged firm access to competitively sensitive information about its rivals could harm competition by reducing rivals' incentive to compete aggressively.[699] A vertical merger could also improve market transparency or symmetry in a way that would facilitate coordination.[700]

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[698] *See infra* § VIII.D.2.

[699] *See*, *e.g.*, Complaint, United States v. UnitedHealth Group Inc., Case No. 1:22-cv-481 (D.D.C. filed Feb. 24, 2022) ¶ 12 ("Post-transaction, United . . . would have a strong incentive to use this data to weaken its health insurance rivals' competitiveness. The competitive insights that United would obtain by acquiring Change would allow United to slow its rivals' innovations, reverse-engineer its rivals' proprietary plan and payment rules, preempt their competitive strategies, and compete less vigorously for certain customers by understanding which employer groups pose more risk and have higher costs of treatment. This course would prove profitable to United while harming competition"), ¶ 88 ("With this data, UnitedHealthcare would have the ability to disadvantage its rivals, including by mimicking their innovative policies to make their rivals' healthcare plans less attractive to customers (relative to UnitedHealthcare). This would reduce the rivals' incentives to innovate in claims edits, which would also reduce innovation in commercial health insurance plan and provider network design."), ¶ 89 ("Innovation competition among health insurers would likely decline, because rival insurers would know that United could identify and appropriate the innovation through its access to the innovator's competitively sensitive edits. This harm to innovation would reduce competition in the sale of commercial health insurance to national accounts and large group employers, resulting in less affordable or lower quality plans.").

[700] *See*, *e.g.*, Steven C. Salop, *A Suggested Revision of the 2020 Vertical Merger Guidelines*, Working Paper, (December 31, 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3839768, § 5.3 at 16 ("Coordinated effects may also arise when the merged firm gains access to rivals' sensitive competitive information, which may facilitate either (a) reaching a tacit agreement among market participants, (b) detecting cheating on such an agreement, or (c) punishing cheating firms.").

Finally, remember that some transactions that appear vertical may also be horizontal: some vertical mergers involve parties who are, in addition to their vertical relationship, also potential horizontal competitors of one another. It is important not to forget this![701]

The 2023 Merger Guidelines integrated the treatment of horizontal and vertical mergers into the same guidance document for the first time since 1984. (The period of separate guidelines saw 1992, 1997, and 2010 guidance for horizontal mergers, as well as the 2020 guidance for vertical mergers.) The section from the 2023 Merger Guidelines aimed most directly at vertical mergers is excerpted below. As you will see, it sets out a "traditional" foreclosure theory and an "access to information" theory, and it notes that in some cases a vertical merger might discourage rivals from investing in a market because they fear or expect harmful conduct by the merged firm. It uses the phrase "relevant market" to describe the market in which competition may be harmed, and the phrase "related market" to describe the market in which the merged firm might engage in conduct (*e.g.*, foreclosure) that might harm competition in the relevant market. Thus, for example, in a vertical merger that presented a threat of input foreclosure, the downstream competitive market would be the "relevant" market, and the upstream input market would be the "related" market.

Among other things, note that the 2023 Merger Guidelines suggest (at paragraph 14 and footnote 30 of the extract) that a market share of 50% in the related market can create a presumption that the merged firm will have the ability to foreclose rivals. This is consistent with the position of most courts that market power can be inferred from a market share of 50%, assuming that that share is in a well-defined market protected by barriers to entry.[702] Whether or not it will have the *incentive* to foreclose must of course be analyzed separately.

Merger Guidelines § 2.5

Guideline 5: Mergers Can Violate the Law When They Create a Firm that May Limit Access to Products or Services That Its Rivals Use to Compete.

[1] The Agencies evaluate whether a merger may substantially lessen competition when the merged firm can limit access to a product, service, or route to market that its rivals may use to compete. Mergers involving products or services rivals may use to compete can threaten competition in several ways, for example: (A) the merged firm could limit rivals' access to the products or services, thereby weakening or excluding them, lessening competition; (B) the merged firm may gain or increase access to rivals' competitively sensitive information, thereby facilitating coordination or undermining their incentives to compete; or (C) the threat of limited access can deter rivals and potential rivals from investing.

[2] These problems can arise from mergers involving access to any products, services, or routes to market that rivals use to compete, and that are competitively significant to those rivals, whether or not they involve a traditional vertical relationship such as a supplier and distributor relationship. Many types of related products can implicate these concerns, including products rivals currently or may in the future use as inputs, products that provide distribution services for rivals or otherwise influence customers' purchase decisions, products that provide or increase the merged firm's access to competitively sensitive information about its rivals, or complements that increase the value of rivals' products. Even if the related product is not currently being used by rivals, it might be competitively significant because, for example, its availability enables rivals to obtain better terms from other providers in negotiations. The Agencies refer to any product, service, or route to market that rivals use to compete in that market as a "related product." [. . .]

2.5.A. The Risk that the Merged Firm May Limit Access

[3] A merger involving products, services, or routes to market that rivals use to compete may substantially lessen competition when the merged firm has both the ability and incentive to limit access to the related product so as to weaken or exclude some of its rivals (the "dependent" rivals) in the relevant market.

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[701] *See generally* Alison Oldale, Bilal Sayyed & Andrew Sweeting, *A review of cases involving the loss of potential and nascent competition at the FTC, with particular reference to vertical mergers*, 6 Comp. L. & Pol'y Debate 60 (2020).

[702] *See supra* § III.E.

[4] The merged firm could limit access to the related product in different ways. It could deny rivals access altogether, deny access to some features, degrade its quality, worsen the terms on which rivals can access the related product, limit interoperability, degrade the quality of complements, provide less reliable access, tie up or obstruct routes to market, or delay access to product features, improvements, or information relevant to making efficient use of the product. All these ways of limiting access are sometimes referred to as "foreclosure."

[5] Dependent rivals can be weakened if limiting their access to the related product would make it harder or more costly for them to compete; for example, if it would lead them to charge higher prices or offer worse terms in the relevant market, reduce the quality of their products so that they were less attractive to trading partners, or interfere with distribution so that those products were less readily available. Competition can also be weakened if the merger facilitates coordination among the merged firm and its rivals, for example by giving the merged firm the ability to threaten to limit access to uncooperative rivals.

[6] Rivals or potential rivals may be excluded from the relevant market if limiting their access to the related product could lead them to exit the market or could deter them from entering. For example, potential rivals may not enter if the merged firm ties up or obstructs so many routes to market that the remaining addressable market is too small. Exclusion can arise when a new entrant would need to invest not only in entering the relevant market, but also in supplying its own substitute for the related product, sometimes referred to as two-stage entry or multi-level entry. [. . .]

2.5.A.1. Ability and Incentive to Foreclose Rivals

[7] The Agencies assess the merged firm's ability and incentive to substantially lessen competition by limiting access to the related product for a group of dependent rivals in the relevant market by examining four factors.

> *1. Availability of Substitutes.* The Agencies assess the availability of substitutes for the related product. The merged firm is more able to limit access when there are few alternative options to the merged firm's related product, if these alternatives are differentiated in quality, price, or other characteristics, or if competition to supply them is limited.
>
> *2. Competitive Significance of the Related Product.* The Agencies consider how important the related product is for the dependent firms and the extent to which they would be weakened or excluded from the relevant market if their access was limited.
>
> *3. Effect on Competition in the Relevant Market.* The Agencies assess the importance of the dependent firms for competition in the relevant market. Competition can be particularly affected when the dependent firms would be excluded from the market altogether.
>
> *4. Competition Between the Merged Firm and the Dependent Firms.* The merged firm's incentive to limit the dependent firms' access depends on how strongly it competes with them. If the dependent firms are close competitors, the merged firm may benefit from higher sales or prices in the relevant market when it limits their access. The Agencies may also assess the potential for the merged firm to benefit from facilitating coordination by threatening to limit dependent rivals' access to the related product. These benefits can make it profitable to limit access to the related product and thereby substantially lessen competition, even though it would not have been profitable for the firm that controlled the related product prior to the merger. [. . .]

[8] *Barriers to Entry and Exclusion of Rivals.* The merged firm may benefit more from limiting access to dependent rivals or potential rivals when doing so excludes them from the market, for example by creating a need for the firm to enter at multiple levels and to do so with sufficient scale and scope (multi-level entry).

[9] *Prior Transactions or Prior Actions.* If firms used prior acquisitions or engaged in prior actions to limit rivals' access to the related product, or other products its rivals use to compete, that suggests that the merged firm has the ability and incentive to do so. However, lack of past action does not necessarily indicate a lack of incentive in the present transaction because the merger can increase the incentive to foreclose.

[10] *Internal Documents.* Information from business planning and merger analysis documents prepared by the merging firms might identify instances where the firms believe they have the ability and incentive to limit rivals' access. Such documents, where available, are highly probative. The lack of such documents, however, is less informative.

[11] *Market Structure.* Evidence of market structure can be informative about the availability of substitutes for the related product and the competition in the market for the related product or the relevant market.

2.5.A.2. Analysis of Industry Factors and Market Structure

[12] [. . .] *Structure of the Related Market.* In some cases, the market structure of the related product market can give an indication of the merged firm's ability to limit access to the related product. In these cases, the Agencies define a market (termed the "related market") around the related product. The Agencies then define the "foreclosure share" as the share of the related market to which the merged firm could limit access. If the share or other evidence show that the merged firm is approaching or has monopoly power over the related product, and the related product is competitively significant, those factors alone are a sufficient basis to demonstrate that the dependent firms do not have adequate substitutes and the merged firm has the ability to weaken or exclude them by limiting their access to the related product.[30]

[13] *Structure of the Relevant Market.* Limiting rivals' access to the related product will generally have a greater effect on competition in the relevant market if the merged firm and the dependent rivals face less competition from other firms. In addition, the merged firm has a greater incentive to limit access to the dependent firms when it competes more closely with them. Market share and concentration measures for the merged firm, the dependent rivals, and the other firms, can sometimes provide evidence about both issues. [. . .]

[14] *Trend Toward Vertical Integration.* The Agencies will generally consider evidence about the degree of integration between firms in the relevant and related markets, as well as whether there is a trend toward further vertical integration and how that trend or the factors driving it may affect competition. A trend toward vertical integration may be shown through, for example: a pattern of vertical integration following mergers by one or both of the merging companies; or evidence that a merger was motivated by a desire to avoid having its access limited due to similar transactions among other companies that occurred or may occur in the future. [. . .]

[15] . . . When assessing [an argument, made by merging parties, that the merged firm would not foreclose its rivals because by doing so it would be sacrificing the profits it would make from selling the related product to them], the Agencies examine whether the reduction in profits would prevent the full range of reasonably probable strategies to limit access. When evaluating whether this rebuttal evidence is sufficient to conclude that no substantial lessening of competition is threatened by the merger, the Agencies will give little weight to claims that are not supported by an objective analysis, including, for example, speculative claims about reputational harms. Moreover, the Agencies are unlikely to credit claims or commitments to protect or otherwise avoid weakening the merged firm's rivals that do not align with the firm's incentives. The Agencies' assessment will be consistent with the principle that firms act to maximize their overall profits and valuation rather than the profits of any particular business unit. A merger may substantially lessen competition or tend to create a monopoly regardless of the claimed intent of the merging companies or their executives. [. . .]

2.5.B. Mergers Involving Visibility into Rivals' Competitively Sensitive Information

[16] [. . .] *Undermining Competition.* The merged firm might use visibility into a rival's competitively sensitive information to undermine competition from the rival. For example, the merged firm's ability to preempt, appropriate, or otherwise undermine the rival's procompetitive actions can discourage the rival from fully pursuing competitive opportunities. Relatedly, rivals might refrain from doing business with the merged firm rather than risk that the merged firm would use their competitively sensitive business information to undercut them. Those

[30] The Agencies will generally infer, in the absence of countervailing evidence, that the merging firm has or is approaching monopoly power in the related product if it has a share greater than 50% of the related product market. A merger involving a related product with share of less than 50% may still substantially lessen competition, particularly when that related product is important to its trading partners.

rivals might become less-effective competitors if they must rely on less-preferred trading partners or accept less favorable trading terms because their outside options have worsened or are more limited.

[17] *Facilitating Coordination.* A merger that provides access to rivals' competitively sensitive information might facilitate coordinated interaction among firms in the relevant market by allowing the merged firm to observe its rivals' competitive strategies faster and more confidently.

2.5.C. Mergers that Threaten to Limit Rivals' Access and Thereby Create Barriers to Entry and Competition

[18] [. . .] Rivals or potential rivals that face the threat of foreclosure, or the risk of sharing sensitive information with rivals, may reduce investment or adjust their business strategies in ways that lessen competition. Firms may be reluctant to invest in a market if their success is dependent on continued supply from a rival, particularly because the merged firm may become more likely to foreclose its competitor as that competitor becomes more successful. Firms may use expensive strategies to try to reduce their dependence on the merged firm, weakening the competitiveness of their products and services. Even if the merged firm does not deliberately seek to weaken rivals, rivals or potential rivals may fear that their access will be limited if the merged firm decides to use its own products exclusively. These effects may occur irrespective of the merged firm's incentive to limit access and are greater as the merged firm gains greater control over more important inputs that those rivals use to compete.

Mergers That "Extend a Dominant Position"

One of the most striking innovations in the 2023 Merger Guidelines is the introduction of a guideline—Guideline 6—stating that in merger analysis "[t]he Agencies [will] consider whether a merger may entrench or extend [a] dominant position." The 2010 guidance did not use the concept of dominance, although the 1982 and 1984 guidelines did contain a "leading firm proviso" as noted above.[703] It is not yet clear how this Guideline relates to the familiar concepts of market or monopoly power, or to traditional theories of harm.

The concept of "extension" of a dominant position is particularly interesting for vertical merger analysis. The Merger Guidelines state that "[t]he Agencies . . . examine the risk that a merger could enable the merged firm to extend a dominant position from one market into a related market, thereby substantially lessening competition or tending to create a monopoly in the related market. For example, the merger might lead the merged firm to leverage its position by tying, bundling, conditioning, or otherwise linking sales of two products. A merger may also raise barriers to entry or competition in the related market, or eliminate a nascent competitive threat . . . . For example, prior to a merger, a related market may be characterized by scale economies but still experience moderate levels of competition. If the merged firm takes actions to induce customers of the dominant firm's product to also buy the related product from the merged firm, the merged firm may be able to gain dominance in the related market, which may be supported by increased barriers to entry or competition that result from the merger."

The Guidelines further express a concern that "[t]he prospect of market power in the related market may strongly affect the merged firm's incentives in a way that does not align with the interests of its trading partners, both in terms of strategies that create dominance for the related product and in the form of reduced incentives to invest in its products or provide attractive terms for them after dominance is attained. In some cases, the merger may also further entrench the firm's original dominant position, for example if future competition requires the provision of both products."

This language can be read in at least two ways. On one reading, this new language could simply be understood as an expression of traditional vertical-merger concerns. On this reading, if the parties to a vertical merger have market or monopoly power, the agencies will evaluate whether the merged firm may engage in harmful foreclosure that inflicts welfare harms by excluding rivals, as courts and agencies have done for decades. On a more innovative reading, though, this language—and the very existence of a separate Guideline dealing with dominant businesses—could be understood as going further and staking out a more aggressive position. For example, it

[703] *See supra* § VIII.B.1.

might be understood: as an assertion that more demanding legal standards apply to mergers that involve dominance; as a claim that a merger that increases a dominant firm's market power might be a matter of concern even if it does not involve harm to anyone except rivals; or as a suggestion that some or all complementarities may be unwelcome if the merged firm enjoys a certain level of market power.

Time will tell what agencies and courts will make of this Guideline. It may come to be understood as an innovation in merger enforcement or the law of Section 7, or simply as an expression of familiar principles.

Vertical merger policy is controversial. Some argue that the federal government and the courts have been too reluctant to try to block vertical mergers in recent decades.[704] Today, it is fairly clear that enforcers are mounting a programmatic effort to invigorate vertical enforcement and create some supportive authority through litigation. The 2023 revisions to the Merger Guidelines—including the extract that you have just read—are widely understood to reflect, among other things, an effort to strengthen the government's hand in vertical merger cases by emphasizing the ways in which vertical mergers can cause harm.

The leading edge of the modern wave of vertical merger enforcement was the Department of Justice's 2017 challenge to the merger of AT&T and Time Warner, which was litigated up to the D.C. Circuit. AT&T's DirecTV subsidiary was a downstream distributor of television to viewers; Time Warner was an upstream supplier of TV content, through its ownership of TV networks. The Department of Justice alleged that the merged firm would have the ability and incentive to foreclose competing distributors' access to Time Warner's programming. In the district court, Judge Leon was not convinced; and, on appeal, the D.C. Circuit agreed. Note the court's repeated emphasis on the importance of "real-world" evidence, by contrast with economic models.

United States v. AT&T, Inc.

916 F.3d 1029 (D.C. Cir. 2019)

Judge Rogers.

[1] The video programming and distribution industry traditionally operates in a three-stage chain of production. Studios or networks create content. Then, programmers package content into networks and license those networks to video distributors. Finally, distributors sell bundles of networks to subscribers. For example, a studio may create a television show and sell it to Turner Broadcasting System ("Turner Broadcasting"), a programmer, which would package that television show into one of its networks, such as CNN or TNT. Turner Broadcasting would then license its networks to distributors, such as DirecTV or Comcast.

[2] Programmers license their content to distributors through affiliate agreements, and distributors pay "affiliate fees" to programmers. Programmers and distributors engage in what are oftentimes referred to as "affiliate negotiations," which, according to evidence before the district court, can be lengthy and complicated. If a programmer and a distributor fail to reach an agreement, then the distributor will lose the rights to display the programmer's content to its customers. This situation, known as a "blackout" or "going dark," is generally costly for both the programmer, which loses affiliate fee revenues, and the distributor, which risks losing subscribers. Therefore, blackouts rarely occur, and long-term blackouts are especially rare. The evidence indicated, however, that programmers and distributors often threaten blackouts as a negotiating tactic, and both may perform "go dark" analyses to estimate the potential impact of a blackout in preparation for negotiations.

[3] The evidence before the district court also showed that the industry has been changing in recent years. Multichannel video programming distributors ("MVPDs") offer live television content as well as libraries of licensed content "on demand" to subscribers. So-called "traditional" MVPDs distribute channels to subscribers on cable or by satellite. Recently, "virtual" MVPDs have also emerged. They distribute live videos and on-demand videos to subscribers over the internet and compete with traditional MVPDs for subscribers. Virtual MVPDs, such

[704] *See*, *e.g.*, Jonathan B. Baker, THE ANTITRUST PARADIGM: RESTORING A COMPETITIVE ECONOMY (2019); Adil Abdela, Kristina Karlsson & Marshall Steinbaum, *Vertical Integration and the Market Power Crisis*, Roosevelt Institute Issue Brief (Apr. 2019); Steven C. Salop, *Invigorating Vertical Merger Enforcement*, 127 Yale L.J. 1962 (2018).

as DirecTV Now and YouTube TV, have been gaining market share, the evidence showed, because they are easy to use and low-cost, often because they offer subscribers smaller packages of channels, known as "skinny bundles."

[4] In addition, subscription video on demand services ("SVODs") have also emerged on the market. SVODs, such as Netflix, do not offer live video content but have large libraries of content that a viewer may access on demand. SVODs also offer low-cost subscription plans and have been gaining market share recently. Increasingly, cable customers are "cutting the cord" and terminating MVPD service altogether. Often these customers do not exit the entertainment field altogether, but instead switch to SVODs for entertainment service.

[5] Leading SVODs are vertically integrated, which means they create content and also distribute it. Traditional MVPDs typically are not vertically integrated with programmers. In 2009, however, Comcast Corporation ("Comcast") (a distributor and the largest cable company in the United States) announced a $30 billion merger with NBC Universal, Inc. ("NBCU") (a content creator and programmer), whereby it would control popular video programming that included the NBC broadcast network and the cable networks of NBC Universal, Inc. The government sued to permanently enjoin the merger under Section 7, alleging that Comcast's "majority control of highly valued video programming would prevent rival video-distribution companies from competing against the post-merger entity." *United States v. Comcast*, 808 F.Supp.2d 145, 147 (D.D.C. 2011). The district court, with the defendants' agreement and at the government's urging, allowed the merger to proceed subject to certain remedies for the alleged anticompetitive conduct post-merger, including remedies ordered in a related proceeding before the Federal Communications Commission ("FCC"). One remedy in the Comcast-NBCU merger was an agreement by the defendants to submit, at a distributor's option, to "baseball style" arbitration—in which each side makes a final offer and the arbitrator chooses between them—if parties did not reach a renewal agreement. During the arbitration, the distributor would retain access to NBC content, thereby mitigating concerns that Comcast-NBCU may withhold NBC programming during negotiations in order to benefit Comcast's distribution subscriptions. Comcast-NBCU currently operates as a "vertically integrated" programmer and distributor.

[6] Now the government has again sued to halt a proposed vertical merger of a programmer and a distributor in the same industry. On October 22, 2016, AT&T Inc. announced its plan to acquire Time Warner Inc. ("Time Warner") as part of a $108 billion transaction. AT&T Inc. is a distribution company with two traditional MVPD products: DirecTV and U-verse. DirecTV transmits programming over satellite, while U-verse transmits programming over cable. Time Warner, by contrast, is a content creator and programmer and has three units: Warner Bros., Turner Broadcasting, and Home Box Office Programming ("HBO"). Warner Bros. creates movies, television shows, and other video programs. Turner Broadcasting packages content into various networks, such as TNT, TBS, and CNN, and licenses its networks to third-party MVPDs. HBO is a "premium" network that provides on-demand content to subscribers either directly through HBO Now or through licenses with third-party distributors. The merged firm would operate both AT&T MVPDs (DirecTV and U-verse) and Turner Broadcasting networks (which license to other MVPDs). The government alleged that "the newly combined firm likely would use its control of Time Warner's popular programming as a weapon to harm competition."

[7] A week after the government filed suit to stop the proposed merger, Turner Broadcasting sent letters to approximately 1,000 distributors "irrevocably offering" to engage in "baseball style" arbitration at any time within a seven-year period, subject to certain conditions not relevant here. According to President of Turner Content Distribution Richard Warren, the offer of arbitration agreements was designed to address the government's concern that as a result of being commonly owned by AT&T, Turner Broadcasting would have an incentive to drive prices higher and go dark with its affiliates. In the event of a failure to agree on renewal terms, Turner Broadcasting agreed that the distributor would have the right to continue carrying Turner networks pending arbitration, subject to the same terms and conditions in the distributor's existing contract.

[*]

[8] The government's increased leverage theory is that by combining Time Warner's programming and DirecTV's distribution, the merger would give Time Warner increased bargaining leverage in negotiations with rival distributors, leading to higher, supracompetitive prices for millions of consumers. Under this theory, Turner Broadcasting's bargaining position in affiliate negotiations will change after the merger due to its relationship with AT&T because the cost of a blackout will be lower. Prior to the merger, if Turner Broadcasting failed to reach a

deal with a distributor and engaged in a long-term blackout, then it would lose affiliate fees and advertising revenues. After the merger, some costs of a blackout would be offset because some customers would leave the rival distributor due to Turner Broadcasting's blackout and a portion of those customers would switch to AT&T distributor services. The merged AT&T-Turner Broadcasting entity would earn a profit margin on these new customers. Because Turner Broadcasting would make a profit from switched customers, the cost of a long-term blackout would decrease after the merger and thereby give it increased bargaining leverage during affiliate negotiations with rival distributors sufficient to enable it to secure higher affiliate fees from distributors, which would result in higher prices for consumers.

[9] To support this theory of competitive harm, the government presented evidence purporting to show the real-world effect of the proposed merger. Specifically, it introduced statements in prior FCC filings by AT&T and DirecTV that vertical integration provides an incentive to increase prices and poses a threat to competition. Various internal documents of the defendants were to the same effect. Third-party competitors, such as cable distributors, testified that the merger would increase Turner Broadcasting's bargaining leverage.

[10] The government also presented the expert opinion of Professor Carl Shapiro on the likely anticompetitive effect of the proposed merger. He opined, based on the economic theory of bargaining—here, the Nash bargaining theory—that Turner Broadcasting's bargaining leverage would increase after the merger because the cost of a long-term blackout would decrease. His quantitative model predicted net price increases to consumers. Specifically, his model predicted increases in fees paid by rival distributors for Turner Broadcasting content and cost savings for AT&T through elimination of double marginalization ("EDM"). The fee increases for rival distributors were based on the expected benefit to AT&T of a Turner Broadcasting blackout after the merger. Professor Shapiro determined the extent to which rival distributors and AT&T would pass on their respective cost increases and cost decreases to consumers. His model predicted: (1) an annual fee increase of $587 million for rival distributors to license Turner Broadcasting content, and cost savings of $352 million for AT&T; and (2) an annual net increase of $286 million in costs passed on to consumers in 2016, with increases in future years.

[11] AT&T responded by pointing to testimony of executives' past experience in affiliate negotiations, and presenting testimony by its experts critiquing Professor Shapiro's opinion and model. It purported to show through its own experts that the government's prima facie case inaccurately predicted the proposed merger's probable effect on competition. Professor Dennis Carlton's econometric analysis (also known as a regression analysis), showed that prior instances of vertical integration in the MVPD market had not had a statistically significant effect on content prices, pointing to data on the Comcast-NBCU merger in 2011 as well as prior vertical integration between News Corp.-DirecTV and Time Warner Cable-Time Warner Inc., which split in 2008 and 2009, respectively. Professor Carlton and Professor Peter Rossi critiqued the "inputs" used by Professor Shapiro in his quantitative model, opining for instance that values he used for subscriber loss rate and diversion rate were not calculated through reliable methods. Professor Carlton also opined that Professor Shapiro's quantitative model overestimated how quickly harm would occur because it failed to consider existing long-term contracts.

[12] Professor Shapiro, in turn, critiqued Professor Carlton's econometric analysis as comparing different types of vertical mergers. Regarding the "inputs" to his quantitative model, Professor Shapiro conceded that he was unaware the subscriber loss rate percentage he used (from a consultant report for Charter Communications, Inc.) had been changed after the report was presented to Charter executives. He also acknowledged that he had not considered the effects of the arbitration agreements offered by Turner Broadcasting and that to do so would require preparation of a new model.

[13] The district court acknowledged the uncertainty regarding the measure of proof for the government's burden because Section 7 does not require proof of certain harm. The government and AT&T had used various phrases to describe the government's burden, including that it must show an "appreciable danger" of competitive harm, or that it must show that harm is "likely" or "reasonably probable." The district court concluded that it need not articulate the differences between these phrases because even assuming the "reasonable probability" or "appreciable danger" formulations govern here its conclusions regarding the government's failure of proof would remain unchanged. Acknowledging also the lack of precedent and the complexity in establishing the correct approach in a Section 7 challenge to a proposed vertical merger, the district court viewed the outcome of the litigation to turn on whether, notwithstanding the proposed merger's conceded procompetitive effects, the

government has met its burden of establishing, through "case-specific evidence," that the merger of AT&T and Time Warner, at this time and in this remarkably dynamic industry, is likely to substantially lessen competition in the manner it predicts. [. . .]

[14] The district court found that the government had failed to clear the first hurdle of showing that the proposed merger is likely to increase Turner [Broadcasting]'s bargaining leverage in affiliate negotiations. Although acknowledging, as Professor Shapiro had opined, that the Nash bargaining theory could apply in the context of affiliate fee negotiations, the district court found more probative the real-world evidence offered by AT&T than that offered by the government. The econometric analysis of AT&T's expert had examined real-world data from prior instances of vertical integration in the video programming and distribution industry and concluded that the bulk of the results show no significant results at all, but many do show a decrease in content prices. The district court also credited the testimony of several industry executives . . . that vertical integration had not affected their affiliate negotiations in the past. By contrast, the testimony from third-party competitors that the merger would increase Turner Broadcasting's bargaining leverage was, the district court found, speculative, based on unproven assumptions, or unsupported. Although Professor Shapiro's opinion was that the Nash bargaining theory predicted an increase in Turner Broadcasting's post-merger bargaining leverage, leading to an increase in affiliate fees, the district court found, in view of the industry's dynamism in recent years, that Professor Shapiro's opinion (by contrast with Professor Carlton's) had not been supported by sufficient real-world evidence.

[15] Second, the district court found that Professor Shapiro's quantitative model, which estimated the proposed merger would result in future increases in consumer prices, lacked sufficient reliability and factual credibility to generate probative predictions of future competitive harm. Relying on critiques by Professor Carlton and Professor Rossi, the district court found errors in the model "inputs," for example, the value used for subscriber loss rate was not calculated through a reliable method. Neither the model nor Professor Shapiro's opinion accounted for the effect of the irrevocably-offered arbitration agreements, which the district court stated would have "real world effects" on negotiations and characterized "as extra icing on a cake already frosted," i.e., another reason the government had not met its first-level burden of proof.

[16] The district court therefore concluded that the government failed to present persuasive evidence that Turner Broadcasting's bargaining leverage would "materially increase" as a result of the merger, or that the merger would lead to "any raised costs" for rival distributors or consumers. It therefore did not address the balancing analysis offered by Professor Shapiro's quantitative model, nor the question whether any increased costs would result in a substantial lessening of competition.

[*]

[17] On appeal, the government contends that the district court (1) misapplied economic principles, (2) used internally inconsistent logic when evaluating industry evidence, and (3) clearly erred in rejecting Professor Shapiro's quantitative model. Undoubtedly the district court made some problematic statements, which the government identifies and this court cannot ignore. And in the probabilistic Section 7 world, uncertainty exists about the future real-world impact of the proposed merger on Turner Broadcasting's post-merger leverage. At this point, however, the issue is whether the district court clearly erred in finding that the government failed to clear the first hurdle in meeting its burden of showing that the proposed merger is likely to increase Turner Broadcasting's bargaining leverage.

[18] **(1) Application of economic principles.** The government contends that in evaluating the evidence in support of its increased leverage theory, the district court erroneously discarded or otherwise misapplied two economic principles—the Nash bargaining theory and corporate-wide profit maximization.

[19] *(a) Nash bargaining theory.* The Nash bargaining theory is used to analyze two-party bargaining situations, specifically where both parties are ultimately better off by reaching an agreement. The theory posits that an important factor affecting the ultimate agreement is each party's relative loss in the event the parties fail to agree: when a party would have a greater loss from failing to reach an agreement, the other party has increased bargaining leverage. In other words, the relative loss for each party affects bargaining leverage and when a party has more bargaining leverage, that party is more likely to achieve a favorable price in the negotiation.

[20] The district court had to determine whether the economic theory applied to the particular market by considering evidence about the structure, history, and probable future of the video programming and distribution industry. As one circuit has put it, the Nash theorem arrives at a result that follows from a certain set of premises, while the theory asserts nothing about what situations in the real world fit those premises. The district court concluded that the government presented insufficient real-world evidence to support the prediction under the Nash bargaining theory of a material increase of Turner Broadcasting's post-merger bargaining leverage in affiliate negotiations by reason of less-costly long-term blackouts. The government's real-world evidence consisted of statements by AT&T Inc. and DirecTV in FCC regulatory filings that vertical integration, such as in the proposed Comcast-NBCU merger, can give distributors an incentive to charge higher affiliate fees and expert opinion and a quantitative model prepared by Professor Shapiro. The expert opinion and model were subject to deficiencies identified by AT&T's experts, some of which Professor Shapiro conceded. By contrast, AT&T's expert's econometric analysis of real-world data showed that content pricing in prior vertical mergers in the industry had not increased as the Nash bargaining theory and the model predicted. Given evidence the industry was now "remarkably dynamic," the district court credited CEO testimony about the null effect of vertical integration on affiliate negotiations.

[21] In other words, the record shows that the district court accepted the Nash bargaining theory as an economic principle generally but rejected its specific prediction in light of the evidence that the district court credited. The district court explained that its conclusion

> does not turn on defendants' protestations that the theory is "preposterous," "ridiculous," or "absurd." but instead on its evaluation of the shortcomings in the proffered third-party competitor testimony, the testimony about the complex nature of these negotiations and the low likelihood of a long-term Turner Broadcasting blackout, and the fact that real-world pricing data and experiences of individuals who have negotiated on behalf of vertically integrated entities all fail to support the government's increased-leverage theory.

[22] More concerning is the government's contention that the district court misapplied the Nash bargaining theory in a manner that negated its acceptance of the economics of bargaining by erroneously focusing on whether long-term blackouts would actually occur after the merger, rather than on the changes in stakes of such a blackout for Turner Broadcasting. The government points to the district court's statements that Professor Shapiro's testimony was undermined by evidence that a blackout would be infeasible. The district court also stated that there has never been, and is likely never going to be, an actual long-term blackout of Turner Broadcasting content. The district court noted that Turner Broadcasting would not be willing to accept the "catastrophic" affiliate fee and advertising losses associated with a long-term blackout.

[23] The question posed by the Nash bargaining theory is whether Turner Broadcasting would be more favorably positioned after the merger to assert its leverage in affiliate negotiations whereby the cost of its content would increase. Considered in isolation, the district court's statements could be viewed as addressing the wrong question. Considered as part of the district court's analysis of whether the stakes for Turner Broadcasting would change and if so by how much, the statements address whether the threat of long-term blackouts would be credible, as posited by the government's increased leverage theory. The district court found that after the merger the stakes for Turner Broadcasting would change only slightly, so its threat of a long-term blackout "will only be somewhat less incredible." Recognizing Professor Shapiro applied the Nash bargaining theory in opining that if a party's alternative to striking a deal improves, that party is more willing and able to push harder for a better deal because it faces less downside risk if the deal implodes, the district court rejected the assumption underlying the government's theory that Turner Broadcasting would gain increased leverage from this slight change in stakes. It relied on testimony that the small change in bargaining position from a less costly blackout would not cause Turner Broadcasting to take more risks, specifically noting the Time Warner CEO's analogy of the cost difference between having a 1,000-pound weight fall on Turner Broadcasting and a 950-pound weight fall on it—the difference being unlikely to change the risk Turner Broadcasting would be willing to take.

[24] The district court's statements identified by the government, then, do not indicate that the district court misunderstood or misapplied the Nash bargaining theory but rather, upon considering whether in the context of a dynamic market where a similar merger had not resulted in a "statistically significant increase in content costs,"

the district court concluded that the theory inaccurately predicted the post-merger increase in content costs during affiliate negotiations.

[25] Of course, it was not enough for the government merely to prove that after the merger the costs of a long-term blackout would change for Turner Broadcasting. Its theory is that Turner Broadcasting's bargaining leverage would increase sufficiently to enable it to charge higher prices for its content. The district court's focus on the slight change in the cost of a long-term blackout in finding Turner Broadcasting's bargaining leverage would not meaningfully change aligns with determining whether the government's evidence established that a change in the post-merger stakes for Turner Broadcasting would likely allow it to extract higher prices during affiliate negotiations. The district court reasoned that because long-term blackouts are very costly and would therefore be infeasible for Turner Broadcasting even after the merger, there was insufficient evidence that a post-merger Turner Broadcasting would, or even could, drive up prices by threatening distributors with long-term blackouts. In finding the government failed to prove that Turner Broadcasting's post-merger negotiating position would materially increase based on its ownership by AT&T, the district court reached a fact-specific conclusion based on real-world evidence that, contrary to the Nash bargaining theory and government expert opinion on increased content costs, the post-merger cost of a long-term blackout would not sufficiently change to enable Turner Broadcasting to secure higher affiliate fees. Witnesses such as a Turner Broadcasting president Coleman Breland, AT&T executive John Stankey, and Time Warner CEO Jeff Bewkes, whom the district court credited, testified that after the merger blackouts would remain too costly to risk and that any change in that cost would not affect negotiations as the government's theory predicted.

[26] Not to be overlooked, the district court also credited the efficacy of Turner Broadcasting's "irrevocable" offer of arbitration agreements with a no-blackout guarantee. It characterized the no-blackout agreements as "extra icing on a cake already frosted." In crediting Professor Carlton's econometric analysis, the district court explained that it was appropriate to consider the analysis of the Comcast-NBCU merger because the Comcast-NBCU merger was similar to the proposed merger—a vertical merger in the video programming and distribution industry. There the government had recognized, especially in vertical mergers, that conduct remedies, such as the ones proposed in the Comcast case, can be a very useful tool to address the competitive problems while preserving competition and allowing efficiencies that may result from the transaction. Like there, the district court concluded the Turner arbitration agreements would have real-world effect.

[27] The post-merger arbitration agreements would prevent the blackout of Turner Broadcasting content while arbitration is pending. As mentioned, Turner Broadcasting "irrevocably offer[ed]" approximately 1,000 distributors agreements to engage in baseball style arbitration in the event the parties fail to reach a renewal agreement, and the offered agreement guarantees no blackout of Turner Broadcasting content once arbitration is invoked. AT&T's counsel represented the no-blackout commitment is "legally enforceable," and AT&T "will honor" the arbitration agreement offers. Consequently, the government's challenges to the district court's treatment of its economic theories becomes largely irrelevant, at least during the seven-year period. Counsel for Amici Curiae 27 Antitrust Scholars explained that arbitration agreements make the Nash bargaining model premised on two-party negotiations substantially more complicated, and Professor Shapiro acknowledged that taking the arbitration agreements into account would require a completely different model. [. . .]

[28] [T]he district court's finding of the efficacy of Turner Broadcasting's irrevocable offers of no-blackout arbitration agreements means the merger is unlikely to afford Turner Broadcasting increased bargaining leverage.

[29] *(b) Corporate-wide profit maximization.* Still, the government maintains that the reliance on past negotiation experience indicates that the district court misunderstood, and failed to apply, the principle of corporate-wide profit maximization by treating the principle as a question of fact, when the assumption of profit maximization is crucial in predicting business behavior. This principle posits that a business with multiple divisions will seek to maximize its total profits. . . . Companies with multiple divisions must be viewed as a single actor, and each division will act to pursue the common interests of the whole corporation.

[30] . . . [T]he government's position that the district court never accepted this economic principle overlooks that it did accept Professor Shapiro's (and the Government's) argument that generally, a firm with multiple divisions will act to maximize profits across them. And it ignores that if the merged firm was unable to exert the leverage

required by the government's increased leverage theory, then inquiring (as the district court did of Professor Shapiro) about an independent basis to conclude that the firm did have such leverage is not a rejection of the corporate-wide profit maximization principle.

[31] The government maintains that the district court's misapplication of the principle of corporate-wide profit maximization is evident from its statement the evidence suggests vertically integrated corporations have previously determined that the best way to increase company wide profits is for the programming and distribution components to separately maximize their respective revenues. Stating that the programming and distribution divisions would "separately maximize their respective revenues" is contrary to the maximization principle to the extent separate units would act against the merged entity's common interest. At this point in its opinion, however, the district court was explaining why "that profit-maximization principle is not inconsistent with testimony that the identity of a programmer's owner has not affected affiliate negotiations in real-world instances of vertical integration." The district court can be viewed as conveying its understanding that Turner Broadcasting's interest in spreading its content among distributors, not imposing long-term blackouts, would redound to the merged firm's financial benefit, not that Turner Broadcasting would act in a manner contrary to the merged firm's financial benefit. Industry executives testified that the identity of a programmer's owner has not affected affiliate negotiations in real-world instances of vertical integration. For instance, the Chair of Content Distribution at NBC Universal testified that at Comcast-NBCU, he "never once took into account the interest of Comcast cable in trying to negotiate a carriage agreement" for NBC Universal.

[32] To the extent the government maintains this testimony is irreconcilable with the legal principle of corporate-wide profit maximization, it gives no credence to the district court's focus on the best way to increase company wide profits, referring to the merged firm. In other words, the district court was explaining that real-world evidence reflected the profit-maximization principle. Even if the district court could have made clearer that it understood the principle was not a question of fact, the government does not explain how considering how that is done in a particular industry is contrary to the principle of corporate-wide profit maximization. [. . .]

[33] *(3) Rejection of Professor Shapiro's quantitative model.* Finally, the government contends that the district court clearly erred in rejecting Professor Shapiro's quantitative bargaining model. Specifically, that the district court erred in finding insufficient evidence to support Professor Shapiro's calculations of fee increases for rival distributors and in finding no proof of any price increase to consumers.

[34] Preliminarily, the court does not hold that quantitative evidence of [a] price increase is required in order to prevail on a Section 7 challenge. Vertical mergers can create harms beyond higher prices for consumers, including decreased product quality and reduced innovation. Indeed, the Supreme Court upheld the Federal Trade Commission's Section 7 challenge to Ford Motor Company's proposed vertical merger with a major spark plug manufacturer without quantitative evidence about price increases. *Ford Motor Co. v. United States*, 405 U.S. 562, 567–69, 578 (1972). Here, however, the government did not present its challenge to the AT&T-Time Warner merger in terms of creating non-price related harms in the video programming and distribution industry, and we turn to the government's challenges to the district court's handling of the quantitative evidence regarding the proposed merger's predicted effect on consumer price.

[35] Professor Shapiro presented a quantitative model that predicted an annual net increase of $286 million being passed on to consumers in 2016, with increasing costs in future years. This figure was based on the model's predictions of an annual fee increase of $587 million for rival distributors to license Turner Broadcasting content and cost savings of $352 million for AT&T. The district court accepted Professor Shapiro's testimony about the $352 million cost savings from the merger. But it found that insufficient evidence supported the inputs and assumptions used to estimate the annual costs increases for rival distributors, crediting criticisms by Professor Carlton and Professor Rossi. Indeed, the district court found that the quantitative model as presented through Professor Shapiro's opinion testimony did not provide an adequate basis to conclude that the merger will lead to any raised costs for distributors or consumers, much less consumer harms that outweigh the conceded $350 million in annual cost savings to AT&T's customers.

[36] Whatever errors the district court may have made in evaluating the inputs for Professor Shapiro's quantitative model, the model did not take into account long-term contracts, which would constrain Turner Broadcasting's

ability to raise content prices for distributors. The district court found that the real-world effects of Turner Broadcasting's existing contracts would be "significant" until 2021 and that it would be difficult to predict price increases farther into the future, particularly given that the industry is continually changing and experiencing increasing competition. This failure, the district court found, resulted in overestimation of how quickly the harms would occur. Professor Shapiro acknowledged that predictions farther into the future, after the long-term contracts expire, are more difficult. Neither Professor Shapiro's opinion testimony nor his quantitative model considered the effect of the post-litigation offer of arbitration agreements, something he acknowledged would require a new model. And the video programming and distribution industry had experienced "ever-increasing competitiveness" in recent years. Taken together, the government's clear-error contention therefore fails. [. . .]

[37] Accordingly, because the district court did not abuse its discretion in denying injunctive relief, we affirm the district court's order denying a permanent injunction of the merger.

* * *

So the merger was allowed to close. But the ending was not a happy one: the parties separated a few years later.[705]

We noted above that the *AT&T* case was the first in a wave of recent federal challenges to vertical mergers. One of the subsequent challenges—the FTC's litigation to block the Illumina / Grail merger—went all the way to the Fifth Circuit, leading to a flagship win for the government in some important respects. Illumina, a leading provider of DNA sequencing platforms, purchased Grail, which was developing a multi-cancer early detection test. In an unusual twist, Grail had originally been founded and then spun off by Illumina itself: this litigation resulted from Illumina's effort to buy Grail back a few years later. The FTC's concern was that Grail's rivals—whose cancer tests were still in development—would be foreclosed from access to Illumina's critical sequencing platforms. Perhaps taking a page or two from the AT&T / Time Warner playbook, the merging parties made an "Open Offer" to Grail's rivals, committing to give other test providers access to Illumina's platform on non-discriminatory terms.

The FTC challenged the deal anyway. An FTC administrative law judge rejected the FTC's theory, three days after the European Commission had blocked the deal on EU competition grounds.[706] But the ALJ was subsequently reversed by the Commission.[707] The merging parties appealed to the Fifth Circuit, which vacated the Commission's decision while effectively endorsing its central logic. After this decision was handed down, the parties abandoned their deal.

What does *Illumina* teach us about the analysis of vertical mergers? For one thing, the court provides a detailed discussion of evidence tending to suggest that the merged firm would have the ability and incentive to foreclose its rivals. For another thing, *Illumina* is a reminder that vertical merger cases can be "future competition" cases too! Grail's rivals were not yet in the market, but the prospect of their future foreclosure was the court's main concern. For a third thing, the court provides a thorough analysis of the "Open Offer" and its place in the burden-shifting structure of merger analysis. And, finally, notice the court's suggestion that the Supreme Court's *Brown Shoe* opinion can be understood to set up a second path to proving anticompetitive foreclosure, distinct from the traditional analysis of the merged firm's ability and incentive. (Is this really a different theory of harm, or just a different way of describing the same theory? And, if it's different, *how* is it different?)

Illumina, Inc. v. FTC

88 F.4th 1036 (5th Cir. 2023)

Judge Clement.

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[705] *See* Victor Glass, *Culture Clash and the Failure of the AT&T/Time Warner Merger*, Rutgers Bus. Rev. 350 (Fall 2021).

[706] *See* Initial Decision, In the Matter of Illumina, Inc., FTC Dkt. No. 9401 (Mar. 31. 2023); Case M.10188, Illumina / Grail (prohibition decision of Sept. 6, 2022).

[707] *See* Opinion of the Commission, In the Matter of Illumina, Inc., FTC Dkt. No. 9401 (Sept. 9, 2022). For discussion of the FTC's Part 3 administrative litigation process, *see infra* Chapter XI.

[1] Founded in 1998, Illumina is a publicly traded, for-profit corporation that specializes in the manufacture and sale of next-generation sequencing ("NGS") platforms. NGS is a method of DNA sequencing that is used in a variety of medical applications. In September 2015, Illumina founded a wholly-owned subsidiary, Grail, which was so-named because its goal was to reach the "Holy Grail" of cancer research—the creation of a multi-cancer early detection ("MCED") test that could identify the presence of multiple types of cancer from a single blood sample.

[2] Grail was incorporated as a separate entity in January 2016. Illumina maintained a controlling stake in the company until February 2017 when . . . Illumina decided to bring in outside investors. This spin-off reduced Illumina's equity stake in Grail to 12%. . . . Then, on September 20, 2020, Illumina entered into an agreement to re-acquire Grail for $8 billion, with the goal of bringing Grail's now-developed MCED test to market.

[3] [By September 2020,] Grail's MCED test—which it named Galleri—had acquired a breakthrough device designation from the U.S. Food and Drug Administration ("FDA"), and Grail had published promising results from a clinical study concerning the initial version of Galleri and was undergoing additional clinical studies to validate its updated version. Meanwhile, Thrive Earlier Detection Corporation had announced that the initial version of its own MCED test—CancerSEEK—had also been clinically validated. And other MCED tests—including Singlera Genomics, Inc.'s PanSeer—were in development. All of the MCED tests in development—including Galleri, CancerSEEK, and PanSeer—relied on Illumina's NGS platforms for sequencing, and there were no available alternatives.

[4] Given their reliance on Illumina's NGS platforms, Illumina's customers—both within and without the MCED-test industry—expressed concern about whether they would be able to continue to purchase Illumina's NGS products post-merger on the same terms and conditions as pre-merger. So, Illumina developed a standardized supply contract (the "Open Offer") that it made available to all for-profit U.S. oncology customers on March 30, 2021. The Open Offer is irrevocable, may be accepted by a customer at any time until August 18, 2027, became effective as of the merger's closing, and will remain effective until August 18, 2033. Among other terms, the Open Offer requires Illumina to provide its NGS platforms at the same price and with the same access to services and products that is provided to Grail.

[5] . . . While Galleri [*i.e.*, Grail's test] is the only NGS-based MCED test currently available on the market, others expect to go to market soon and to directly compete with Galleri. Illumina's NGS platforms are still the only means of sequencing MCED tests and will remain so for the foreseeable future. [. . .]

[6] . . . [The Federal Trade Commission] concluded that the merger was likely to substantially lessen competition in the market for the research, development, and commercialization of MCED tests. . . . The Commission also held that the Open Offer was a remedy that should not be factored into the liability analysis. But the Commission evaluated the Open Offer as rebuttal evidence anyway, finding that the Open Offer failed to rebut Complaint Counsel's prima facie case because it would not "eliminate the effects" of the merger. . . . The Commission therefore ordered Illumina to divest Grail. Illumina now appeals. [. . .]

[7] We start by reviewing Complaint Counsel's prima facie case. The Commission concluded that Complaint Counsel had carried its burden of (1) identifying the relevant product and geographic market as the market for the research, development, and commercialization of MCED tests in the United States, and (2) showing that the Illumina-Grail merger was likely to substantially lessen competition in this market. We find that these conclusions are supported by substantial evidence. [. . .]

[9] . . . As the Commission recognized, courts have used two different but overlapping standards for evaluating the likely effect of a vertical transaction: (1) the *Brown Shoe* standard, which requires courts to look . . . at the factors first enunciated in *Brown Shoe* and carried on through its progeny . . . ; and (2) the "ability-and-incentive" standard, which asks whether the merged firm will have both the ability and the incentive to foreclose its rivals, either from sources of supply or from distribution outlets. Commissioner Wilson, concurring in the Commission's decision, argued that there is no *Brown Shoe* standard—only the "ability-and-incentive" test—for vertical mergers in modern antitrust analysis. But we need not resolve this issue because we find that, under either standard, Complaint Counsel established a prima facie case supported by substantial evidence. [. . .]

[10] Illumina concedes that it would have the ability to foreclose Grail's rivals post-merger. . . .

[11] That leaves incentive to foreclose as the determining factor in evaluating the Illumina-Grail merger under the ability-and-incentive test. As the Commission explained, the degree to which Illumina has an incentive to foreclose Grail's rivals depends upon the balance of two competing interests: Illumina's interest in maximizing its profits in the downstream market for MCED tests vis-à-vis its ownership interest in Grail versus Illumina's interest in maximizing its profits in the upstream market for NGS platforms vis-à-vis its sales to all MCED-test developers. Foreclosing Grail's rivals would increase the former (by diverting MCED-test sales from competitors to Grail) but decrease the latter (by reducing the total number of MCED tests in the marketplace). So, the Commission reasoned, the greater Illumina's ownership stake in Grail, the more its interest in maximizing downstream profits will outweigh its interest in preserving upstream profits, and thus the more incentive it will have to foreclose. And since the merger would increase Illumina's ownership stake in Grail from 12% to 100%, Illumina would now earn much more from the sale of a Grail test than from the sale of a rival's test and would therefore have a significantly greater incentive to foreclose Grail's rivals rather than to keep them on a level playing field.

[12] Illumina challenges this conclusion on two bases. First, Illumina argues that, even if the merger would result in Illumina earning larger profits from the sale of a Grail test than the sale of a rival MCED test, that profit differential means nothing without proof of diversion, *i.e.*, Grail's capture of sales lost by rival MCED-test developers. Illumina is correct that diversion is necessary for a vertical merger to give rise to foreclosure incentives. If Illumina forecloses Grail's rivals, preventing them from entering the MCED-test market or lowering their sales, Illumina's NGS-sales revenue generated from those rivals will suffer. Therefore, a foreclosure strategy is only economically rational if Grail can pick up enough of its competitors' lost MCED-test sales to offset the losses to Illumina's NGS-sales revenue. But, Illumina argues, because Galleri is the only test on the market today, there are no sales to divert, so foreclosing Grail's rivals would only harm Illumina's NGS revenue without any concomitant benefit to Grail's MCED-test-sales revenue.

[13] This contention suffers from the same fatal flaw as Illumina's arguments concerning the Commission's market definition—it insists that the Commission must consider only the MCED tests on the market right now, not those likely to be on the market in the future. But the relevant market is not "MCED tests commercialized today," it is the "research, development, and commercialization of MCED tests." And as explained earlier, there is substantial evidence in the record showing that other MCED-test developers are, right now, working on creating tests that will rival Grail's capabilities and that are expected to make it to the market in the near future. And when they do, they would divert sales from Grail—or vice versa, should a foreclosure strategy be pursued.

[14] Illumina's second argument—that harm to Illumina's NGS business from foreclosure of Grail's rivals would outweigh any benefit to Grail's MCED-testing business—is more compelling. Pre-merger, the vast majority of Illumina's revenue—nearly 90% in 2020—was earned through its core business of selling NGS products. And Illumina is right that pursuing a foreclosure strategy threatens material harm to this business in two ways: first, by loss of NGS sales to the foreclosed MCED-test developers, and second, by loss of NGS business in areas outside of cancer detection as a result of reputational damage. But, as the Commission identified, there are two reasons why the risk of such harm is not as great as Illumina claims. First, there are myriad ways in which Illumina could engage in foreclosing behavior without triggering suspicion in other customers, such as by making late deliveries or subtly reducing the level of support services. And second, and more importantly, Illumina's monopoly power in the NGS-platform market means that, even if other customers did learn about Illumina's foreclosing behavior and therefore wanted to take their business elsewhere, they would have nowhere else to turn.

[15] In any event, there is a more fundamental reason why any harm to Illumina's NGS business may not disincentivize Illumina from pursuing a foreclosure strategy against Grail's rivals—the Illumina-Grail merger was the cornerstone of a foundational change in Illumina's business model through which Illumina planned to transform itself into a clinical testing and data driven healthcare company as opposed to its current iteration as a life sciences tools & diagnostics company focused on genomics. In other words, Illumina was willing to suffer losses to its NGS-platform sales in order to accelerate the growth of its MCED-test sales because it now viewed the latter, not the former, as its primary (and far more profitable) business. Illumina's own internal projections bear this out, predicting that, although Illumina would lose money in the short term as a result of the merger, by 2035, its "net

margin profit pool" for clinical testing services would be nearly eight times the projected profit pool for its NGS-related sales.

[16] In light of the foregoing, the Commission had substantial evidence to support its conclusion that Complaint Counsel made a prima facie showing that, post-merger, Illumina had a significantly increased incentive to crowd out Grail's competitors from the market. MCED testing is a nascent field in which, although only one firm—Grail—has begun to commercialize its product, numerous firms are researching and developing their own products with the end goal of commercialization. And all of the players expect the field to one day generate tens of billions of dollars in yearly revenue. To create and eventually sell this product, each developer will need access to one critical input—NGS platforms. Now, the sole supplier of that input—Illumina—has purchased the first mover in this nascent industry. Given Illumina's monopoly power and shifting business priorities, it was reasonable for the Commission to conclude that Illumina would likely foreclose against Grail's competitors—even at the expense of some short-term profits—to pursue its long-term goal of establishing itself (via Grail) as the market leader in clinical testing.

[17] The Commission also applied the factors first identified in *Brown Shoe* . . . to determine whether the Illumina-Grail merger was likely to substantially lessen competition. These factors include:

> [T]he nature and economic purpose of the [transaction], the likelihood and size of any market foreclosure, the extent of concentration of sellers and buyers in the industry, the capital cost required to enter the market, the market share needed by a buyer or seller to achieve a profitable level of production (sometimes referred to as "scale economy"), the existence of a trend toward vertical concentration or oligopoly in the industry, and whether the merger will eliminate potential competition by one of the merging parties. To these factors may be added the degree of market power that would be possessed by the merged enterprise and the number and strength of competing suppliers and purchasers, which might indicate whether the merger would increase the risk that prices or terms would cease to be competitive.

[Fruehauf Corp. v. FTC, 603 F.2d 345, 353 (2d Cir. 1979)].

[18] The Commission found that at least four of the factors—likely foreclosure, the nature and purpose of the transaction, the degree of market power possessed by the merged firm, and entry barriers—supported a finding of a probable Section 7 violation. We conclude that the Commission's *Brown Shoe* determination was supported by substantial evidence.

[19] The first factor the Commission relied upon—likelihood of foreclosure—weighs in favor of Complaint Counsel for the reasons set forth in our ability-and-incentive analysis. The second factor—nature and purpose of the transaction—also overlaps significantly with our prior discussion and supports Complaint Counsel: The "nature" of the transaction is the acquisition of a downstream customer by a sole-source supplier, and the "purpose" is to fundamentally transform Illumina's business model such that it would be competing most intensely in the downstream market, i.e., the same market in which it has the ability to foreclose.

[20] As for the third factor—degree of market power— . . . the Commission properly considered the longer-term impact of the merger and found that the merger was likely to lead to a concentration of market power in the merged firm. This factor thus favors Complaint Counsel as well.

[21] Finally, the Commission found that the merger would increase barriers to entry in the relevant market. Specifically, based on testimony from other MCED-test developers and Complaint Counsel's expert witness, the Commission found that rival firms would be disincentivized from investing in MCED-test development post-merger. . . .

[22] Nor did the Commission commit legal error by omitting three of the *Brown Shoe* factors from its analysis. There is no precise formula when it comes to applying these factors. [. . .]

[23] Next, we address the Open Offer—the long-term supply agreement that Illumina offered to rival MCED-test developers. . . .

[24] Based on the record, the parties' arguments, and applicable case law, we see three different options for the point in the Section 7 analysis at which the Open Offer could come into play. The first option—pressed by Illumina—is to require Complaint Counsel to account for the Open Offer as part of its prima facie case. The second option—adhered to by the Commission's majority opinion—is to only consider the Open Offer at the remedy stage following a finding of liability. The third option—suggested by Commissioner Wilson in her concurring opinion—is to place the burden of showing the Open Offer's competitive effects on Illumina as part of its rebuttal to the prima facie case. As explained below, we agree with Commissioner Wilson.

[25] The parties' divergent views on this issue appear to stem from a disagreement over whether the Open Offer should be treated as a "market reality"—as Illumina contends—or a remedy—as the Commission found. But we do not think that the Open Offer fits neatly into either bucket, and we decline to force it into one.

[26] On the one hand, it is evident that the Open Offer is not just a normal commercial supply agreement but instead a direct response to anticompetitive concerns over the Illumina-Grail merger. The opening sentence of the Open Offer makes this plain; it explains that the Open Offer was made in connection with Illumina's proposed acquisition of Grail to allay any concerns relating to the merger, including that Illumina would disadvantage Grail's potential competitors. So, to treat the Open Offer as just another fact of the marketplace seems to miss the forest for the trees.

[27] But, on the other hand, the Open Offer is different in kind from a Commission-or court-ordered remedy, which, as the Commission itself noted, can be imposed only on the basis of a violation of the law, i.e., after a finding of liability. . . .

[28] In this sense, the Open Offer is somewhere in between a fact and a remedy—a post-signing, pre-closing adjustment to the status quo implemented by the merging parties to stave off concerns about potential anticompetitive conduct. [. . .]

[29] . . . [S]uch agreements should be addressed at the liability—not remedy—stage of the Section 7 proceedings.

[30] Having determined that the Open Offer should be considered at the liability stage, the question remains: where does it fit within the burden-shifting framework for determining liability? Illumina urges that Complaint Counsel was required to incorporate the Open Offer into its prima facie case. Commissioner Wilson says that the Open Offer only comes into play as part of Illumina's rebuttal to Complaint Counsel's prima facie case. We find the latter approach most compatible with the flexible framework at play. [. . .]

[31] At the rebuttal stage of the Section 7 analysis, Illumina bore the burden to present evidence that the prima facie case inaccurately predicts the relevant transaction's probable effect on future competition. Because Complaint Counsel preemptively addressed the Open Offer as part of its case-in-chief, Illumina's burden on rebuttal was heightened. To be sure, Illumina's burden was only one of production, not persuasion; the burden of persuasion remained with Complaint Counsel at all times. But to satisfy its burden of production, Illumina was required to do more than simply put forward the terms of the Open Offer; it needed to affirmatively show why the Open Offer undermined Complaint Counsel's prima facie showing to such an extent that there was no longer a probability that the Illumina-Grail merger would substantially lessen competition.

[32] This is where the Commission erred. The Commission held Illumina to a rebuttal standard that was incompatible with the plain language of Section 7 of the Clayton Act, which only prohibits transactions that will "substantially" lessen competition. . . . Specifically, the Commission held that Illumina was required to show that the Open Offer would restore the pre-merger level of competition, i.e., eliminate Illumina's ability to favor Grail and harm Grail's rivals. In effect, Illumina could only rebut Complaint Counsel's showing of a likelihood of a substantial reduction in competition with a showing that, due to the Open Offer, the merger would not lessen competition at all. This was legal error.

[33] The Commission's standard stems from its mistaken belief that the Open Offer is a remedy. . . .

[34] . . . To rebut Complaint Counsel's prima facie case, Illumina was only required to show that the Open Offer sufficiently mitigated the merger's effect such that it was no longer likely to substantially lessen competition.

Illumina was not required to show that the Open Offer would negate the anticompetitive effects of the merger entirely. [. . .]

[35] To sum up, . . . Complaint Counsel carried its initial burden of showing that the Illumina-Grail merger is likely to substantially lessen competition in that market under either the ability-and-incentive test or looking to the *Brown Shoe* factors . . . . However, in considering the Open Offer, the Commission used a standard that was incompatible with the plain language of the Clayton Act. We therefore VACATE the Commission's order and REMAND the case for reconsideration of the effect of the Open Offer under the proper standard.

CASENOTE: United States v. UnitedHealth Group, Ltd.

630 F. Supp. 3d 118 (D.D.C. 2022)

Although foreclosure is the most common concern in vertical cases, it is not the only one. DOJ's effort in 2022 to block the acquisition by Optum, a subsidiary of UnitedHealth (the country's largest health insurer, or "payer"), of Change Healthcare, was heavily motivated by a concern that the merged firm would harm competition through acquiring access to rivals' confidential information. Change was a health technology supplier and the country's largest electronic data interchange clearinghouse for transmitting data about insurance claims between healthcare providers and insurers. Suing to block the deal, DOJ argued among other things that the merged firm would use its control over other insurers' confidential information to weaken those insurers' incentive to compete against United. In the court's telling, the concern was that "(1) Optum will gain incremental access and use rights to the claims data of [United's] rivals; (2) Optum will have an incentive to share these data—or the competitively sensitive insights derived from the data—with [United]; (3) rival payers' fear of [United] using these data or insights will chill innovation; and (4) less innovation means less competition in the relevant markets."

But Judge Nichols of the U.S. District Court for the District of Columbia rejected that theory, finding that it "rests on speculation rather than real-world evidence[.]" (There's that "real-world evidence" theme again!) For the merged firm to cause harm through data misuse, the court held, "United would have to uproot its entire business strategy and corporate culture; intentionally violate or repeal longstanding firewall policies; flout existing contractual commitments; and sacrifice significant financial and reputational interests." And, at trial, the Government had "failed to show that United's post-merger incentives will lead it to take such extreme actions. Nor has the Government put forward real-world evidence that United's rivals are likely to innovate less out of fear that United will poach their data. No payer witness made that claim; in fact, all the payer witnesses testified to just the opposite." Among other things, United had maintained internal firewalls for many years to ensure that its vertical integration did not lead to leakage of competitively sensitive information, and "[t]he evidence does not reflect a single instance in which these firewalls have been breached."

So the court concluded that the United / Change deal would not, in fact, harm competition in this (or any other) way, and DOJ's challenge failed. But the court seemed to accept that a vertical merger could, in principle, violate Section 7 through the sharing of confidential information that drained rivals' incentives to compete. Proving liability on that theory would have to wait for another day, and a stronger record.

NOTES

1) Why would a merged firm with upstream monopoly power want to sell fewer inputs to downstream rivals?
2) Why do you think vertical mergers have not often been litigated in recent decades?
3) Do you think that the 2023 Merger Guidelines would or could have led to a different outcome in *AT&T*?
4) In *AT&T / Time Warner*, the court was persuaded that foreclosure was unlikely based in large point on testimony from party executives, despite economic analysis to the contrary. Under what circumstances do you think a court should credit party testimony over econometrics, and vice versa? Why?
5) "The agencies should prioritize bringing vertical merger cases—even at the expense of other meritorious merger cases that would otherwise be higher enforcement priorities—until they secure a critical mass of victories that can provide precedential support for future vertical merger enforcement." Do you agree or disagree with this statement of enforcement policy?

6) What do you make of the pre-emptive remedy offered by the parties in *AT&T / Time Warner* and *Illumina / Grail*—how should a court react to that fact in litigation? What if the parties to a horizontal merger made a unilateral offer to charge only reasonable prices post-consummation, with a right to arbitrate in the event of a dispute?
7) Can you explain why the Fifth Circuit didn't just affirm the FTC in *Illumina*?
8) In paragraph 15 of the extract from Section 2.5 of the 2023 Merger Guidelines, the document warns that "the Agencies are unlikely to credit claims or commitments to protect or otherwise avoid weakening the merged firm's rivals that do not align with the firm's incentives." What do you think is the purpose of that language? What kind of thing might the drafters have had in mind?
9) Suppose that you are investigating a vertical merger that raises the prospect that the merged firm will have access to the confidential information of rivals. What questions would you want to prioritize in evaluating the merger and how would you examine them?
10) When do you think a court or agency should accept the argument that a merged firm would have the *ability* to inflict competitive harm but not the *incentive* to do so?

D. Procompetitive Benefits and Defenses

Merger analysis involves more than just an assessment of harms: it also involves a careful weighing of the merger's beneficial effects, as well as any legal defenses that could apply. Some defenses, like the "state action" defense, apply to all antitrust claims, including mergers: those will be discussed in Chapter IX.

In this Section, we will discuss three issues that are often raised by defendants in merger cases. The first is the proposition that a horizontal or vertical merger will lead to cost savings that will make the transaction beneficial, not harmful, to competition. This is sometimes, somewhat misleadingly, described as an efficiency "defense." While the legal status of efficiencies in merger review remains somewhat uncertain, the best view is probably that efficiencies are not a "defense," but rather can and should be taken into account in figuring out whether a merger is anticompetitive in the first place. Whatever the precise legal framing, in practice agencies and courts give serious consideration to the effects of production cost savings arising from mergers, and the impact of those cost savings upon competition and consumers.

The second issue is not strictly an efficiency (in the sense of a production cost saving) so much as an incentive effect: the elimination of double marginalization ("EDM") specific to vertical mergers. EDM arises from the same impact of a vertical merger on incentives as does anticompetitive foreclosure: in each case, the change in incentives from the integration causes the integrated division to be treated more favorably than its unintegrated rivals, with ambiguous effects on competition and consumers.

The third issue is the "failing firm" defense. This is the argument—often made but seldom accepted—that one of the merging parties is failing and that even an anticompetitive transaction is better than the *even more anticompetitive* alternative of exit. We will also meet the somewhat related, but different, argument that a merging party is declining in competitive strength, such that existing market shares overstate its competitive importance.

1. Efficiencies

Mergers may have positive as well as negative effects on competition. For example, they may reduce the costs of valuable coordination in ways that would be more difficult or impossible through arms-length contracting. By combining the parties' existing assets, they may unlock economies of scale (*i.e.*, cost reductions from increased scale of operation) and scope (*i.e.*, cost reductions from supply of different products and services), or other synergies, that reduce the merged firm's costs and exert downward pressure on its prices. They may also create a merged firm with greater ability or incentive to innovate in socially valuable ways. The result can be a more effective competitor and overall benefits for consumers.[708]

[708] *See generally*, *e.g.*, Louis Kaplow, *Efficiencies in Merger Analysis*, 83 Antitrust L.J. 557 (2021); Herbert J. Hovenkamp, *Appraising Merger Efficiencies*, 24 Geo. Mason L. Rev. 703 (2017); Daniel A. Crane, *Rethinking Merger Efficiencies*, 110 Mich. L. Rev. 347 (2011).

But merger efficiencies do not arise in every case, and in some cases negative efficiencies, or "diseconomies," may even result from a deal.[709] And even when efficiencies do arise, the merger may still be harmful overall because the harmful tendencies outweigh the beneficial ones. (There is a considerable literature on the empirics of the net effects of mergers on price, quality, and innovation.[710]) The merger may also be unnecessary in order to achieve the benefits in question (*e.g.*, because the same benefits could be obtained through arm's-length contracting with less harm to competition). So a careful examination is necessary in every case before concluding that efficiencies justify a troubling merger.

Although, as we shall see, it is not clear whether the courts really accept an "efficiencies defense" to an otherwise-anticompetitive merger, the agencies generally do consider the impact of efficiencies.[711] The 2023 Merger Guidelines clearly indicate that efficiencies may rebut evidence that a merger may harm competition, so long as the efficiencies satisfy certain criteria.[712] In particular, efficiencies must be "cognizable"—that is, they must be specific to the proposed transaction and verifiable—and they must also be sufficiently substantial in magnitude to "prevent the risk of a substantial lessening of competition in the relevant market." They must also not arise from anticompetitive reductions in output or other terms. And they must be enough to ensure that the merger is not anticompetitive in *any* relevant market: if a merger is harmful in Market A, efficiencies in Market B do not help![713] If these factors are all present, the guidelines indicate that the agencies will not regard the deal as harmful to competition.[714]

It was not always so. In the mid-century years, it was widely believed that mergers virtually never generated procompetitive efficiencies (or "economies"),[715] or that such efficiencies were actively harmful and a reason to prevent, rather than permit, mergers. In *Brown Shoe*, for example, the Court had given some lip service to the idea that efficiencies alone were not a cause for concern, noting:

> [A]t the same time that it sought to create an effective tool for preventing all mergers having demonstrable anti-competitive effects, Congress recognized the stimulation to competition that might flow from particular mergers. When concern as to the Act's breadth was expressed, supporters of the amendments indicated that it would not impede, for example, a merger between two small companies to enable the combination to compete more effectively with larger corporations dominating the relevant market, nor a merger between a corporation which is financially healthy and a failing one which no longer can be a vital competitive factor in the market. . . . Taken as a whole, the legislative history illuminates congressional concern with the

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[709] On diseconomies of scope, *see*, *e.g.*, Evan Rawley and Timothy S. Simcoe, *Diversification, Diseconomies of Scope, and Vertical Contracting: Evidence from the Taxicab Industry*, 57 Mgmt. Sci. 1534 (2010); Cynthia A. Montgomery, *Corporate Diversification*, 8 J. Econ. Persp. 163 (1994). On diseconomies of scale, *see*, *e.g.*, Oliver E. Williamson, *Hierarchical Control and Optimum Firm Size*, 75 J. Pol. Econ. 123 (1967).

[710] *Compare generally* Maureen K. Ohlhausen & Taylor M. Owings, *Build, Borrow, Buy: The Case for Merger Efficiencies*, 11 J. Antitrust Enforcement 242 (2023) *with* Nancy L. Rose & Jonathan Sallet, *The Dichotomous Treatment of Efficiencies in Horizontal Mergers: Too Much? Too Little? Getting It Right*, 168 U. Pa. L. Rev. 1941 (2020). For a selection from the healthcare industry, *see*, *e.g.*, Nancy Beaulieu et al., *Changes in Quality of Care after Hospital Mergers and Acquisitions*, 382 New Eng. J. Med. 51 (Jan. 2, 2020); Gautam Gowrisankaran, Aviv Nevo, & Robert Town, *Mergers When Prices Are Negotiated: Evidence from the Hospital Industry*, 105(1) Am. Econ. Rev. 172 (2015); Patrick S. Romano & David J. Balan, *A Retrospective Analysis of the Clinical Quality Effects of the Acquisition of Highland Park Hospital By Evanston Northwestern Healthcare*, 18(1) Int'l J. Econ. Bus. 45 (2011); John E. Schneider et al., *The Effect of Physician and Health Plan Market Concentration on Prices in Commercial Health Insurance Markets*, 8(1) Int'l J. Health Care Fin. & Econ. 13 (2008); Vivian Ho & Barton H. Hamilton, *Hospital Mergers and Acquisitions: Does Market Consolidation Harm Patients?*, 19(5) J. Health Econ. 767 (2000).

[711] *See*, *e.g.*, Malcolm B. Coate & Andrew Heimert, *Merger Efficiencies at the Federal Trade Commission 1997-2007*, FTC BE Working Paper (Feb. 2009).

[712] U.S. Dept. of Justice & FTC, MERGER GUIDELINES (2023) § 3.3 ("To successfully rebut evidence that a merger may substantially lessen competition, cognizable efficiencies must be of a nature, magnitude, and likelihood that no substantial lessening of competition is threatened by the merger in any relevant market.").

[713] U.S. Dept. of Justice & FTC, MERGER GUIDELINES (2023) § 3.3 & n.71 (stating that "[t]he Agencies will not credit efficiencies if they reflect or require a decrease in competition in a separate market" and that "cognizable efficiencies must be [such] that no substantial lessening of competition is threatened by the merger in any relevant market"). *See also infra* notes 734–735 and accompanying text.

[714] HMGs § 10.

[715] George J. Stigler, *Mergers and Preventive Anti-Trust Policy*, 54 U. Pa. L. Rev. 176, 181 (1955) ("mergers which increase both concentration and competition are most uncommon"); Donald Dewey, *Mergers and Cartels: Some Reservations About Policy*, 51 Am. Econ. Rev. 255, 257 (1961) ("Most mergers . . . have virtually nothing to do with either the creation of market power or the realization of scale economies. They are merely a civilized alternative to bankruptcy or the voluntary liquidation that transfers assets from falling to rising firms.").

> protection of competition, not competitors, and its desire to restrain mergers only to the extent that such combinations may tend to lessen competition.[716]

But the Court went on, later in *Brown Shoe*, to reject the idea that efficiencies might justify the transaction:

> A . . . significant aspect of this merger is that it creates a large national chain which is integrated with a manufacturing operation. The retail outlets of integrated companies, by eliminating wholesalers and by increasing the volume of purchases from the manufacturing division of the enterprise, can market their own brands at prices below those of competing independent retailers. Of course, some of the results of large integrated or chain operations are beneficial to consumers. Their expansion is not rendered unlawful by the mere fact that small independent stores may be adversely affected. It is competition, not competitors, which the Act protects. But we cannot fail to recognize Congress' desire to promote competition through the protection of viable, small, locally owned business. Congress appreciated that occasional higher costs and prices might result from the maintenance of fragmented industries and markets. It resolved these competing considerations in favor of decentralization. We must give effect to that decision.[717]

Likewise, in *Von's Grocery* the Court condemned a merger to a combined market share of 7.5% in a market with a postmerger HHI of less than 745 on the basis that, among other things, the transaction involved "two already powerful companies merging in a way which makes them even more powerful than they were before."[718] And the Court said outright in *FTC v. Procter & Gamble* that "Possible economies cannot be used as a defense to illegality. Congress was aware that some mergers which lessen competition may also result in economies but it struck the balance in favor of protecting competition."[719]

With the advent of scholarship suggesting that efficient mergers might improve competition,[720] and with the shift in antitrust law's emphasis from skepticism of size and success toward welfare impacts on consumers,[721] the picture began to change. Oliver Williamson's seminal article on *Economies as an Antitrust Defense* was published in 1968,[722] the same year that the Justice Department issued its first Merger Guidelines. These provided a kind of backhanded provision for an efficiencies defense, implicitly acknowledging the in-principle benefits of efficiencies though expressing doubt that the factual predicates would be established in many cases:

> Unless there are exceptional circumstances, the Department will not accept as a justification for an acquisition normally subject to challenge under its horizontal merger standards the claim that the merger will produce economies (i.e., improvements in efficiency) because, among other reasons, (i) the Department's adherence to the standards will usually result in no challenge being made to mergers of the kind most likely to involve companies operating significantly below the size necessary to achieve significant economies of scale; (ii) where substantial economies are potentially available to a firm, they can normally be realized through internal expansion; and (iii) there usually are severe difficulties in accurately establishing the existence and magnitude of economies claimed for a merger.[723]

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[716] Brown Shoe Co. v. United States, 370 U.S. 294, 319–20 (1962).

[717] Brown Shoe Co. v. United States, 370 U.S. 294 (1962)

[718] United States v. Von's Grocery Co., 384 U.S. 270 (1966).

[719] FTC v. Procter & Gamble Co., 386 U.S. 568, 580 (1967). *But see* id. at 603 (Harlan, J., concurring) ("The Commission [below]—in my opinion quite correctly—seemed to accept the idea that economies could be used to defend a merger, noting that a merger that results in increased efficiency of production, distribution or marketing may, in certain cases, increase the vigor of competition in the relevant market.").

[720] *See*, *e.g.*, Oliver E. Williamson, *Economies as an Antitrust Defense: The Welfare Tradeoffs*, 58 Am. Econ. Rev. 18 (1968) (arguing that significant competitive harms are necessary to offset modest efficiencies from a merger, and that antitrust agencies should consider efficiencies in the exercise of prosecutorial discreation); Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. Pol. Econ. 110 (1965) (arguing that many mergers are driven by the existence of inefficiently managed firms that would be more productive under new ownership); Michael C. Jensen, *Takeovers: Their Causes and Consequences*, 2 J. Econ. Per. 21 (1988) (enumerating, among other things, various positive effects of mergers); Robert Pitofsky, *Proposals for Revised United States Merger Enforcement in a Global Economy*, 81 Geo. L.J. 195 (1992) (proposing adoption of an efficiency defense).

[721] *See supra* § I.E.

[722] Oliver E. Williamson, *Economies as an Antitrust Defense: The Welfare Tradeoffs*, 58 Am. Econ. Rev. 18 (1968).

[723] U.S. Dept. of Justice, MERGER GUIDELINES (1968), § 10.

And through the 1970s, as we have seen, the Court began to embrace the value of efficiency in antitrust analysis, including by relaxing the *per se* rule against vertical nonprice distribution restraints in *GTE Sylvania*,[724] and by accepting the efficiency justification for a form of (what could be called) "price fixing" in *BMI*.[725] In 1980, Phillip Areeda and Donald Turner "became the first widely respected antitrust legal scholars to argue in favor of incorporating efficiencies into the merger review process on a broader scale than the 1968 Merger Guidelines [had] contemplated."[726] Since that time, the recognition of efficiencies as a consideration in merger review has gained ground unevenly in successive Merger Guidelines.[727] The courts too began to indicate, rather cautiously, that efficiency generation was a point in favor of, rather than against, the legality of a transaction in merger review. They remain cautious to this day, often indicating that efficiencies may at least play a role in evaluating whether a merger is anticompetitive, while acknowledging the uncertain legal status of efficiencies in a merger case.[728]

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[724] Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36 (1977).

[725] Broadcast Music, Inc. v. Columbia Broadcasting Sys., Inc., 441 U.S. 1 (1979).

[726] William Kolasky & Andrew Dick, *The Merger Guidelines and the Integration of Efficiencies into Antitrust Review of Horizontal Mergers*, 71 Antitrust L.J. 207, 216 (2003).

[727] *See*, *e.g.*, U.S. Dept. of Justice, MERGER GUIDELINES (1982), § V.A. at 29 ("In the overwhelming majority of cases, the Guidelines will allow firms to achieve available efficiencies through mergers without interference from the Department. Except in extraordinary cases, the Department will not consider a claim of specific efficiencies as a mitigating factor for a merger that would otherwise be challenged. Plausible efficiencies are far easier to allege than to prove. Moreover, even if the existence of efficiencies were clear, their magnitudes would be extremely difficult to determine."), *id.* at 29 n.53 ("At a minimum, the Department will require clear and convincing evidence that the merger will produce substantial cost savings resulting from the realization of scale economies, integration of production facilities, or multi-plant operations which are already enjoyed by one or more firms in the industry and that equivalent results could not be achieved within a comparable period of time through internal expansion or through a merger that threatened less competitive harm. In any event, the Department will consider such efficiencies only in resolving otherwise close cases."); U.S. Dept. of Justice, MERGER GUIDELINES (1984) § 3.5 ("The primary benefit of mergers to the economy is their efficiency-enhancing potential, which can increase the competitiveness of firms and result in lower prices to consumers. Because the antitrust laws and, thus, the standards of the Guidelines, are designed to proscribe only mergers that present a significant danger to competition, they do not present an obstacle to most mergers. As a consequence, in the majority of cases, the Guidelines will allow firms to achieve available efficiencies through mergers without interference from the Department. Some mergers that the Department otherwise might challenge may be reasonably necessary to achieve significant net efficiencies. If the parties to the merger establish by clear and convincing evidence that a merger will achieve such efficiencies, the Department will consider those efficiencies in deciding whether to challenge the merger. Cognizable efficiencies include, but are not limited to, achieving economies of scale, better integration of production facilities, plant specialization, lower transportation costs, and similar efficiencies relating to specific manufacturing, servicing, or distribution operations of the merging firms. The Department may also consider claimed efficiencies resulting from reductions in general selling, administrative, and overhead expenses, or that otherwise do not relate to specific manufacturing, servicing, or distribution operations of the merging firms, although, as a practical matter, these types of efficiencies may be difficult to demonstrate. In addition, the Department will reject claims of efficiencies if equivalent or comparable savings can reasonably be achieved by the parties through other means. The parties must establish a greater level of expected net efficiencies the more significant are the competitive risks identified in Section 3."); U.S. Dept. of Justice & FTC, MERGER GUIDELINES (1992) § 4 (substantially following 1984 language but omitting the requirement to show efficiencies by "clear and convincing evidence"); U.S. Dept. of Justice & FTC, MERGER GUIDELINES (1997) § 4 (switching to extended treatment requiring and defining cognizability in a manner similar to the modern form); U.S. Dept. of Justice & FTC, HORIZONTAL MERGER GUIDELINES (2010) § 10 (providing extended discussion and stating that "[t]he Agencies will not challenge a merger if cognizable efficiencies are of a character and magnitude such that the merger is not likely to be anticompetitive in any relevant market").

[728] *See*, *e.g.*, United States v. Anthem, Inc., 855 F.3d 345, 355 (D.C. Cir. 2017) ("[T]he circuit precedent that binds us allowed that evidence of efficiencies could rebut a prima facie showing, which is not invariably the same as an ultimate defense to Section 7 illegality. . . . [P]rudence counsels that the court should leave for another day whether efficiencies can be an ultimate defense to Section 7 illegality. We will proceed on the assumption that efficiencies as presented by Anthem could be such a defense under a totality of the circumstances approach[.]"); FTC v. Penn State Hershey Med. Ctr., 838 F.3d 327, 348 (3d Cir. 2016) (expressing some skepticism, reserving the issue, but analyzing efficiencies anyway); Saint Alphonsus Med. Ctr.–Nampa, Inc. v. St. Luke's Health Sys., Ltd., 778 F.3d 775, 790 (9th Cir. 2015) (assuming efficiencies may constitute a basis for concluding that a merger that would otherwise harm competition does not); FTC v. H.J. Heinz Co., 246 F.3d 708, 720–22 (D.C. Cir. 2001) (accepting and evaluating efficiency "defense"); FTC v. Tenet Health Care Corp., 186 F.3d 1045, 1054 (8th Cir. 1999) ("[T]he district court should . . . have considered evidence of enhanced efficiency in the context of the competitive effects of the merger."); FTC v. Univ. Health, Inc., 938 F.2d 1206, 1222 (11th Cir. 1991) ("[E]vidence that a proposed acquisition would create significant efficiencies benefiting consumers is useful in evaluating the ultimate issue—the acquisition's overall effect on competition. We think, therefore, that an efficiency defense to the government's prima facie case in section 7 challenges is appropriate in certain circumstances."); United States v. Aetna Inc., 240 F.Supp.3d 1 (D.D.C. 2017) ("Although the Supreme Court has never recognized the 'efficiencies' defense in a Section 7 case, the D.C. Circuit as well as the Horizontal Merger Guidelines recognize that, in some instances, efficiencies resulting from the merger may be considered in rebutting the government's prima facie case.") (internal quotation marks omitted); FTC v. Sanford Health, No. 1:17-CV-133, 2017 WL 10810016, at *27 (D.N.D. Dec. 15, 2017) ("Efficiencies resulting from a merger can rebut a presumption of illegality if they are demonstrated to be merger-specific and are independently verifiable."), *aff'd sub nom.* FTC v. Sanford Health, 926 F.3d 959 (8th Cir. 2019); FTC v. Sysco Corp., 113 F. Supp. 3d 1, 81 (D.D.C. 2015) (same); FTC v. Swedish Match, 131 F. Supp. 2d 151, 171–72 (D.D.C. 2000) (stating that "[i]t is unclear whether a defense showing that the

Today, the merger guidelines set out the agencies' modern approach in some detail, including the criteria that must be satisfied for the agencies to exercise their prosecutorial discretion not to challenge a merger.

Merger Guidelines § 3.3

Procompetitive Efficiencies

[1] The Supreme Court has held that "possible economies [from a merger] cannot be used as a defense to illegality." Competition usually spurs firms to achieve efficiencies internally, and firms also often work together using contracts short of a merger to combine complementary assets without the full anticompetitive consequences of a merger.

[2] Merging parties sometimes raise a rebuttal argument that, notwithstanding other evidence that competition may be lessened, evidence of procompetitive efficiencies shows that no substantial lessening of competition is in fact threatened by the merger. This argument asserts that the merger would not substantially lessen competition in any relevant market in the first place. When assessing this argument, the Agencies will not credit vague or speculative claims, nor will they credit benefits outside the relevant market that would not prevent a lessening of competition in the relevant market. Rather, the Agencies examine whether the evidence[69] presented by the merging parties shows each of the following:

[3] *Merger Specificity.* The merger will produce substantial competitive benefits that could not be achieved without the merger under review.[70] Alternative ways of achieving the claimed benefits are considered in making this determination. Alternative arrangements could include organic growth of one of the merging firms, contracts between them, mergers with others, or a partial merger involving only those assets that give rise to the procompetitive efficiencies.

[4] *Verifiability.* These benefits are verifiable, and have been verified, using reliable methodology and evidence not dependent on the subjective predictions of the merging parties or their agents. Procompetitive efficiencies are often speculative and difficult to verify and quantify, and efficiencies projected by the merging firms often are not realized. If reliable methodology for verifying efficiencies does not exist or is otherwise not presented by the merging parties, the Agencies are unable to credit those efficiencies.

[5] *Prevents a Reduction in Competition.* To the extent efficiencies merely benefit the merging firms, they are not cognizable. The merging parties must demonstrate through credible evidence that, within a short period of time, the benefits will prevent the risk of a substantial lessening of competition in the relevant market.

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intended merger would create significant efficiencies in the relevant, thereby offsetting any anticompetitive effects, may be used by a defendant to rebut the government's prima facie case," but analyzing efficiencies and finding them insufficient anyway because "speculative"); FTC v. Staples, Inc., 970 F.Supp. 1066, 1088–90 (D.D.C. 1997) (Staples I) (noting uncertainty of legal grounding but analyzing efficiencies anyway); U.S. v. Long Island Jewish Medical Center, 983 F.Supp. 121, 147 (E.D.N.Y. 1997) ("[T]he Court finds that, with regard to the so-called 'efficiencies defense,' the defendants must clearly demonstrate that the proposed merger itself will, in fact, create a net economic benefit for the health care consumer."); FTC v. Butterworth Health Corp., 946 F. Supp. 1285, 1300 (W.D. Mich. 1996) ("The courts have recognized that in certain circumstances, a defendant may rebut the government's prima facie case with evidence showing that the intended merger would create significant efficiencies in the relevant market.") (internal quotation marks and citation omitted), *aff'd sub nom.* FTC v. Butterworth Health Corp., 121 F.3d 708 (6th Cir. 1997); Cargill, Inc. v. Monfort of Colorado, Inc., 479 U.S. 104, 114–17 (1986) (rejecting theory of antitrust harm based on the merged firm becoming too competitive); United States v. LTV Corp., Case No. Civ-A-84-884, 1984 WL 21973, at *14 (D.D.C. Aug. 2, 1984) (approving proposed consent decree in a Tunney Act proceeding and noting: "The purpose of the present merger is to achieve savings in cost through increased efficiencies which will enable the surviving company to compete more effectively both here and in the export market. We cannot predict that these efforts will succeed, but we can say with some certainty, that without an opportunity to improve their acute financial predicament, their future will indeed be bleak.").

[69] In general, evidence related to efficiencies developed prior to the merger challenge is much more probative than evidence developed during the Agencies' investigation or litigation.

[70] If inter-firm collaborations are achievable by contract, they are not merger specific. The Agencies will credit the merger specificity of efficiencies only in the presence of evidence that a contract to achieve the asserted efficiencies would not be practical.

[6] *Not Anticompetitive.* Any benefits claimed by the merging parties are cognizable only if they do not result from the anticompetitive worsening of terms for the merged firm's trading partners.[71]

[7] Procompetitive efficiencies that satisfy each of these criteria are called cognizable efficiencies. To successfully rebut evidence that a merger may substantially lessen competition, cognizable efficiencies must be of a nature, magnitude, and likelihood that no substantial lessening of competition is threatened by the merger in any relevant market. Cognizable efficiencies that would not prevent the creation of a monopoly cannot justify a merger that may tend to create a monopoly.

* * *

As we have just seen, the Merger Guidelines explicitly state that efficiency evidence can "rebut evidence that a merger may substantially lessen competition." Many courts have likewise accepted that the assessment of efficiencies is required in merger analysis.[729] But courts are often cautious about saying explicitly that efficiencies can justify an otherwise-illegal merger. Indeed, at the time of writing no circuit court of appeals has found that harm to competition has been actually established but outweighed by efficiencies. The closest thing to such a case is probably the states' challenge to the *Sprint / T-Mobile* merger, which we will meet below.

Judicial caution in handling merger efficiencies was on display when the Department of Justice challenged a merger of two insurers in *Anthem / Cigna*. The D.C. Circuit expressed reservations about the legal status of the efficiencies defense; then-Judge Kavanaugh, in dissent, did not.

CASENOTE: United States v. Anthem, Inc.

855 F.3d 345 (D.C. Cir. 2017)

Anthem / Cigna concerned a proposed merger between the second- and third-largest sellers of health insurance to large companies in the United States. DOJ sued to block the deal, and the D.C. district court concluded that the transaction violated Section 7, as it would lessen competition in certain markets for the sale of health insurance. The parties appealed to the D.C. Circuit on the ground that the transaction would generate sufficient efficiencies—in the form of cost savings—to offset any threatened harm. The case presented an opportunity for the nation's most prominent antitrust court to clarify the role of efficiencies under Section 7. But, alas, that was not the outcome!

Judge Rogers, writing for the panel, cast plenty of doubt on the question of whether efficiencies could justify an otherwise-anticompetitive deal: "Despite . . . widespread acceptance of the potential benefit of efficiencies as an economic matter, *see*, *e.g.*, [2010 Horizontal Merger] Guidelines § 10, it is not at all clear that they offer a viable legal defense to illegality under Section 7. In *FTC v. Procter & Gamble Co.*, 386 U.S. 568 . . . (1967), the Supreme Court enjoined a merger without any consideration of evidence that the combined company could purchase advertising at a lower rate. It held that '[p]ossible economies cannot be used as a defense to illegality. Congress was aware that some mergers which lessen competition may also result in economies but it struck the balance in favor of protecting competition.' In his concurrence, Justice Harlan . . . accepted the idea that economies could be used to defend a merger. No matter that Justice Harlan's view may be the more accepted today, the Supreme Court held otherwise[.]"

The court acknowledged that lower courts had generally assumed the relevance of efficiencies. Indeed, even the D.C. Circuit itself had left the door open to treating efficiencies favorably, noting that "the Supreme Court [in *Procter & Gamble*] can be understood only to have rejected 'possible' efficiencies, while efficiencies that are verifiable can be credited."

Ultimately, the court punted again on the legal status of efficiencies, confining its decision to the evidence. "In this expedited appeal, prudence counsels that the court should leave for another day whether efficiencies can be an

[71] The Agencies will not credit efficiencies if they reflect or require a decrease in competition in a separate market. For example, if input costs are expected to decrease, the cost savings will not be treated as an efficiency if they reflect an increase in monopsony power

[729] *See supra* note 728.

ultimate defense to Section 7 illegality. We will proceed on the assumption that efficiencies as presented by Anthem could be such a defense under a totality of the circumstances approach, because Anthem has failed to show the district court clearly erred in rejecting Anthem's purported medical cost savings as an offsetting efficiency."

Justice Kavanaugh dissented, arguing that merger law had long ago left *Procter & Gamble* behind. "In landmark decisions in the 1970s—including *United States v. General Dynamics Corp.*, 415 U.S. 486 (1974), and *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977)—the Supreme Court indicated that modern antitrust analysis focuses on the effects on the consumers of the product or service, not the effects on competitors. In the horizontal merger context, the Supreme Court in the 1970s therefore shifted away from the strict anti-merger approach that the Court had employed in the 1960s[.]." Under the modern approach, "we must take account of the efficiencies and consumer benefits that would result from this merger."

So what does an efficiencies analysis look like? Many courts have undertaken extensive analysis of actual and claimed efficiencies in merger cases.[730] One of the most extended and favorable judicial treatments of merger efficiency claims in recent history is found in the district court's decision in the states' challenge to the T-Mobile/Sprint merger. The transaction in that case—the merger of mobile network operators T-Mobile and Sprint—had triggered the structural presumption by a considerable margin.[731] But the court went on to hold that the presumption had been rebutted, emphasizing evidence that: (1) the transaction would turn the merged firm into a more efficient competitor, (2) Sprint was a weakened competitor that was unlikely to continue providing strong competitive pressure, and (3) remedies obtained as a result of FCC and DOJ review would "ameliorate any remaining concerns of anticompetitive effect."[732] In the following passage, the court applies the merger-specificity and verifiability tests to a complex trial record.

New York v. Deutsche Telekom AG

439 F.Supp.3d 179 (S.D.N.Y. 2020)[733]

Judge Marrero.

[1] It remains unclear whether and how a court may consider evidence of a merger's efficiencies. While the Supreme Court has previously stated that possible economies cannot be used as a defense to illegality, lower courts have since considered whether possible economies might serve not as justification for an illegal merger but as evidence that a merger would not actually be illegal. The trend among lower courts has thus been to recognize or at least assume that evidence of efficiencies may rebut the presumption that a merger's effects will be anticompetitive, even if such evidence could not be used as a defense to an actually anticompetitive merger.

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730 *See*, *e.g.*, United States v. Anthem, Inc., 855 F.3d 345, 356–67 (D.C. Cir. 2017) (considering and rejecting claimed efficiencies defense in Anthem / Cigna health insurance merger); FTC v. Penn State Hershey Medical Center, 838 F.3d 327, 347–52 (3d Cir. 2016) (analyzing and rejecting claimed efficiencies in hospital merger); FTC v. H.J. Heinz Co., 246 F.3d 708, 720–24 (D.C. Cir. 2001) (analyzing and rejecting claimed efficiencies in merger of baby food manufacturers); New York v. Deutsche Telekom AG, 439 F.Supp.3d 179 (S.D.N.Y. 2020) (considering efficiencies as part of a "totality of the circumstances" analysis); United States v. Aetna Inc., 240 F. Supp. 3d 1, 94–98 (D.D.C. 2017) (considering and rejecting claimed efficiencies defense in Aetna / Humana health insurance merger); FTC v. Staples, Inc., 970 F. Supp. 1066, 1088–90 (D.D.C. 1997 (analyzing and rejecting claimed efficiencies in first Staples / Office Depot merger).

731 New York v. Deutsche Telekom AG, 439 F.Supp.3d 179, 206 (S.D.N.Y. 2020) ("By either measure, Plaintiff States have satisfied their prima facie burden. [Plaintiffs' expert Carl] Shapiro calculated that New T-Mobile would have a national market share of either 37.8 percent if measured by subscribers or 34.4 percent if measured by revenues, and the national HHI would increase by 679 points for a total HHI of 3186. The shares are higher in certain local markets. For example, the total HHIs for the local CMAs corresponding to Los Angeles and New York would be as high as 4158 and 4284 respectively, and market share in Los Angeles would be as high as 57 percent. These figures are more than enough to establish a presumption that the Proposed Merger would be anticompetitive. It bears repeating, however, that market shares and HHIs establish only a presumption, rather than conclusive proof of a transaction's likely competitive impact.").

732 New York v. Deutsche Telekom AG, 439 F.Supp.3d 179, 207 (S.D.N.Y. 2020) (summarizing rebuttal evidence).

733 For opposing perspectives on the deal and the remedy obtained by the Department of Justice, *see* Melody Wang & Fiona Scott Morton, *The Real Dish on the T-Mobile/Sprint Merger: A Disastrous Deal From the Start*, ProMarket (Apr. 23, 2021) (criticizing the transaction); Competitive Impact Statement, United States v. Deutsche Telekom AG, Case No. 1:19-cv-02232 (D.D.C. filed July 30, 2019) (explaining the DOJ view of the adequacy of the remedy).

[2] Additionally, the DOJ and FTC have indicated that they will not challenge a merger if its efficiencies indicate that the merger will not be anticompetitive in any relevant market. See [2010] Merger Guidelines § 10 (noting as an example that "merger-generated efficiencies may enhance competition by permitting two ineffective competitors to form a more effective competitor, e.g., by combining complementary assets"). Courts and the Merger Guidelines generally require that claimed efficiencies be both merger-specific and verifiable.

[3] Despite the skepticism that some courts have expressed . . . this Court will consider evidence of efficiencies, given courts' and federal regulators' increasingly consistent practice of doing so, and because Section 7 requires evaluation of a merger's competitive effects under the totality of the circumstances.

[4] Defendants project that the Proposed Merger would result in a variety of efficiencies that would be passed on to consumers through more aggressive service offers, leading to annual consumer welfare gains that will range from $540 million in 2020 to $18.17 billion by 2024. Defendants' claimed efficiencies include: (1) more than doubling the standalone firms' network capacity, which is projected to result in 15 times the speeds now offered by the four major [mobile network operators ("MNOs")] to consumers; (2) saving $26 billion in network costs and another $17 billion in other operating costs; (3) increasing network coverage to strengthen competition in underserved markets; and (4) accelerating the provision of 5G service. Defendants' bottom-line conclusion is that they will use these advantages to lower prices and thus compete more effectively against AT&T and Verizon. Even if the Court assumed that the efficiencies cited by Defendants would not, absent other circumstances, rebut Plaintiff States' prima facie case, the Court concludes that the efficiencies are sufficiently verifiable and merger-specific to merit consideration as evidence that decreases the persuasiveness of the prima facie case.

[5] The primary efficiency Defendants claim is the increased capacity that New T-Mobile would gain from adding Sprint's mid-band spectrum and 11,000 cell sites to T-Mobile's network. T-Mobile argues that these cell sites and spectrum would provide it with enough additional capacity to meet the market's projected growth in data consumption and thus avoid the erosion in quality of service that would result from saturating its existing capacity. The undisputed evidence at trial reflects that combining Sprint and T-Mobile's low-band and mid-band spectrum on one network will not merely result in the sum of Sprint and T-Mobile's standalone capacities, but will instead multiply the combined network's capacity because of a technological innovation referred to as "carrier aggregation" and certain physical properties governing the interaction of radios. Because mobile networks are the basis for mobile wireless telecommunications services, this increase in network capacity would translate to what T-Mobile's President of Technology, Neville Ray ("Ray"), described as an "inordinate amount" of new supply in the market. Not only would this excess capacity allow New T-Mobile to support additional subscribers at reduced marginal costs, it would improve the speeds at which current subscribers could use data services. Defendants argue that this is particularly important in a world where data-intensive streaming video now accounts for over 50 percent of the traffic on T-Mobile's network. Defendants project that the Proposed Merger would result in speeds averaging between 400 to 500 mbps, or at least 15 times current speeds.

[6] Defendants next note that the Proposed Merger would allow New T-Mobile to operate at reduced cost, projecting that roughly $26 billion in efficiencies will result from network cost synergies alone. They project that the retirement of Sprint's network would save $4.2 billion in operating costs per year. In addition to reduced operating costs and the benefits of combining spectrum on one network, that New T-Mobile will take over 11,000 of Sprint's existing towers would reduce the cost and delay that T-Mobile would otherwise incur from building new towers for future network development. By reducing these network costs while combining the standalone firms' customers onto one network, New T-Mobile would achieve economies of scale on par with those of market leaders AT&T and Verizon. Defendants also project savings from streamlined advertising, the closing of 3,000 redundant retail stores, and reducing the costs of billing and other professional "back office" services, which combine with the network cost savings for total net cost savings of $43 billion.

[7] Apart from capacity and cost benefits, Defendants claim that New T-Mobile will provide better coverage than Sprint customers currently receive because T-Mobile's low-band spectrum covers a broader range and penetrates through buildings more effectively than Sprint's mid-band holdings can. Having a broad range of spectrum would allow New T-Mobile to dedicate each band of spectrum to its best use; it could prioritize the use of low-band in areas that mid-band and mmWave [(other categories of spectrum)] could not reach, while instead prioritizing the other two bands in areas correspondingly closer to the cell sites.

[8] Defendants further claim that the Proposed Merger would accelerate mobile wireless carriers' provision of 5G service in the United States. They argue that in fact, the mere announcement of the Proposed Merger has already procompetitively improved the rollout of 5G services. Defendants state that though AT&T and Verizon originally planned to deploy 5G service primarily on mmWave spectrum, they have since, in response to the prospect that New T-Mobile would deploy 5G services across its broader-reaching low-band and mid-band holdings, broadened the spectrum that they will use. Because spectrum must generally be dedicated to either 4G or 5G and carriers must continue to serve customers without 5G-capable handsets, acquiring Sprint's currently underused mid-band assets would allow New T-Mobile to dedicate spectrum to 5G more quickly than either standalone firm could. Apart from the greater spectral efficiency associated with 5G, Defendants state that faster adoption of 5G will also catalyze the earlier creation of new applications and services not currently possible in the [pre-5G] 4G/LTE environment.

[9] Defendants conclude that New T-Mobile would use these advantages to decrease consumer prices because doing so would actually be profitable. As New T-Mobile would have relatively low network marginal costs and more excess capacity to fill than AT&T and Verizon, it could rationally lower its prices and advertise the higher quality of its network to attract customers away from AT&T and Verizon, thus increasing competition in the [retail mobile wireless telecommunications services ("RMWTS")] Markets.

[10] Other courts have similarly noted that the incentive to use excess capacity given lower marginal costs, as well as the reduction of required capital and operational expenditures, increases the likelihood of competition rather than coordination.

[11] These cases and the record evidence confirm that there is substantial merit to Defendants' claims that the efficiencies arising from the Proposed Merger will lead T-Mobile to compete more aggressively to the ultimate benefit of all consumers, and in particular the subscribers of each of the four major competitors. Sprint customers would benefit from greater coverage, T-Mobile customers would benefit from greater speeds and 5G service sooner. And even AT&T and Verizon customers would benefit insofar as New T-Mobile continued T-Mobile's past practice of pushing AT&T and Verizon to adopt pro-consumer offerings.

[12] While Plaintiff States do not deny that generally the Proposed Merger could generate efficiencies, they respond that these efficiencies are not cognizable because they are neither merger-specific nor verifiable. The Court now considers both grounds pressed by Plaintiff States, concluding that these arguments lack sufficient merit to warrant disregard of Defendants' claimed efficiencies.

a. Merger Specificity

[13] Efficiencies are merger-specific if they cannot be achieved by either company alone, as otherwise those benefits could be achieved without the concomitant loss of a competitor. In this regard, the DOJ and FTC consider only alternatives that are practical in the business situation faced by the merging firms and do not insist upon a less restrictive alternative that is merely theoretical.

[14] Plaintiff States argue that Defendants' claimed efficiencies are not merger specific because Defendants have alternate means of increasing capacity and coverage, and because both Sprint and T-Mobile will inevitably provide 5G services on a nationwide basis. In particular, Plaintiff States emphasize that Defendants can alternatively increase capacity by acquiring spectrum through auctions and private transactions.

[15] Auctions present multiple issues for T-Mobile and Sprint. They are infrequent, their timing is uncertain, and it can take years for a contemplated auction to occur. There is no guarantee that Sprint or T-Mobile could win a substantial amount of spectrum at these auctions because AT&T and Verizon can leverage their higher market capitalization to dominate the auctions with high bids. Moreover, the spectrum that the FCC chooses to auction may not practically address the merging parties' needs. For example, while Sprint needs low-band spectrum, there have been no such auctions since 2015 and there are no future low-band auctions anticipated at this time.

[16] Similarly, while the mid-band "C-Band" spectrum that the FCC will eventually auction might address some of T-Mobile's needs, no date for the auction has been set, it could take years for the spectrum to actually become available for use after the auction, and T-Mobile would also need to deploy radios and handsets that can use this

newly available spectrum. The mid-band CBRS spectrum that the FCC will auction is similarly impractical to address T-Mobile's requirements because the Department of Defense will always have priority over its use; as T-Mobile's rights are necessarily subordinate, its ability to use such spectrum for RMWTS purposes is inherently subject to uncertainty.

[17] Private transactions are certainly possible, as T-Mobile has consistently acquired spectrum through either this method or auctions in every year since 2013. But private transactions usually entail small amounts of spectrum and depend upon counterparties' willingness to part with their spectrum. Opportunities to acquire the desired bands of spectrum in any significant measure are thus infrequent. While T-Mobile or Sprint could theoretically spend another decade negotiating and acquiring the required spectrum bit-by-bit, doing so would clearly not allow for anywhere near the efficiencies of the Proposed Merger in anywhere near the same timeframe.

[18] Finally, even assuming that the standalone firms could acquire some additional capacity through auctions or private transactions, that capacity would not nearly approach the capacity that would result from combining the standalone firms' broad spectrum assets on one network. The combination of each firm's spectrum creates unused capacity without the need for, and without excluding the possibility of, New T-Mobile acquiring additional spectrum in the future. And because of the multiplicative effect associated with combining spectrum on one set of infrastructure, New T-Mobile's acquisition of additional spectrum would inherently create more capacity than if either standalone firm acquired the exact same amount of spectrum. While Plaintiff States' claims are not entirely without merit, the alternatives they cite all present significant practical difficulties and do not promise nearly the same capacity benefits that the combination of T-Mobile and Sprint's spectrum assets onto one network would achieve.

[19] With respect to coverage, Plaintiff States proposed at various points during trial that gaps in coverage could be filled by small cells through so-called "densification" projects. This is an interesting and potentially useful solution in more limited contexts, but its benefits are not comparable to those possible under the Proposed Merger. As Ray noted at trial, such small cells would need to be deployed by the millions to match the network coverage that would result from the Proposed Merger. As deployment costs for small cells could thus run well into the billions, densification is simply not a practical alternative at the nationwide scale suggested by Plaintiff States.

[20] Plaintiff States are correct that both Sprint and T-Mobile will provide 5G service without the Proposed Merger. But they fail to adequately acknowledge that the standalone firms' 5G networks will be materially more limited in their scope and require a longer timeframe to establish. Legere testified that while T-Mobile will deploy 5G across its low-band spectrum, that could not compare to the ability to provide 5G service to more consumers nationwide at faster speeds across the mid-band spectrum as well. Sprint's deployment of 5G has been limited to discrete and distant markets, and its prospects for deploying 5G more broadly are uncertain given mid-band spectrum's limited reach and Sprint's financial challenge . . . . And though Plaintiff States make much of the possibility that a technology called Dynamic Spectrum Sharing ("DSS") can allow spectrum to be used for either 4G or 5G, the evidence at trial reflected that the technology is still experimental, will not be deployed for at least a year, and currently results in a 20 to 30 percent loss of usable spectrum wherever it is deployed. Considering the significant uncertainty surrounding this technology, the Court is not persuaded that it promises nearly the same efficiencies as the Proposed Merger.

[21] Finally, Plaintiff States argue that rather than merging with each other, T-Mobile or Sprint could realize similar efficiencies through a merger with DISH. However, this argument seems speculative because both companies have previously attempted to negotiate with DISH and failed. The Court simply cannot presume that DISH would inevitably agree to a merger with T-Mobile or Sprint, particularly considering the record evidence that DISH plans to enter the RMWTS Market with a materially different 5G network and its own competitive strategy . . . . In sum, it may be that Defendants are not entirely incapable of improving their networks and services through means other the Proposed Merger. But none of those alternatives appear reasonably practical, especially in the short term, and neither company as a standalone can achieve the level of efficiencies promised by the Proposed Merger. Accordingly, the Court concludes that Defendants' claimed efficiencies satisfy the merger-specific test.

Verifiability

[22] Courts consider efficiencies verifiable if they are not speculative and shown in what economists label "real" terms. The DOJ and FTC similarly state that efficiency claims will not be considered if they are vague, speculative, or otherwise cannot be verified by reasonable means. Projections of efficiencies may be viewed with skepticism, particularly when generated outside of the usual business planning process. By contrast, efficiency claims substantiated by analogous past experience are those most likely to be credited. The Merger Guidelines also note that efficiencies resulting from shifting production among facilities formerly owned separately, which enable the merging firms to reduce the incremental cost of production, are more likely to be susceptible to verification and are less likely to result from anticompetitive reductions in output.

[23] Most of Plaintiff States' criticisms regarding the verifiability of Defendants' claimed efficiencies center on the "Montana Model," which Defendants prepared to quantify the benefits of increased capacity for the purposes of this action. The Montana Model is an adaptation of a Network Engineering Model ("NEM") that T-Mobile uses in its ordinary course of business to predict which of its cell sites will become "congested," or reach a threshold capacity at which T-Mobile deems its customers would not receive the quality of service they expect. This "congestion threshold" is defined in terms of speed, as the NEM forecasts the speeds that consumers would require for their anticipated future uses. T-Mobile typically uses the NEM to plan solutions aimed at avoiding congestion, such as the deployment of small cells or the creation of new macro cell towers. The NEM is updated every year and forecasts network traffic over a five-year period, predicting consumer demand by incorporating information from T-Mobile's marketing teams and studies on likely future consumer applications and data demands. T-Mobile employees expressed satisfaction with the NEM at trial, noting that it predicts capacity needs at over 99 percent accuracy in the ordinary course of business.

[24] T-Mobile's Vice President of Network Technology, Ankur Kapoor ("Kapoor"), oversaw the creation of the Montana Model by adapting the NEM (which he regularly oversees) to account for both the advent of 5G and Sprint's future standalone performance. . . . Kapoor then adapted the NEM to model Sprint's future congestion by meeting with his counterparts at Sprint and incorporating the assumptions that then controlled under Sprint's April 2018 plan of record. Defendants' economic expert, Katz, then quantified the value of the resulting efficiencies by measuring the marginal costs required to solve network congestion and comparing New T-Mobile's marginal costs with those for standalone T-Mobile and Sprint. Katz also quantified the value of increased speeds by extrapolating from a 2012 study regarding the fixed in-home broadband services market, which he considered sufficiently analogous based on the increasing convergence between the mobile wireless (also called mobile broadband) and fixed in-home broadband markets. Based on these assumptions, Katz calculated that New T-Mobile's network marginal costs would be 1/10 of standalone T-Mobile's, and the value of its increased speeds would be over $15 per month per subscriber.

[25] Plaintiff States claim that Defendants' claimed efficiencies are unverifiable because the Montana Model was prepared for the purposes of litigation rather than in the ordinary course of business. They note as an example that the Montana Model predicts Sprint's future congestion even though Sprint does not do any similar modeling in the ordinary course of its business, and even though Sprint would not actually follow the April 2018 plan of record used to supply the Montana Model's inputs if the Proposed Merger did not occur. Plaintiff States add that the NEM is updated every year, whereas the Montana Model has not been updated since its completion in roughly September of 2018. They finally cite a letter from T-Mobile's counsel stating that "any model created in the ordinary course would not have attempted to model as far into the future" as the Montana Model does.

[26] The Court is not persuaded that these criticisms render the Montana Model so unreliable that it should not be credited to any degree. . . . Kapoor testified that the Montana Model follows the same core logic as the NEM, which suggests that though the Montana Model was initially created for litigation, it was nevertheless closely based on a model that has proven highly successful in the ordinary course of business. That T-Mobile now uses the Montana Model in the ordinary course of its business also confirms that it essentially tracks the logic of the undisputedly reliable NEM. The Montana Model used the inputs regarding Sprint that were available at the time of its creation, and it would be unreasonable to require constant updates every time Sprint considers a change of strategy. . . . Plaintiff States' criticisms are relevant and noted, but that does not mean that the Montana Model is without value. [. . .]

[27] As the Merger Guidelines explicitly note, efficiencies are generally more susceptible to verification where they result from combining separate facilities and thus reducing the incremental cost of production. No party in this action has disputed that combining Sprint and T-Mobile's network facilities will result in reduced network marginal costs and a large increase in capacity, which in the RMWTS Market effectively equates to supply or output. None of Plaintiff States' arguments challenge this basic reality. Their arguments instead go primarily to the weight that the Court accords to the model's output, rather than barring altogether any recognition of the model's results. As a practical matter, the model almost certainly cannot exactly quantify the extent to which each specific aspect of the Proposed Merger would benefit consumers, even if it is 99 percent accurate.

[28] As the Supreme Court noted almost sixty years ago, the predictive exercises demanded by Section 7 are not susceptible of a ready and precise answer in most cases. To expect otherwise in the dynamic and rapidly changing RMWTS Market is to invite almost certain disappointment. Section 7 calls for a predictive judgment, necessarily probabilistic and judgmental rather than demonstrable. Accordingly, the Court concludes that the Montana Model is sufficiently reliable to indicate that Defendants' claimed efficiencies will be substantial, even if not quite as large as the model's precise prediction.

[29] Of course, the Court need not, and does not, rest its conclusion of verifiability on the Montana Model alone. Indeed, despite the considerable trial time dedicated to the trustworthiness of the Montana Model, the Court is not persuaded that the model's results are particularly integral to a finding of verifiability or lack of it. As noted above, the Merger Guidelines state that efficiency claims may be verifiable if substantiated by analogous past experience. Defendants' claimed efficiencies are verifiable in significant part because of T-Mobile's successful acquisition of MetroPCS in 2013. T-Mobile actually underpredicted the efficiencies that would result from the MetroPCS merger: the merger resulted in network synergies of $9–10 billion rather than the $6–7 billion predicted. Those economies were realized in two years rather than the three predicted. Moreover, Metro's customers have more than doubled since the merger, and Metro's unlimited plans have decreased in price from $60 to $50.

[30] As multiple witnesses noted at trial, the integration of Sprint and T-Mobile would be very similar to the integration of T-Mobile and MetroPCS and could follow the same basic organizational structure and strategy. Although the Proposed Merger would take place on a larger geographic scale, T-Mobile witnesses noted that integration might actually be easier in the sense that over 80 percent of Sprint customers already use handsets compatible with T-Mobile's network, whereas T-Mobile had to provide MetroPCS customers with new handsets due to differences in voice technology protocols at the time of the MetroPCS merger. Considering T-Mobile has already overdelivered on its projected efficiencies in an analogous past merger, the Court is persuaded that the Proposed Merger's efficiencies are ultimately verifiable rather than speculative.

[31] In sum, the Court concludes that Defendants' proposed efficiencies are cognizable and increase the likelihood that the Proposed Merger would enhance competition in the relevant markets to the benefit of all consumers. However, mindful of the uncertainty in the state of the law regarding efficiencies and Plaintiff States' pertinent criticisms, the Court stresses that the Proposed Merger efficiencies it has recognized constitute just one of many factors that it considers and do not alone possess dispositive weight in this inquiry.

Out-of-Market Benefits and *PNB*

What if the efficiencies and harms are in different markets: such that the merger creates net benefits in one market but inflicts harm in another? Although the rule for similar situations in conduct cases remains unclear,[734] the general rule in merger cases is that such "out of market" efficiencies are normally not cognizable: that is, efficiencies in Market A cannot be used to allay competitive concerns in Market B.

The flagship authority for that proposition is none other than *Philadelphia National Bank*. The critical analysis in *PNB* itself occupied all of two paragraphs:

[734] *See* Chapter IV (noting that this is an open question in rule of reason analysis).

> [I]t is suggested that the increased lending limit of the resulting bank will enable it to compete with the large out-of-state bank, particularly the New York banks, for very large loans. We reject this application of the concept of countervailing power. If anticompetitive effects in one market could be justified by procompetitive consequences in another, the logical upshot would be that every firm in an industry could, without violating s 7, embark on a series of mergers that would make it in the end as large as the industry leader. For if all the commercial banks in the Philadelphia area merged into one, it would be smaller than the largest bank in New York City. This is not a case, plainly, where two small firms in a market propose to merge in order to be able to compete more successfully with the leading firms in that market. Nor is it a case in which lack of adequate banking facilities is causing hardships to individuals or businesses in the community. The present two largest banks in Philadelphia have lending limits of $8,000,000 each. The only business located in the Philadelphia area which find such limits inadequate are large enough readily to obtain bank credit in other cities.
>
> This brings us to appellees' final contention, that Philadelphia needs a bank larger than it now has in order to bring business to the area and stimulate its economic development. We are clear, however, that a merger the effect of which "may be substantially to lessen competition" is not saved because, on some ultimate reckoning of social or economic debits and credits, it may be deemed beneficial. A value choice of such magnitude is beyond the ordinary limits of judicial competence, and in any event has been made for us already, by Congress when it enacted the amended s 7. Congress determined to preserve our traditionally competitive economy. It therefore proscribed anticompetitive mergers, the benign and the malignant alike, fully aware, we must assume, that some price might have to be paid.

The 2023 Merger Guidelines clearly indicate that out-of-market efficiencies will not be considered by the Agencies. They state at § 3.3: "To successfully rebut evidence that a merger may substantially lessen competition, cognizable efficiencies must be of a nature, magnitude, and likelihood that no substantial lessening of competition is threatened by the merger in any relevant market." This is a change from the 2010 document, which had indicated that, "[i]n some cases, . . . the Agencies in their prosecutorial discretion will consider efficiencies not strictly in the relevant market, but so inextricably linked with it that a partial divestiture or other remedy could not feasibly eliminate the anticompetitive effect in the relevant market without sacrificing the efficiencies in the other market(s)."[735]

2. EDM

EDM—the elimination of double marginalization[736]—is not a saving in the cost of production, and it is not a defense, in that it is not a separate ground for exculpation for a merger that would otherwise harm competition. Rather, it is an incentive effect that can arise from the fact that a vertically merged firm will not attempt to maximize the profits of its upstream division and downstream division separately (*i.e.*, taking a maximum profit margin at each level in isolation), but will rather maximize its total profits. This will often involve setting a downstream price for its own downstream-division sales that will be lower than would arise in an unintegrated setting. The price will be lower because each firm will internalize the benefit to the other division from a reduction in its own price, as well as any benefit of its own in the form of increased sales. (As we have already seen, antitrust analysis invariably assumes that an integrated firm will attempt to maximize its overall profits.[737])

EDM arises from many, but not all, vertical mergers. Predicting the overall likely effects on consumers from the interaction of EDM (which tends to lower consumer prices) and foreclosure of rivals (which can exclude competition, resulting in consumer harm and higher prices) can require complex expert analysis.

Some basic prerequisites for a cognizable EDM effect include: (1) the downstream division and upstream division were actually dealing with one another before the transaction; (2) the downstream division and upstream division

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[735] U.S. Dept. of Justice & FTC, HORIZONTAL MERGER GUIDELINES (2010) § 10 n.14.

[736] Also, electronic dance music.

[737] United States v. AT&T, Inc., 916 F.3d 1029, 1043 (D.C. Cir. 2019) ("[A] business with multiple divisions will seek to maximize its total profits."); Copperweld Corp. v. Indep. Tube Corp., 467 U.S. 752, 770 (1984) ("[T]he operations of a corporate enterprise organized into divisions must be judged as the conduct of a single actor.").

will actually deal with one another after the transaction; and (3) the parties would not achieve the same internalization without the transaction (or a similarly harmful measure).

The 2023 Merger Guidelines have the following to say about EDM in a footnote:

> A common rebuttal argument is that the merger would lead to vertical integration of complementary products and as a result, "eliminate double marginalization," since in specific circumstances such a merger can confer on the merged firm an incentive to decrease prices to purchasers. The Agencies examine whether elimination of double marginalization satisfies the approach to evaluating procompetitive efficiencies in Section 3.3, including examining: (a) whether the merged firm will be more vertically integrated as a result of the merger, for example because it increases the extent to which it uses internal production of an input when producing output for the relevant market; (b) whether contracts short of a merger have eliminated or could eliminate double marginalization such that it would not be merger-specific, and (c) whether the merged firm has the incentive to reduce price in the relevant market given that such a reduction would reduce sales by the merged firm's rivals in the relevant market, which would in turn lead to reduced revenue and margin on sales of the related product to the dependent rivals.[738]

The *Illumina* litigation, discussed earlier in this chapter, gave the Fifth Circuit the opportunity to clarify the burdens of proving EDM in a vertical merger litigation. The merging parties had argued that the FTC had an obligation to account for EDM in its own modeling of the incentive effects from the acquisition. In principle, there is something to be said for this idea: EDM is not a cost saving, it's just a consequence of the same incentive effect that generates the foreclosure concern. But the Fifth Circuit said a decisive no, indicating that EDM should be treated like a claimed efficiency:

> . . . Illumina argued that the merger would eliminate double marginalization—i.e., Illumina would no longer charge Grail a margin, as it did before the merger—leading to additional consumer surplus. But Illumina never put forward a proposed model for calculating this benefit, only an "illustrative" one. Illumina does not contest this fact. Rather, Illumina contends that it was Complaint Counsel's burden to model these benefits. But when it comes to efficiencies, much of the information relating to efficiencies is uniquely in the possession of the merging firms. It is therefore Illumina—not Complaint Counsel—that must demonstrate that the intended acquisition would result in significant economies. And because Illumina failed to demonstrate that this proposed efficiency was verifiable, the Commission had substantial evidence in support of its decision not to recognize it.[739]

3. Failing and Flailing Firms

It is fairly common for a party to a proposed merger to argue to an agency or court that they are failing and that an—admittedly somewhat anticompetitive—transaction is the only alternative to an even worse outcome of complete market exit by one of the parties. Courts have long recognized that a merger may be lawful for this reason.[740]

Today, the Merger Guidelines allow such a defense sparingly:

> When merging parties suggest the weak or weakening financial position of one of the merging parties will prevent a lessening of competition, the Agencies examine that evidence under the "failing firm" defense established by the Supreme Court. This defense applies when the assets to be acquired would imminently cease playing a competitive role in the market even absent the merger.

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[738] U.S. Dept. of Justice & FTC, MERGER GUIDELINES (2023) § 2.5 n.31.

[739] Illumina, Inc. v. FTC, 88 F.4th 1036, 1060 (5th Cir. 2023).

[740] *See* Int'l Shoe Co. v. FTC, 280 U.S. 291, 302–03 (1930) ("In the light of the case . . . of a corporation with resources so depleted and the prospect of rehabilitation so remote that it faced the grave probability of a business failure with resulting loss to its stockholders and injury to the communities where its plants were operated, we hold that the purchase of its capital stock by a competitor (there being no other prospective purchaser), not with a purpose to lessen competition, but to facilitate the accumulated business of the purchaser and with the effect of mitigating seriously injurious consequences otherwise probable, is not in contemplation of law prejudicial to the public and does not substantially lessen competition or restrain commerce within the intent of the Clayton Act.").

As set forth by the Supreme Court, the failing firm defense has three requirements:

> A. The evidence shows that the failing firm faces the grave probability of a business failure. The Agencies typically look for evidence in support of this element that the allegedly failing firm would be unable to meet its financial obligations in the near future. Declining sales and/or net losses, standing alone, are insufficient to show this requirement.
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> B. The prospects of reorganization of [the failing firm are] dim or nonexistent. The Agencies typically look for evidence suggesting that the failing firm would be unable to reorganize successfully under Chapter 11 of the Bankruptcy Act, taking into account that companies reorganized through receivership, or through the Bankruptcy Act often emerge as strong competitive companies. Evidence of the firm's actual attempts to resolve its debt with creditors is important.
>
> C. The company that acquires the failing firm or brings it under dominion is the only available purchaser. The Agencies typically look for evidence that a company has made unsuccessful good-faith efforts to elicit reasonable alternative offers that pose a less severe danger to competition than does the proposed merger.[62]
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> Although merging parties sometimes argue that a poor or weakening position should serve as a defense even when it does not meet these elements, the Supreme Court has confined the failing company doctrine to its present narrow scope. The Agencies evaluate evidence of a failing firm consistent with this prevailing law.[741]

As this extract suggests, in practice, the agencies and courts alike tend to take a hard line when parties invoke this defense.[742] In *Otto Bock*, the FTC challenged the acquisition by Otto Bock of Freedom, an important competitor in the manufacture of microprocessor-equipped prosthetic knees. The parties offered a "failing firm" defense on the basis that Freedom had been in some financial trouble. The Commission was unmoved.

Opinion of the Commission, In the Matter of Otto Bock HealthCare North America, Inc.

FTC Docket No. 9378, 2019-2 Trade Cases ¶ 80,990, 2019 WL 6003207 (F.T.C. Nov. 1, 2019)

Commissioner Chopra.

[1] Respondent argues that it has demonstrated the failing firm defense, which would be a complete defense to Complaint Counsel's showing of liability.

1. Legal Standard

[2] The Supreme Court first recognized the failing firm defense in *International Shoe Co. v. FTC*, 280 U.S. 291 (1930), where it refused to enjoin the acquisition of a failing corporation by the only available purchaser. The defense provides a safety valve for the parties when, in the absence of the proffered transaction, the competitive assets would otherwise exit the market. The defense is, in a sense, a "lesser of two evils" approach, in which the possible threat to competition resulting from an acquisition is deemed preferable to the adverse impact on competition from the company's going out of business. The . . . Merger Guidelines explain that the antitrust agencies do not normally credit a failing firm defense unless all of the following circumstances are met: (1) the allegedly failing firm would be unable to meet its financial obligations in the near future; (2) it would not be able to reorganize successfully under Chapter 11 of the Bankruptcy Act; and (3) it has made unsuccessful good faith efforts to elicit reasonable alternative offers that would keep its tangible and intangible assets in the market and pose a less severe danger to competition than does the proposed merger. The . . . Merger Guidelines define a "reasonable alternative offer" as one that exceeds the liquidation value of the assets. A successful failing firm defense effectively permits a

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[62] Any offer to purchase the assets of the failing firm for a price above the liquidation value of those assets will be regarded as a reasonable alternative offer. Parties must solicit reasonable alternative offers before claiming that the business is failing.

[741] U.S. Dept. of Justice & FTC, MERGER GUIDELINES (2023) § 3.1.

[742] *See*, *e.g.*, ProMedica Health System, Inc. v. F.T.C., 749 F.3d 559, 572 (6th Cir. 2014) (the "Hail-Mary pass of presumptively doomed mergers").

transaction that otherwise would violate the antitrust laws. Thus, the Supreme Court has narrowly confined the scope of the doctrine. The proponent of the defense bears the burden to prove each element, and failure to prove any element is fatal. [. . .]

[3] In order to demonstrate the first element of the defense, i.e., that Freedom was unable to meet financial obligations, Respondent cannot simply show that it had an imminent payment that exceeded its existing cash on hand. Rather, the analysis must account for the commercially reasonable options that firms in today's markets can pursue when facing a liquidity shortfall. To meet the first element, Respondent needs to prove that Freedom had resources so depleted and the prospect of rehabilitation so remote that it faced the grave probability of a business failure absent the challenged transaction. We find that Respondent failed to meet the first prong of the defense by demonstrating a grave probability of Freedom's failure. At the time of the Acquisition and during the approximately one year leading up to it, Freedom was engaged in a turnaround that had begun to show results. Freedom hired its new CEO, Mr. Smith, in April 2016. By December 2016, many of Freedom's financial metrics were starting to improve. [. . .]

[4] A second requirement of the failing firm defense is that a failing firm not be able to reorganize successfully under Chapter 11 of the Bankruptcy Act. As with the defense's other elements, Respondent bears the burden of proof. Respondent argues that Freedom considered and rejected the possibility of Chapter 11, determining that it would not have successfully emerged from the process. [. . .]

[5] Although this element is a closer call, we find that Respondent has not demonstrated that prospects for Chapter 11 reorganization were dim or nonexistent. . . . . Freedom had valuable products in its pipeline, including Quattro, that drove its projected revenue growth and underpinned its investment bankers' enterprise valuation. . . . Yet Freedom did not, it appears, explore the possibilities that could have helped it surmount its liquidity challenges and launch those products. [. . .]

[6] To sustain a failing firm defense, the proponent is called upon to demonstrate that the acquiring company was the only available purchaser. The antitrust enforcement agencies have implemented this element of the failing firm defense by focusing on the respondent's efforts to elicit reasonable alternative offers that would keep its tangible and intangible assets in the relevant market and pose a less severe danger to competition. Defendant's burden is quite heavy. Like the ALJ, we hold that Respondent failed to meet its burden. [. . .]

[7] Respondent states that Freedom preferred a refinancing to a sale, but that it could not obtain refinancing, such that a sale to a strategic acquirer became the only option. However, the evidence suggests that potential financing sources did express interest in Freedom, but on terms that the existing shareholders did not like. [. . .]

[8] As to the sales process, the evidence again shows that Freedom focused prematurely on Otto Bock. Freedom's representatives began to meet with Otto Bock regarding a potential sale in October 2016. Then, from October 2016 to April 2017, neither Freedom nor its investment banker contacted any potential alternative strategic buyers besides Otto Bock. They finally did so because they were not satisfied with Otto Bock's initial offer. Freedom's belated outreach to strategic acquirers besides Otto Bock suffered from shortcomings similar to those experienced with its refinancing efforts. [. . .]

[9] A respondent must make a sufficiently clear showing that it undertook a well-conceived and thorough canvass of the industry such as to ferret out viable alternative partners for merger. Here, Moelis contacted seven potential strategic acquirers, but failed to contact several prosthetics makers who later expressed interest in Freedom. . . . Some of the firms that Moelis neglected were small, but two . . . are firms that Respondent now touts as capable of replacing competition lost by the Acquisition. And at least in some cases, approaching smaller companies in a given industry might be exactly what is required of a company seeking the protection of the failing company defense. [. . .]

[10] In sum, Freedom's executives and shareholders were focused on obtaining the highest possible offer, which is a different objective from searching for a reasonable alternative offer above Freedom's liquidation value. [. . .]

[11] Because Respondent failed to establish the three elements of the failing firm defense—*i.e.*, that Freedom would be unable to meet its financial obligations in the near future, that it would not be able to reorganize successfully

under Chapter 11 of the Bankruptcy Act, and that it conducted a reasonable, good faith search for alternative offers that would keep its assets in the market and pose a less severe danger to competition—we find the defense inapplicable.

Ian Conner, On "Failing" Firms—and Miraculous Recoveries

FTC Competition Matters Blog (May 27, 2020)

[1] Over the past few years, the [FTC's Bureau of Competition] has faced a surprising number of failing firm claims by merging parties. Even when the economy was booming, we heard many iterations of the same argument: The acquired firm is failing. The acquiring firm is failing. Both firms are failing (which presumably would justify the merger on the basis that if you tie two sinking rocks together, they're more likely to float). The entire industry is failing. But despite many claims and much time spent assessing the financial health of numerous firms, the Bureau rarely finds that the facts support a failing firm argument. Saying it doesn't make it so: if you want the Bureau to accept such an argument in your case, you had better actually be failing, and able to prove it.

[2] It's important to remember the procompetitive rationale for entertaining claims that a firm is failing. The failing firm defense is just that, a defense. The merger that is being proposed is anticompetitive, but, assuming the elements of the failing firm defense are met, it is preferable to have the assets in the hands of the acquirer than see the assets exit the market completely. Note that failing is equated with reducing the acquired firm to nothing—not only does the business no longer exist, but the productive assets are also dismantled or redeployed for use outside the relevant market.

[3] The failing firm defense has been described in every iteration of the . . . Merger Guidelines since 1982. . . . [T]he argument is often made, but rarely accepted.

[4] Some commentators have suggested that the agencies may face a wave of mergers with failing firm arguments in the coming months, in light of current economic conditions in some sectors of the economy. And while no such wave has yet materialized—in fact, filings have fallen significantly from their recent annualized rate—parties contemplating such an argument should understand that the Bureau will not relax the stringent conditions that define a genuinely "failing" firm. We will continue to apply the test set out in the Guidelines and reflected in our long-standing practice, and in doing so we will require the same level of substantiation as we required before the COVID pandemic. As I noted previously, we have not relaxed, and will not relax, the intensity of our scrutiny or the vigor of our enforcement efforts. Consumers deserve the protection of the antitrust laws now as much as ever.

[5] Finally, a cautionary note for those advising and representing merging parties: think twice before making apocalyptic predictions of imminent failure during a merger investigation. Candor before the agency remains paramount, and it has been striking to see firms that were condemned as failing rise like a phoenix from the ashes once the proposed transaction was abandoned in light of our competition concerns. No doubt some of these recoveries are due to the tireless efforts of the firm's leadership and employees to turn around a struggling business. But other examples have suggested to us that a serious effort to assess the standalone future of the company was not undertaken before representing that the failure of the merger would result in the imminent demise of that company. Counsel who make too many failing-firm arguments on behalf of businesses that go on to make miraculous recoveries may find that we apply particularly close scrutiny to similar claims in their future cases.

[6] To be clear, we support vigorous competition and hope that firms that have been hard hit by the economic downturn recover quickly and remain viable competitors so that they can continue to serve their customers. We will accept solid evidence that a firm is failing, and step aside when justified by the full evidence. But we will not turn away from the challenges ahead by changing the rules that have served us well in the past, including during prior economic downturns. And we ask that counsel not make that job harder by seeking advantage from the suffering of some.

* * *

Although failing firm arguments seldom succeed, a lighter-lift version of the argument sometimes has better luck. Courts and agencies have on some occasions recognized that a firm might be declining in competitive importance,

such that evidence of its past strength is a poor guide to its current, or expected future, importance to competition. This argument received its seminal statement in *General Dynamics,* and it has since become known as the "flailing firm" argument. It is not a defense in a strict sense, because it is really just an argument about the competitive effects of the merger, made by the defendant in an effort to rebut the plaintiff's affirmative case. But it is so similar in spirit to a failing-firm argument that the two are presented together here.[743]

In *General Dynamics* itself, the Court considered whether the acquisition of United Electric by General Dynamics would harm competition in a market for coal production, given (among other things) an argument advanced by the parties—and accepted by the district court—that historical data overstated United Electric's competitive vitality.

United States v. General Dynamics Corp.

415 U.S. 486 (1974)

Justice Stewart.

[1] [T]he District Court [below] found that the evidence did not support the Government's contention that the 1959 acquisition of United Electric [by General Dynamics] substantially lessened competition in any product or geographic market. . . . [T]he court found that United Electric's coal reserves were so low that its potential to compete with other coal producers in the future was far weaker than the aggregate production statistics relied on by the Government might otherwise have indicated. In particular, the court found that virtually all of United Electric's proved coal reserves were either depleted or already committed by long-term contracts with large customers, and that United Electric's power to affect the price of coal was thus severely limited and steadily diminishing. On the basis of these considerations, the court concluded: "Under these circumstances, continuation of the affiliation between United Electric and [General Dynamics] is not adverse to competition, nor would divestiture benefit competition even were this court to accept the Government's unrealistic produce and geographic market definitions." [. . .]

[2] In this case, the District Court relied on evidence relating to changes in the patterns and structure of the coal industry and in United Electric's coal reserve situation after the time of acquisition in 1959. Such evidence could not reflect a positive decision on the part of the merged companies to deliberately but temporarily refrain from anticompetitive actions, nor could it reasonably be thought to reflect less active competition than that which might have occurred had there not been an acquisition in 1959. As the District Court convincingly found, the trend toward increased dependence on utilities as consumers of coal and toward the near-exclusive use of long-term contracts was the product of inevitable pressures on the coal industry in all parts of the country. And, unlike evidence showing only that no lessening of competition has yet occurred, the demonstration of weak coal resources necessarily and logically implied that United Electric was not merely disinclined but unable to compete effectively for future contracts. Such evidence went directly to the question of whether future lessening of competition was probable, and the District Court was fully justified in using it.

[3] [T]he Government contends that reliance on depleted and committed resources is essentially a "failing company" defense which must meet the strict limits placed on that defense by this Court's decisions[.] . . . A company invoking the defense has the burden of showing that its resources (were) so depleted and the prospect of rehabilitation so remote that it faced the grave probability of a business failure, and further that it tried and failed to merge with a company other than the acquiring one.

[4] The Government asserts that United Electric was a healthy and thriving company at the time of the acquisition and could not be considered on the brink of failure, and also that the appellees have not shown that Material Service [(General Dynamics' predecessor)] was the only available acquiring company. These considerations would be significant if the District Court had found no violation of s 7 by reason of United Electric's being a failing

[743] In *Arch Coal II* the parties tried an incautious version of this argument: that the proposed transaction would allow Arch to "focus on its most profitable operations in the hopes of earning positive margins." The court was bemused, and pointed out that "Arch's underlying logic . . . supports the Court's finding that the parties have the incentive and intention to maximize profits by cutting output." FTC v. Peabody Energy Corporation, 492 F. Supp. 3d 865, 901 (E.D. Mo. 2020).

company, but the District Court's conclusion was not, as the Government suggests, identical with or even analogous to such a finding. The failing-company defense presupposes that the effect on competition and the loss to the company's stockholders and injury to the communities where its plants were operated, will be less if a company continues to exist even as a party to a merger than if it disappears entirely from the market. It is, in a sense, a "lesser of two evils" approach, in which the possible threat to competition resulting from an acquisition is deemed preferable to the adverse impact on competition and other losses if the company goes out of business. The appellees' demonstration of United's weak reserves position, however, proved an entirely different point. Rather than showing that United would have gone out of business but for the merger with Material Service, the finding of inadequate reserves went to the heart of the Government's statistical prima facie case based on production figures and substantiated the District Court's conclusion that United Electric, even if it remained in the market, did not have sufficient reserves to compete effectively for long-term contracts. The failing-company defense is simply inapposite to this finding and the failure of the appellees to meet the prerequisites of that doctrine did not detract from the validity of the court's analysis. [. . .]

[5] Since we agree with the District Court that the Government's reliance on production statistics in the context of this case was insufficient, it follows that the judgment before us may be affirmed[.]

NOTES

1) Suppose that a court, reviewing a proposed transaction, is confident that the deal will harm some customers, but will benefit some others through the creation of efficiencies. What rule should the court apply to decide whether to permit the merger? Does it matter whether the "some" and "others" are within the same market—and if so, why?
2) Why do you think parties make the failing firm argument so frequently, but then—if the deal is blocked or abandoned—turn out to be just fine? (Bonus points for something more thoughtful than "everybody lies.")
3) Suppose that you represented a company that was genuinely on track for failure, but agency staff were skeptical. What evidence do you think would be most persuasive?
4) Is *General Dynamics* inconsistent with the logic of the structural presumption?
5) Should the agencies recognize a "national security" defense to a merger: that is, a defense for a merger that may harm competition but will advance national security? What questions would you want to ask to determine whether this would be a good idea? How would you formulate it in law?[744]
6) The HMGs say: "Efficiencies are difficult to verify and quantify, in part because much of the information relating to efficiencies is uniquely in the possession of the merging firms." Can you think of any other reasons?

E. Remedies

Merger remedies can be divided into two broad groups: structural remedies, which change the structure of the market (*e.g.*, by "breakup" or "divestiture"—that is, sale—of businesses or assets) and behavioral remedies, which instruct market participants to behave in particular ways or to refrain from behaving in particular ways.

We will talk more generally about antitrust remedies in Chapters XI (injunctions) and XII (damages). In this Chapter we will focus on the distinctive issues that arise in merger, rather than conduct, cases. These remedies may be imposed by a court or agency (sua sponte or based on a proposal from an agency or litigating party) or—as we shall see at the end of this section—imposed by agreement between an agency and the merging parties. In general, courts have indicated that enforcers enjoy considerable discretion in formulating a remedy.[745]

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[744] *See* Statement of Commissioner William E. Kovacic, with whom Chairman Deborah Platt Majoras and Commissioner J. Thomas Rosch Join, In the Matter of Lockheed Martin Corporation, The Boeing Company, and United Launch Alliance, L.L.C., FTC File No. 051 0165, Docket No. C-4188 (May 8, 2007); Analysis of Agreement Containing Consent Order to Aid Public Comment, In the Matter of The Boeing Company, Lockheed Martin Corporation, and United Launch Alliance, FTC File No. 051-0165 (Oct. 3, 2006).

[745] *See*, *e.g.*, Polypore Int'l, Inc. v. FTC, 686 F.3d 1208, 1218 (11th Cir. 2012) ("The Commission has broad discretion in the formulating of a remedy for unlawful practices."); Hospital Corp. of America v. FTC, 807 F.2d 1381 (7th Cir. 1986) (noting in a merger case that "the Commission has a broad discretion, akin to that of a court of equity, in deciding what relief is necessary to

1. Structural Merger Remedies

Structural remedies—orders to spin off, break up, or sell businesses—are (at least in theory) the default remedy in merger cases. In the simplest cases, if the acquisition by A of B, or the merger of A and B, is unlawful, then the natural fix is an injunction requiring that the transaction not go ahead (if the deal has not yet "closed" or been consummated), or, if the deal has already closed, an injunction requiring that the target be sold off again, or the merger be unwound. In slightly more complex cases, if an acquisition by A of B raises competitive concerns with respect to some of B's business units, but does not raise such concerns with respect to B's other business units, the parties might be required to divest the business units that give rise to the concerns, as long as a buyer can be found with the ability and incentive to run them as an effective competitive force. With that remedy in place, the parties may be able to proceed with the rest of the deal.

The agencies prefer structural remedies because it is usually safer to eliminate the merged firm's *ability* to engage in harmful conduct (*e.g.*, by eliminating the market power created by an unlawful transaction) than to try to manage its *incentives* by threatening penalties for detected misconduct. After all, monitoring is difficult, expensive, and uncertain. Market participants and agencies will not always be able to spot misconduct; and even when they do, they will not always be able to prove it to a judge—and seldom without considerable burden and expense. It is often cleaner and cheaper to solve a competitive problem at its root, by undoing the illegal transaction (or the illegal piece of the transaction), and let the parties and the agencies get on with their respective lives in relative peace.

Divestiture is easier in some cases than others. In practice, most federal government merger challenges deal with *proposed*, rather than consummated, transactions, because of the HSR premerger notification rules that require parties to give prior notice of large deals to the agencies. (We will discuss these rules in Chapter XI.) When the deal is merely proposed, a court can issue a simple order to prohibit or "block" the deal, solving the problem before it arises.

But some mergers have already been closed by the time they are challenged or ruled unlawful. This can happen, for example, if the transaction was not subject to HSR notification, such that the agencies did not become aware of the transaction until after the deal was done. It can also arise when the transaction was reviewed but not challenged at the time of the initial review, only for the agency to later conclude that enforcement action was appropriate.[746]

Requiring divestiture in a consummated merger case can be very difficult, and is often likened to "unscrambling eggs," as the two firms may no longer be meaningfully distinct. Courts and agencies generally do not want to impose a remedy that is not in the public interest: *i.e.*, not reasonably likely to restore competitive conditions to what they would have been but-for the unlawful transaction, or as close as possible. A divestiture that butchers the merged firm and results in one or two non-viable competitors is not likely to be in the public interest. The problems can be formidable:

> For many reasons, it may be hard to resurrect a competitor or form a new player that is able to exert the same competitive intensity that the target would have provided, but for the [consummated] merger in question. . . .
>
> . . . [T]he challenges here can come not only from "scrambled" assets, but also from lost business relationships: customers may have chosen new suppliers, employees may have left or taken different positions, suppliers may no longer be available for needed inputs. And degraded assets cause other challenges: machinery may have been actively destroyed or intellectual property may not have been properly upgraded. The companies may have shared confidential business information, knowhow, trade secrets, or proprietary data that were key to the competitive significance of the acquired firm. Additionally, the passage of time may have resulted in the loss of brand or reputational cachet. . . . Nevertheless, even when it is hard and may require assets

cure a violation of law and ensure against its repetition"); Olin Corp. v. FTC, 986 F.2d 1295, 1307 (9th Cir. 1993) ("[T]he Commission has broad discretion to cope with any unlawful practices disclosed by the record").

[746] *See infra* Chapter XI (describing the relationship between HSR and merger enforcement).

> and services beyond those acquired, breakup of the merged company to reestablish competition is still the most likely remedy for a consummated merger.[747]

In the past, federal courts have emphasized that divestiture is the preferred remedy in a merger case, at least in a government challenge.[748] In a classic remedial decision, the Supreme Court insisted on divestiture despite the parties' protestation that this would have unreasonably harsh consequences because of applicable tax laws. Note the Court's insistence on the clarity and effectiveness of structural relief—the "surer, cleaner" solution—rather than behavioral constraints designed to manage the parties' behavior while leaving the objectionable economic structure intact, as well as its explicit recognition of the practical difficulties of enforcement.

United States v. E.I. du Pont de Nemours & Co.

366 U.S. 316 (1961)

Justice Brennan.

[1] [In a previous proceeding the Court] held that du Pont's acquisition of the 23 percent of General Motors stock had led to the insulation from free competition of most of the General Motors market in automobile finishes and fabrics, with the resultant likelihood, at the time of suit, of the creation of a monopoly of a line of commerce, and, accordingly, that du Pont had violated s 7 of the Clayton Act. We did not, however, determine what equitable relief was necessary in the public interest. [. . .]

[2] [In the District Court on remand,] Du Pont objected that the Government's plan of complete divestiture entailed harsh income-tax consequences for du Pont stockholders and, if adopted, would also threaten seriously to depress the market value of du Pont and General Motors stock. Du Pont therefore proposed its own plan designed to avoid these results. The salient feature of its plan was substitution for the Government's proposed complete divestiture of a plan for partial divestiture in the form of a so-called 'pass through' of voting rights, whereby du Pont would retain all attributes of ownership of the General Motors stock, including the right to receive dividends and a share of assets on liquidation, except the right to vote. The vote was to be 'passed through' to du Pont's shareholders proportionally to their holdings of du Pont's own shares[.] [. . .]

[3] Before we examine the adequacy of the relief allowed by the District Court, it is appropriate to review some general considerations concerning that most drastic, but most effective, of antitrust remedies—divestiture. The key to the whole question of an antitrust remedy is of course the discovery of measures effective to restore competition. Courts are not authorized in civil proceedings to punish antitrust violators, and relief must not be punitive. But courts are authorized, indeed required, to decree relief effective to redress the violations, whatever the adverse effect of such a decree on private interests. Divestiture is itself an equitable remedy designed to protect the public interest. . . .

[4] If the Court concludes that other measures will not be effective to redress a violation, and that complete divestiture is a necessary element of effective relief, the Government cannot be denied the latter remedy because economic hardship, however severe, may result. Economic hardship can influence choice only as among two or more effective remedies. If the remedy chosen is not effective, it will not be saved because an effective remedy would entail harsh consequences. This proposition is not novel; it is deeply rooted in antitrust law and has never been successfully challenged. The criteria were announced in one of the earliest cases. In *United States v. American Tobacco Co.*, [221 U.S. 106, 185 (1911)], we said:

> In considering the subject three dominant influences must guide our action: 1, The duty of giving complete and efficacious effect to the prohibitions of the statute; 2, the accomplishing of this result with as little injury as possible to the interest of the general public; and, 3, a proper

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[747] Ian Conner, *Fixer Upper: Using the FTC's Remedial Toolbox to Restore Competition* (remarks of Feb. 8, 2020), 4. The reference in the text to destruction of acquired assets is not conjectural. *See*, *e.g.*, Analysis to Aid Public Comment, In the Matter of Charlotte Pipe and Foundry, FTC File No. 111-34, 2 ("After the Acquisition, Charlotte Pipe destroyed the CISP production equipment that it acquired from Star Pipe."). (How might this affect the objectives of a remedy?)

[748] California v. Am. Stores Co., 495 U.S. 271, 280–81 (1990) ("[I]n Government actions divestiture is the preferred remedy for an illegal merger or acquisition"). *See generally* Post-Trial Brief of the United States, United States v. AT&T Inc., Case No. 1:17-cv-2511 (D.D.C. filed May 8, 2018), 22–25 (expressing and explaining strong preference for structural relief and citing authorities).

> regard for the vast interests of private property which may have become vested in many persons as a result of the acquisition either by way of stock ownership or otherwise of interests in the stock or securities of the combination without any guilty knowledge or intent in any way to become actors or participants in the wrongs which we find to have inspired and dominated the combination from the beginning.

[5] The Court concluded in that case that, despite the alleged hardship which would be involved, only dissolution of the combination would be effective, and therefore ordered dissolution. Plainly, if the relief is not effective, there is no occasion to consider the third criterion.

[6] Thus, in this case, the adverse tax and market consequences which the District Court found would be concomitants of complete divestiture cannot save the remedy of partial divestiture through the 'pass through' of voting rights if, though less harsh, partial divestiture is not an effective remedy. We do not think that the 'pass through' is an effective remedy and believe that the Government is entitled to a decree directing complete divestiture.

[7] It cannot be gainsaid that complete divestiture is peculiarly appropriate in cases of stock acquisitions which violate s 7. That statute is specific and narrowly directed, and it outlaws a particular form of economic control—stock acquisitions which tend to create a monopoly of any line of commerce. The very words of s 7 suggest that an undoing of the acquisition is a natural remedy. Divestiture or dissolution has traditionally been the remedy for Sherman Act violations whose heart is intercorporate combination and control, and it is reasonable to think immediately of the same remedy when s 7 of the Clayton Act, which particularizes the Sherman Act standard of illegality, is involved. Of the very few litigated s 7 cases which have been reported, most decreed divestiture as a matter of course. Divestiture has been called the most important of antitrust remedies. It is simple, relatively easy to administer, and sure. It should always be in the forefront of a court's mind when a violation of s 7 has been found.

[8] The divestiture only of voting rights does not seem to us to be a remedy adequate to promise elimination of the tendency of du Pont's acquisition offensive to s 7. Under the decree, two-thirds of du Pont's holdings of General Motors stock will be voted by du Pont shareholders—upwards of 40 million shares. Common sense tells us that under this arrangement there can be little assurance of the dissolution of the intercorporate community of interest which we found to violate the law. The du Pont shareholders will ipso facto also be General Motors voters. It will be in their interest to vote in such a way as to induce General Motors to favor du Pont, the very result which we found illegal on the first appeal. It may be true, as appellees insist, that these shareholders will not exercise as much influence on General Motors as did du Pont when it held and voted the shares as a block. And it is true that there is no showing in this record that the du Pont shareholders will combine to vote together, or that their information about General Motors' activities will be detailed enough to enable them to vote their shares as strategically as du Pont itself has done. But these arguments misconceive the nature of this proceeding. The burden is not on the Government to show de novo that a 'pass through' of the General Motors vote, like du Pont's ownership of General Motors stock, would violate s 7. It need only appear that the decree entered leaves a substantial likelihood that the tendency towards monopoly of the acquisition condemned by s 7 has not been satisfactorily eliminated. We are not required to assume, contrary to all human experience, that du Pont's shareholders will not vote in their own self-interest. Moreover, the General Motors management, which over the years has become accustomed to du Pont's special relationship, would know that the relationship continues to a substantial degree, and might well act accordingly. The same is true of du Pont's competitors. They might not try so vigorously to break du Pont's hold on General Motors' business, as if complete divestiture were ordered. And finally, the influence of the du Pont company itself would not be completely dissipated. For under the decree du Pont would have the power to sell its General Motors shares; the District Court expressly held that there would be nothing in the decree to prevent such dispositions. Such a sale would presumably restore the vote separated from the sold stock while du Pont owned it. This power to transfer the vote could conceivably be used to induce General Motors to favor du Pont products. In sum, the 'pass through' of the vote does not promise elimination of the violation offensive to s 7. . . .

[9] Du Pont replies, inter alia, that it would be willing for all of its General Motors stock to be disenfranchised, if that would satisfy the requirement for effective relief. This suggestion, not presented to the District Court, is distinctly an afterthought. If the suggestion is disenfranchisement only while du Pont retains the stock, it would

not avoid the hazards inherent in du Pont's power to transfer the vote. If the suggestion is permanent loss of the vote, it would create a large and permanent separation of corporate ownership from control, which would not only run directly counter to accepted principles of corporate democracy, but also reduce substantially the number of voting General Motors shares, thereby making it easier for the owner of a block of shares far below an absolute majority to obtain working control, perhaps creating new antitrust problems for both General Motors and the Department of Justice in the future. And finally, we should be reluctant to effect such a drastic change in General Motors' capital structure, established under state corporation law.

[10] Appellees argue further that the injunctive provisions of the decree supplementary to the 'pass through' of voting rights adequately remove any objections to the effectiveness of the 'pass through.' Du Pont is enjoined, for example, from in any way influencing the choice of General Motors' officers and directors, and from entering into any preferential trade relations with General Motors. And, under . . . the decree, the Government may reapply in the future should this injunctive relief prove inadequate. Presumably this provision could be used to prevent the exercise of the power to transfer the vote. But the public interest should not in this case be required to depend upon the often cumbersome and time-consuming injunctive remedy. Should a violation of one of the prohibitions be thought to occur, the Government would have the burden of initiating contempt proceedings and of proving by a preponderance of the evidence that a violation had indeed been committed. Such a remedy would, judging from the history of this litigation, take years to obtain. Moreover, an injunction can hardly be detailed enough to cover in advance all the many fashions in which improper influence might manifest itself. And the policing of an injunction would probably involve the courts and the Government in regulation of private affairs more deeply than the administration of a simple order of divestiture. We think the public is entitled to the surer, cleaner remedy of divestiture. The same result would follow even if we were in doubt. For it is well settled that once the Government has successfully borne the considerable burden of establishing a violation of law, all doubts as to the remedy are to be resolved in its favor.

[11] We therefore direct complete divestiture.

CASENOTE: Chicago Bridge & Iron Co. N.V. v. FTC

534 F.3d 410 (5th Cir. 2008)

A viable divestiture may require that the company sell off more than just the acquired assets: the package may also include assets and resources from outside the relevant market where these are necessary to ensure competitive adequacy.[749] A great example is presented by the *Chicago Bridge* litigation. In that case, the Chicago Bridge & Iron Company had acquired assets from Pitt-Des Moines ("PDM") used for the business of making cryogenic storage tanks. The FTC found that the acquisition violated Section 7, and ordered that the merged firm should divide its cryogenic business into two equally competitive entities. The FTC insisted that the divestiture package should include not just the acquired cryogenic tank assets in the market of competitive concerns, but also acquired water tank assets. On appeal, the merged firm argued that this relief was an abuse of the Commission's discretion, because it required divestiture outside the market of competitive concern. The Fifth Circuit disagreed.

The court began by emphasizing that the agencies enjoy considerable deference in the design of a merger remedy: "All doubts as to the remedy are to be resolved in [the FTC's] favor. The Commission is clothed with wide discretion in determining the type of order that is necessary to bring an end to the unfair practices found to exist. It has wide latitude for judgment and the courts will not interfere except where the remedy selected has no reasonable relation to the unlawful practices found to exist."

And here, the court held, the FTC had exercised this discretion appropriately, by mandating that the merged firm divest sufficient assets to create a new competitor "capable of competing for an equal share of the market similar to the situation pre-acquisition." The Commission had reasonably concluded that the creation of a viable competitor required the divestiture of not just the overlapping cryogenic-tank assets but also the target's water plant division. As a result, "the Commission did not abuse its discretion, but instead fashioned a remedy reasonably

[749] See Ian Conner, *Fixer Upper: Using the FTC's Remedial Toolbox to Restore Competition* (remarks of Feb. 8, 2020), 5–6.

calculated to eliminate the anti-competitive effects of CB&I's acquisition in violation of the Clayton and FTC Acts."

So—what does this look like in practice? A divestiture order may sound like a simple matter: an instruction to sell off an acquired business. But in practice crafting an effective divestiture is always an intricate undertaking. Following the FTC's successful challenge to a consummated acquisition in the *Otto Bock* case, the buyer, Otto Bock, was ordered to sell off the target, Freedom. The full Final Order is more than 20 pages long, including almost six pages of definitions: the following extract includes some of the key provisions, giving a flavor of the kind of thing that divestiture orders must grapple with in practice. As you can imagine, the expertise of remedial specialists is absolutely indispensable in designing merger remedies, even in fairly simple cases.

FTC, Final Order, In the Matter of Otto Bock HealthCare North America, Inc., FTC Dkt. No. 9378 (Nov. 1, 2019)

II.

IT IS FURTHER ORDERED that:

A. Otto Bock shall:

1. No later than ninety (90) days from the date this Order becomes final and effective, divest absolutely and in good faith, and at no minimum price, the Freedom Assets and Business to an Acquirer that receives the prior approval of the Commission and in a manner, including pursuant to a Divestiture Agreement, that receives the prior approval of the Commission;

Provided, however, that Otto Bock may retain any or all of the Divestiture Products Group A unless the Acquirer demonstrates to the Commission's satisfaction: (i) that any such asset is necessary to achieve the purpose of this Order; and (ii) that the Acquirer needs such asset to effectively operate the Freedom Business in a manner consistent with the purpose of this Order, and the Commission approves the divestiture with the divestiture of such asset.

Provided, however, that Otto Bock must divest any or all of the Divestiture Products Group B unless the Acquirer demonstrates to the Commission's satisfaction: (i) that any such asset is not necessary to achieve the purpose of this Order; and (ii) that the Acquirer does not need such asset to effectively operate the Freedom Business in a manner consistent with the purpose of this Order, and the Commission approves the divestiture without the divestiture of such asset.

2. Comply with all terms of the Divestiture Agreement approved by the Commission pursuant to this Order, which agreement shall be deemed incorporated by reference into this Order; and any failure by Otto Bock to comply with any term of the Divestiture Agreement shall constitute a failure to comply with this Order. The Divestiture Agreement shall not reduce, limit or contradict, or be construed to reduce, limit or contradict, the terms of this Order; *provided, however,* that nothing in this Order shall be construed to reduce any rights or benefits of any Acquirer or to reduce any obligations of Otto Bock under such agreement; *provided further*, that if any term of the Divestiture Agreement varies from the terms of this Order ("Order Term"), then to the extent that Otto Bock cannot fully comply with both terms, the Order Term shall determine Otto Bock's obligations under this Order. Notwithstanding any paragraph, section, or other provision of the Divestiture Agreement, any failure to meet any condition precedent to closing (whether waived or not) or any modification of the Divestiture Agreement, without the prior approval of the Commission, shall constitute a failure to comply with this Order. [. . .]

5. Take all actions and shall effect all arrangements in connection with the divestiture of the Freedom Assets and Business necessary to ensure that the Acquirer can conduct the Freedom Assets and Business in substantially the same manner as operated prior to the Acquisition, including, but not limited to:

a. Complying with the Hold-Separate Agreements, the Hold-Separate Manager Agreement, the Hold-Separate Monitor Agreement, or the Procedures, Terms, and Conditions Agreement or any term of the above Agreements,

b. Providing Transitional Services,

c. Providing the opportunity to recruit and employ all Freedom Employees.

6. Convey as of the Effective Date of Divestiture to the Acquirer the right to use any Licensed Intangible Property (to the extent permitted by the third-party licensor), if such right is needed for the operation of the Freedom Business by the Acquirer and if the Acquirer is unable, using commercially-reasonable efforts, to obtain equivalent rights from other third parties on commercially-reasonable terms and conditions.

7. Otto Bock shall:

a. Place no restrictions on the use by the Acquirer of the Freedom Assets and Business, including any Intangible Property;

b. On or before the Effective Date of Divestiture, provide to the Acquirer contact information about customers, Payors, and Suppliers for the Freedom Assets and Business;

c. With respect to contracts with Freedom Business Suppliers, at the Acquirer's option and as of the Effective Date of Divestiture:

i. If such contract can be assigned without third-party approval, assign its rights under the contract to the Acquirer; and

ii. If such contract can be assigned to the Acquirer only with third-party approval, assist and cooperate with the Acquirer in obtaining:

(a) Such third-party approval and in assigning the contract to the acquirer; or

(b) A new contract.

8. At the request of the Acquirer, for two (2) years from the Effective Date of Divestiture, with the option of the Acquirer to renew for two six (6) month periods with written notification to Commission staff, except as otherwise approved by the Commission, and in a manner (including pursuant to an agreement) that receives the prior approval of the Commission:

a. Otto Bock shall provide Transitional Services to the Acquirer sufficient to enable the Acquirer to conduct the Freedom Business in substantially the same manner that the Freedom Business was conducted prior to the Acquisition and during the Hold-Separate Period.

b. Otto Bock shall provide the Transitional Services required by this Paragraph II.A.8 at substantially the same level and quality as such services are provided by Otto Bock in connection with the Hold-Separate Agreements. [. . .]

IV.

IT IS FURTHER ORDERED that:

A. From the date this Order becomes final and effective (without regard to the finality of the divestiture requirements herein) until the Effective Date of Divestiture, Otto Bock shall take such actions as are necessary to maintain the viability, marketability, and competitiveness of the Freedom Assets and Business, as provided in the Hold-Separate Agreements. Among other things that may be necessary, as provided for in the Hold-Separate Agreements, Otto Bock shall:

1. Maintain the operations of the Freedom Business relating to the Freedom Assets in the ordinary course of business and in accordance with the Hold-Separate Agreements;

2. Use best efforts to maintain and increase revenues of the Freedom Business, and to maintain at budgeted levels for the year 2018 or the current year, whichever are higher, all administrative, technical, and marketing support for the Freedom Business and in accordance with the Hold-Separate Agreements;

3. Use best efforts to maintain the current workforce and to retain the services of employees and agents in connection with the Freedom Business, including payments of bonuses as necessary, and maintain the relations and goodwill with customers. [. . .]

VII.

IT IS FURTHER ORDERED that:

A. If Otto Bock has not divested, absolutely and in good faith, the Freedom Assets and Business pursuant to the requirements of Paragraph II of this Order, within the time and manner required by Paragraph II of this Order, the Commission may at any time appoint one or more Persons as Divestiture Trustee to divest the Freedom Assets and Business, at no minimum price, and pursuant to the requirements of Paragraph II of this Order, in a manner that satisfies the requirements of this Order. [. . .]

VIII.

IT IS FURTHER ORDERED that:

A. Otto Bock shall submit the complete Divestiture Agreement to the Commission at ElectronicFilings@ftc.gov and bccompliance@ftc.gov no later than 30 days after the Divestiture Date.

B. Otto Bock shall submit verified written reports ("compliance reports") in accordance with the following:

1. Otto Bock shall submit: a. Interim compliance reports (i) no later than thirty (30) days after the Order becomes final and effective (without regard to the finality of the divestiture requirements herein), and every thirty (30) days thereafter until the divestiture of the Freedom Assets and Business is accomplished, and (ii) thereafter, every sixty (60) days (measured from the Effective Date of Divestiture) until the date Otto Bock completes its obligations under this Order; and b. Additional compliance reports as the Commission or its staff may request.

2. Otto Bock shall include in its compliance reports, among other things required by the Commission, a full description of the efforts being made to comply with the relevant Paragraphs of this Order, the identity of all parties contacted, copies of 20 all written communications to and from such parties, internal documents and communications, and all reports and recommendations concerning the divestiture, the date of divestiture, and a statement that the divestiture has been accomplished in the manner approved by the Commission. Each compliance report shall contain sufficient information and documentation to enable the Commission to determine independently whether Otto Bock is in compliance with each Paragraph of the Order. Conclusory statements that Otto Bock has complied with its obligations under the Order are insufficient.

2. Behavioral Merger Remedies

The term "behavioral remedy" is a capacious one: it encompasses any remedy or relief that amounts to an instruction to the merged firm to do something or to refrain from doing something. Behavioral remedies may play a role in cases that also involve a divestiture: for example, the merged firm might be required to divest certain business units (structural remedy) *and also* to provide certain inputs, licenses, or support to the divestiture buyer on an ongoing basis for a certain period (behavioral remedy). In other cases, relief may be entirely behavioral.

Behavioral remedies are always creatures of their unique circumstances, designed to solve particular problems in light of particular market circumstances. For example, if the competitive concern is that a merged firm's upstream division may "foreclose" rivals of the downstream division, a behavioral remedy might require that the merged firm deal with such rivals on a non-discriminatory basis. Likewise, if the competitive concern is that the merged firm might access rivals' competitively sensitive information, reducing their incentives or ability to compete

vigorously with the merged firm, a behavioral remedy might require that such information be firewalled off from the rest of the merged firm.

The toolkit of behavioral remedies is very broad. They may include, for example:

- obligations to supply products, services, or data at particular prices, for free, or on non-discriminatory terms;
- obligations to license intellectual property rights at particular royalty rates, for free, or on non-discriminatory terms;
- obligations to refrain from tying, conditioning, or bundling products and services in particular ways;
- obligations to refrain from seeking or incentivizing partial or complete exclusivity, either with particular trading partners or with any trading partners;
- obligations to submit to, or to offer, arbitration with trading partners regarding particular terms of dealing;
- firewalls, which require information or data to be held confidentially within the merged firm;
- obligations to communicate, or to refrain from communicating, in particular ways with customers; and
- whistleblower protection rules prohibiting retaliation for complaining to a governmental agency.

In general, behavioral relief can present any or all of three main kinds of difficulty: (1) design difficulties (*i.e.*, a government agency working on a proposed settlement or proposed court order is not always able to understand the full implications of particular choices); (2) monitoring difficulties (*i.e.*, it can be hard for an agency or court to detect violations); and (3) enforcement difficulties (*i.e.*, demonstrating a violation to a court or agency may be a difficult, costly, and lengthy process).[750] These concerns inform the general view that structural remedies should be the starting point in merger control.[751] Purely behavioral relief is much more common in conduct cases, as we shall see in Chapter XI.

A good example of purely behavioral relief is the consent decree imposed in Northrop Grumman's acquisition of Orbital ATK. The concern in that case, which united Northrop (a "prime contractor" supplier of missiles to the U.S. Government, among other defense products) with Orbital ATK (a key supplier of solid rocket motors ("SRMs") used in missiles) was a vertical one: the threat that the merged firm might foreclosure rival missile prime contractors' access to Orbital ATK's SRM motors. The following extracts include the Commission's summary of its reasoning as well as the central terms of the order itself.[752] Again, the point is to give you a flavor of the detail and granularity with which behavioral merger remedies are specified, to demonstrate the intricacy of the task: do not agonize over the details here!

FTC, Analysis of Proposed Agreement Containing Consent Order to Aid Public Comment, In the Matter of Northrop Grumman Corporation and Orbital ATK, Inc.

FTC File No. 181-0005 (F.T.C. June 5, 2018)

[1] The Federal Trade Commission ("Commission") has accepted an Agreement Containing Consent Order ("Consent Agreement") designed to remedy the anticompetitive effects resulting from Northrop Grumman Corporation's ("Northrop") proposed acquisition of Orbital ATK, Inc. ("Orbital ATK"). Under the terms of the Consent Agreement, Northrop would be required to (1) continue to act as a non-discriminatory merchant supplier of Orbital ATK's solid rocket motors ("SRMs") rather than favor its now-vertically integrated missile system

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[750] *See*, *e.g.*, Saint Alphonsus Med. Ctr.-Nampa Inc. v. Saint Luke's Health Sys., Ltd., 778 F.3d 775, 793 (9th Cir. 2015) (behavioral remedies "risk excessive government entanglement in the market"); ProMedica Health Sys., Inc. v. FTC, 749 F.3d 559, 573 (6th Cir. 2014) (noting that "there are usually greater long term costs associated with monitoring the efficacy of a conduct remedy than with imposing a structural solution").

[751] *See*, *e.g.*, Post-Trial Brief of the United States, United States v. AT&T Inc., Case No. 1:17-cv-2511 (D.D.C. filed May 8, 2018), 25 ("The United States is not aware of any Section 7 case in which a court's order of exclusively behavioral relief over the objection of the United States survived appellate review. Behavioral relief has instead been ordered in conjunction with structural relief and at the request of the United States.").

[752] *See infra* § VIII.E.3 (consent remedies in merger cases).

business, and (2) protect SRM and missile system competitors' competitively sensitive information from improper use or disclosure. [. . .]

[2] The Commission's Complaint alleges that the Acquisition is in violation of Section 5 of the FTC Act, as amended, 15 U.S.C. § 45, and that the acquisition, if consummated, would violate Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18, and Section 5 of the FTC Act, as amended, 15 U.S.C. § 45, by lessening the competition in the United States market for missile systems. The Acquisition would provide Northrop with the ability and incentive to withhold its SRMs from competing missile system prime contractors, or only offer its SRMs at disadvantageous terms, thereby raising rivals' costs or otherwise undermining their ability to compete on future missile system bids. The Consent Agreement will remedy the alleged violations by prohibiting Northrop from discriminating against competing missile prime customers in supplying SRMs. [. . .]

[3] Northrop is one of only four companies capable of supplying missile systems to the United States Government. Missile systems provide essential national defense capabilities for the United States Government. The United States Armed Forces employ multiple types of missile systems, including short-range tactical missiles, longer-range strategic missiles, and missile defense interceptors designed to defeat ballistic missile threats. Each type of missile system purchased by DOD has unique capabilities and is designed specifically to perform its given mission(s).

[4] Orbital ATK is one of only two viable suppliers of SRMs for U.S. Government missile systems and the dominant supplier of large SRMs used for long-range strategic missiles. SRMs are used to propel tactical, missile defense, and strategic missiles to their intended targets. SRMs are used for virtually all missile systems purchased by the United States Government because they offer numerous advantages over all other existing propulsion technologies. [. . .]

[5] Following the Acquisition, Northrop will be one of only two viable suppliers of SRMs for U.S. Government missile systems. The choice of SRM can have a significant impact on the final determination of a missile system prime competition because the propulsion system is a critical element of the overall missile design. SRMs comprise a large portion of the cost of the integrated missile and their performance affects the range, accuracy, and payload capacity of the missile. Absent the protections of the Consent Agreement, Northrop would have the ability to disadvantage competitors for future missile prime contracts by denying or limiting their access to Northrop's SRM products and technologies, which would lessen the ability of Northrop's missile system competitors to compete successfully for a given missile system prime contract. The Acquisition would also give Northrop access, through the former Orbital ATK SRM business, to the proprietary information that rival missile prime contractors must share with its SRM vendor. Similarly, the Acquisition creates a risk that the proprietary, competitively sensitive information of a rival SRM supplier supporting Northrop's missile system business could be transferred to Northrop's vertically integrated SRM business. [. . .]

[6] The Consent Agreement remedies the acquisition's likely anticompetitive effects by requiring, whenever Northrop competes for a missile system prime contract, that Northrop must make its SRM products and related services available on a non-discriminatory basis to all other third-party competing prime contractors that wish to purchase them. The non-discrimination prohibitions of the Consent Agreement are comprehensive and apply to any potential discriminatory conduct affecting price, schedule, quality, data, personnel, investment, technology, innovation, design, or risk.

[7] The Consent Agreement requires Northrop to establish firewalls to ensure that Northrop does not transfer or use any proprietary information that it receives from competing missile prime contractors or SRM suppliers in a manner that harms competition. These firewall provisions require that Northrop maintain separate firewalled teams to support offers of SRMs to different third-party missile prime contractors and to maintain these firewalled teams separate from the team supporting Northrop's missile prime contractor activities. The firewall provisions also prohibit Northrop's missile business from sharing proprietary information it may receive from third-party SRM suppliers with Northrop's SRM business.

[8] The Consent Agreement also provides that the [Department of Defense's] Under Secretary of Defense for Acquisition and Sustainment shall appoint a compliance officer to oversee Northrop's compliance with the Order. The compliance officer will have all the necessary investigative powers to perform his or her duties, including the

right to interview respondent's personnel, inspect respondent's facilities, and require respondents to provide documents, data, and other information. The compliance officer has the authority to retain third-party advisors, at the expense of Northrop, as appropriate to perform his or her duties. Access to these extensive resources will ensure that the compliance officer is fully capable of overseeing the implementation of, and compliance with, the Order.

FTC, Decision & Order, In the Matter of Northrop Grumman Corporation and Orbital ATK, Inc.

FTC File No. 181-0005 (F.T.C. June 5, 2018)

II.

IT IS FURTHER ORDERED THAT:

A. Respondents shall not Discriminate in any Missile Competition where Northrop: (i) is currently competing to be the Prime Contractor; or (ii) has the capability to compete and has taken the steps identified in Paragraph IV. and continues to take steps to compete as a Prime Contractor. By way of example, Respondents shall:

> 1. Not Discriminate in developing or providing an Offer requested by or made to a Third Party Prime Contractor, or in supporting the proposal of the Third Party Prime Contractor in connection with the Offer;
>
> 2. Not Discriminate in providing SRM Information;
>
> 3. Not Discriminate regarding staffing, resource allocation, or design decisions in connection with SRMs and Related Services to be provided to any Third Party Prime Contractor;
>
> 4. Not Discriminate in making any Offers to, or entering into Collaborative Agreements or other similar arrangements with, any Third Party Prime Contractor, or in the negotiation of such Offers, agreements, or other arrangements with Third Party Prime Contractors; Provided, however, that no provision of this Order shall require Respondents to provide products, services or technologies, including SRMs and Related Services, to any Third Party without commercially reasonable terms or if it is commercially unreasonable because (i) the Northrop SRM Business does not have the technical capability to supply the Third Party Prime Contractor or (ii) the Northrop SRM Business does not have the capacity (and it is not commercially reasonable to expand its capacity) to provide SRMs or a Firewalled SRM Customer Team to one or more Prime Contractors that have requested such services or team because the number or burden of Prime Contractors seeking the benefit of Paragraph II.A. of this Order becomes unreasonably large, so long as Respondents are providing SRMs and Related Services to at least one Third Party Prime Contractor in the applicable Missile Competition;
>
> 5. Not Discriminate in making available for use in Missile Competitions any technologies for SRMs and Related Services developed by the Northrop SRM Business under independent research and development funding, government-funded research and development activities or other funds expended by the Northrop SRM Business . . . ;
>
> 6. Establish and maintain separate Firewalled SRM Customer Teams as required by Paragraph III. of this Order to support each Third Party Prime Contractor; and
>
> 7. As to each separate Firewalled SRM Customer Team, take all steps reasonably necessary to ensure that a Prime Contractor's Non-Public Missile Information is kept confidential and protected from unauthorized disclosure and use, including such steps as Respondents would take to protect their own Non-Public Information and as required pursuant to Paragraph III.

B. The provision of any protected information, technology, or product to the Respondents by any Third Party, or to any Third Party by the Respondents, pursuant to this Order shall be subject to appropriate customary confidentiality agreements[.] [. . .]

D. The purpose of the provisions of Paragraph II. of this Order is to assure that the Northrop SRM Business continues to provide its services to Third Party Prime Contractors in any Missile Competition after the Acquisition on a non-discriminatory basis and in the same manner and of the same performance level and quality as before the Acquisition, and to remedy the lessening of competition resulting from the Acquisition as alleged in the Commission's Complaint.

III.

IT IS FURTHER ORDERED THAT Respondents shall protect a Third Party Prime Contractor's Non-Public Missile Information and Non-Public SRM Information in any Missile Competition where Northrop (i) is currently competing to be the Prime Contractor or (ii) has the capability to compete and has taken the steps identified in Paragraph IV. and continues to take steps to compete as a Prime Contractor. Specifically, Respondents shall take all actions as are reasonably necessary and appropriate to prevent access to, or the disclosure or use of, any Non-Public Missile Information or Non-Public SRM Information by or to any Person(s) not authorized to access, receive, or use such Non-Public Information pursuant to the terms of this Order, and shall develop and implement procedures and requirements to protect such Non-Public Information and to comply with the prohibitions and requirements of this Order, including, but not limited to, taking the following actions in any such Missile Competition covered by Paragraph II. of this Order to protect such Non-Public Information:

A. Northrop Firewalled SRM Customer Teams shall maintain firewalls and confidentiality protections, consistent with company practices and industry standards, and in compliance with the following requirements and prohibitions:

> 1. Northrop Personnel assigned to the Firewalled SRM Customer Teams shall receive training on the restrictions on the disclosure, use, and dissemination of Non-Public Information and, following completion of the relevant Missile Competition, will be reminded of their ongoing obligations with respect to such Non-Public Information;
>
> 2. Northrop Personnel assigned to the Firewalled SRM Customer Teams shall sign appropriate non-disclosure or equivalent agreements providing written acknowledgement of their responsibilities regarding the restrictions on the use and dissemination of Non-Public Information;
>
> 3. Northrop shall keep separate and limit access to Non-Public Missile Information and Non-Public SRM Information of the respective Firewalled SRM Customer Teams, e.g., by separating data in information systems; physically separating, securing, and/or shielding prototypes, models, and hard copies of such NonPublic Information; utilizing identification badge hangers to identify members of Firewalled SRM Customer Teams; and employing other processes designed to confine the flow of such Non-Public Information to personnel who have permission to see it in connection with the Missile Competition;
>
> 4. No member of a Firewalled SRM Customer Team supporting a Third Party Prime Contractor in a Missile Competition where Northrop is currently competing to be the Prime Contractor or has the capability to compete and has taken the steps identified in Paragraph IV. and continues to take steps to compete as a Prime Contractor (i) may participate in any way, directly or indirectly, in support of Respondents' efforts to participate as a Prime Contractor in the Missile Competition, including the preparation or review of a proposal or other response to a Request for Information, Request for Proposal or similar inquiry from the Government Customer or (ii) disclose any Non-Public Missile Information to any Northrop Personnel outside the Firewalled SRM Customer Team, except as permitted in Paragraph III.A.5. or Paragraph III.D. of this Order; [. . .]

B. The Firewalled SRM Customer Teams shall protect all Non-Public Missile Information, such that, absent a Third Party Prime Contractor's prior written consent or otherwise as provided below, the Firewalled SRM Customer Teams shall not:

> 1. Disclose any of that Third Party Prime Contractor's Non-Public Missile Information to Northrop Personnel in a Firewalled SRM Customer Team supporting Northrop or another Third Party Prime Contractor, or

2. Use that Third Party Prime Contractor's Non-Public Missile Information for any purpose other than developing or providing an Offer requested by or made to that Third Party Prime Contractor, or in supporting the proposal of that Third Party Prime Contractor in connection with the Offer.

C. The Northrop Missile Business shall take all reasonable steps to protect any Non-Public SRM Information, and shall not provide, disclose, or otherwise make any Non-Public SRM Information available to the Northrop SRM Business. Northrop shall use Non-Public SRM Information only in Northrop's capacity as a Prime Contractor absent the prior written consent of the proprietor of the Non-Public SRM Information. [. . .]

V. IT IS FURTHER ORDERED THAT:

A. The Under Secretary of Defense for Acquisition and Sustainment shall appoint a Compliance Officer, who shall be an employee of the United States government not otherwise involved in Missile Competitions or in setting the requirements for or the procurement of SRMs, Missiles or Missile Systems. The Compliance Officer shall have the power and authority to oversee compliance by the Respondents with the terms of this Order.

B. To the extent reasonably necessary to perform his or her duties and responsibilities pursuant to this Order, and subject to any legally recognized privilege or other forms of protection of information, the Compliance Officer shall be authorized to and may, in the presence of counsel for Northrop:

1. during normal business hours, interview any of Respondents' personnel, upon three days' notice to that Respondent and without restraint or interference by Respondents, relating to any matters contained in this Order;

2. during normal business hours, inspect and copy any document in the possession, custody, or control of Respondents relating to any matters contained in this Order;

3. during normal business hours, obtain access to and inspect any systems or equipment, relating to any matters contained in this Order, to which Respondents' personnel have access;

4. during normal business hours, obtain access to and inspect any physical facility, building, or other premises, relating to any matters contained in this Order, to which Respondents' personnel have access; and

5. require Respondents to provide access to documents, data, and other information, relating to any matters contained in this Order, to the Compliance Officer in such form as the Compliance Officer may reasonably direct and within such time periods as the Compliance Officer may reasonably require.

C. Respondents shall timely comply with the Compliance Officer's reasonable requests relating to Respondents' compliance with their obligations pursuant to this Order, and the Compliance Officer shall not unreasonably withhold approval of any request for additional time.

VI.

IT IS FURTHER ORDERED THAT:

A. Respondents shall develop and implement written procedures and protocols and maintain a system of access and data controls, with the advice and assistance of the Compliance Officer, to comply with the requirements of this Order . . .

B. Respondents shall design, maintain, and operate a Compliance Program to assure compliance with the requirements and prohibitions of this Order . . . .

VII.

IT IS FURTHER ORDERED THAT:

[. . .]

B. Respondents shall submit verified written reports ("compliance reports") in accordance with the following:

1. [. . .]

2. Each compliance report shall set forth in detail the manner and form in which Respondents intend to comply, are complying, and have complied with this Order, including, as applicable:

a. the name and status of all Missile Competitions where Northrop is a competitor (or, for potential future Missile Competitions, when Northrop has the capability to compete and has taken steps in anticipation of potentially competing pursuant to Paragraph IV.) to be the Prime Contractor;

b. the identity of all Third Party Prime Contractors seeking SRMs from Northrop for any such Missile Competition and the status of such request for each Third Party Prime Contractor; and

c. such other information as the Compliance Officer may request.

CASENOTE: The Evanston Hospital Remedy

In the matter of Evanston Northwestern Healthcare Corp., 2007 WL 2286195 (F.T.C. Aug. 6, 2007)

The legacy of the *Evanston Hospital* hospital merger litigation is a complicated one. In 2000, Evanston Northwestern Healthcare Corp. ("Evanston"), a two-hospital system, merged with Highland Park Hospital ("Highland"). Four years later (!), the FTC sued in Part 3 administrative court under Section 7. (The Part 3 process is described in more detail in Chapter XI.) The FTC's Administrative Law Judge ("ALJ") imposed liability and required divestiture of Highland, and the merging parties appealed to the Commission.

The Commission upheld the ALJ's decision on liability. The merged firm had "substantially" raised its prices after the deal, and the weight of econometric evidence tended to exclude most likely benign explanations for the price increase. The inference of competitive harm was also consistent with the documentary evidence: the Commission pointed out that "the merging parties' documents reflect that a primary motivation of the senior officials in agreeing to merge the hospitals was to increase their bargaining leverage with MCOs in order to raise prices." For example, the minutes of one meeting recorded an Evanston employee's comment that the deal "would be an opportunity to join forces and grow together rather than compete with each other." The Commission noted that these documents "reflect[ed] the merging parties' unvarnished contemporaneous analyses of the parties' market positions by their most senior officials. The statements are not simple bravado or unsubstantiated hyperbole from middle managers or sales representatives." The Commission concluded that the deal had enabled the merged firm to exercise market power, and that it had resulted in a price increase of at least 9–10%.

But things got sticky on remedy. The Commission began by acknowledging that structural remedies are "preferred" in merger cases, including by reason of divestiture's superior efficacy and lower monitoring costs, compared with behavioral relief. But the Commission concluded that a breakup would not be in the public interest in this case.

The Commission relied on a number of considerations to reach this conclusion. First, and perhaps most obviously, a long time had elapsed since the consummation of the deal in 2000 and the end of the litigation in 2007. This increased the difficulty of a divestiture remedy, as well as its costs and risks of failure. Second, the parties had implemented certain improvements to the acquired facilities: regardless of whether these were cognizable efficiencies under the merger guidelines, they constituted real benefits that a divestiture would jeopardize or reduce.

Third, the Commission emphasized its concern that a divestiture could harm the quality of patient care at Highland. There was particular reason to fear for Highland's cardiac surgery program: "Complaint counsel's [*i.e.*, the FTC staff's] expert . . . testified that it was not clear whether, without Evanston, Highland Park would have the volume that it needed to maintain the cardiac surgery program. If Highland Park lost its cardiac surgery program, or if the quality of its surgical program diminished, then the quality of patient care to the community would suffer. Highland Park would need to transport some or all of its patients needing emergency cardiac surgery

to other hospitals, potentially creating life-threatening risks. The possibility of a delay in reestablishing cardiac surgery services at Highland Park is a significant factor that we must weigh in considering a remedy." In addition, Highland's ability to use the EPIC record keeping software would be imperiled, raising "concern[s] about the potential effects on patient care from the inevitable glitches involved in Highland Park's swapping out complex software systems."

As a result, the Commission opted for behavioral relief of a very unusual kind. "[W]e reject divestiture as a remedy and will impose an injunctive remedy that requires respondent to establish separate and independent negotiating teams—one for Evanston and Glenbrook Hospitals ("E&G"), and another for Highland Park. While not ideal, this remedy will allow [managed care organizations ("MCOs")] to negotiate separately again for these competing hospitals, thus re-injecting competition between them for the business of MCOs." The Commission warned that this would not signal a change in remedies policy for future cases: divestiture remained the preferred remedy.

Although this remedy is widely regarded as a unique effort to make the best of an unfortunate situation, the *Evanston Hospital* litigation itself claims a more positive legacy for merger enforcement. The case marked the first substantive victory for the antitrust agencies in many years in a merger case: the result of a multi-year program—the Merger Litigation Task Force, inaugurated by then-Director Joe Simons of the Bureau of Competition in August 2002 to figure out how to break the federal government's long losing streak in such cases.[753] In the years since *Evanston*, the Commission has lost just one hospital merger litigation.[754]

3. Negotiated Remedies in Merger Cases

Most merger "remedies" in practice are not imposed by courts after victory in litigation, but are negotiated between an agency and the merging parties.

Generally speaking, negotiated merger remedies arise in two types of situations. The first involves transactions that raise competitive concerns with respect to some business lines but not others. Thus, for example, suppose that Company A has a car business, a motorbike business, and a speedboat business, and that it plans to merge with Company B, which makes only speedboats. That deal might raise competitive concerns only with respect to speedboat markets. In this kind of situation, the merger would likely not raise competitive concerns as long as Company A's speedboat business was carved out of the deal by "divesting" (selling) it to another buyer that would operate it with equal competitive vigor. The second involves transactions that raise concerns that—notwithstanding the general preference for structural relief—really can be adequately addressed with a behavioral order, allowing the transaction to proceed with the remedy in place.

Most commonly, a negotiated divestiture remedy involves the company working with the antitrust agencies to identify the areas of competitive concern presented by the transaction, and then working to identify one or more potential "divestiture buyers" who would be suitable stewards of the divested businesses. The company and the agency then typically enter into a consent decree or settlement agreement—entered by a federal court for a DOJ case (and subject to Tunney Act review), or entered by the Commission or a federal court in an FTC case[755]—in which the merging parties agree to undertake the relevant divestiture, and perhaps to provide certain kinds of interim support for the divested business to help assure the continued viability of the divestiture package. The court and/or the FTC typically retains ongoing jurisdiction over the remedial order to ensure compliance with the terms. For example, the remedy in Northrop/Orbital ATK, excerpted above, was imposed by consent decree.

"DIY" Merger Remedies and Litigating the Fix

In some cases, merging parties might try to design their own divestiture in a "fix-it-first" move, by selling off the business units that are likely to raise concerns before turning to the ultimate transaction.[756] From the company's

[753] *See* FTC, Press Release, Federal Trade Commission Announces Formation of Merger Litigation Task Force (Aug. 28, 2002), ("The Task Force will be responsible for reinvigorating the Commission's hospital merger program[.]").

[754] FTC v. Thomas Jefferson Univ., 505 F. Supp. 3d 522, 527 (E.D. Pa. 2020).

[755] For discussion of agency procedures and the differences between FTC and DOJ litigations, *see infra* Chapter XI.

[756] We are setting aside here the applicability of HSR merger notification rules. *See infra* § XI.E.

perspective, this path has the advantage of avoiding the time and expense of agency engagement, but it runs the risk that the agency may conclude that the fix—in which agency staff did not participate—was competitively inadequate. And from the public's point of view, this path has the disadvantage of sacrificing agency oversight of the proposed deal (including the nature of the package and the adequacy of the buyer) and ongoing monitoring and jurisdiction to deal with any concerns.[757]

In other cases, merging parties might offer, or just unilaterally implement, a fix of some kind during an investigation or litigation. In a number of cases, courts have been willing to evaluate under Section 7 not the transaction as originally formulated and notified to the agencies under the HSR merger notification system, but as modified by the parties with divestitures or unilateral commitments.[758] "Litigating the fix" in this way can be a stiff challenge for an enforcement agency.[759]

In practice, the agencies' negotiated merger remedies appear generally, if imperfectly, successful. In January 2017, the FTC released a study of merger remedies from 2006–12. This extract summarizes some of its conclusions.

FTC, The FTC's Merger Remedies 2006-2012: A Report of the Bureaus of Competition and Economics

January 2017

[1] The . . . study evaluated the success of each [consent] remedy and examined the remedy process more generally. Staff used three methods to conduct the study. First, staff examined 50 of the Commission's orders using a case study method. . . . [S]taff interviewed buyers of divested assets and the merged firms. Staff also interviewed other market participants and analyzed seven years of sales data gathered from significant competitors. Second, staff evaluated an additional 15 orders affecting supermarkets, drug stores, funeral homes, dialysis clinics, and other health care facilities by examining responses to questionnaires directed to Commission-approved buyers in the relevant transactions. Finally, staff evaluated 24 orders affecting the pharmaceutical industry using both internal and publicly available information and data. In all, staff reviewed 89 orders and conducted more than 200 interviews, analyzed sales data submitted by almost 200 firms, examined responses to almost 30 questionnaires, and reviewed significant additional information related to the pharmaceutical industry.

[2] In evaluating the 50 orders in the case study component, Commission staff considered a merger remedy to be successful only if it cleared a high bar—maintaining or restoring competition in the relevant market. Using that standard, all of the divestitures involving an ongoing business succeeded. Divestitures of limited packages of assets in horizontal, non-consummated mergers fared less well, but still achieved a success rate of approximately 70%.

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[757] For some criticism of agency practices that might lead to more "off the books" remedies of this kind, see Noah J. Phillips, *Disparate Impact: Winners and Losers from the New M&A Policy* (remarks of Apr. 27, 2022) 8–9 ("Without a consent, there is nothing for enforcers to approve. Sure, this strategy probably will push a few otherwise settleable matters into expensive, uncertain litigation and force staff to review prior approval applications for transactions that would not otherwise merit investigation. Fine, companies will fix it first. And, yes, the agencies will be less effective and efficient as a result. But at least the leadership will be able to dodge some difficult and unpopular decisions. This is a political benefit, not a policy. I am very concerned we are going to start seeing deals with divestitures but without consents. There are today murmurings in the private bar that the agencies are refusing to engage on remedies, and instead are conveying their competitive concerns and leaving it up to the merging parties to attempt a resolution. This is fixing it first with a wink and a nod—and no enforceable agreement with the government. As a result, the public loses out on the protections that a consent agreement provides—including, ironically, prior approval policy. Only agency heads, who get to avoid the appearance of blessing mergers, gain. Reading strident dissents about failed remedies for years, it never occurred to me that one solution might be neither blocking nor remediating deals at all.").

[758] *See*, *e.g.*, United States v. AT&T, Inc., 916 F.3d 1029, 1042–43 (D.C. Cir. 2019) (relying in part on post-complaint "irrevocable offers" to arbitrate prices and terms with downstream trading partners); United States v. UnitedHealth Group, Ltd., __ F. Supp. 3d. __, 2022 WL 4365867, at *8–10 & n.5 (D.D.C. Sept. 21, 2022) (discussing the analytical framework for a DIY divestiture announced between HSR notification and complaint, pursuant to an agreement entered into following the complaint, indicating that the relevant transaction for legal analysis is the *modified* transaction, but applying a more pro-plaintiff test because the Court concluded that the same outcome would result); Initial Decision, In the matter of Illumina, Inc., and Grail Inc., FTC Dkt. No. 9401, 2022 WL 4199859 (F.T.C. 2022), § III.D.3. (declining to block deal, partly in light of an "open offer" that would protect against foreclosure).

[759] *See*, *e.g.*, Steven C. Salop & Jennifer Sturiale, *Fixing "Litigating the Fix,"* Georgetown Law Faculty Working Paper No. 2470 (October 2022); Katherine M. Ambrogi, *The Elephant in the Courtroom: Litigating the Premerger Fix in* Arch Coal *and Beyond*, 47 Wm. & Mary L. Rev. 1781 (2006); David Gelfand & Leah Brannon, *A Primer on Litigating the Fix*, 31 Antitrust 10 (2016).

Remedies addressing vertical mergers also succeeded. Overall, with respect to the 50 orders examined, more than 80% of the Commission's orders maintained or restored competition.

[3] For the remedies involving supermarkets, drug stores, funeral homes, dialysis clinics, and other health care facilities evaluated as part of the questionnaire portion of the study, the vast majority of the assets divested under those 15 orders are still operating in the relevant markets. And, with respect to the 24 orders affecting the pharmaceutical industry, the majority of buyers that acquired products on the market at the time of the divestiture continued to sell those products. Additionally, all of the divested assets relating to products that were in development and not available on the market at the time of the divestiture were successfully transferred to the approved buyers.

[4] The study also confirmed that the Commission's practices relating to designing, drafting, and implementing its merger remedies are generally effective, but it identified certain areas in which improvements can be made. Specifically, some buyers expressed concerns with the scope of the asset package, the adequacy of the due diligence, and the transfer of back-office functions. While the concerns raised may not have interfered with buyers' ability to compete in the relevant markets over the long term, they may have resulted in additional challenges that buyers had to work around or otherwise overcome. Staff has already taken various steps to address these concerns. They include asking additional targeted questions about remedy proposals to divest limited asset packages, asking more focused questions about financing, and monitoring the due diligence process even more carefully. Staff is also more closely scrutinizing buyers' back-office needs, and, in some cases, is considering additional order language. Finally, the study surprisingly revealed that there continued to be a reluctance among buyers to raise concerns with staff and independent monitors when they arose. Staff is increasing efforts to remind buyers of the benefits of reaching out to staff or monitors when issues arise.

* * *

In recent years, while the use of remedial consent decrees continues to be an indispensable part of the work of the federal agencies, the practice has attracted some criticism from commentators on the right and left.[760] In the following extracts, note the different treatment, less than ten years apart, of the options of litigation and settlement!

Deborah L. Feinstein, The Significance of Consent Orders in the Federal Trade Commission's Competition Enforcement Efforts

Remarks of Sept. 17, 2013

[1] I would like to start by discussing generally why the Commission settles rather than litigates in certain matters.

[2] Above all, although they are often lower profile, in appropriate cases, consent orders are as effective in maintaining or restoring competition as going to court. A well-crafted consent order can achieve divestitures necessary to preserve existing levels of competition, stop anticompetitive conduct, cause firms to take additional steps to restore competition, or clear away impediments to future competition. Where a consent order can address the harm the Commission alleges has occurred or is likely to occur without the need for litigation, there are enormous benefits to resolving matters through consent orders.

[3] First, resolving a matter through a consent order can lead to a quicker resolution of a matter. Litigation takes considerable time, and may prolong the anticompetitive effects of the illegal conduct and delay implementation of the remedy. The most obvious examples involve ongoing anticompetitive conduct or a consummated merger. Even where a merger is not consummated, obtaining relief quickly is important. Competition can be affected during the pendency of a merger. For example, customers and employees may go elsewhere because of the

760 See Douglas H. Ginsburg & Joshua D. Wright, *Antitrust Settlements: The Culture of Consent* in Nicolas Charbit et al. (eds.) 1 WILLIAM E. KOVACIC: AN ANTITRUST TRIBUTE – LIBER AMICORUM (February 2013) (arguing that agencies can use consent decrees to extract more stringent relief than they would obtain in court); Open Markets Institute, Public Comments Submitted by the Open Markets Institute for the Antitrust Division's Roundtable on Antitrust Consent Decrees (Apr. 20, 2018) ("In many instances, consent decrees fail to strike at the root of anti-competitive conduct. They often serve as band-aid solutions that seek to regulate the harms generated by market power without addressing the underlying incentive and ability that firms have to wield it. Moreover, consent decrees can introduce unwieldy regulatory regimes that are both difficult to administer and susceptible to runarounds by the private parties they are intended to cover.").

uncertainty related to the transaction. Plans of the parties may get put on hold while they consider what they might do jointly if the transaction proceeds. And, although unlawful, there is always the potential for gun-jumping which can also harm competition.

[4] Second, in addition to being time-consuming, litigation is resource intensive. In this regard, the Commission seeks to be a good steward of public resources. Resolving a matter through a consent order frees up resources to be spent on investigating, and if necessary challenging other anticompetitive mergers or conduct. And it is not only Commission resources that are at stake. While decisions on fully litigated records may provide greater guidance on the state of the law, it is generally not good public policy to impose substantial costs on respondents and third parties to bring to trial matters that can be settled based on the sound application of law to the substantial record the Commission has developed during an investigation.

[5] Third, litigation is uncertain. And it is important, especially in unconsummated mergers, to achieve a remedy before the eggs are scrambled and a remedy becomes unavailable or less effective. Sometimes, even when we ultimately win, it can be a bittersweet victory. This was the outcome recently when the Commission settled its case challenging the acquisition of Palmyra Park Hospital by its only hospital competitor in Albany Georgia. [. . .]

[6] Fourth, litigation can be a blunt instrument—especially federal court injunction cases where a merger is either blocked or allowed to proceed in its entirety. In some cases, the decision to litigate is the result of rejecting a settlement proposal and accepting that the litigation outcome will be all or nothing. In contrast, a consent order allows us to be surgical in our approach—to eliminate the anticompetitive aspects of a transaction or conduct with the detailed information needed to do so while not adversely affecting procompetitive aspects of an arrangement.

[7] Finally, as I noted at the outset, in addition to maintaining or restoring competition, consents can provide significant guidance as to how the Commission views the competitive issues raised by a particular transaction or conduct.

Jonathan Kanter, Remarks to the New York State Bar Association Antitrust Section

Remarks of Jan. 24, 2022

[1] I would . . . like to touch briefly on how we remedy antitrust violations. . . . [Former AAG Robert] Jackson's wisdom guides us. "We should not spend great sums to obtain decrees which are economically unenforceable," he said, "and, when carried out in form, are often only lessons in futility."

[2] Like Jackson, I am focused on how a remedy will function. After the ink has dried and the press cycle has faded, does a settlement in fact restore competition? Does it preserve the competitive process? Most importantly, does our overall approach to remedies, carried out across cases and industries, protect competition as the law demands? We are law enforcers, not regulators.

[3] I am concerned that merger remedies short of blocking a transaction too often miss the mark. Complex settlements, whether behavioral or structural, suffer from significant deficiencies. Therefore, in my view, when the division concludes that a merger is likely to lessen competition, in most situations we should seek a simple injunction to block the transaction. It is the surest way to preserve competition.

[4] Let me explain why. First, determining the contours of a remedy that carves up a business to maintain competition assumes we can capture with precision the contours of competition in the market. Competition is not static, however. It is dynamic, complex and often multidimensional. How do we determine the appropriate divestiture for evolving business models and innovative markets?

[5] We must give full weight to the benefits of preserving competition that already exists in a market, rather than predicting whether a divestiture will actually serve to keep a market competitive. That will often mean that we cannot accept anything less than an injunction blocking the merger—full stop.

[6] Moreover, merger settlements that include partial divestitures too often result in what might be called "concentration creep." This happens when divested assets end up in the hands of someone that does not make

effective use of them. Divestiture buyers may lose interest in assets after acquiring them, or be less effective than they expected.

[7] Finally, settlements do not move the law forward. We need new published opinions from courts that apply the law in modern markets in order to provide clarity to businesses. This requires litigation that sets out the boundaries of the law as applied to current markets, and we need to be willing to take risks and ask the courts to reconsider the application of old precedents to those markets.

[8] That is not to say divestitures should never be an option. Sometimes business units are sufficiently discrete and complete that disentangling them from the parent company in a non-dynamic market is a straightforward exercise, where a divestiture has a high degree of success. But in my view those circumstances are the exception, not the rule.