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IN THIS ISSUE

Mergers: Understanding the Rules of the Road

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FALL 2016

from the Section Chair

Merger Policy and the Direction of Antitrust Enforcement

Dear Colleagues,

THE MAGAZINE THAT consistently sets the standard for practical and readable analysis of competition and consumer protection, ANTITRUST offers another issue that blends hot topics and serious scholarship. Here we examine the latest developments in merger enforcement and the policy informing it, but the contents cover much more ground, from liability for price signaling to redress in consumer protection cases, to new criminal exposure for cartel defendants. As always, the articles include healthy helpings of economics.

This issue could not have come at a better time. Merger policy has preoccupied the debate over the vigor and direction of antitrust enforcement. Skeptics and critics of recent enforcement question whether the agencies have pursued enough deals, whether the courts have allowed too many, and whether the remedies have been effective.

In an Issue Brief last April (https://www.whitehouse.gov/), the Council of Economic Advisors listed 13 industry categories and observed that the shares of the top 50 firms in 10 of them had increased in the last 15 years. The categories were so broad that the top 50 firms accounted for less than half the revenue in all but one—utilities. But increases of up to 11 percentage points inspired CEA to suggest that "record levels" of M&A had left behind "more market concentration, higher profits for a few firms, and declining entry, all of which could result from less competition." After acknowledging the enforcement efforts of the agencies, CEA concluded, "There may however be scope for additional actions to be taken . . . ."

Delving more deeply into transactional data, the Center for American Progress reviewed academic studies of selected mergers and concluded that decades of inadequate antitrust enforcement has allowed companies to acquire market power and raise prices. Its report, "Reviving Antitrust" (https://www.americanprogress.org/), cited research that purported to find price increases after the agencies allowed mergers to proceed, and called for stronger presumptions of illegality in horizontal mergers, increased scrutiny of vertical deals, tougher restrictions on competitors' conduct, more resources for the agencies, and a Presidential advisor on antitrust policy.

The agencies have weighed in on the debate as well. All three Commissioners at the FTC and the Assistant Attorney General at the Antitrust Division have given their assessments of cases brought, cases won, cases lost, and the state of enforcement policy. In speeches available at https://www.ftc.gov/ and https://www.justice.gov/atr, the agency leaders gave detailed accounts of the decisions they made on the front lines of enforcement and the decisions the courts made in ruling on the challenges. The officials maintain that neither aggregate measures of economic concentration nor small samples of individual transactions can diagnose the competitive effects that the agencies examine in extensive investigations. They note that economists have discounted the presumption pitting concentration against competition.

Merger policy has preoccupied the debate over the vigor and direction of antitrust enforcement. Skeptics and critics of recent enforcement question whether the agencies have pursued enough deals, whether the courts have allowed too many, and whether the remedies have been effective.

All of these perspectives illuminate important aspects of economic policy and the role of merger policy. How do we square the critics' reviews with the officials' reports?

Let's hear from the witnesses. We don't yet have the perspectives of the practitioners and experts who stepped into the courtrooms to present the evidence, articulate the theories, and argue the law that governs the outcomes. And we haven't heard from the judges who determined the outcomes (although their opinions portend where they might come out in the debate). This issue of ANTITRUST rounds out the record. In the following pages, those who litigated and ruled on the cases give their accounts. Competition and consumers, not to mention practitioners and commentators, will benefit from the knowledge that these articles impart.

For more on mergers, the October issue of *The Antitrust Source* offers tips on handling nonparty witnesses in merger litigation, and a Roundtable discussion of substantive and procedural issues facing merger practitioners today, as well as coverage of late-breaking topics we have come to expect from our online authors at *The Source*. ■

With best regards,

Bill

William C. MacLeod
Chair, ABA Section of Antitrust Law
2016–2017

TO: Antitrust Section Members

FROM: Wiiliam C. MacLeod, Chair, Section of Antitrust Law

SUBJECT: Nominating Committee

PURSUANT TO THE BYLAWS of the Section of Antitrust Law, the Chair of the Section is called upon to appoint a Nominating Committee composed of five Section members to make nominations to the Section membership for open positions among the Officers and Council to be elected at the next Annual Meeting. I am pleased to announce that I have appointed the following distinguished members of the Section to serve on the 2016–2017 Nominating Committee:

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Any member of the Section wishing to make recommendations to the Nominating Committee should convey comments to the Nominating Committee Chair or to any other member of the Committee.

Editor's Note: U.S. Merger Enforcement: The Way Forward

BY GREGORY G. WROBEL

THE COVER THEME OF THIS FALL 2016 issue of ANTITRUST focuses on U.S. merger enforcement, with articles offering practical and forward-looking guidance for antitrust attorneys, economists, courts, and in-house counsel who must decode antitrust law for their business managers. This column affords some leeway for broader comments on the focus of U.S. merger enforcement, which has been shaped in large part by legal standards and economic principles adopted by courts over many years under Section 7 of the Clayton Act, rather than by economic, fiscal, and trade policy goals that a new administration may pursue.

For the most part, modern U.S. merger enforcement encompasses: (1) compliance with premerger notification requirements for larger deals; (2) focused investigations in a small percentage of deals by the Department of Justice Antitrust Division and Federal Trade Commission (in some cases with participation by state attorneys general); the (3) negotiated settlements (mostly structural relief; some behavioral/conduct remedies) in a small fraction of deals with premerger filings (plus a few non-reported transactions); and (4) contested court cases (and/or FTC administrative cases), for a very small percentage of challenged deals that are not settled.[1] Private plaintiffs may have standing to pursue claims under Section 7 of the Clayton Act, but these claims are infrequent and rarely prevent deals from closing.

The articles in this theme are part of extensive ongoing coverage of merger enforcement by ANTITRUST. This level of attention is warranted both for analytical reasons that antitrust practitioners can appreciate (e.g., merger cases present unique challenges in both factual and economic analysis), and because merger enforcement attracts broader public attention than might be anticipated from the small number of litigated merger cases. Mergers and the court cases they draw are often highly visible and fast paced; media sources, analysts, and legislators often depict these deals as flash points for debate on wider issues of economic, fiscal, trade, and even social and political policy; and the record of the agencies in merger cases is often used as a litmus test for their overall effectiveness as antitrust enforcers.

As this issue of ANTITRUST was proceeding to publication, Acting Assistant Attorney General Renata Hesse and FTC Chairwoman Edith Ramirez gave speeches and *The Economist* had a cover theme that touched in important ways on the public face of mergers and merger enforcement.[2] Key passages from the speeches serve well to illustrate issues that animate current public discourse on the process and focus of U.S. merger enforcement.

Gregory G. Wrobel, Editorial Board Chair of ANTITRUST, is a shareholder and head of the Antitrust Practice Group of Vedder Price P.C. All opinions expressed herein are his alone and do not necessarily reflect those of his firm or any of its clients.

Enforcement Goals: Fairness, Transparency, Technical Analysis

Hesse focused on public perceptions of economic fairness, and using court cases to make the technical analysis of antitrust enforcement more accessible, while Ramirez focused on safeguarding the competitive process without seeking to reshape markets to achieve broader policy goals.

Hesse

> At bottom, these diverse voices agree on the basic proposition that it is unfair to allow companies to grab unearned monopoly power over markets that they can wield at the expense of consumers, workers, and would-be competitors. By and large, I think this increased public interest in antitrust and competition is a good thing. It is good for the public—because antitrust enforcement promotes the interests of the public over the power of the few—and it is also good for antitrust—because it keeps enforcers focused on the ultimate goal of antitrust, economic fairness.
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> * * * * *
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> Animating the beliefs of ordinary Americans who demand vigorous antitrust enforcement are the value of fairness and the belief that properly functioning competitive markets are themselves fair. To say it another way, competition is fair because it gives a chance to the small business owner to succeed in her business venture, because it delivers lower prices to consumers, and because it drives the innovation that improves products, business processes, and more.
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> * * * * *
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> It is our job as public servants to explain to the public why we do what we do; for example, when we use economics tools with obscure names like "Herfindahl-Hirschman Index" or "Gross Upward Pricing Pressure Index," we are simply measuring intuitive phenomena like the concentration of economic power or the tendency of mergers to reduce competitive pressures that keep prices down. . . . I believe strongly that in the last decade we have been reducing the gap between expert and popular antitrust as we have been litigating more and more cases, forcing us to explain our claims

of harmed competition to lay judges and juries who must determine the rightness of our causes. Antitrust is too important to be left solely in the hands of antitrust experts.

Ramirez

We are not in the business of picking winners or losers; our job is to enforce the rules that safeguard vigorous competition if we see them being broken. We prefer to leave markets alone, allowing customer preferences to dictate what will be produced and sold, and competition to determine which firms make what goods and at what price. Competition leads to lower prices, higher quality, and innovation, all to the benefit of consumers.

* * * * *

[O]ur role is by necessity a limited one. First and foremost, we are law enforcers, not sector regulators. Our job is not to transform markets; we must take them as they are. We also have no direct authority over prices. High prices unaccompanied by anticompetitive behavior do not violate the antitrust laws. Without more, neither do price increases resulting from inadequate supply or other natural market disruptions. We act only when the competitive process itself is harmed or threatened, through anticompetitive combinations or conduct.

Second, we intervene only when the facts warrant it. This requires a deep analytical dive into reliable qualitative and quantitative evidence to understand the actual or likely competitive impact of the merger or conduct under scrutiny.

Size and Concentration

Hesse and Ramirez expressed similar views that growth of large firms and economy-wide trends toward consolidation are not proper targets for antitrust/merger enforcement.

Hesse

The big-is-bad view takes aim, as I see it, at the wrong target for antitrust enforcers. First of all, many of the measures of concentration have from an antitrust perspective the wrong measure of bigness in mind. Antitrust is concerned with a situation where a firm or firms are large enough in proportion to the rest of the market—and thus face too little competition—that they can raise prices alone or take actions that prevent new competition from undercutting high prices. Such firms, we say, have "market power." Many concentration studies simply do not measure market power in this way.

* * * * *

Second, even when we have the right measure of bigness in mind—that is, market power—market power by itself is not the focus of antitrust . . . . In other words, antitrust enforcers don't go after firms that become large just because they are good at competing. So long as competitive processes are not subverted, new firms can rise to displace today's winners. That is how competition works. We are concerned with situations where market power is achieved or protected by anticompetitive means.

Ramirez

The Council of Economic Advisors, for example, cites increases in corporate profits and revenue share of the 50 leading firms in various industries, as well [as] downward trends in firm entry and exit rates to suggest there may be reason for concern about the current state of competition. *The Economist* similarly identifies high profits, particularly in certain sectors like technology and health care, as a basis for concluding that the U.S. economy must be "too cozy for incumbents," while the *Wall Street Journal* attributes lessened innovation and weak start-up activity to supposed market concentration.

* * * * *

But, in contrast to the granular assessment of individual markets that we undertake when evaluating the competitive effects of increases in concentration, broad industry measures like those cited by the CEA, *The Economist*, and the *Wall Street Journal* tell us little about market dynamics or the level of competition in a particular industry. The fact that there may be fewer firms today in certain sectors than in years past does not necessarily mean that these sectors are any less competitive from a consumer welfare perspective.

* * * * *

Nor can we simply decry an increase in the presence of large firms—or even dominant ones—merely because they are big or have a high market share, although deals and conduct involving such firms are more likely to draw antitrust scrutiny. In many cases, being big is a consequence of being better than rivals at offering customers what they want. We are rightly hesitant to view success, and by extension size, with automatic suspicion. Indeed, large firms can have scale economies and other efficiencies that are beneficial for consumers. In short, one cannot assess the state of competition in the absence of a fact-intensive analysis of specific product and service overlaps, the availability of substitutes, and other relevant market dynamics.

Consumer Welfare, Competitive Impact, and Presumption of Anticompetitive Effects

Hesse and Ramirez both reference the presumption of anticompetitive effects for merged firms with a high market share in concentrated markets. Hesse goes a bit further in arguing that effects on competition and the competitive process, rather than impact on consumer welfare, are the guiding standard for enforcement action.

Hesse

Just as some popular views of antitrust miss the mark somewhat, so do some of the expert views . . . Some commentators have accordingly suggested that the antitrust laws should judge all practices by their impact on the welfare of downstream consumers, as measured by price and output effects in downstream markets. But, although we believe competition maximizes consumer welfare, the ultimate standard by which we judge practices is their effect on competition, not on consumer welfare.

* * * * *

One bedrock tool for protecting against anticompetitive mergers has been recognized by the Supreme Court for over fifty years. In *Philadelphia National Bank*, decided in 1963, the Supreme Court announced 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 the law will presume it unlawful.

* * * * *

That said, in the more routine horizontal merger case we almost always do introduce proof of consumer harm where it exists—along with demonstrating likely reductions in quality and slowing of innovation—because we want to present a full account of the anticompetitive effects of challenged practices to the finder of fact. Moreover, we rarely rely solely on the presumption: even where price and output effects cannot be quantified, we usually have some concrete evidence such as documents or lay testimony showing that competition between the merging firms is important and will be lost with a merger.

Ramirez

For us, of course, stopping anticompetitive combinations is among the most important jobs we perform. And market shares and market structure continue to play an important role in merger analysis and enforcement, even as our focus has shifted to more direct assessments of competitive effects. Where a proposed merger significantly increases concentration in an already highly concentrated market, we are justifiably entitled to a presumption of competitive harm.

Trials and Settlements

Hesse and Ramirez both emphasize litigation readiness as an effective tool to achieve enforcement goals. Hesse also argues that public trials shift how cases are prepared and presented.

Hesse

As a matter of process, the way that antitrust as expert practice has become more engaged with the general public's enthusiasm for antitrust, and to make itself more relevant to the public, is to change the way disputes are resolved. We have been moving from a quasi-regulatory system—in which disputes are typically resolved by settlement crafted largely within the halls of the agencies—to a litigation mode—where disputes are more often resolved by lay third-party arbiters.

* * * * *

Showing to the public that we are prepared to litigate has paid off: in this administration, a total of 40 mergers have been blocked by court order or wholly abandoned by the merging companies in the face of our investigation, a stark increase from 16 in the prior administration.

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Litigating more means changing the way we talk about our

Photo: SuperStock

disputes. When cases are settled, the conversation hardly leaves the corridors of agencies and law firms, and so it can stay at the rarified level of economics tools such as HHIs, cross-price elasticities, and GUPPIs. When we litigate, we put our dispute before a neutral lay arbiter—a judge or a jury. That means we have to tell a compelling and coherent story about why certain business practices are harming competition and thereby participants in the economy. The proof will be varied, and it will almost always include sophisticated expert presentation of economics evidence—theoretical or empirical or both—as part of the evidence. But that must be packaged with qualitative evidence that confirms in a palpable and intuitive way the story told through the numbers of the expert. And ultimately the plaintiff's story should highlight the moral underpinnings of the antitrust laws—fighting against the unfairness of concentrated economic power profiting at the expense of consumers, suppliers, or competitors who could challenge the defendant's dominance.

Ramirez

To those who think us too permissive, I note that the Commission has challenged 44 mergers in the last two years alone, including suing to stop eight transactions outright. Among other major wins, we successfully challenged the Sysco/US Foods, Staples/Office Depot, and St. Luke's/Saltzer mergers. We have been particularly active in addressing what we believe to be anticompetitive consolidation in the healthcare, pharmaceutical, retail, and energy sectors, among others.

* * * * *

. . . [M]ost often we are able to resolve the competition concerns we identify through consent orders requiring divestitures of overlapping products. Settlements offer the advantage of addressing the competitive harm of a transaction while still allowing realization of the merger's efficiencies. Despite their many advantages, however, our remedies have also been the subject of criticism.

* * * * *

> Some contend that the FTC would rather accept an inadequate remedy rather than litigate. Our recent track record, including our merger suits in Sysco/US Foods, Staples/Office Depot, and Superior/Canexus, directly belie that contention. In each of these cases, the parties offered substantial divestitures to buyers ready to compete in the business, but we determined that the divestitures would not fully replicate the competition lost through the merger and appropriately rejected them.

The Way Forward

This publication is not usually a forum for high-level debate on antitrust policy, and certainly not on broader government policy toward large and growing firms across the full spectrum of regulation, taxation, equality in compensation, or other concerns. Rather, we focus on how antitrust practitioners, courts, and parties in cases grapple with issues (and merger deals) under existing law.

The same is and should be true for agency merger enforcement. Substantive standards under Section 7 focus on competition in the relevant market(s) directly affected by a merger, not broader economic or social consequences of the deal or its effects on wider trends in the U.S. economy (or globally) in firm size, employment, wage levels, or myriad other factors.

Enforcement agencies exercise discretion over what deals to investigate and challenge, but they do not possess (or exercise, in the case of the FTC) authority to issue regulations pronouncing new substantive antitrust standards to animate Section 7. That job is left to U.S. courts. It is noteworthy that Hesse prominently cited the *Philadelphia National Bank* Supreme Court decision dating back to 1963 for the presumed correlation between market concentration and competitive harm. Courts can make new law under Section 7 only when ruling on litigated merger cases, and the Supreme Court and federal courts of appeals seldom receive (or accept) merger cases to review.

Both Hesse and Ramirez note that litigation readiness helps to achieve enforcement goals, and Hesse argues that the increasing number of cases going to trial serves broader goals in publicly communicating the moral underpinnings of antitrust law. More frequent litigation of merger cases may produce fresh judicial guidance on substantive standards and proof required to block mergers. The goal of merger enforcement, however, is not to create new case law, but rather to step in only where deals that emerge from the broth of global competition pose a direct threat to competition and consumer welfare in particular relevant markets in which the merger parties overlap.

Important traits of merger deals, by their nature, create challenges that impede the evolution of case law under Section 7. For the most part, merger cases must be tried under the time pressures of the HSR review process and termination dates embedded in the parties' agreements and financing arrangements (in addition to the forces of stock market movements for public companies). This means that the cases are presented in court through preliminary injunction proceedings or their functional equivalent, with highly compressed discovery and expert work.

These dynamics may not produce the best factual records for district court decisions, given the inherent complexities of expert analysis and the use of historical information to predict future market events. Decisions of the district courts typically stand as the last word in merger cases due to time pressures that the parties face but the agencies do not, which may leave the agencies better positioned to exercise rights of appeal if they lose in the district court.[3]

Public commentary on antitrust and competition policy has been more visible recently than is typical for election cycles. Ramirez notes that "[w]ith election day fast approaching, we find ourselves in the midst of a public debate over the effectiveness of current competition policy in the United States," and both Hesse and *The Economist* invoke populist sentiments of economic fairness, opportunities for small businesses to compete, employment impact, and backlash against "corporatism" (presumably an undesirable relationship between large companies and government).[4] These themes seem to be resonating now across a range of policy issues that are much more pressing for voters than government merger enforcement. But the economic trends that prompt these sentiments cannot be laid at the doorstep of mergers, as many large firms have grown their core businesses internally. Nor should these sentiments shape the legal standards under Section 7 that courts now apply in merger cases, and that presumably guide enforcement decisions (and agency enforcement guidelines).

Hesse describes a deliberate shift from technical analysis of consumer welfare leading to negotiated settlements, in favor of merger cases tried to district court judges, focused more broadly on effects on competition and the competitive process. But her comments are balanced with the continuing need to delve into technical details of economic analysis, matched with evidence from the merger parties and other market participants.

Merger cases are inherently forward-looking, predicting likely competitive impacts that often require a range of analytical tools and expert evidence that are grounded in varying ways in economic theory and methods. A shift to trials in court will not change the use of these tools or the complexity of the evidence they produce, as the economic theory and models from which these tools derive are now deeply embedded in antitrust standards.[5]

Mechanisms already exist to promote greater public awareness of merger cases that are not litigated. The agencies issue statements that explain proposed settlements in merger cases to aid in public comment before final action on the settlement. Perhaps more can be done in individual cases (and periodically on a collective basis) to explain the technical analysis used in both litigated merger cases and settlements, and thereby bridge the divide noted by Hesse between agency/law firm corridors and the courts. Even if this is so, the public attention span and "popular enthusiasm" for merger enforcement are likely to have limits, at least in terms of absorbing the analytical details on which settlements and court decisions are properly grounded.

Both Hesse and Ramirez acknowledge a continuing need for technical economic and factual analysis framed by established judicial standards for merger enforcement, which means that antitrust practitioners, courts, and parties should continue to find value in the practical guidance the articles in this theme offer. ■

[1] *See, e.g.*, Fed. Trade Comm'n and U.S. Dep't of Justice, *Hart-Scott Rodino Act Report*, Fiscal Year 2015, https://www.ftc.gov/policy/reports/policy-reports/annual-competition-reports. The Report shows 1,801 transactions with HSR filings, of which 258 (14.7%) resulted in clearance to DOJ or FTC to issue second requests for information, 47 (2.6%) in which second requests were issued, and 40 (2.2%) that were challenged (20 by the DOJ and 20 by the FTC). Of the DOJ challenges, ten were resolved without filing a complaint in court (eight abandoned; two restructured to resolve DOJ issues), and ten resulted in filing a complaint in court (eight filed as settlements, two abandoned). Of the FTC challenges, 17 were settled by consent order and three resulted in court filings (one blocked by the court, one abandoned, one in which the court denied relief to the FTC). Thus, of 1,801 transactions with HSR filings, five resulted in contested court filings (0.3%), of which three were abandoned and two resulted in rulings on the merits (one victory and one defeat for the FTC). Reports for FY 2009–2014 show figures consistent with the pattern for FY 2015, with an aggregate total of only five transactions for the FTC and three for the DOJ in which a court actually ruled on the merits.

[2] *See* Acting Assistant Attorney General Renata Hesse of the Antitrust Division Delivers Opening Remarks at 2016 Global Antitrust Enforcement Symposium (Sept. 20, 2016), https://www.justice.gov/opa/speech/acting-assistant-attorney-general-renata-hesse-antitrust-division-delivers-opening; Keynote Remarks of FTC Chairwoman Edith Ramirez, 10th Annual Global Antitrust Enforcement Symposium, Georgetown University Law School, Washington, DC (Sept. 20, 2016), https://www.ftc.gov/system/files/documents/public_statements/985423/ramirez_-_global_antitrust_enforcement_symposium_keynote_remarks_9-20-16.pdf; The Economist, *Future Policy, a Delicate Balance*, *in Special Report on Companies: The Rise of the Superstars* 14–16 (Sept. 17, 2016), http://www.economist.com/news/special-report/21707054-how-keep-superstars-their-toes-without-making-them-fall-over-delicate-balance.

[3] *See, e.g.*, FTC v. Sysco Corp., 113 F. Supp. 3d 1, 15, 21 (D.D.C. 2015) (parties advised court that transaction would be abandoned if court entered a preliminary injunction); FTC v. Penn St. Hershey Med. Ctr., No. 16-2365, slip op. at 45 (3d Cir. Sept. 27, 2016) (same).

[4] *See, e.g.*, *Future Policy, a Delicate Balance*, *supra* note 2, at 15–16 ("This special report has shown that there are good reasons to worry about corporate consolidation. The age of entrepreneurialism that started in the early 1980s is giving way to a new age of corporatism. This has been particularly true in the world's most advanced economy, America, and in the world's most knowledge-intensive industries. Big companies have been getting bigger and putting down deeper roots . . . . At the same time the rate of small-business creation is at its lowest level since the 1970s . . . . The more entrenched companies get, the more unhealthy their relations with government are likely to become as they employ large numbers of lobbyists and put former politicians on their boards.").

[5] *See, e.g.*, Penn St. Hershey Medical Center, No. 16-2365, slip op. at 11 ("[W]here a district court applies an incomplete economic analysis or an erroneous economic theory to those facts that make up the relevant geographic market, it has committed legal error subject to plenary review.").

A Primer on Litigating the Fix

BY DAVID GELFAND AND LEAH BRANNON

When the U.S. antitrust agencies conclude that proposed transactions are likely to lessen competition, parties often resolve those concerns by way of consent decrees requiring divestitures.[1] In 2015, for example, the FTC brought 22 merger enforcement challenges, and in 17 of those the agency accepted consent orders to resolve its concerns.[2]

The DOJ and the FTC, however, have also shown increasing reluctance to enter into consent decrees when there are doubts about whether proposed divestitures will fully resolve competitive concerns.[3] The agencies have rejected proposed divestitures in a series of high-profile merger cases over the past two years, and several of these matters have resulted in litigation involving the proposed divestiture.[4]

- In *FTC v. Sysco Corp.*,[5] the defendants proposed to divest a collection of regional food distribution facilities to the third-largest distributor in the United States, thereby expanding its national footprint. The court, however, concluded that this proposed remedy was not sufficient to eliminate the anticompetitive effects of the transaction.
- In *FTC v. Staples*,[6] the defendants argued that a proposed assignment of contracts would address the competitive harm alleged. The court declined to consider this argument because the defendants opted not to present a defense at trial.
- In *United States v. Halliburton*,[7] the complaint challenging Halliburton's acquisition of Baker Hughes included allegations preemptively rebutting an anticipated divestiture defense by the defendants.[8] The defendants abandoned the transaction after one month of litigation.
- In *United States v. Aetna*,[9] the defendants stated in their answer that they planned to divest their Medicare Advantage business in all 364 markets in which the DOJ alleges competitive harm.[10] This case is pending.

To date, the government has won most of the cases in which parties have litigated a fix. There are many factors that have likely contributed to the government's high success rate. Among other things, when parties offer fixes that clearly resolve competitive concerns, the agencies are likely to accept those remedies and there will be no need for litigation. Alternatively, when the parties have strong arguments that there are no competitive concerns in the first instance, they are unlikely to offer divestitures. Litigated fixes are thus most likely to arise when both sides recognize that there are significant competitive issues but the proposed remedy does not clearly resolve those concerns to the satisfaction of the agency.

Despite the government's strong track record in these cases, however, litigating a fix is certainly something that should be considered as part of your plan to defend a merger. This article addresses some of the questions that parties may have as they consider this possibility.

Will the court consider my divestiture in assessing the legality of my merger?

If you identify the set of assets to be divested, sign an agreement with a committed buyer before a lawsuit is filed or reasonably early in the litigation, and present these facts as part of your defense, the court will almost certainly consider your proposed divestiture in evaluating the legality of your merger.

In *FTC v. Libbey, Inc.*,[11] the defendants amended their merger agreement one week after the lawsuit was filed in order to exclude a business from the transaction in an attempt to address the anticompetitive effect the merger would have in that market. The FTC argued that the amended agreement was a "sham" and that the party retaining the business did not intend to continue operating it as a competitor in the relevant market.[12] The court noted that it had not found "any precedent that has addressed how an amended merger agreement impacts the original agreement," but went on to conclude that "the amended agreement is properly before the Court for judicial review."[13] The court rejected the FTC's argument that the parties "sought to evade FTC and judicial review by proposing the amended agreement" and held that the amended agreement was a genuine attempt to address the agency's concerns.[14] The court, however, ultimately enjoined the transaction because it found that even as modified the transaction was likely to substantially lessen competition.

In *FTC v. Arch Coal, Inc.*,[15] the district court also considered the parties' proposed remedy. In that case, after receiving a second request, the buyer informed the FTC that it intended to divest one of the two coal mines it was acquir-

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ing in the proposed transaction and had executed an agreement with a divestiture buyer. The FTC rejected this proposed remedy and filed suit seeking to enjoin the proposed acquisition. The agency also moved to exclude all evidence and argument related to the divestiture. The court denied this motion, holding that it could not ignore the divestiture because the "Court's task in determining the likelihood of the FTC's success in showing that the challenged transaction may substantially lessen competition . . . requires the Court to review the entire transaction in question."[16] The court declined to enjoin the transaction because it was not persuaded that the FTC had met its burden.

Since *Arch Coal*, the agencies generally have not disputed that courts have authority to consider fixes, and the courts have typically considered parties' proposed remedies. The two exceptions to this are the FTC's challenges to Ardagh's proposed acquisition of Saint-Gobain in 2013 and Staples' proposed acquisition of Office Depot in 2016. In both of these somewhat unusual cases, the courts refused to consider the parties' proposed remedies.

In *FTC v. Ardagh*,[17] the acquirer (Ardagh) waited until after the close of discovery to announce that it would divest four glass-making plants and extend certain existing customers' contracts in an attempt to remedy competition concerns.[18] Ardagh had told the FTC of this plan just one day before the FTC's deposition of Ardagh's chief executive officer.[19] Furthermore, Ardagh had not yet identified a buyer for its divested plants.[20] The court refused to consider evidence of the divestiture plan, explaining that the remedy was not sufficiently concrete and that the FTC had not been given enough time to evaluate it.[21] The court nonetheless encouraged the parties to explore settlement, and the parties did ultimately settle the case with a consent decree requiring Ardagh to sell six manufacturing plants.[22]

In *FTC v. Staples*,[23] the court found itself presented with a highly unusual situation in which the merging parties chose not to present any defense at trial. Accordingly, the court declined to consider the defendants' proposed remedy.[24]

The courts in *Ardagh* and *Staples* did not reject the idea that a serious divestiture involving a signed contract with an identified buyer should be considered in evaluating a merger. Rather, the courts rejected what they seemed to perceive as game-playing by the parties. Reading all of these cases together, the lesson is clear: If you want a court to consider your proposed divestiture, reach an agreement with a committed buyer as early as possible and present the remedy as part of your defense.

What standard will the court apply in considering my proposed divestiture, and who has the burden of proof?

Good question. The relatively small set of published decisions in this area does not provide a clear answer. As the court in *FTC v. Sysco Corp.* put it, there is a "lack of clear precedent providing an analytical framework for addressing the effectiveness of a divestiture that has been proposed to remedy an otherwise anticompetitive merger."[25] For example, do defendants who propose a fix have the burden of showing that their proposed remedy will fully restore competition to pre-merger levels, or does the government have the burden of showing that a transaction as modified will substantially lessen competition?

If parties divest an entire business to eliminate any horizontal concentration (or if parties design a transaction in the first instance to avoid creating any horizontal concentration of assets), there is an argument that this precludes any concern under Section 7 of the Clayton Act. In *Libbey*, however, the court took a careful look at the proposed remedy even when the defendants argued that they had eliminated the overlap by carving out the competitive business from the merger. The remedy largely divested the overlap business back to the seller but did not include manufacturing facilities.[26] The defendants argued that this was not particularly meaningful because manufacturing could readily be outsourced.[27] The court, however, concluded that the FTC had shown that the transaction even as modified would substantially lessen competition because outsourced manufacturing would cause the divested business to have higher costs and compete less effectively after the merger.[28]

This approach seems consistent with the court's observation in *Arch Coal* that, in considering whether a merger will substantially lessen competition, a court must "review the entire transaction in question," i.e., the cumulative effect of the original transaction as well as any divestiture.[29] Similarly, in *Sysco*, the court looked at the modified Herfindahl-Hirschman Index (HHI) levels after divestitures in evaluating whether the proposed divestitures would remedy the anticompetitive effects of the transactions. The court noted that, while the divestitures need not "replicate pre-merger HHI levels," Sysco's proposed divestiture was insufficient to maintain the intensity of existing competition between the merging firms.[30]

Finally, in dicta in *Staples*, the court endorsed a pro-government formulation of the standard, stating that "Defendants bear the burden of showing that any proposed remedy would negate any anticompetitive effects of the merger."[31] This formulation obviously places the burden on the defendants and arguably suggests that defendants face a high bar. Although this statement appears in dicta in a footnote, it is nonetheless notable given the limited precedent in this area.

In sum, pending further development of the law on these issues, parties should be prepared to make a strong showing that their specific proposed divestiture will restore lost competition.

What factors will the court consider if I litigate a divestiture fix?

The court will likely look to the same factors that the agencies consider in assessing remedies, including whether: (1) the parties have executed an agreement with a divestiture buyer; (2) the buyer is qualified; (3) the buyer will have all of the assets that it needs to compete on a cost-effective basis, such that the divestiture can fully remedy the competitive

[P]arties should start from the premise that successfully litigating a fix will be challenging. *Arch Coal* is the rare instance in which merging parties were able to proceed with their transaction after successfully litigating a fix, and the facts there were very favorable to the defense.

problem(s) in each relevant market; (4) the buyer will be independent of the merging parties; and (5) the buyer is in fact likely to compete effectively.[32] If you can demonstrate that your proposed divestiture adheres to most or all of the factors set forth in the antitrust agencies' own policy guidelines, this should be highly relevant to the court's assessment.[33] On the other hand, offering a divestiture that fails on a number of these factors can be fatal. The cases confirm this point.

Ardagh, for example, is a good reminder of the importance of having an actual divestiture agreement signed with a qualified buyer. There, the merging parties had not yet identified a buyer for the divested plants and, as noted, the court rejected the remedy as insufficiently concrete.[34] Similarly, in *Staples* the parties did not present the court with a specific buyer much less a signed divestiture agreement.

Libbey is a good example of the importance of divesting the right set of assets. In that case, Libbey sought to acquire Anchor Hocking, a wholly-owned subsidiary of Newell Rubbermaid. Under the amended merger agreement, the merging parties agreed to exclude Anchor's food service glassware business from the proposed merger and transfer it to a different subsidiary of Newell, which would outsource production to a third-party manufacturer.[35] In concluding that the remedy was ineffective, the court noted that outsourcing the production would increase production costs, and found that the divested business "would not be in a position to provide effective competition" against the merged companies.[36]

Sysco illustrates the need to avoid ongoing entanglement between the merged entity and the divestiture buyer.[37] In that case, the merging parties proposed to grant the buyer, Performance Food Group (PFG), access to their private label products at 11 divested distribution centers for a period of three years. In addition, the agreement gave PFG the right to license a key database from the merging parties for five years with a continuing option to license the database for an additional five years after that.[38] Based on these ongoing relationships, the *Sysco* court concluded that PFG would "be dependent on the merged entity for years following the transaction" and thus "will not be a truly independent competitor," which "cut[] against the divestiture as a proposed fix."[39]

United States v. Halliburton illustrates nearly all of these concerns in a single case. There, the parties proposed to divest a substantial package of assets, but the DOJ rejected the proposed remedy as "wholly inadequate to resolve the risks to competition posed by this transaction."[40] The parties had no buyer signed up, much less a well-qualified one, and the DOJ alleged that the proposed divestiture package was a hodgepodge of assets that lacked key elements and would not allow a buyer to compete effectively in the relevant businesses. Further, the DOJ alleged that the proposed remedy would leave the buyer dependent on Halliburton for numerous services crucial to the businesses being divested, thus creating substantial ongoing entanglement.[41]

Apart from the factors related to the design of the remedy, it is also worth considering how the remedy proposal will be presented to the court. Company witnesses, witnesses from the divestiture buyer, company documents, and customer testimony can all be critical. Parties should also be mindful that the agency may have locked in key witness testimony during the investigative phase, as was the case with the proposed divestiture buyer in *Sysco*.[42]

Consideration should also be given to using an industry expert or an expert in business disposals who could opine on how the divestiture assets are likely to perform post-transaction. Past experience in the industry with similar asset sales might be particularly helpful.

So what are my odds of successfully litigating a fix?

It depends on your facts and how good your proposed remedy is, of course, but parties should start from the premise that successfully litigating a fix will be challenging. *Arch Coal* is the rare instance in which merging parties were able to proceed with their transaction after successfully litigating a fix, and the facts there were very favorable to the defense. As the court noted, the FTC had only a borderline case of anticompetitive harm to begin with: there were 14 coal mines in the relevant geographic area, the original proposed transaction would have combined two of them with two others, and the divestiture meant that the transaction would combine two mines with one. As a result, there would be no change in the number of competitors, and there would be only a small increase in concentration (HHI increase of only 49 points), which is "far below [the levels] typical of antitrust challenges brought by the FTC and DOJ."[43]

Moreover, the divestiture itself—transfer of a coal mine—was straightforward and already agreed upon: there was a signed agreement between Arch and the divestiture buyer, and the court noted that the divestiture "will definitely occur."[44] The fix did not involve the sorts of complexities that were present in some of the more recent cases, such as *Halliburton*, in which the parties proposed to divest a mixed package of diverse assets, and there would be ongoing entanglement between the seller and the divestiture buyer. *United States v. Aetna* will be an interesting case for the development of the law in this area and happens to be pending before the same judge who decided *Arch Coal*.

Anything else I should know about litigating a fix?

Yes. By agreeing to a fix, parties run the risk that the court might conclude they have admitted that the transaction as originally proposed would reduce competition. The parties may want to make a record designed to mitigate this risk.

In addition, if you do decide to proceed with a fix, you should think about possible premerger filings that might be required. If proposed divestitures are subject to notifications in other countries, for example, this could create delay and uncertainty about timing, and might even raise questions as to the certainty of closing the divestiture sale. The fix might also be independently subject to a Hart-Scott-Rodino filing. Divestitures pursuant to consent decree do not require such a filing because of the exemption in the HSR regulations for transactions subject to court order.[45] It is possible that a revised transaction (for example, the buyer just leaving some of the assets with the seller) might be within the scope of the original HSR filing and might not require a new filing. But a sale to a divestiture buyer might well require a new notification, and this issue requires careful reflection. Failure to file could introduce a complication into your defense (because you would now need to ask the court to order the divestiture in order to help the parties meet the regulatory exemption to an HSR filing), while making a new HSR filing might introduce delay and a new agency investigation.

So what should I do if I want to litigate a divestiture fix?

First, do a thorough antitrust assessment at the outset of the transaction to see what the competitive issues are and how they might be remedied. Are there divestitures that are specifically tailored to resolving potential antitrust concerns, and are those particular divestitures acceptable to the buyer? It is not sufficient to agree to a dollar value of divestitures without mapping out a more detailed plan. This contingency planning should begin even before the transaction is signed, dovetailing with the negotiation of the merger agreement, including antitrust risk allocation and timing provisions.

Second, recognize that not every potential antitrust concern requires a divestiture. After learning more about the facts, you might decide that the government will have a strong case in certain markets and decide that it makes sense to consider divestitures in those areas. But you might also conclude that the government has a relatively weak case in other markets and decide that it is worth litigating in those areas.

Third, be transparent and work in good faith with the agency. The court will expect the parties to have attempted to resolve issues with the government before presenting a proposed fix to the court.

Fourth, design a divestiture package that will effectively address the competitive issues. This should include as much of the overlap business as necessary to make the divestiture effective in restoring competition and should have as few ongoing entanglements with the merging parties as possible.

Fifth, choose a strong buyer. The buyer will be a key participant in the litigation and will need to show itself to be capable and likely to compete effectively with the divestiture assets. Do not assume that the highest bidder is the most qualified from a competitive standpoint.

[J]ust because you have gone down the road of litigating a divestiture fix does not mean that you should rule out any possibility of actually settling the case.

Sixth, lock in the terms of your divestiture as early as possible. The court is unlikely to force the government to litigate against a moving target.

Seventh, approach your litigation plan for the fix as seriously and thoroughly as you approach every other aspect of the case. You need witnesses and evidence. You need to make sure that you have experts lined up as needed.

Eighth, do not assume that the agencies will accept your proposed divestiture, settle the case, and declare victory. By committing to a fix, you are effectively creating a safety net for the agency: it now can litigate and, at worst, wind up with the divestiture that you are already offering. There are many factors to consider here but, at a minimum, you should not count on settling the case if your proposed remedy does not fully resolve the concerns the government is articulating.

Ninth, just because you have gone down the road of litigating a divestiture fix does not mean that you should rule out any possibility of actually settling the case. This is the flip side of the prior point—while you should not assume that the government will settle, you should also not rule out the possibility that it might. In cases such as *Ardagh*, and *United States v. US Airways Group*,[46] the parties and the agency ultimately reached a settlement agreement after litigation commenced.

Tenth, carefully plan your timeline. If you want to leave open the possibility of presenting a fix to the court, you need to consider your plan very early on and allow time for litigation on both the merits of the merger as well as any additional issues that might be raised by the proposed divestiture. Do not assume that a court will rush the process to meet the parties' desired deadlines. You also need to allow time for foreign notifications of the divestiture and a separate HSR filing, where applicable. There may be a divergence of views between the buyer and seller on timing, and it is important to think these issues through from the beginning and allow sufficient time to maximize your chances of successfully litigating a fix. ■

[1] *See, e.g.*, Bill Baer, Assistant Att'y Gen., U.S. Dep't of Justice, Antitrust Div., Remedies Matter: The Importance of Achieving Effective Antitrust Outcomes (Sept. 25, 2013), https://www.justice.gov/atr/ speech /remedies-matter-importance-achieving-effective-antitrust-outcomes.

2 *See* Fed. Trade Comm'n & U.S. Dep't of Justice Hart-Scott-Rodino Annual Report Fiscal Year 2015 at 2, https://www.ftc.gov/system/files/documents/reports/federal-trade-commission-bureau-competition-department-justice-antitrust-division-hart-scott-rodino/160801hsrreport.pdf. The DOJ similarly brought 20 merger challenges in 2015, ten of which involved complaints filed in federal court, and eight of those ten involved settlement papers filed simultaneously with the complaint. In the ten merger challenges in which the DOJ did not file a complaint, the parties either abandoned or restructured their transactions to address the DOJ's concerns. *See id.* at 2–3.

3 *See, e.g.*, *Oversight of the Enforcement of the Antitrust Laws: Hearing Before the S. Subcomm. on Antitrust, Competition Policy, & Consumer Rights and S. Comm. on the Judiciary* 114th Cong. 8–9 (2016) (statement of Bill Baer, Assistant Att'y Gen., U.S. Dep't of Justice, Antitrust Div. ("We will not settle Clayton Act violations unless we have a high degree of confidence that a remedy will fully protect consumers from anticompetitive harm both today and tomorrow.").

4 We focus here on proposed divestitures. On occasion, parties have offered behavioral remedies, such as an agreement to hold pricing at current levels, but there is broad consensus that such remedies rarely address the competitive harm in horizontal mergers. *See, e.g.*, U.S. Dep't of Justice, Antitrust Division Policy Guide to Merger Remedies 8 (2004), https://www.justice.gov/sites/default/files/atr/legacy/2011/06/16/205108.pdf.

5 FTC v. Sysco Corp., 113 F. Supp. 3d 1 (D.D.C. 2015).

6 FTC v. Staples, No. 15-cv-02115 (D.D.C. 2016).

7 United States v. Halliburton, No. 16-cv-00233 (D. Del. 2016).

8 Co-author David Gelfand represented the DOJ in the *Halliburton/Baker Hughes* case. All discussion of the case is based on public information.

9 United States v. Aetna, No. 16-cv-01494 (D.D.C. 2016).

10 Complaint at 4–5, United States v. Aetna, No. 16-cv-01494 (D.D.C. July 21, 2016).

11 FTC v. Libbey, Inc., 211 F. Supp. 2d 34 (D.D.C. 2002).

12 *Id.* at 42–43.

13 *Id.* at 46. Actually, at the time there was at least one recent case dealing with a litigated fix. See United States v. Franklin Elec. Co., 130 F. Supp. 2d 1025, 1035–36 (W.D. Wisc. 2000) (considering defendant's proposed "fix" to license intellectual property to a third party, but holding that it did not cure the anticompetitive effects of a merger between the only two existing manufacturers of the relevant product).

14 *Id.*

15 FTC v. Arch Coal, Inc., 329 F. Supp. 2d 109 (D.D.C. 2004), *case dismissed*, No. 04-5291, 2004 WL 2066879 (D.C. Cir. Sept. 15, 2004).

16 FTC v. Arch Coal, Inc., No. 04-0534, slip op. at 7 (D.D.C. July 7, 2004).

17 FTC v. Ardagh, No. 13-1021 (D.D.C. 2013).

18 Angelike Andrinopoulos Mina & Jim Abell, *The Fix Is (Not) In: Lessons from the* Ardagh *Case*, Federal Trade Comm'n, https://www.ftc.gov/news-events/blogs/competition-matters/2014/04/fix-not-lessons-ardagh-case.

19 *See* Transcript of Pre-Hearing Conference at 22–25, FTC v. Ardagh Grp., No. 13-1021 (D.D.C. Sept. 24, 2013), https://www.ftc.gov/sites/default/files/documents/cases/130924ardaghtranscript.pdf.

20 *See* Mina & Abell, *supra* note 18.

21 *See* Transcript of Pre-Hearing Conference at 29, *Ardagh Group*, No. 13-1021 ("I do not believe that [the adequacy of the proposed remedy] can be thoroughly investigated in the three weeks between now and my hearing. I just don't see it. I just don't think the negotiations are far enough along the line, and I don't think it's fair to the other side to ask them to do that.").

22 *See id.* at 37 (encouraging settlement talks); Decision and Order, Ardagh Group, S.A., No. 9356 (FTC June 17, 2014).

23 FTC v. Staples, Inc., No. CV 15-2115 (EGS), 2016 WL 2899222, at *25 n.15 (D.D.C. May 17, 2016).

24 *See id.*

25 FTC v. Sysco, 113 F. Supp. 3d 1, 72 (D.D.C. 2015).

26 FTC v. Libbey, 211 F. Supp. 2d 34, 42 (D.D.C. 2002)

27 *Id.* at 43.

28 *Id.* at 47–48.

29 FTC v. Arch Coal, Inc., No. 04-0534, slip op. at 7 (D.D.C. July 7, 2004).

30 *See Sysco*, 113 F. Supp. 3d at 73–75.

31 *See Staples*, 2016 WL 2899222, at *25 n.15.

32 *See, e.g.*, U.S. Dep't of Justice, *Antitrust Division Policy Guide to Merger Remedies* (2011), https://www.justice.gov/sites/default/files/atr/legacy/2011/06/17/272350.pdf; Fed. Trade Comm'n, *Negotiating Merger Remedies* (2012), https://www.ftc.gov/system/files/ attachments/negotiating-merger-remedies/merger-remediesstmt.pdf. In *United States v. Dairy Farmers of America, Inc.*, 426 F.3d 850, 852 (6th Cir. 2005), the Sixth Circuit held that the defendants also had the burden of demonstrating that the government's claim against the original agreement was moot. In that case, Dairy Farmers of America, a Kansas milk marketing organization, acquired a 50 percent stake in Southern Belle Dairy Co., the owner of a Kentucky milk processing plant. Both the DOJ and State of Kentucky challenged the acquisition. In July 2004, less than one week prior to filing its motion for summary judgment, Dairy Farmers agreed to swap its voting shares in Southern Belle for non-voting securities. The district court granted summary judgment for Dairy Farmers on the basis of the amended transaction because it concluded that, as revised to cover only non-voting securities, the transaction "has not resulted in [Dairy Farmers] controlling a large portion of the relevant market." United States v. Dairy Farmers of Am., Inc., No. CIV. A. 03-206KSF, 2004 WL 2186215, at *3 (E.D. Ky. Aug. 31, 2004), *rev'd and remanded*, 426 F.3d 850 (6th Cir. 2005). The Sixth Circuit, however, disagreed. The court noted that Dairy Farmers had not presented evidence it would not revert to the original agreement, and held that the plaintiffs' claim "with respect to the original agreement was not mooted by the adoption of the revised agreement." *Id.* at 857.

33 *See, e.g.*, Fed. Trade Comm'n, *Statement on Negotiating Merger Remedies*, https://www.ftc.gov/tips-advice/competition-guidance/merger-remedies (discussing what the FTC staff looks for in evaluating a proposed divestiture).

34 *See* Transcript of Pre-Hearing Conference at 29, FTC v. Ardagh Grp., No. 13-1021 (D.D.C. Sept. 24, 2013).

35 *See* FTC v. Libbey, 211 F. Supp. 2d 34, 42–43 (D.D.C. 2002).

36 *See id.* at 47–48.

37 *See also* FTC v. CCC Holdings, Inc., 605 F. Supp. 2d 26 (D.D.C. 2009). In *CCC Holdings*, the FTC sued to enjoin the merger of CCC Holdings and Mitchell International, Inc., two of the three largest automobile insurance software companies. *See id.* at 30. The merging parties proposed revising a license of Mitchell's software to a smaller competitor, Web-Est, to remove virtually all restrictions on Web-Est's rights to sell to insurance companies. *See id.* Nonetheless, the court concluded that Web-Est could not "be considered a truly independent actor because Mitchell will continue to be so involved in its business." *See id.* at 57–59. The court noted that, for a divestiture to be "curative," it "must be made to a new competitor that is in fact a willing, independent competitor capable of effective production in the market." *Id.* (internal citations and quotations omitted).

38 *Sysco*, 113 F. Supp. 3d at 77–78.

39 *See id.* at 77–78.

40 *See* Complaint at 2, United States v. Halliburton, No. 16-cv-00233_UNA (D.D.C. 2016).

41 *Id.*

42 *See Sysco*, 113 F. Supp. 3d at 21–22.

43 *See Arch Coal*, 329 F. Supp. 2d 109, 129 (D.D.C. 2004).

44 *See Arch Coal*, No. 04-0534, slip op. at 5 (D.D.C. July 7, 2004).

45 16 C.F.R. § 802.70 (2016).

46 United States v. US Airways Group, No. 13-cv-01236 (D.D.C. Aug. 13, 2013).

Modifying Merger Consent Decrees to Improve Merger Enforcement Policy

BY STEVEN C. SALOP

THIS ARTICLE ANALYZES MY short proposal for reviewing and modifying merger consent decrees to permit additional relief if the provisions of the initial consent merger are found to fail to preserve or restore competition in a reasonable period of time after the merger was consummated.[1] My proposal also would involve more frequent reviews of consummated mergers that have been cleared without challenge, particularly those that were close calls. While "Don't Look Back" might be the best anthem for artists, economic decision theory would not support that approach to merger policy.[2]

Predicting the impact of proposed mergers and remedies on consumers is difficult. As a result, remedies sometimes turn out to be insufficient to protect consumers and competition. This review and modification process would help to correct insufficient, poorly designed, or otherwise ineffective consent decrees. It will place more of the risk of failure on the merging parties who claim to the agency that the merger would not harm competition and that the remedy is sufficient to cure the agency's concerns. As a result, the merging firms likely would be incentivized to provide more efficient and effective remedies at the HSR stage, rather than bear the risk of less efficient remedies, disgorgement and other relief later. This allocation of risk to the merged firm also would help to deter the post-merger exercise of market power achieved or enhanced by the merger. For the same reasons, it also would increase the deterrence of anticompetitive mergers. Finally, it also could reduce the moral hazard of overreaching argumentation by the merging parties and their attorneys.

Review of consummated mergers is neither novel nor new. While HSR has involved pre-merger notification for the past 40 years, it did not eliminate the ability of the agencies to issue complaints against consummated mergers. The agencies occasionally do bring enforcement actions for consummated transactions after several years. Perhaps the most notable recent example is the action brought in 2004 against Evanston Northwestern Healthcare about four years after the transaction closed without challenge.[3] The FTC's hospital merger retrospectives studies apparently began sometime after August 2002.[4] There have also been cases where complaints were issued immediately after a merger was consummated, including *Bazaarvoice*,[5] *Heraeus Electro-Nite*,[6] and *Chicago Bridge*.[7]

While these matters involved transactions that previously either were not notified or not challenged under HSR, post-merger review and modification provisions also should be included as a matter of course for mergers that are challenged and settled with consent decrees.[8] Proposals for such post-merger reviews also are not new. In his 1998 article, Brian Facey took a decision-theory approach in proposing post-merger review of efficiencies.[9] He pointed out that Professor Joseph Brodley made a proposal for post-merger reviews a decade earlier.[10] The FTC also contemplated a post-merger review in the Lilly/PCS vertical merger. As described by FTC Chairman Robert Pitofsky in a 1995 speech, the FTC's statement said that "[i]f subsequent developments indicate anticompetitive effects, despite the presence of the negotiated order, the Commission commits itself to seek other relief including, if necessary, post-acquisition divestiture."[11] Facey also cited a Pennsylvania hospital case that contained a "put up or shut up" consent decree requiring "efficiency shortfall to be paid to the Attorney General's office after 5-year trial period."[12]

However, the type of consent decree review process outlined here has not become the norm.

The Goals and Benefits of the Review and Modification Proposal

There are two general goals served by antitrust sanctions, which can be called "ex ante" and "ex post" goals. The ex ante goal is to deter initial conduct that would lead to the need for ex post relief. If deterrence works perfectly, of course, there will be no need for the ex post remedy. In cases where deterrence fails, the ex post goal is to prevent future harms. Interestingly, ex post remedial inefficiency that can arise from delaying relief is a two-edged sword. A higher cost ex post remedy actually can incentivize more efficient ex ante behav-

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ior. Those extra costs should incentivize the merging firms to avoid proposing ineffective remedies during the premerger process or exercising market power caused by the merger. In this way, the post-merger review and modification process acts as a partial guarantee by the merging firms.

These two general goals suggest three specific benefits of the review and modification proposal: (1) to remedy ineffective consent decrees in order to preserve and restore competition; (2) to facilitate the adoption of more effective remedies during the HSR process; and (3) to deter anticompetitive mergers and the exercise of market power achieved from mergers.

First, the review and modification process can provide an important backstop process for divestitures that fail from (say) bankruptcy of the divestee or unethical behavior by the divesting firm that does not violate the decree The well-known bankruptcies in the Hertz/Dollar Thrifty[13] and Albertsons/Safeway[14] divestitures are two recent examples.

Second, these reviews and potential modifications can provide a backstop where the assumptions underlying the relief in the initial consent decree turn out to have been incorrect or where the relief turns out to be insufficient to preserve competition and protect consumer welfare. Firms already have the right to petition for relief from consent decrees when conditions in the market have changed. This proposal creates symmetry.

This backstop is needed, given the record of current merger policy. For example, John Kwoka has reported on his research on merger retrospectives. In his 2013 article, his database had 46 true mergers, for which 38 (83 percent) had price increases averaging almost 10 percent, whereas the other 8 had average decreases averaging almost 5 percent, implying significantly higher prices on balance.[15] In his 2015 book, Kwoka had a larger sample of transactions.[16] Robert Skitol's review of Kwoka's book highlighted and quoted the following highly "provocative" results:[17]

- "At the product level, the average outcome for all 119 observations on postmerger prices is an increase of 4.3 percent . . . . More than 60 percent of product price changes show increases, and those increases average nearly 9 percent. . . . Of all mergers that resulted in price increases, the agencies acted in only 38 percent of cases, suggesting substantial under-enforcement. Incorrectly cleared mergers on average resulted in price increases in excess of 10 percent."[18]
- "For all cases in which the agencies challenged mergers, the outcome was . . . an average price increase of 7.71 percent, indicating incorrect determinations or ineffective remedies to the mergers."[19]
- "[D]ivestiture remedies are associated with price increases of 6.11 percent," casting doubt on their adequacy. "Conduct remedies result in price increases of 12.81 percent, suggesting that these are largely ineffective in restraining postmerger price increases."[20]
- While less frequently studied, "the nonprice effects of mergers generally mirror the measured price effects. Anticompetitive price increases tend to be accompanied by reductions in quantity, quality, and R&D."[21]

While these studies do not indicate that all mergers lead to higher prices, they do indicate a weakness in merger enforcement policy.[22]

These harms are not surprising in light of the agencies' current apparently limited remedial goals. The goal of preserving competition is often considered to mean that a remedy (say, a divestiture) should be limited to just enough to prevent harms from the merger, not to strictly benefit consumers, relative to the absence of the merger.[23] With this limited goal, consumers would be expected on average to obtain zero net benefits from settled mergers.

Suppose that the parties instead reject the settlement demand, in which case the transaction is abandoned or litigation ensues. If the transaction is abandoned or if the case goes to court and the agency successfully secures a court injunction, there would be neither benefits nor harms. But, if the agency loses its challenge, and the decision is a false negative, then consumers are made worse off. Thus, if the agency's expectations were accurate, then overall consumer welfare would be harmed on balance from the entire universe of challenged mergers. Consumers also would be harmed from mergers where the agency accepts a somewhat weaker divestiture (i.e., accepting some consumer harm) in order to avoid the greater possible harm from losing its challenge in court.

Third, the proposal also can have beneficial effects on the incentives of the merging parties, both before and after the merger. During the pre-merger process, the merging parties and their attorneys might be deterred from over-claiming, once they recognize that their claims about large efficiencies, easy entry, big buyers, or other reasons for lack of potential market power harms might be later reviewed and evaluated. Their incentives to propose flawed remedies similarly would be reduced, knowing that the remedial failure would lead to further relief. The fact that future remedies may be more costly could provide a further incentive to solve the problems before the merger. After the merger is consummated, the merged firm also may be deterred from exercising market power gained from the merger out of fear that this conduct will lead to demands for further relief. Finally, the proposal might deter some anticompetitive mergers, in that the likely private benefits from such mergers would be reduced.

Finally, while this post-merger review and consent decree modification process is designed to complement pre-merger relief, in principle it might permit the agencies to demand smaller divestitures or other relief in certain cases, knowing that there can be further adjustments later, if needed. Similarly, the prospect of subsequent reviews in principle could allow the agencies to forgo challenging some very "close-call" mergers that otherwise would be challenged, as mentioned by Chairman Pitofsky.[24] However, it is important that this forbearance is applied only in the most limited circumstances, not as a significant change in merger enforcement policy. Replacing the current process of pre-merger relief with one in which mergers routinely are permitted to be consummated, subject only to subsequent enforcement during a probationary period, would be a serious policy error. Post-consummation reviews may be imperfect and remedial choices will be more limited. In addition, it may be difficult to compensate customers for the harms suffered during the interim period. The "Pyrrhic victories" of the pre-HSR world and the *Evanston Northwestern* consent decree make this point crystal clear. While a full-fledged policy of disgorgement and Treasury payments (as discussed below) might generate deterrence, it is better to fix the merger in advance or "just say no."

The Basic Review and Modification Proposal

The review and modification proposal would make explicit the performance goals currently implicit in any consent decree. Currently, DOJ consent decrees contain general language regarding potential modification by the court, and the Commission has the right to reopen and modify FTC orders.[25] However, the court often will treat the provisions of a consent decree as contractual and limiting, and will not permit modification if those provisions fail to achieve some overarching goal of maintaining at least the same level of competition as existed before the merger or would occur absent the merger. Nor do consent decrees state this overarching goal. By making the performance goals and review process explicit, the proposed policy will overcome the current limitations on modifying consent decrees.

Under the proposal, consent decrees would include explicit review and modification provisions that would give the agency the power to petition the court to order further relief if the consent decree fails to preserve competition and protect consumer welfare.[26] While I will not suggest specific language here, the consent decree would specify that modification of the remedial conditions are permitted where the purpose of the decree to preserve the degree of competition that would occur absent the merger (or, restore and preserve competition, in the case of judgments applied to consummated mergers) has not been achieved. It would be useful to flag specific issues that might suggest a potential need for subsequent modification as well as general language about preserving competition. The types of harms might be flagged, but merely as non-exclusive examples, so that the decree is not overly limiting to the agency or the court. It also might be useful for the provision to specify the burden of proof and production. In this way, the relevant conditions would be clear to the parties, and the voluntarily agreed-upon consent decree provisions could be better enforced by a court. Similar language might be used in closing statements for mergers that are cleared without challenge.

The overarching purpose of the remedial modifications would be to terminate the harm to competition, restore competitive conditions, and deprive the merged firm of the fruits of an ineffective remedy. As discussed in more detail below, the modifications could involve further divestitures or other remedies. They also could include disgorgement of supracompetitive profits. Absent another effective remedy, they might include monetary payments to the Treasury to disgorge expected future supracompetitive profits caused by the merger or oversight of future prices.

A consent decree also should require the merged firm to submit certain annual information to the agency to facilitate potential review of the success of the decree in preserving (and restoring) competition. This routinely provided information should not be excessive. For example, the agencies obviously should not be provided an annual "refresh" to the HSR second request. While more analysis of the data requirements needs to be undertaken, ordinary course data on prices, margins, quantities, and market shares of the merged firm and its competitors may well be sufficient, at least for an initial review. If the agency requires additional information for a full-fledged review, the parties should have the right to demand that the agency show the reasonableness of its requests. The requirement for these disclosures should involve a sunset provision. Merging firms should not be subject to perpetual probation.

If the merging parties dispute the need for further relief, the agency would need to defend its actions in court (or perhaps through an administrative hearing process in the case of the FTC) in an expedited proceeding. The burden of persuasion to modify the decree would be placed on the agency, but the burden should not be excessive. A burden of production would be placed on the parties because they have better access to certain information.

The *Evanston Northwestern* complaint was filed about four years after the merger, though the review obviously began before that date. This raises the question of the normal time lag before carrying out the typical review. On the one hand, a longer time frame means that more independent market forces could be affecting competition, which would make it more difficult to know whether the initial relief had failed or whether other factors were responsible for the outcome. A longer time frame also means that the remedy would be delayed and the remedial alternatives may become narrowed. On the other hand, it might take a significant period for the market power harms to become clear. There is also the concern that the merged firm might hold down prices until the review period has passed. Thus, the choice of time frame is an issue for further analysis. One initial proposal might be for the agencies typically to carry out the review within a 3–4 year period. It also seems reasonable to limit the agencies to only a single review. However, this comes with a significant caveat. If there is evidence that the merged firm subsequently raised prices as a result of market power flowing from or enhanced by the merger, the period might be lengthened somewhat or there might be a second review. The same caveat would apply if the parties were found to have engaged in substantial misrepresentation.

Any judicial or administrative proceeding for modification of a consent decree should be carried out on an expedited basis, if possible. A longer delay may reduce the ability to craft an efficient remedy and thus subject the firm to additional disgorgement and/or damages from private litigation.

Alternative Remedial Modifications and Relief Provisions

There are potential limitations involved in enforcement after the consummation of the merger. In *Evanston Northwestern*, the Commission did not follow the Administrative Law Judge's recommendation to require divestiture.[27] It also did not order disgorgement of the supracompetitive profits.[28] Instead, it simply adopted a "highly unusual" remedy of requiring the parties to engage in "independent negotiation." Unfortunately, this remedy seems impossible to monitor and instead mainly appears to be window dressing.

This remedial failure raises the issue of whether the review and modification proposal ever could lead to any real-world market benefits. It can be difficult to unscramble the eggs. However, analysis of the ex ante and ex post goals suggests that there would be substantial benefits by restoring competition and increasing deterrence through alternative modifications.

The agency might ask the court to order one or more of the following specific types of relief:

- ***Divestitures:*** Divestitures are the standard remedy to preserve competition potentially lost from the merger. They also would be the first remedy considered in the post-merger review and modification process. The efficacy of divestitures would depend on the type of industry. While it might be straightforward to divest some additional grocery stores, divestiture of a plant would be impossible if, in the years following the transaction, the merged firm replaced two pre-merger factories with a single, larger factory.
- ***Other Structural and Behavioral Remedies:*** In the situation where divestitures are not possible or are highly inefficient, the modification remedy might involve licensing of intellectual property rights, technology, or know-how at zero or below-market rates. Customers may be given the option to terminate existing contracts early in order to reduce barriers to entry. If the merging firm faces a small fraction of captive customers that have been targeted for price increases while most other customers are more mobile and obtain lower prices, then it might be feasible and efficient to mandate contractual constraints on price differentials. Or, it might be efficient to prohibit contractual or unilateral restraints on resale by non-captive customers.[29]
- ***Divestitures and Remedies in Other Markets:*** If divestitures or other remedies in the harmed market are not possible or are highly inefficient, the remedy might entail divestitures or other remedies designed to increase competition in other markets in which the merged firm competes and has market power. It would be preferable for the remedies to target other products purchased by the same consumers harmed by the merger. While this involves some cross-market balancing that is not normally done for mergers, the difference here is that the fear of such remedies could have beneficial deterrence effects on the merged firm regardless of which group of consumers gain the benefits.[30]
- ***Disgorgement:*** While disgorgement of overcharges flowing from supracompetitive prices does not eliminate market power, the fear of disgorgement can deter its exercise. Thus, if the merged firm fears that the agency would be able to prove that the merger raised prices, relative to the but-for world, that fear could deter post-merger price increases. Fear of private treble damages actions might have similar deterrence effects. If these penalties are not certain, or if not all mergers are reviewed, the deterrence benefits will be more limited, which suggests that the policy should be more aggressive when harm is detected. In addition, the fact that the policy likely would involve a single post-merger review conducted within a few years after the merger is consummated raises a separate concern that the fear of disgorgement might only deter price increases during this interim period.
- ***Payments to the Treasury:*** Suppose that the post-merger review shows that the merger provided the firm with durable market power that cannot be effectively remedied ex post. In that case, the agency might petition the court to order the merged firm to make monetary payments to the Treasury to disgorge the net present value of future profits accruing from the likely exercise of market power caused by the merger. These payments would not deter those future price increases, of course. However, the anticipation of having to make such payments could deter merging firms from undertaking the very conduct that would lead to these payments being required.
- ***Ongoing Oversight of Prices:*** Oversight of prices can be a remedy of last resort as a substitute for the monetary payments to the Treasury. If deterrence fails and the agency makes a dramatic error of clearing a merger that creates durable monopoly power that cannot be otherwise remedied, society may be left with only two choices: (1) have a court (or regulatory agency) monitor and regulate the monopoly with the attendant imperfection of regulation; or (2) force consumers and society to suffer the distributional and efficiency harms inherent in monopoly (albeit while forcing the firm to disgorge the expected future supracompetitive profits with payments to the Treasury). While ongoing oversight of prices may create great discomfort for antitrust practitioners, commentators, and the regulated firms, paying monopoly prices creates great discomfort for consumers, who are entitled to protection by the antitrust laws.

Potential Criticisms of the Proposal

There are several criticisms that might be levied against the review and modification process. First, these post-merger reviews would involve more work for the agencies and more cost for the parties. While the costs likely would fall far short of a full HSR second request, they would not be trivial in situations where market power harms appear to have occurred. For this same reason, not all mergers would be reviewed in detail and detection of remedial failure would necessarily be imperfect. However, this does not seem to be a good policy reason to abandon the proposal. The bang-per-buck in terms of market correction and deterrence likely would be high.

Second, the available remedies available after the eggs have been scrambled may be more limited than those that could have been mandated in advance. However, as already discussed, certain divestitures and other remedies will remain possible. In addition, the fear of monetary sanctions and other corrective actions can serve to deter anticompetitive behavior by merged firms and anticompetitive mergers.

Third, the post-merger review raises a potential "false positive" error cost concern. The review might erroneously attribute adverse competitive effects to the merger and would lead the court to order additional relief. If this is a significant possibility, the fear of such erroneous remedies might deter the merged firm from engaging in certain procompetitive conduct.[31]

However, this concern about over-deterrence comes with several significant caveats. For one thing, it is well known in the law and economics literature that both false positive and false negative errors tend to lead to under-deterrence, not over-deterrence.[32] In addition, there is less (if any) over-deterrence concern for certain types of conduct. For example, suppose that the merged firm is concerned that it will face the prospect of additional relief if it leads or follows consciously parallel, oligopolistic price increases after the merger. (While such oligopoly pricing does not violate Section 1, a merger that facilitates more successful oligopoly pricing can violate Section 7.) That deterrence actually would increase consumer welfare. Moreover, deterring oligopolistic price increases that would have occurred even absent the merger would not cause social harm. The same consumer benefits would accrue to price increases forgone in response to demand increases when prices initially are supracompetitive and variable costs are constant.

Price increases also could have been caused by changes in demand or costs or other exogenous supply factors not related to the merger. The merged firm may fear that this conduct might be falsely criticized as the exercise of harmful market power flowing from the merger. Similarly, the merged firm contemplating a quality increase that would raise nominal prices, while reducing quality-adjusted prices, might fear that the agency would undervalue or even ignore the quality increase, and thereby treat the conduct as an exercise of market power.

This source of error and over-deterrence does raise a caution. It means that the agencies will need to take care in carrying out their reviews. It is not enough simply to evaluate the change in nominal prices since the merger. The agency must evaluate quality-adjusted prices as well as nominal price increases and the resulting impact on output. The agency similarly must determine the prices relative to those that would have occurred absent the merger. However, this type of comparison is within the competence of the agencies and the courts to evaluate. It therefore does not seem like a sufficient reason to give the firm a free pass after settling the case with a consent decree.

Finally, this latter discussion might lead to a criticism that the proposal is demanding a zero failure rate for merger consent decrees. That is not the case. While the agencies certainly should strive for perfection, that outcome is not possible in an uncertain world, even with this modification process. The modification process will face the remedial constraints detailed here, as well as informational constraints. Instead, the goal and benefits of the proposal are to lead to improved outcomes and deterrence. In addition, by reviewing the efficacy of consent decrees in this process, it is likely that the design of future consent decrees also can be improved. While this will be more work for the agencies, that extra work is necessary. Leaving in place flawed consent decrees harms consumers and competition and compromises the integrity and public perception of the merger enforcement process.

Conclusion

Legislation is not required to adopt this review and modification proposal. All that is required is a will by the agencies to improve merger enforcement policy. For a merger settled by consent decree, the agencies can insist on including a review and modification provision in the consent decrees. In a case in which the merging parties "litigate the fix" in court and prevail, it also would be natural for the court to include a review and modification provision in its order.

However the policy is implemented, using review and modification provisions in merger enforcement makes economic sense. As emphasized above, consumers currently bear the entire downside risk. Merging firms have little incentive to avoid over-reaching claims during the HSR review. The use of post-merger reviews and consent decree modification provisions can mitigate these concerns. Asking the merging firms to "put their money where their mouth is" can both partially insure consumers against the downside risk and facilitate a more efficient merger enforcement process. ■

1 This proposal was discussed on a panel at the ABA Antitrust Section Spring meeting, April 6, 2016. I would like to thank Mark Angland, Jonathan Baker, David Balto, Steven Calkins, Brian Facey, Richard Gilbert, Kathryn Fenton, Andrew Gavil, William Kovacic, John Kwoka, Roger Noll, Steve Ross, Fiona Scott Morton, Steven Sunshine, David Vladeck, and the panel participants (John Harkrider, James Nichols, Barry Nigro, and Paula Render) for helpful comments on the proposal.

2 *See* Bob Dylan, *She Belongs to Me* (1965).

3 Opinion of the Commission, Evanston Northwestern Healthcare Corp., FTC Docket No. 9315 (Aug. 6, 2007), https://www.ftc.gov/sites/default/files/documents/cases/2007/08/070806opinion.pdf. For a survey of con-

summated merger cases, see U.S. Submissions to OECD and Other International Competition Fora, *Investigations of Consummated and Non-Notifiable Mergers* (Feb. 5, 2014), https://www.ftc.gov/system/files/attachments/us-submissions-oecd-other-international-competition-fora/consummated_mergers_us_oecd.pdf.

4 Press Release, Fed. Trade Comm'n, Federal Trade Commission Announces Formation of Merger Litigation Task Force (Aug. 28, 2002), https://www.ftc.gov/news-events/press-releases/2002/08/federal-trade-commission-announces-formation-merger-litigation.

5 United States v. Bazaarvoice, No. 13-cv-00133-WHO, 2014 WL 203966 (N.D. Cal. filed Jan. 8, 2014), https://www.justice.gov/atr/case-document/file/488846/download.

6 Final Judgment, United States v. Heraeus Electro-Nite Co., No. 1:14-cv-00005-JEB (Apr. 7, 2014), https://www.justice.gov/atr/case-document/file/498631/download.

7 Chicago Bridge & Iron Co. v. FTC, 534 F.3d 410, 420 and n.2 (5th Cir. 2008).

8 This is the process for at least some non-merger consent decrees. A notable example involves the ASCAP and BMI consent decrees, which have been revisited periodically. In the most recent review in 2014, the DOJ's request for comments explicitly included questions about competitive effects. For example, they asked, "Are there provisions that are ineffective in protecting competition?" and "What, if any, modifications to the Consent Decrees would enhance competition and efficiency?" *See* Antitrust Division Review of ASCAP and BMI Consent Decrees 2014, https://www.justice.gov/atr/ascap-bmi-decree-review.

9 Brian A. Facey, T*he Future of Looking Back: The Efficient Modeling of Subsequent Review*, 44 Antitrust Bull. 519 (1999).

10 Joseph Brodley, *The Economic Goals of Antitrust: Efficiency, Consumer Welfare and Technological Progress*, 62 N.Y.U. L. Rev. 1020 (1987).

11 Robert Pitofsky, Chairman, Fed. Trade Comm'n, Subsequent Review: A Slightly Different Approach to Antitrust Enforcement, Address to the ABA Antitrust Section (Aug. 7, 1995). The Commission Statement concludes: "If the Commission concludes that competition is being reduced as a result of these vertical arrangements, it will seek appropriate relief against any firms engaged in anticompetitive conduct, including if necessary post-acquisition divestitures." Statement of the Commission, Eli Lilly and Co., FTC Docket No. C-3594, 120 F.T.C. 243, 254 (1995).

12 Facey, *supra* note 9, at 525 n.22 (citing Pennsylvania v. Providence Health Sys., Inc., No. 4: CV-94-772, 1994 WL 374424 (M.D. Pa. May 26, 1994)).

13 Hertz divested the Advantage brand in December 2012 to FNSA in a transaction financed by Macquarie. David McLaughlin, Mark Clothier & Sara Forden, *Hertz Fix in Dollar Thrifty Deal Fails as Insider Warned,* Bloomberg (Nov. 19, 2013), http://www.bloomberg.com/news/articles/2013-11-29/hertz-fix-in-dollar-thrifty-deal-fails-as-insider-warned. The FNSA CEO was fired some months later and Advantage subsequently declared bankruptcy in late 2013. *Id.* The Advantage assets were later sold to a private equity firm, Catalyst Capital, in January 2014, which then acquired the EZ Rent-A-Car chain in a transaction that closed in June 2015. Danny King, *Advantage Completes E-Z Rent-A-Car Deal*, Travel Weekly (June 8, 2015), http://www.travelweekly.com/Travel-News/Car-Rental-News/Advantage-completes-EZ-Rent-A-Car-deal?ct=.

14 The divestee, Haggen, declared bankruptcy and sued Albertsons for damages in September 2015. Complaint, Haggen Holdings v. Albertsons, No. 1:99-mc-09999, 2015 WL 5138125 (D. Del. Sept. 1, 2015) [hereinafter Haggen Complaint], http://media2.haggen.com.s3.amazonaws.com/website/temp/Haggen_Albertsons-Timestamped_copy_of_complaint.pdf. In the end, the lawsuit was settled for $5.75 million in January 2016. In April 2016, Haggen sold 29 stores in the Northwest U.S to Albertsons for $106 million. *See* Ivan Cruz, *Alberstons Paying 5.75 Million to Settle Haggen Lawsuit*, Abasto (Jan. 26, 2016), http://abastomedia.com/en/news/albertsons-paying-5-75-million-to-settle-haggen-lawsuit/; Associated Press, *Judge OKs $106 Million Sale of Haggen to Alberstons*, Wash. Post (Mar. 29, 2016), https://www.washingtonpost.com/business/judge-oks-106-million-sale-of-haggen-to-albertsons/2016/03/29/9ec0d90a-f625-11e5-958d-d038dac6e718_story.html.

15 John W. Kwoka, Jr., *Does Merger Control Work? A Retrospective on U.S. Enforcement Actions and Merger Outcomes*, 78 Antitrust L.J. 619, 632 (2013). The sample also included some joint ventures and airline code sharing agreements.

16 John W. Kwoka, Jr., Mergers, Merger Control and Remedies; A Retrospective Analysis of U.S. Policy (2015).

17 Robert A. Skitol, *A Harsh Report Card on the Merger Enforcement Process*, Antitrust Source (Feb. 2015), http://www.americanbar.org/content/dam/aba/publishing/antitrust_source/feb15_skitol_review_2_11f.pdf.

18 Kwoka, *supra* note 16, at 155.

19 *Id.* at 156.

20 *Id.*

21 *Id.* at 159.

22 The FTC currently is engaged in a study that will analyze the sufficiency of remedies. Press Release, Fed. Trade Comm'n, FTC Proposes to Study Merger Remedies (Jan. 9, 2015), https://www.ftc.gov/news-events/press-releases/2015/01/ftc-proposes-study-merger-remedies. However, it does not appear that the FTC intends to bring enforcement actions to modify consent decrees for mergers that have failed to attain their goal of preserving competition.

23 For further analysis of this issue, see Steven C. Salop, *Merger Settlement and Enforcement Policy for Optimal Deterrence and Maximum Welfare*, 81 Fordham L. Rev. 2647 (2013).

24 Pitofsky, *supra* note 11.

25 *See, e.g.*, United States v. United Shoe Co., 391 U.S. 244, 252 (1968). For two competing approaches to consumer protection consent decrees, compare FTC v. Trudeau, 662 F.3d 947 (7th Cir. 2011), with FTC v. Garden of Life, Inc., 845 F. Supp. 2d 1328 (S.D. Fla. 2012).

26 There are some informal look-backs today. Certain firms are repeat players at the agencies. When a subsequent merger is notified, it is common for the agencies to look back at previous merger to determine whether the "promised" results were achieved. In addition, if the agency finds evidence of misrepresentation in the previous deal, they presumably could bring an enforcement action for that conduct.

27 Opinion of the Commission, Evanston Northwestern Healthcare Corp., FTC Docket No. 9315, at 5 (Aug. 6, 2007), https://www.ftc.gov/sites/default/files/documents/cases/2007/08/070806opinion.pdf.

28 Opinion of the Commission on Remedy, Evanston Northwestern Healthcare Corp., FTC Docket No. 9315 (Apr. 28, 2008), https://www.ftc.gov/sites/default/files/documents/cases/2008/04/080428commopiniononremedy.pdf.

29 Where exactly to place these remedies along the structural-behavioral continuum is unclear. Most require less (if any) continued monitoring by the agency or court than would ongoing price regulation. But determining the royalty level for "below-cost" licenses even once would insert the agency or court into a price setting role.

30 Of course, competitors currently benefiting from legitimate market power in the second market might complain about the increase in competition being forced on their market.

31 In an extreme scenario, the merged firm might raise prices in order to prevent an inefficient divestee from exiting the market. However, while the divestee would not exit, the price increases themselves would attract the attention of the agency.

32 Jonathan Baker, *Taking the Errors Out of "Error Cost" Analysis: What's Wrong with Antitrust's Right*, 80 Antitrust L.J. 1, 6 n.19 (2015); Salop, *supra* note 23, at 2669 n.60.

Private Equity and Antitrust: A New Landscape

BY JAMES A. KEYTE AND KENNETH B. SCHWARTZ

IN 2015, MERGER AND ACQUISITION activity hit record numbers. While that record-setting pace slowed during the first half of 2016, private equity transactions did not, as PE investors had "more than enough capital to fuel typical investment cycles for some time."[1] And while the year's end will bring more clarity on how deal flow charted during the second half of 2016, experts anticipate that PE deal flow will spike during the period.[2]

At the same time, PE firms (and their advisors) are increasingly beginning to understand that antitrust is no longer a subject that can be taken for granted. To be sure, for decades very few PE deals—typically "financial" deals with no competitive consequence—raised antitrust concerns. But this, too, has changed. Not only are PE firms engaged in more "strategic" deals than ever—which can be subject to review by the Federal Trade Commission or the Department of Justice—the agencies are also increasingly concerned over partial acquisitions and overlapping minority interests in competitors.[3] When the risk of private litigation (e.g., over "club deals") is added, PE firms are well advised to make antitrust a standard gating issue for all transactions.

In this article, we provide an overview of antitrust issues that PE firms have faced, including majority acquisitions, "club" bidding, minority investments and interlocking directorates. We then provide some practical tips on how to keep PE firms out of hot water in today's antitrust environment.[4]

Relevant Statutes

There are two antitrust statutes under which private equity firms' conduct can be challenged—the Clayton Act and the Sherman Act. Section 7 of the Clayton Act prohibits any acquisition that may substantially lessen competition in a relevant market, while Section 8 prohibits the same individuals from serving as board members for two competing firms (i.e., "interlocking directorates"). Section 1 of the Sherman Act prohibits agreements between or among competitors (including, of course, competing firms fully or partially owned by PE firms) that unreasonably restrain trade. For PE firms, all of these provisions are in play.

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Clayton Act Section 7: Full Acquisitions

While less frequent than partial acquisitions of new companies, there are situations where a PE firm wishes to fully combine two of its majority-owned portfolio companies. The starting point for antitrust analysis in such situations is the Supreme Court's decision in *Copperweld Corp. v. Independence Tube Corp.*[5] In *Copperweld*, the Court held that a firm is incapable of conspiring with its wholly owned subsidiary because, for purposes of the antitrust laws, the two companies should be treated as a "single entity."[6] Shortly thereafter, courts began to recognize that—under *Copperweld*—two firms that were wholly owned by the same company (so-called sister companies) likewise should be viewed as a single entity.[7] An interesting question, however, is, how should a firm's *majority-owned* subsidiaries—or in the private equity context, how should a fund's *majority-owned* portfolio companies—be viewed under the antitrust laws and the agencies' Horizontal Merger Guidelines?[8] While one might reasonably presume that the merging of a PE's majority-owned companies should be an antitrust non-event, the DOJ's recent investigations into two transactions show that it is not so simple.

The issue arose in the 2015 merger of Ainsworth Lumber Co. Ltd. and Norbord Inc., both of which were majority-owned, but not wholly owned, by Brookfield Asset Management (BAM). Specifically, at the time of the transaction, BAM owned 50.53 percent of Norbord and 54.4 percent of Ainsworth, and both companies produced oriented strand board (OSB). The parties argued that because BAM had legal control—through these ownership positions—over both Ainsworth and Norbord, all three companies should be treated as a single entity and thus be shielded from challenges under the antitrust laws, including Section 7.

The issue was particularly hot because, less than a year earlier, the DOJ had threatened to block Louisiana-Pacific Corp.'s (LP) acquisition of Ainsworth (the LP deal)—a threat that caused LP to abandon the transaction.[9] According to the DOJ, the LP deal would have harmed competition in geographic markets defined as the "Upper Midwest" and the "Pacific Northwest" because LP and Ainsworth were two of only three principal producers of OSB in the region (i.e., in the DOJ's view, the deal was a "3-to-2" merger with serious structural concerns that made it presumptively anticompetitive).[10] Critically, the other OSB producer that created the problem for the DOJ was Norbord, even though it and Ainsworth were majority-owned by the same private equity firm. Hence, in the subsequent proposed transaction—where Norbord rather than LP would acquire its sister company, Ainsworth—the natural assumption was that the DOJ would maintain that this was a 3-to-2 merger that eliminated one of three OSB competitors in the region, presumably raising the same antitrust concerns as the abandoned LP/Ainsworth transaction.

In the subsequent investigation, the scope and history of *Copperweld* quickly became a major issue. In *Copperweld* (back in 1984), the DOJ filed an amicus brief in which it advanced a fairly simple position: firms that shared a common owner are a single entity for antitrust purposes so long as the common owner has *legal control* over both firms as a result of its ownership positions.[11] Indeed, the DOJ went further in its brief, explaining that this rule should apply even when the two commonly owned firms hold themselves out to the marketplace as independent competitors.[12]

Federal courts largely embraced this power-to-control test in the wake of *Copperweld*. The most directly on-point case is *Novatel Communications, Inc. v. Cellular Telephone Supply, Inc.*,[13] in which the court recognized that a company and its 51 percent-owned subsidiary deserved single-entity treatment under *Copperweld*. Essential to the court's reasoning was that the parent corporation had legal control of its subsidiary and thus could direct its actions at any time: "The 51 percent ownership retained by Novatel–Canada assured it of full control over Carcom and assured it could intervene at any time that Carcom ceased to act in its best interests."[14] The court's conclusion was clear: if a parent has over 50 percent ownership in a subsidiary's voting shares, then it has legal control over that subsidiary, and the two companies should be considered a single entity for antitrust purposes.[15]

Other courts, as well, have found that over 50 percent ownership is the proper threshold for single-entity status under *Copperweld*, effectively holding that the parent's ownership interest gives it legal control over the subsidiaries.[16] For example, in *Bell Atlantic Business System Services v. Hitachi Data Systems Corp.*,[17] the court held that the parent's legal control over its subsidiary eliminated the need for any factual inquiry before holding that the two companies were a single entity for antitrust purposes.[18] The court reasoned that because owning over 50 percent of a subsidiary's voting shares gives the parent legal control over the subsidiary, *Copperweld*'s control test is satisfied, and single-entity status therefore should apply.

Yet for those practitioners who find themselves working through a *Copperweld* issue (for PE firms or others and in any context), there are a few "outlier" decisions. For example, in *Aspen Title & Escrow, Inc. v. Jeld-Wen, Inc.*,[19] the District of Oregon adopted a de minimis standard that appears to flow from a misinterpretation of post-*Copperweld* case law. The *Aspen Title* court held that a parent and its two majority-owned subsidiaries (in which the parent owned 60 percent and 70 percent, respectively) should not be treated as a single entity.[20] But critical to that holding was the (questionable) reliance on *Sonitrol of Fresno, Inc. v. AT&T Co.*,[21] in which the court merely declined to extend *Copperweld* protection to AT&T and two corporations in which AT&T owned *minority* interests of 32.6 percent and 23.9 percent, respectively.[22] Further, the *Sonitrol* court noted that legal control of the subsidiaries "rested firmly in the hands of their board of directors," not in the hands of AT&T.[23] In other words, the *Sonitrol* court itself recognized the legal control principle as the guiding factor; it just found that AT&T did not actually have legal control because it did not own a majority of the subsidiaries' voting shares.

Aspen Title also is in conflict with *Bell Atlantic*, another district court case within the Ninth Circuit in which the court held that, because the parent had legal control over its subsidiary, it need not engage in a factual inquiry before holding that the two companies were a single entity for antitrust purposes.[24] Together, *Sonitrol* and *Bell Atlantic* make clear—even within the Ninth Circuit—that the proper test for single-entity status is whether the companies in question share a common majority owner. If they do, then *Copperweld* immunity should protect all three companies (the parent and its two majority-owned subsidiaries) from antitrust liability.

Ultimately, the DOJ did not challenge the Norbord/Ainsworth transaction, and while the parties cannot be sure that the *Copperweld* issue was dispositive, there is little doubt that it was an issue that would have been a tough one for the DOJ to litigate in a merger context. Indeed, the Hart-Scott-Rodino Act itself is interpreted as treating "control" similarly, providing that "control" is present in the cases of a 50 percent economic interest for noncorporate entities or a 50 percent ownership of the voting securities in a corporate entity (or the contractual right to appoint 50 percent of the corporate entity's directors).[25]

In sum, a PE firm's decision to merge majority-owned entities should not be a Section 7 problem, but practitioners need to know that the agencies may not view the *Copperweld* issue the same way, and the parties, therefore, should be prepared to address it.

Club Bidding/Pooling Deals. Another acquisition context that has received an enormous amount of attention is when private equity funds engage in some form of "pooling" or "club" deals—transactions in which multiple private equity funds collaborate with each other in some fashion in order to bid jointly for a target. Unlike the stock acquisition scenarios discussed above, club bidding issues typically arise before an acquisition—i.e., when the clubs or collaborations first form for the purpose of making a joint bid—and thus fall under Section 1 of the Sherman Act.[26]

The DOJ opened an investigation into club bidding practices in 2006, but no formal decision resulted from that investigation. Presumably, the DOJ concluded that there was no issue, because sellers could control the bidding process, including requiring transparency of participants and their relationships. With no agency action forthcoming, the only enforcement efforts that have been made were by private plaintiffs, who have brought a handful of private class actions since 2006. In those actions, courts have consistently found that the rule of reason should apply to the agreements to form bidding clubs; this means that, if the club formation were challenged, plaintiffs would have to demonstrate anticompetitive effects in a well-defined economic market, and the pool/club would have to be prepared to demonstrate that there were substantial procompetitive justifications for the agreement to submit a joint bid and that these justifications outweighed any adverse anticompetitive effects.[27] One court has dismissed a Section 1 club dealing claim at the pleading stage based on plaintiff's failure to allege such anticompetitive effects.[28]

Dahl v. Bain Capital Partners, LLC[29] is the leading case in analyzing club bidding. Former shareholders of public companies that had gone through leveraged buyouts (LBOs) sued the private equity funds involved in orchestrating and executing the LBOs. The plaintiffs claimed that the defendant private equity funds conspired with one another, through submitting joint club bids and agreeing that some firms would not participate in certain companies' LBOs, in order to drive down the purchase prices for those companies. Given the alleged market allocation and alleged agreement to manipulate LBO purchase prices, the plaintiffs claimed that they were deprived of the true value of their stock during the buyouts. The plaintiffs' case survived a motion to dismiss.[30]

Following discovery, the defendant private equity firms moved for summary judgment, arguing that the club bids were not part of a broad, overarching conspiracy, but rather were commercially beneficial arrangements motivated by many procompetitive justifications. Specifically, the firms asserted that club deals allowed private equity firms to compete for larger transactions than otherwise possible, share business expertise, cut costs, and diversify and minimize risk.[31] The fund defendants argued that, in light of these procompetitive benefits, the transaction was presumptively lawful under the rule of reason. These arguments prevailed as to the claim of an alleged industry-wide scheme.[32]

As to a narrower set of transactions, however, the court refused to grant summary judgment. While acknowledging that defendants' justifications had merit and that club deals very well could be the product of procompetitive business relationships, the court held that it was up to a jury to decide whether the individual club deals in question were lawful under the rule of reason or were instead the product of an anticompetitive conspiracy among defendants not to meddle in each other's announced proprietary deals.[33] Importantly, in denying summary judgment, the *Dahl* court relied heavily on e-mails among employees at the different funds in which it appeared that certain funds were promising to "stand down"—i.e., not to compete against other funds—for certain bids.[34] In other words, the court left it to the jury to decide whether, for certain deals, the club bids were merely pretext that provided cover for each participant to decide for which bids each defendant would or would not compete.

In short, although club bids by no means automatically violate the antitrust laws—in fact, in most cases, there are substantial procompetitive justifications—they still can be problematic when evidence suggests (as it did in *Dahl*) that certain bids may be viewed as anticompetitive in purpose and effect—e.g., solely agreements not to compete with one another. Eventually, those defendants that were not dismissed in *Dahl* settled, leaving no final decision, but offering another cautionary tale where firms that can properly collaborate may be viewed as crossing the line into impermissible coordination.

Clayton Act Section 7: Partial Acquisitions

The Clayton Act, of course, applies to both full and partial acquisitions. Here, we focus exclusively on those acquisitions that result in one firm holding an ownership share in two competing firms. In certain circumstances, courts have sided with the agencies to enjoin these deals under the Clayton Act. More commonly, though, the agencies have sought and obtained consent decrees to limit the acquisition's alleged anticompetitive impact. As discussed in more detail below, the case law and consent decrees surrounding these partial acquisitions show that the agencies often use three theories when initiating such challenges.[35]

Transactions that Provide the Acquirer with Control or Influence Through Governance Rights. The most obvious theory used by the agencies is that the acquirer will use its partial acquisition to control or influence the targets to coordinate their actions in a way that reduces competition between the two entities.[36] In 2007, for example, the FTC challenged the attempt of The TC Group (Carlyle) and Riverstone Holdings to acquire—through a co-owned fund—a 22.6 percent interest in Kinder Morgan, Inc. (KMI), a gasoline and petroleum terminal provider. Because Carlyle and Riverstone also owned a 50 percent interest in Magellan Midstream Partners, another terminal company that competed extensively with KMI in the Southeast United States, the FTC challenged the acquisition.[37] Although Carlyle and Riverstone did not have a majority stake in either company, the FTC claimed their joint ownership of 22.6 percent and 50 percent in the two companies, respectively, would result in Carlyle and Riverstone having material control or influence over the two competing firms.

Specifically, the FTC focused on two ways in which Carlyle and Riverstone might exert control over the firms to reduce the competition between them: (1) seeking representation on both entities' boards of directors, and/or (2) exercising veto power at Magellan.[38] The FTC argued that Carlyle and Riverstone could use these tools to control the firms' operations and thereby implement practices that would reduce competition between them. The consent decree forced Carlyle and Riverstone to remove their agents from the Magellan board and also prevented the firms from controlling or influencing (or attempting to control or influence) Magellan's operations.

In 2011, similar concerns drove the DOJ to challenge Deutsche Börse's proposed acquisition of the stock exchange NYSE Euronext. At the time of the acquisition, Deutsche Börse owned 31.5 percent of and also possessed significant governance rights over Direct Edge, the operator of the fourth-largest stock exchange in the United States (and thus a clear competitor of Euronext). The DOJ claimed that Deutsche Börse could use its significant governance rights and veto rights over Direct Edge (as well as its representation on the Direct Edge board) to restrict Direct Edge's future competition against Euronext post-transaction. As a condition to resolving the dispute, the DOJ required Deutsche Börse to divest its holdings in Direct Edge and to refrain from participating in the governance or business of Direct Edge before the divestiture.[39]

Transactions that May Alter Existing Competitive Incentives. But proof that the acquirer will directly control or influence the competing firms after the transaction is not always necessary. Indeed, invoking the Horizontal Merger Guidelines, the agencies have also successfully argued that partial acquisitions of competing firms are anticompetitive when they adversely alter the competing firms' competitive incentives (i.e., the firms themselves will not be motivated to compete against one another as aggressively as they had been before the deal).[40] This is because, in large part, the acquirer could increase one firm's post-transaction prices when the second firm—which the acquirer also owns—would recoup some of the first firm's lost sales. The agencies grow particularly concerned when the acquirer holds partial ownership of two firms in a concentrated industry, given that the competitive options for consumers—aside from the two co-owned firms—are inherently limited in such circumstances.[41]

The most instructive case on this point has been the Sixth Circuit's decision in *United States v. Dairy Farmers of America, Inc.*[42] There, the DOJ challenged Dairy Farmers of America's (DFA) 50 percent interest in Southern Belle Dairy Co., LLC, a dairy processing firm, on the ground that DFA already owned a 50 percent share in National Dairy Holding, L.P., one of the only other milk processing firms competing with Southern Belle. According to the DOJ, Southern Belle and National Dairy were the only milk processing firms that submitted bids for school milk contracts in 42 school districts in Kentucky. Given that the two firms were the only two options for those school districts (and thus faced no competitive pressure beyond one another), the DOJ argued that the firms would have greater incentives to increase price if they shared a common owner.

The Sixth Circuit agreed. Critical to the Sixth Circuit's decision was expert testimony offered by the DOJ's economist, who testified that the acquisition would skew Southern Belle's incentives and, as a result, alter its existing behavior in the marketplace by causing it to compete less aggressively against National Dairy. In other words, all parties would have a strong incentive to suppress competition with each other post-transaction because "DFA, National Dairy and Southern Belle all profit from the elimination of competition between the dairies."[43] The court found persuasive the DOJ expert's final conclusion: "[T]o think that the nature of the interaction between the two dairies will not change is naive, because that would be contrary to the economic incentive of all parties."[44]

More recently, in response to the Hikma Pharmaceuticals PLC's acquisition of Roxane Laboratories, Inc., the FTC obtained a consent decree on similar grounds. There, Hikma was fully acquiring Roxanne but also owned 23 percent of a company called Unimark, which is currently developing a drug that, after FDA approval, will compete with Roxane's drug. Because Hikma would be selling Roxane's drug post-transaction, but would still have a 23 percent share in Unimark (along with the marketing rights for Unimark's in-development drug), the FTC claimed Hikma would have the incentive to slow Unimark's introduction of that drug. Thus, even though Hikma did not control Unimark, the FTC still argued that both firms' incentives would be adversely altered post-acquisition. The resulting consent decree required Hikma to return its marketing rights in the drug back to Unimark, and also sell its entire 23 percent equity interest in Unimark.[45]

Transactions that Provide the Acquirer with Access to Competitively Sensitive Information. The agencies have also given close attention to partial acquisitions that could result in the anticompetitive exchange of commercially sensitive information. These actions are premised on the notion that such information can lead to both coordinated and unilateral anticompetitive behavior.[46] Typically, the agencies cite access to competitively sensitive information as just a supplemental ground on which to challenge transactions that are already suspect for other reasons. Yet it is a concern that the agencies often seek to remedy through consent decrees. For example, in response to the Carlyle and Riverstone acquisition of KMI (discussed above in the context of an acquirer gaining control over two competitors), the FTC also required in its consent decree that the funds establish firewalls to block the exchange of competitively sensitive information between KMI and Magellan.[47]

Likewise, in response to Boston Scientific Corporation's acquisition of Guidant Corporation, the FTC imposed a firewall between Boston Scientific and Cameron, a company in which Boston Scientific owned 10–15 percent. There, Guidant was one of the three providers of implantable cardioverter defibrillators (ICDs). Although Boston Scientific did not make ICDs itself—and thus did not compete with

Guidant to sell them—Cameron *was* in the process of developing a new ICD. Further, in addition to its 10–15 percent ownership, Boston Scientific also had an option to acquire Cameron, which provided Boston Scientific with certain information-access and control rights prior to exercise of the option.

Given that Boston Scientific would own Guidant's ICD business after the transaction—and also have a small ownership share in Cameron (and the ability to access Cameron's information related to ICDs)—the FTC thought Guidant could use its option over Cameron for anticompetitive ends. Accordingly, the FTC's consent decree imposed limits on Boston Scientific's access to Cameron information by requiring establishment of a firewall limiting the circumstances in which Boston Scientific could receive Cameron information and also limiting the individuals at Boston Scientific who could receive such information.[48]

Collaborations Among Underlying Portfolio Companies. Understandably, if a PE fund has partial ownership in two competitors (even only minority interests), the fund might assume it makes business sense to coordinate its portfolio companies' behavior to allocate resources in the most efficient manner. But unless the two companies are majority-owned (as we discussed above in the context of *Copperweld*'s application to BAM's majority ownership of both Ainsworth and Norbord), such behavior can have legal implications because the two partially owned firms may be considered independent competitors under Section 1. In fact, because minority ownership does not provide legal control (and thus does not trigger *Copperweld*'s single-entity status), any coordination between minority-owned firms must be analyzed under the agencies' Antitrust Guidelines for Collaborations Among Competitors and relevant case law.[49] Section 3.34 of the Collaborations Guidelines provides the following factors to guide whether a proposed collaboration would be lawful under Section 1:

- the extent to which the relevant agreement is non-exclusive in that participants are likely to continue to compete independently outside the collaboration in the market in which the collaboration operates;
- the extent to which participants retain independent control of assets necessary to compete;
- the nature and extent of participants' financial interests in the collaboration or in each other;
- the control of the collaboration's competitively significant decision making;
- the likelihood of anticompetitive information sharing; and
- the duration of the collaboration.[50]

Applying these six factors, PE firms should be cautious about coordinating the activities of their minority portfolio companies (and, for that matter, with independent competitors). Depending on the PE firm's role in competitive decision making (which is often significant), coordination among the companies—as well as more tacit conduct like information sharing—may very well expose the PE firm to antitrust liability. In the European Union, for example, a PE firm has been found liable for its portfolio companies' antitrust violations under the theory of "parental liability," even though the PE firm itself did nothing, and knew nothing, about the underlying conspiracy.[51] Given prior enforcement efforts to block partial acquisitions in competing portfolio companies from even being consummated, it is safe to assume that the agencies would actively prosecute coordination among such companies when they think the coordination will cause anticompetitive effects that outweigh procompetitive benefits.

Clayton Act Section 8: Interlocking Directorates

Private equity firms often place agents on the boards of the companies in which they invest in order to manage their investments and create value. Indeed, in many instances, a fund's employees have substantial experience with specific industries and thus can offer beneficial guidance on how their investments should be operated. But antitrust issues will arise when a fund places the same employee on boards of competing firms. Practitioners often refer to this situation as a "direct interlock," and it is flatly prohibited by Section 8 of the Clayton Act.[52]

Importantly, Section 8's prohibition against director interlocks do not apply to all overlaps, as there are de minimis thresholds that apply as follows:

- Each firm has profits that do not exceed $31,841,000;
- Each firm has competitive sales that do not exceed $3,184,100;
- The competitive sales of either firm are less than 2 percent of that firm's total sales; and
- The competitive sales of each firm are less than 4 percent of the firm's total sales.[53]

Section 8 surfaced in the technology industry as recently as 2010, when John Doerr—who served as a director for both Google and Amazon—stepped down from his role as an Amazon director to cure the direct interlock.[54] Section 8 also caused Eric Schmidt to resign from the Apple board (because he also served as a director and Chief Executive Officer for Google at the time) and Arthur Levinson to resign from the Google board (because he also served as a director for Apple at the time).

A more complicated scenario, however, is indirect interlocks. In this scenario, the same individual does not sit on two boards; instead, two individuals hold the respective director seats, but the two individuals are employed by or affiliated with a common entity (here, the PE firm). The most instructive case on this issue is *Reading International, Inc. v. Oaktree Capital Management LLC*.[55] There, Oaktree Capital owned minority positions—40 percent and 17 percent, respectively—in two competing movie theaters, and Oaktree placed its president on one theater's board and its principal on the other theater's board. When confronted with the question of whether such an arrangement could state a cognizable

Section 8 claim, the court held that it could and refused to dismiss the claim. It reasoned that the term "person" in the Clayton Act applied to both a natural person and a legal person and that Oaktree very well could have violated Section 8 by placing two of its employees on competing boards.[56] Although use of the indirect interlocks theory is uncommon, the Agencies had in fact applied this theory before *Oaktree*, and they will not hesitate to do so in the future.[57] In sum, *Oaktree* makes clear that a fund should not place the same employee *or* different employees on the boards of two competing firms (at least not if Section 8's thresholds are satisfied).

Practice Pointers

As with many areas of antitrust, one of the keys to advising PE clients is to recognize potential issues as early as possible. Certainly, many (if not most) PE-related transactions are non-strategic and will not present any antitrust issues. But, at the same time, finding issues late in an M&A process, especially for strategic deals premised on achieving synergies and efficiencies, can be costly, time-consuming, and potentially make the deal not worth pursuing (e.g., if the execution risk is too high or would require divestitures).

What to look for is straightforward. Advisors to PE firms need to understand, from the onset of the engagement, the PE firm's structural relationship to its portfolio companies (e.g., ownership, governance, participation in management) as well as the underlying marketplace positions of the companies involved in the proposed transaction or collaboration. With that background, it will be fairly easy to identify antitrust issues, assess the risk, and recommend a course of action. Without that early preparation, both the PE clients and their corporate advisors may be surprised and unhappy when an otherwise manageable antitrust issue becomes an unwelcome hurdle. ■

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1 Garrett James Black, *What Does PE's Nearly $750B in Capital Overhang Foretell?*, PITCHBOOK (Aug. 19, 2016), http://pitchbook.com/news/articles/what-does-pes-nearly-750b-in-capital-overhang-foretell.

2 ERNST & YOUNG, PRIVATE EQUITY CAPITAL BRIEFING: MONTHLY INSIGHTS AND INTELLIGENCE ON PE TRENDS 4 (2016) ("PE continues to build capital that is ready for deployment. The industry ended July with buyout dry powder up 12% versus a year ago, to US$540.4b. The PE industry appears to be ready to put more of its reserves to work starting in the second half of 2016 . . . .").

3 Just recently, it appears the DOJ has taken issue with the PE firm Vista Equity Partners' $1.65 billion buyout of Cvent because it already owns Lanyon Solutions, which sells a software product similar to Cvent's. *See* Gillian Tan, *Next Contestant on Antitrust Jeopardy: Cvent*, BLOOMBERG GADFLY (Sept. 16, 2016), https://www.bloomberg.com/gadfly/articles/2016-09-16/vista-plays-antitrust-roulette-with-software-firm-cvent.

4 Critically, antitrust liability can flow not just from government enforcement actions brought by the FTC or the DOJ but also from private class action litigation. Although we often refer to "the Agencies" as the enforcer of the antitrust laws, this article discusses cases in which the government and/or private litigants have raised antitrust challenges to conduct that could be applicable to PE firms.

5 Copperweld Corp. v. Indep. Tube Corp., 467 U.S. 752 (1984).

6 *Id.* at 771–72, 772 n.18.

7 *See, e.g.*, Advanced Health-Care Servs., Inc. v. Radford Cmty. Hosp., 910 F.2d 139, 146 (4th Cir. 1990) (holding that two subsidiaries wholly owned by the same parent should be treated as a single entity under *Copperweld*).

8 U.S. Dep't of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines (2010), http://ftc.gov/os/2010/08/100819hmg.pdf.

9 Press Release, U.S. Dep't of Justice, Louisiana-Pacific Corp. Abandons Its Proposed Acquisition of Ainsworth Lumber Co. Ltd. (May 14, 2014), https://www.justice.gov/opa/pr/louisiana-pacific-corp-abandons-its-proposed-acquisition-ainsworth-lumber-co-ltd. The authors worked on this matter for Ainsworth.

10 The DOJ defined another geographic market as the Pacific Northwest, where the merger would have been 4-to-3. *Id.*

11 Brief of the United States as Amicus Curiae Supporting Petitioners, *Copperweld*, 467 U.S. 752 (No. 82-1260), 1983 U.S. S. Ct. Briefs LEXIS 398, at *20 n.29.

12 *Id.* at *21 n.31 ("The fact that a parent corporation and its controlled subsidiaries are 'held out' as, or appear to the public to be, competitors does not provide an antitrust policy reason to treat them as independent economic decision makers.").

13 Novatel Commc'ns, Inc. v. Cellular Tel. Supply, Inc., No. Civ. A. C85-2674A, 1986 WL 798475 (N.D. Ga. Dec. 23, 1986).

14 *Id.* at *9.

15 *Id.*; *see also* Direct Media Corp. v. Camden Tel. & Tel. Co., 989 F. Supp. 1211, 1217 (S.D. Ga. 1997) (holding that a parent and its majority-owned subsidiary were viewed as a single entity because the parent "manage[d] and own[ed] fifty-one percent" of the subsidiary and the plaintiff had "not presented any evidence that Defendants had any distinct business interests").

16 *See* Century Oil Tool, Inc. v. Prod. Specialties, Inc., 737 F.2d 1316, 1317 (5th Cir. 1984) (extending single entity treatment to two companies owned by three different men because "[b]oth corporations were under the common ownership and *control* of these three men" (emphasis added)); *see also* Rohlfing v. Manor Care, Inc., 172 F.R.D. 330, 344 (N.D. Ill. 1997) ("*[M]ajority ownership* with its centralized *power to control*, whether or not apparently exercised in detail on a day-to-day basis, presumptively creates a single entity for antitrust purposes." (emphasis added) (quoting 7 PHILLIP E. AREEDA, ANTITRUST LAW ¶ 1467a (1986))); Coast Cities Truck Sales, Inc. v. Navistar Int'l Transp. Co., 912 F. Supp. 747, 765 (D.N.J. 1995) (Even though the subsidiaries had a president running their day-to-day operations, which gave them "[s]ome modicum of independence," this did not change the fact that the parent "owned at all relevant times enough of the voting shares in each [subsidiary] to *dictate the objectives and actions* of each [subsidiary]." (emphasis added)).

17 Bell Atl. Bus. Sys. Servs. v. Hitachi Data Sys. Corp., 849 F. Supp. 702 (N.D. Cal. 1994).

18 *Id.* at 706 ("Under the reasoning of *Copperweld* and its progeny, it is not necessary to conduct a factual inquiry to determine whether a parent and a subsidiary over which the parent has legal control [qualify as a single entity because] . . . a parent and a subsidiary over which the parent has legal control . . . share a unity of interest and common corporate consciousness . . . .").

19 Aspen Title & Escrow, Inc. v. Jeld-Wen, Inc., 677 F. Supp. 1477 (D. Or. 1987).

20 *Id.* at 1486.

21 Sonitrol of Fresno, Inc. v. AT&T Co., No. 83-2324, 1986 WL 953 (D.D.C. Apr. 30, 1986).

22 *Id.* at *3.

23 *Id.* at *5.

24 *Bell Atlasntic Business Systems Services*, 849 F. Supp. 702.

25 Section 7A(c)(3) of the HSR Act (Title II, sec. 201) provides an exemption for "acquisitions of voting securities of an issuer at least 50 per centum of the voting securities of which are owned by the acquiring person prior to

such acquisition." 15 U.S.C. § 18a(c)(3). Moreover, a rule adopted pursuant to the statute—the "Intraperson Transactions" rule—holds that "[a]n acquisition . . . in which the acquiring and at least one of the acquired persons are the same person by reason of § 801.1(b)(1) of this chapter . . . is exempt from the requirements of the Act." 16 C.F.R. § 802.30(a). Section 801.1(a)(1) defines the term "person" as "an ultimate parent entity and all entities which it controls directly or indirectly." 16 C.F.R. § 801.1(a)(1).

26 Section 1 of the Sherman Act typically provides for two standards of review: (1) the per se rule, which applies to very specific types of agreements that have long been understood to be anticompetitive (e.g., price fixing, market allocation, group boycotts, etc.) and are therefore automatically unlawful if proven, and (2) the rule of reason, which applies to all other agreements and requires a full blown economic analysis, under which the court reviewing the agreement must weigh the agreement's procompetitive benefits against its anticompetitive effects.

27 *See* Dahl v. Bain Capital Partners, LLC, 937 F. Supp. 2d 119, 136 (D. Mass. 2013) (recognizing that club deals are "established and appropriate business practices" and "beneficial . . . for a number of reasons" and thus granting summary judgment for some defendants on multiple club deals); *see also* Pa. Ave. Funds v. Borey, 569 F. Supp. 2d 1126, 1133–34 (W.D. Wash. 2008) (holding per se rule did not apply to Section 1 club deal claim because club deals offer a host of procompetitive justifications and thus "promote rather than suppress competition").

28 *Pa. Ave. Funds*, 569 F. Supp. 2d at 1134 (dismissing Section 1 claim in club bid context because plaintiff failed to prove that defendant private equity funds had market power in the market for "corporate control of WatchGuard [the target] and other technology companies" and therefore failed to prove that club deal caused anticompetitive effects).

29 *Dahl*, 937 F. Supp. 2d 119.

30 *See* Dahl v. Bain Capital Partners, LLC, 589 F. Supp. 2d 112, 114 (D. Mass. 2008).

31 *Dahl*, 937 F. Supp. 2d at 126.

32 *Id.* at 138.

33 *See id.* at 145.

34 *Id.* at 131–33, 145–46.

35 Section 7 also contains a passive investor exemption, which excludes from the statute transactions that are made "solely for investment." 15 U.S.C. § 18; *see* United States v. Tracinda Inv. Corp., 477 F. Supp. 1093, 1102 (C.D. Cal. 1979) (declining to enjoin partial acquisition because it fell "squarely within the investment exemption and thus no violation of Section 7 of the Clayton Act can be shown"); *see also* Anaconda Co. v. Crane Co., 411 F. Supp. 1210, 1216, 1218–19 (S.D.N.Y. 1975) (applying the passive investor exemption to the transaction because the acquirer agreed not to vote its shares to anticompetitive ends). Because a private equity fund typically seeks to manage companies in which it purchases ownership—unlike, say, mutual funds whose investments are purely passive—this article does not explore the scope of that exemption.

36 Daniel P. O'Brien & Steven C. Salop, *Competitive Effects of Partial Ownership: Financial Interest and Corporate Control*, 67 Antitrust L.J. 559, 563 (2000) (recognizing that "a central part of the analysis of partial ownership is an assessment of which owners have what type of control over the corporation and how this control translates into management decisions").

37 The FTC also focused on the highly concentrated nature of the market, noting that KMI and Magellan were the only two terminal providers in certain markets and, in other markets, were two of the three companies providing such services. *See* Analysis of Proposed Agreement Containing Consent Orders to Aid Public Comment, In the Matter of TC Group L.L.C., Riverstone Holdings LLC, Carlyle/Riverstone Global Energy and Power Fund II, L.P., and Carlyle/Riverstone Global Energy and Power Fund III, L.P., FTC File No. 061-0197, at 4 (Jan. 25, 2007), https://www.ftc.gov/sites/default/files/documents/cases/2007/01/analysis.pdf.

38 *Id.*

39 Press Release, U.S. Dep't of Justice, Justice Department Requires Deutsche Börse to Divest Its Interest in Direct Edge in Order to Merge with NYSE Euronext (Dec. 22, 2011), https://www.justice.gov/opa/pr/justice-department-requires-deutsche-b-rse-divest-its-interest-direct-edge-order-merge-nyse.

40 *See generally* Horizontal Merger Guidelines, *supra* note 8, § 13.

41 Directorate for Financial & Enterprise Affairs, Competition Committee, Antitrust Issues Involving Minority Shareholding and Interlocking Directorates—United States, at 3–4 (Feb. 19, 2008), https://www.ftc.gov/sites/default/files/attachments/us-submissions-oecd-other-international-competition-fora/uswp3minor.pdf.

42 United States v. Dairy Farmers of Am., Inc., 426 F.3d 850 (6th Cir. 2005).

43 *Id.* at 854.

44 *Id.* at 862 (citation omitted).

45 *See* Analysis of Agreement Containing Consent Orders to Aid Public Comment, In the Matter of Hikma Pharmaceuticals PLC, FTC File No. 151-0198, at 3 (Feb. 26, 2016), https://www.ftc.gov/system/files/documents/cases/160226hikmaanalysis.pdf.

46 *See* Horizontal Merger Guidelines, *supra* note 8, § 13.

47 Analysis of Proposed Agreement Containing Consent Orders to Aid Public Comment, In the Matter of TC Group L.L.C., Riverstone Holdings LLC, Carlyle/Riverstone Global Energy and Power Fund II, L.P., and Carlyle/Riverstone Global Energy and Power Fund III, L.P., *supra* note 37, at 6.

48 Analysis of Agreement Containing Consent Order to Aid Public Comment, In the Matter of Boston Scientific Corporation and Guidant Corporation, FTC File No. 061 0046, at 6 (Apr. 20, 2006), https://www.ftc.gov/sites/default/files/documents/cases/2006/04/0610046analysis060420.pdf.

49 Critically, any collaboration among a PE firm's minority-owned companies with respect to market price, market output, or geographic market presence is categorically unlawful under the per se rule.

50 Federal Trade Comm'n & U.S. Dep't of Justice, Antitrust Guidelines for Collaborations Among Competitors § 3.34 (2000), https://www.ftc.gov/sites/default/files/documents/public_events/joint-venture-hearings-antitrust-guidelines-collaboration-among-competitors/ftcdojguidelines-2.pdf.

51 In 2014, for example, the European Commission pierced the corporate veil to hold Goldman Sachs's private equity arm jointly and severally liable for the conduct of one of its portfolio companies, Prysmian, which (unbeknownst to Goldman Sachs) had engaged in an unlawful cartel. *See* Alex Barker, *Goldman Fined €37m by EU over Subsea Cable Investment*, Fin. Times, Apr. 2, 2014.

52 Section 8 of the Clayton Act provides that "[n]o person shall, at the same time, serve as a director or officer in any two corporations . . . that are . . . competitors [such] that the elimination of competition by agreement between them would constitute a violation of any of the antitrust laws." 15 U.S.C. § 19(a).

53 These threshold figures are updated annually and therefore should be evaluated regularly.

54 Miguel Helft & Brad Stone, *F.T.C. Role Seen in Exit at Amazon*, N.Y. Times, Apr. 1, 2010.

55 Reading Int'l, Inc. v. Oaktree Capital Mgmt. LLC, 317 F. Supp. 2d 301 (S.D.N.Y. 2003).

56 *Id.* at 327 ("There is thus no ground for disputing that corporations are subject to the prohibitions of [S]ection 8."). All but one defendant in this case settled after the court denied defendants' motion to dismiss. By the time the court decided the remaining defendant's summary judgment motion, the indirect interlock had been cured by one of the directors' resignation. The court granted summary judgment, holding that plaintiff's Section 8 claim was moot. See Reading Int'l, Inc. v. Oaktree Capital Mgmt. LLC, No. 03 Civ. 1895 (PAC), 2007 WL 39301 (S.D.N.Y. Jan. 8, 2007) (granting remaining defendant summary judgment opinion).

57 *See, e.g.*, United States v. Int'l Ass'n of Machinists & Aerospace Workers, Civ. A. No. 94-0690, 1994 WL 728884 (D.D.C. June 14, 1994) (The DOJ challenged a union's decision to place two representatives on different boards of competing firms.).

Cash Tender Offers Under the HSR Act: Protecting an Efficient Market for Corporate Control

BY JOHN D. HARKRIDER

HOSTILE CASH TENDER OFFERS present a number of challenges that do not arise in friendly deals. Because the target does not want to be acquired, its board of directors frequently adopts protective measures, such as poison pills and other takeover defenses designed to prevent the threatened acquisition. This resistance can arise despite the acquisition's potential to improve efficiency and increase shareholder value. Significantly, the target board does not have absolute discretion in adopting and utilizing takeover defenses. Rather, in its effort to protect its shareholders, it can only employ defensive measures that are proportionate to the threat posed by the offer.[1]

Although a target's board facing an unwanted suitor will most often allege that the firm is threatened by an inadequate offer, it is not uncommon for the target's board to claim that the offer violates the antitrust laws.[2] This makes sense because if a transaction is blocked or abandoned on antitrust grounds, then not only is the offering price illusory, but the extended antitrust review may distract management and destroy value, and the target's price may fall below even the pre-offer level.

Where the target's board adopts a poison pill or other defensive measures, the offeror typically brings an action in the target's state of incorporation (e.g., suit in Delaware Chancery Court) for an injunction to require the target's board to remove the takeover defenses.[3] Where the target justifies its defensive measures on the grounds that the transaction likely violates the antitrust laws, the offeror will argue that there is no antitrust obstacle to the transaction. This argument is difficult to make credibly where a federal antitrust agency has reached the conclusion that the acquisition would violate Section 7 of the Clayton Act and has threatened or actually brought suit. In that case, one path forward for the offeror is to defeat the government in court as quickly as possible and thus remove the antitrust obstacle to closing.

The problem, however, is that the Federal Trade Commission has in the past taken the position that it need not seek an injunction in district court to stop a hostile cash tender offer because the transaction cannot close given the existence of a poison pill or other defensive measures. In that case, the FTC has only brought a Part III proceeding. Thus, while there is no legal impediment to closing because Part III does not operate as an injunction, the parties cannot close on the offer as long as the target's defensive measures stay in place. And where those defensive measures are being justified, in part, by the alleged existence of antitrust approval risk, it may be difficult to persuade a state court that the defensive measures should be withdrawn for lack of an antitrust issue when the federal government has already initiated a Part III proceeding.

The result is that in cash tender offers, an acquiring company facing a poison pill or other takeover defenses may be required to first beat the FTC in Part III, which may take as much as twice as long as a district court action. Thus, in the case of a cash tender offer challenged by the FTC, the offeror may be unable to avail itself of the strategic option of quickly beating the FTC in district court, an option that exists outside of the cash tender offer context.

This result seems wrong as a matter of policy because the Hart-Scott-Rodino (HSR) Act includes provisions designed to *expedite* the review of cash tender offers—namely, a shortened waiting period for cash tender offers and allowing the second waiting period to run once the offeror certifies substantial compliance as opposed to waiting for the target to comply as well.[4] Indeed, the express purpose of these two provisions was to harmonize HSR review of cash tender offers with the Williams Act of 1968, which gave target shareholders protections to ensure speedy and accurate access to information needed to make an informed decision as to whether they should accept the offer.[5]

Because Part III proceedings take longer than district court proceedings, it may effectively take longer to obtain resolution of the antitrust issues in cash tender offers than in friendly

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mergers. This result seems contrary to Congressional intent. Thus, where the combination of Part III proceedings and the target's defensive measures might cause the offeror to abandon the transaction, counsel for the offeror should consider a number of strategies to resolve antitrust issues quickly. Unfortunately, these strategies are not guaranteed to succeed. Notably, this problem has not arisen at the DOJ, perhaps in part because they cannot bring an action in Part III.

The Williams Act

The Williams Act of 1968 radically altered the execution of tender offers by mandating disclosure obligations as well as rules for how long tender offers must remain open.[6] Its purposes were to protect investors, who often did not have sufficient information to make informed decisions, and to ensure that there was an efficient market for corporate control.[7] In so doing, Congress recognized that cash tender offers are an important tool that helps ensure an efficient market for corporate control.[8] These changes balanced power between bidders and target shareholders by enabling the shareholders to more accurately assess the risks associated with the transaction.[9] By leveling the information playing field, Congress reduced structural asymmetries in the market for corporate control, thus improving the market's efficiency by reducing transaction costs.[10] The delicate nature of this balance of power is confirmed by state anti-takeover jurisprudence, where a delay of a mere ten days in the tender offer has been deemed "inimical" to the purposes of the Williams Act.[11]

The Williams Act's purpose is consistent with economic theory that an efficient market for corporate control helps ensure that management and boards run their companies in a way that maximizes shareholder value. Studies confirm that targets experience significant increases in stock value after a successful tender offer.[12] These increases are larger than the price increases associated with friendly mergers, which may suggest that tender offers create stronger synergies than other mechanisms that alter corporate control.[13] These transactions also produce the largest positive externalities to the economy more generally, including the "lessening of wasteful bankruptcy proceedings, [spurring] more efficient management of corporations, [increasing] the protection afforded [to] non-controlling corporate investors, increas[ing] mobility of capital, and generally [promoting] a more efficient allocation of resources."[14]

Antitrust Review of Cash Tender Offers

Cash tender offers from direct horizontal competitors create the greatest potential efficiencies because competitors are best able to enjoy the fruits of economies of scale and scope, including the elimination of duplicative management. Thus, takeover bids from competitors are the most likely to maximize combined shareholder value because competitors are uniquely capable of achieving certain efficiencies that decrease the point at which expected return equals the cost of acquisition, plus any transaction costs.[15]

Cash tender offers from competitors are also the most likely to generate antitrust challenges and resistance from the target's management.[16] These transactions entail the greatest probability that the duplicative target management would be displaced by the efficient management of the bidder and thus the greatest probability that the target's board will resist. Such defensive measures may violate fiduciary duties, destroy shareholder value, and hamper the operation of the market for corporate control. When Congress enacted the Williams Act, it acknowledged the harms to the market for corporate control that flow from board entrenchment and drafted the statute carefully to avoid exacerbating this problem.[17]

By adopting different rules for cash tender offers in the HSR Act, Congress acknowledged the tension between the efficiencies these bids could produce, the antitrust risk they present, and the possibility that a target's board would attempt to protect its own jobs.[18] For example, the legislative history of the HSR Act notes that had Congress applied the standard 30-day HSR waiting period to tender offers, where "time is frequently of the essence," the HSR Act would have risked conflicting with the Williams Act and might "unduly alter" how tender offers were completed.[19] In an attempt to preserve the balance of power between acquirers and target management crafted by the Williams Act,[20] the expedited review procedure struck a balance of its own, a balance between ensuring that transactions comport with the antitrust laws and providing target shareholders with accurate information about the risk that the tender offer would not receive antitrust approval.[21]

Despite Congress's clear attempts to protect the market-disciplining effect of time sensitive cash tender offers, the FTC has in at least one recent instance disregarded Congress's concern. In Omnicare's cash tender offer to acquire PharMerica, the FTC brought only a Part III action, forgoing the typical practice of seeking a district court injunction at the same time. Although Omnicare was technically free to launch the tender offer given that the filing of a Part III action does not block the transaction from closing, it would have been futile to do so because PharMerica's incumbent board had adopted a poison pill. The PharMerica board, however, was not willing to rescind the pill, and therefore Omnicare was unable to close.[22]

Omnicare needed to resolve the pending antitrust challenge to its offer in order to increase the probability that a Delaware court would intervene. But Part III proceedings are typically not resolved in a short enough time frame to keep the tender offer open.[23]

Although the FTC has revised its rules to expedite Part III proceedings (which have been described as "glacial"), these revisions have not made Part III proceedings as fast as district court proceedings.[24] Over the last five years, Part III merger challenges consistently have had their *initial hearing date* scheduled almost exactly 150 days after the issuance of the administrative complaint.[25] In contrast, over the last five

The existence of a poison pill or other defensive measures, coupled with the FTC's power to initiate proceedings that promise to resolve antitrust risk on a much slower time frame than a district court proceeding, effectively gives the FTC a veto over tender offers.

years the average duration before a district court *decision* on a preliminary injunction in FTC merger challenges has been 117 days from the filing of the FTC's complaint.[26]

Furthermore, in a Part III proceeding, an Administrative Law Judge (ALJ) decision finding that the merger does not violate the antitrust laws and allowing it to proceed will likely be reviewed by the full Commission (and potentially reversed by it).[27] As a result, it takes approximately a year to get through a Part III proceeding.[28] In short, a Part III proceeding without a simultaneous district court proceeding may operate as a death sentence to a hostile cash tender offer.

The existence of a poison pill or other defensive measures, coupled with the FTC's power to initiate proceedings that promise to resolve antitrust risk on a much slower time frame than a district court proceeding, effectively gives the FTC a veto over tender offers. This harms the market for corporate control because the most efficient bidders are dissuaded from bidding, as they face the greatest likelihood of generating FTC opposition, and it destroys shareholder value by pressuring shareholders to accept a lower offer from a bidder that presents less antitrust approval risk, even in cases where the FTC has a relatively weak case on the merits.[29]

Strategic Alternatives in Cash Tender Offers Before the FTC

Some members of Congress have raised a number of concerns regarding the FTC's use of Part III proceedings. Indeed, the Standard Merger and Acquisition Reviews Through Equal Rules (SMARTER) Act is partially motivated by the belief that Part III proceedings should not be used in non-consummated merger cases.[30] Given the limited prospect of Congressional action in the near future, counsel should make themselves aware of strategic options in the case where the FTC has brought a Part III proceeding but not a district court action to challenge a cash tender offer.

First, the bidder can negotiate a consent decree even prior to filing the HSR form and issuing a tender offer. For example, Air Products & Chemicals negotiated a consent decree with the FTC before it filed its HSR notification with respect to its attempt to acquire Airgas. An Air Products press release noted that with the decree in hand, "[t]here remain[ed] no substantive impediments to closing immediately other than the intransigence of the Airgas board."[31] Yet, in such a scenario, the bidder has significantly less leverage during the negotiation with the FTC because it does not have the ability to credibly threaten to go to court if the negotiations with the FTC reach an impasse. These instances of enhanced FTC bargaining power partially motivated the SMARTER Act.[32]

Second, the bidder could request that the FTC seek a preliminary injunction in district court.[33] The FTC may take the position that it cannot do so because the acquiring company cannot close the deal until the takeover defenses are removed by a state court or by the board, thus depriving the agency of the immediacy element typically required in cases seeking preliminary injunctions. However, the FTC in other contexts has argued, and some courts have held, that the FTC's preliminary injunction standard does not include a requirement of immediate or irreparable harm in the absence of preliminary relief.[34] Instead, courts need only determine that the injunction would be in the public interest after "weighing the equities and considering the Commission's likelihood of ultimate success . . . ."[35] This distinction was designed to "place[] a lighter burden on the Commission than that imposed on private litigants by the traditional equity standard . . . ."[36] It is an open question whether this means that a district court can hear a preliminary injunction if there is no dangerous probability that the merger could close.

Third, the bidder or target shareholders could seek a declaratory judgment that a proposed merger would not violate the antitrust laws. Where a tender offer is outstanding and the FTC has not cleared the transaction, the bidder and target shareholders are forced to choose "between abandoning [their] rights or risking prosecution," precisely the sort of dilemma the Declaratory Judgment Act (DJA) was designed to resolve.[37]

While there is no bright line rule as to what allegations and proof are needed to obtain a declaratory judgment, a party must show that given "all the circumstances," there exists a "[1] a substantial controversy, [2] between parties having adverse legal interests, of [3] sufficient immediacy and reality to warrant the issuance of a declaratory judgment."[38] These requirements are not defeated when the plaintiff withholds some action for fear of exposing itself to litigation.[39]

It is by no means certain that a court would grant an offeror's request for declaratory relief. Courts may find themselves bogged down by counterfactuals of whether the shareholders would tender if the FTC approved the transaction, as well as whether the true source of the injury is the board entrenching itself or the agency's failure to act. Nonetheless, given "all the circumstances," the use of declaratory judgment to provide the target's shareholders with better information about antitrust approval risk comports well with the purposes of the DJA, HSR Act, and the Williams Act.

Fourth, provided the bidder agrees not to consummate the transaction until final resolution of the antitrust issues, the FTC could seek a full trial on the merits in an expedited manner in district court.[40] The DOJ typically seeks this type of expedited trial.[41] For example, in the DOJ's challenge to the merger of SunGard and Comdisco, the parties consented to an extremely expedited proceeding in response to the time sensitivity of the concurrent bankruptcy proceedings.[42] The DOJ was able to investigate the transaction and the court rendered a judgment in just four months.[43] Because a full trial avoids the potential preliminary injunction requirement of immediate irreparable harm, it allows the court to reach a decision on the merits of the transaction. While SunGard was an exceptional example of judicial expediency and regulatory prudence, it shows that the FTC can still achieve its mandates and respect Congressional signals when circumstances require a particular sensitivity to delay.[44]

Conclusion

Hostile takeovers are difficult and become even more so when there are antitrust impediments to the transaction. The battle for corporate control frequently takes place in a Delaware court where the offeror argues that the defensive measures employed by the target's board breach its fiduciary duties and the board responds by arguing that its defenses are a proportionate response to a threat to the company posed by an offer that would violate the antitrust laws if consummated. The board's argument obviously gets stronger if the FTC has announced that it will oppose the deal and has filed suit and gets weaker if the offeror defeats the FTC's lawsuit.

It is unclear whether the FTC's decision not to seek an injunction in the Omnicare case represents a policy choice or just a one-off litigation decision. Regardless, forcing hostile cash tender offerors into lengthy Part III proceedings instead of a faster proceeding in district court seems inconsistent with the clear Congressional intent to have HSR review of cash tender offers operate in a more expeditious manner than HSR review of non-cash tender offers.[45] Such delays create an obstacle for an efficient market for corporate control and upset the delicate balance of power between shareholders and incumbent management struck by the Williams Act.

In future cases, there is a strong argument that the FTC should always bring a district court action in addition to a Part III proceeding. In the absence of an FTC action in district court, the bidder is required to negotiate a consent decree with the FTC without a litigation backstop, seek a declaratory judgment, or simply terminate the transaction. All three of these options put greater burdens on the bidder in a cash tender offer, which seems inconsistent with both the Williams and HSR Acts. ■

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1 Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985).

2 *See, e.g.*, Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361 (Del. 1995) (target board justified defensive measures on both antitrust and inadequate price).

3 See *generally* Air Prods. & Chems., Inc. v. Airgas, Inc., 16 A.3d 48 (Del. Ch. 2011).

4 *See* 122 Cong. Rec. 29,342 (1976).

5 An earlier version of the HSR Act provided for a 21-day waiting period instead of the 15-day period adopted in the final version. After acknowledging the importance of cash tender offers in ensuring efficient operations of corporations, the final bill was described as attempting to "strike a balance" between the purposes of the Williams Act and the need for antitrust review. *See* H.R. Rep. No. 94-1373, at 12–13 (1976), *reprinted in* 1976 U.S.C.C.A.N. 4119, 4126–27.

6 *See* 113 Cong. Rec. 24,664 (1967) ("Today, the public shareholder in deciding whether to reject or accept a tender offer possesses limited information."). The required disclosures include the size of the holdings, the source of the funds, financing arrangements, the purpose of the tender offer, and the plans of the offeror. Relevant provisions have been codified as 15 U.S.C. § 78m(d) and 15 U.S.C. § 78n(d)(1).

7 *See* Edgar v. MITE Corp., 457 U.S. 624, 634 (1982) ("Congress sought to protect the investor not only by furnishing him with the necessary information but also by withholding from management or the bidder any undue advantage that could frustrate the exercise of an informed choice."); 113 Cong. Rec. 24,664 (1967) ("It has been strongly urged that takeover bids should not be discouraged, since they often serve a useful purpose by providing a check on entrenched but inefficient management.").

8 *See* David Offenberg & Christo Pirinsky, *How Do Acquirers Choose Between Mergers and Tender Offers?*, 116 J. Fin. Econ. 331 (2015) (discussing the speed advantages of tender offers over mergers and how the delays associated with government review reduce the attractiveness of tender offers as a tool).

9 *See* MITE Corp., 457 U.S. at 633–34 ("This policy of 'evenhandedness' represented a conviction that neither side in the contest should be extended additional advantages vis-à-vis the investor, who if furnished with adequate information would be in a position to make his own informed choice.") (citation omitted).

10 *See* H.R. Rep. No. 90-1711, at 4 (1968) ("The persons seeking control, however, have information about themselves and about their plans which, if known to investors, might substantially change the assumptions on which the market price is based. This bill is designed to make the relevant facts known so that shareholders have a fair opportunity to make their decision."). The effect of information asymmetries on corporate governance is so well documented that Gregory Mankiw's introductory microeconomics textbook highlights this issue as its first case study related to information asymmetries. *See* N. Gregory Mankiw, Principles of Microeconomics 485–86 (4th ed. 2007) (discussing how in the corporate context, information asymmetries exacerbate the principal-agent problem and how board of directors oversight of management just shifts the problem to a different set of actors). The importance of information asymmetries is borne out by the fact that in 2001 the Nobel Prize in Economics was awarded to three economists who had studied the phenomenon. Nobel Media AB, *The Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel 2001*, Nobelprize.org (Oct. 10, 2001), http://www.nobelprize.org/nobel_prizes/economic-sciences/laureates/2001/press.html.

11 *See* Joseph E. Seagram & Sons, Inc. v. Conoco, Inc., 519 F. Supp. 506, 508 (D. Del. 1981) ("In so holding, the court found that the 20-day state provision was inimical to the purposes of the Williams Act and that the tender offeror was thus likely to succeed on his preemption claim.") (citing Kennecott Corp. v. Smith, 637 F.2d 181 (3d Cir. 1980)).

12 These increases are not the result of post-merger market power but rather are likely the result of efficiencies or synergies. Michael C. Jensen & Richard S. Ruback, *The Market for Corporate Control: The Scientific Evidence*, 11 J. Fin. Econ. 5, 7–8 (1983).

13 *See id.* The study does not indicate whether this difference is statistically significant.

14 *See* Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. Pol. Econ. 110, 119 (1965).

15 Firms often have superior industry-specific information about their competitors, and therefore are better able to identify inefficiently managed firms in their industry. For example, competitors are more likely to understand industry benchmarks for profit, capital expenditures, R&D, and SG&A ratios. Those with relatively weaker information will either bid above the true value and generate inefficiencies by transferring bidder shareholder value

to target shareholders, or they will bid below the true value, which will either destroy target shareholder value or be resisted by target management on the basis that it undervalues the target. Because these bidders are more likely to generate an antitrust challenge, they may actually face a unique set of expected transaction costs. Some evidence suggests that the regulatory time delay may comprise the largest component of these additional costs. J. Gregory Sidak, *Antitrust Preliminary Injunctions in Hostile Tender Offers*, 30 Kansas L. Rev. 491, 493 (1982) ("The litigation costs that an antitrust injunction imposes on an offeror, though substantial, seem unlikely to exceed the offeror's risk-adjusted expected benefit from the takeover. Rather, delay seems to be the more determinative tactical result of an antitrust injunction.") (citation omitted). Ideally, these costs should be minimized to avoid dissuading otherwise efficient transactions. Insofar as the FTC raises the transaction costs to these bidders through delay and costs associated with defending against the challenge, it dissuades efficient transactions.

16 Mergers that conglomerate relatively unrelated firms are rarely challenged by antitrust regulators, but they also present few opportunities to generate synergies. After a wave of these sort of mergers in the 1960s and 1970s, the ensuing period discredited the notion that this would achieve efficiencies. The 1980s produced a large increase in hostile tender offers aimed at "busting up" these conglomerates. Gerald F. Davis et al., *The Decline and Fall of the Conglomerate Firm in the 1980s: The Deinstitutionalization of an Organizational Form*, 59 Am. Soc. Rev. 547, 547–48 (2007).

17 *See* Donald C. Langevoort, *State Tender-Offer Legislation Interests Effects and Political Competency*, 62 Cornell L. Rev. 213, 228 (1977) ("The original pro-management version of the Williams Act first introduced in 1965, contained a twenty-day waiting period requirement.").

18 *See* 122 Cong. Rec. 29,342 (1976).

19 *See id.*

20 *See* H.R. Rep. No. 94-1373, at 12–13 (1976), *reprinted in* 1976 U.S.C.C.A.N. 4119, 4126–27.

21 *See supra* text accompanying note 5.

22 As alleged in a complaint against PharMerica's board in Delaware Chancellery court, "[O]n August 25, 2011 the Director Defendants adopted a Stockholder Rights Agreement (the 'Poison Pill'), which will effectively render closing the Tender Offer impossible . . . the Poison Pill was clearly designed to entrench current management to the detriment of the PharMerica's stockholders . . . ." Verified Complaint at ¶ 12, *Omnicare, Inc. v. PharMerica Corp.*, 2011 WL 3983186 (Del. Ch. dismissed 2012). The case was never decided because the offer was revoked after the FTC initiated Part III proceedings.

23 *See* Fed. Trade Comm'n & Dep't of Justice, *Hart-Scott-Rodino Annual Report: Fiscal Year 2012* (Apr. 30, 2013), https://www.ftc.gov/sites/default/files/documents/reports_annual/35th-report-fy2012/130430hsrreport_0.pdf.

24 David A. Balto, *The FTC at a Crossroads: Can It Be Both Prosecutor and Judge?*, 28 Legal Backgrounder 12 (Aug. 23, 2013), http://www.dcantitrustlaw.com/08-23-13Balto_LB.pdf. The slow pace of Part III proceedings has been a long-running problem. *See* FTC v. Freeman Hosp., 911 F. Supp. 1213, 1228 n.8 (W.D. Mo. 1995) ("The average time from the issuance of a complaint by the FTC to an initial decision by an administrative law judge averaged nearly three years in 1988."). In 2009, the FTC revised its rules in an attempt to accelerate the pace of its proceedings. Michael L. Sibarium & Jay L. Levine, *Practical and Strategic Considerations in Litigating Under the FTC's New Part 3 Rules*, Antitrust, Fall 2009, at 33.

25 Eleven merger-related Part III proceedings were identified between 2011 and the present.

26 This covers the seven FTC merger challenges in which a motion for preliminary injunction was decided on the merits: FTC v. Advocate Health Care, 2016 WL 3387163 (N.D. Ill. June 20, 2016); FTC v. Staples, Inc., 2016 WL 2899222 (D.D.C. May 17, 2016); FTC v. Penn State Hershey Med. Ctr., 2016 WL 2622372 (M.D. Pa.), *rev'd and remanded*, 2016 WL 5389289 (3d Cir. 2016); FTC v. Steris Corp., 133 F. Supp. 3d 962 (N.D. Ohio 2015); FTC v. Sysco Corp., 113 F. Supp. 3d 1 (D.D.C. 2015); FTC v. OSF Healthcare Sys., 852 F. Supp. 2d 1069 (N.D. Ill. 2012); FTC v. ProMedica Health Sys., Inc., 2011 WL 1219281 (N.D. Ohio 2011). In the Advocate Health Care/Northshore University merger, the preliminary injunction decision exceeded the time between the issuance of the complaint and the scheduled hearing date.

27 In the *Schering-Plough* matter, the Commission was subsequently reversed by the circuit court, after the court criticized the Commission for carving out "arbitrary exceptions," contradicting itself, and arriving at a conclusion that was "undercut[]" by "substantial and overwhelming evidence." Schering-Plough Corp. v. FTC, 402 F.3d 1056, 1062 & n.10, 1071 (11th Cir. 2005).

28 According to the FTC Rules of Practice, it will take five months to the administrative hearing, 30 business days for a hearing, up to 100 days for the ALJ initial decision, and 100 days for a Commission decision reviewing and potentially reversing an ALJ decision. *See* FTC Rules of Practice, 16 C.F.R. §§ 3.11(b)(4), § 3.41(b)(4), § 3.51(a), § 3.52(a)(1) (2009).

29 In 1988, executives at Stevens were faced with takeover bids from Odyssey and Pepperell. Odyssey seemed poised to retain Stevens's top executives, which led Stevens to resist Pepperell's bid on grounds that it "presented serious antitrust considerations." In the midst of a bidding war, the FTC gave Pepperell the "green light" if it agreed to divest a portion of Stevens. "This made it clear to all parties that the bidding might go much higher." The bidding process, which started "early in February," was brought to a close a little over two months after it started through a joint Pepperell-Odyssey offer only after the FTC clarified the antitrust approval risk associated with Pepperell's offer. *See* Robert J. Cole, *3-Month Battle for J.P. Stevens Ends*, N.Y. Times (Apr. 26, 1988), http://www.nytimes.com/1988/04/26/business/3-month-battle-for-jp-stevens-ends.html?pagewanted=all.

30 The SMARTER Act, being considered by the Senate, would require the FTC to seek to enjoin mergers permanently in an Article III court rather than preliminarily enjoin them in a district court and then litigate the antitrust merits in a Part III proceeding. Motivating this change is the view that because of its follow-on Part III proceeding, the FTC is subject to different standards than is the DOJ in an Article III court proceeding. As of April 4th, 2016, the Bill had passed the House of Representatives and had been referred to the Senate. *H.R.2745–Standard Merger and Acquisition Reviews Through Equal Rules Act of 2015*, Congress.gov (Aug. 23, 2016, 7:12PM), https://www.congress.gov/bill/114th-congress/house-bill/2745. The relevant provision has been generally well received by at least one FTC commissioner. Maureen Ohlhausen, Commissioner, Fed. Trade Comm'n, Remarks at the U.S. Chamber of Commerce: A SMARTER Section 5 (Sept. 25, 2015), https://www.ftc.gov/system/files/documents/public_statements/804511/150925smartersection5.pdf.

31 Notably, the Airgas poison pill was upheld by the Delaware court on the grounds that the board had concluded in good faith that Air Products' offer was inadequate, a conclusion that was supported by the fact that "the three Air Products Nominees on the Airgas board have now wholeheartedly joined in the board's determination—what is more, they believe it is their fiduciary duty to keep Airgas's defenses in place." *Air Products & Chemicals*, 16 A.3d at 122.

32 Part of the motivation for the SMARTER Act is that the FTC has greater leverage than the DOJ because the FTC can pursue a drawn out Part III proceeding. *See* H.R. Rep. No. 113-658, at 4 (2014).

33 Insofar as the FTC simply does not wish to give the bidder a chance to challenge its decision or maintains that the FTC would not be able to satisfy the requirement of a preliminary injunction, this option would be ineffective.

34 15 U.S.C. § 53(b)(2) ("Upon a proper showing that, weighing the equities and considering the Commission's likelihood of ultimate success, such action would be in the public interest . . ."). FTC v. Whole Foods Mkt., Inc., 548 F.3d 1028, 1034–35 (D.C. Cir. 2008) ("Therefore, to obtain a [U.S.C. 15] § 53(b) preliminary injunction, the FTC need not show any irreparable harm . . . ."). The FTC's authority to pursue preliminary injunctions stems from 15 U.S.C. § 53(b) which has different requirements than 15 U.S.C. § 25 and 15 U.S.C. § 26; these two sections apply to the Attorneys General and private parties, respectively.

35 15 U.S.C. § 53(b).

36 FTC v. Warner Commc'ns Inc., 742 F.2d 1156, 1159–60 (9th Cir. 1984) (citations omitted). Some cases discuss irreparable harms as considerations in their "weighing of the equities." *See, e.g.*, FTC v. H.J. Heinz Co., 246 F.3d 708, 726 (D.C. Cir. 2001) (finding that after the merger it would be impossible to "recreate pre-merger competition"); FTC v. Staples, Inc., 970 F. Supp. 1066, 1091 (D.D.C. 1997) (finding that the inability to "unscram-

bl[e] the eggs" after the merger is consummated weighs in favor of the public equities). While relevant to the equities, reading this to suggest that an immediate irreparable harm is a prerequisite for the FTC to be granted an injunction would undo the very conscious alteration embodied in 15 U.S.C. § 53(b).

[37] As codified in 28 U.S.C. § 2201. MedImmune, Inc. v. Genentech, Inc., 549 U.S. 118, 129 (2007) ("The dilemma posed by that coercion—putting the challenger to the choice between abandoning his rights or risking prosecution—is 'a dilemma that it was the very purpose of the Declaratory Judgment Act to ameliorate.'") (citation omitted).

[38] *MedImmune*, 549 U.S. at 127 (citation omitted)

[39] *See id.* at 128–29 ("Our analysis must begin with the recognition that, where threatened action by government is concerned, we do not require a plaintiff to expose himself to liability before bringing suit to challenge the basis for the threat—for example, the constitutionality of a law threatened to be enforced."). This hypothetical differs from two identified examples where parties unsuccessfully sought to use a declaratory judgment to resolve antitrust approval issues. In *Cableamerica Corp. v. FTC*, 795 F. Supp. 1082 (N.D. Ala. 1992), the plaintiffs attempted to preclude the FTC from conducting HSR review. In another case, SCI sought a declaratory judgment that its proposed hostile acquisition of Loewen would not be anticompetitive in order to prevent Loewen's board from resisting the transaction on antitrust grounds; the declaratory judgment action was dismissed when Loewen brought a competing suit to block the transaction in the Eastern District of New York. The Loewen Grp., Inc., Loewen Group Prevails in Texas Federal Court—Loewen's Antitrust Lawsuit Against SCI to Proceed in New York Federal Court (Form 8-K) (Dec. 1, 1996), https://www.sec.gov/Archives/edgar/data/845577/0000950150-96-001491.txt.

[40] *See, e.g.*, United States v. Sungard Data Sys., Inc., 172 F. Supp. 2d 172, 179 (D.D.C. 2001) ("On the morning of October 23—just minutes before the Bankruptcy Court was to approve the acquisition—this Court entered a stipulated order by which the parties agreed to preserve the status quo until the earlier of 1) the Court's ruling on plaintiff's request for permanent injunctive relief or 2) November 15, 2001.").

[41] *See* H.R. Rep. No. 114-449, at 3–4 (2015) ("Generally, DOJ agrees with the transaction parties to combine the proceedings for both a preliminary injunction and permanent injunction before the district court.").

[42] *See* Stephen M. Axinn, *Merger Review and Litigation Involving the Acquisition of Bankrupt Companies*, Antitrust, Summer 2002, at 74–75. In the context of a challenge to a cash tender offer, the court may be unable to reproduce such a short timeline because the HSR Act affords regulators less time to review cash tender offers. *See* 15 U.S.C. § 18a(b)(1)(B).

[43] *See* Axinn, *supra* note 42; *Sungard*, 172 F. Supp. 2d at 179; Barabara Rose, *SunGard to Buy Parts of Comdisco; Hewlett-Packard Challenging Deal*, Journal Times (Oct. 14, 2001), http://journaltimes.com/business/sungard-to-buy-parts-of-comdisco-hewlett-packard-challenging-deal/article_9a899026-b0f1-5b9a-bb12-6c785672dcfc.html. Consolidated proceedings outside of bankruptcy proceedings have been resolved in time frames of between two and eight months. *See, e.g.*, United States v. Long Island Jewish Med. Ctr., 983 F. Supp. 121, 125 (E.D.N.Y. 1997) (deciding the case in roughly four months); United States v. Baker Hughes, Inc., 731 F. Supp. 3, 4 n.1 (D.D.C.), *aff'd*, 908 F.2d 981 (D.C. Cir. 1990) (deciding the case in roughly two months); United States v. Rockford Mem. Hosp., 717 F. Supp. 1251, 1252 (N.D. Ill. 1989), *aff'd*, 898 F.2d 1278 (7th Cir. 1990) (deciding the case in roughly eight months).

[44] *See* H.R. Rep. No. 114-449, at 3–4 (2015) ("[T]he FTC's practice is to seek only a preliminary injunction, despite the fact that it has the authority to consolidate the proceedings in the same fashion as DOJ. In fact, the FTC has affirmatively fought against efforts to consolidate the preliminary injunction and permanent injunction proceedings."). Typically the FTC seeks a preliminary injunction in support of a Part III proceeding; in fact, where the FTC seeks a preliminary injunction, it is *required* to file a Part III complaint within 20 days. 15 U.S.C. § 53(b)(2). Thus, as long as the FTC does not seek a preliminary injunction, as would be the case in an expedited trial, it is free to challenge the acquisition in a federal court.

[45] This conclusion is only reinforced in light of the changes the proposed SMARTER Act would make and their underlying motivations.

Meet the New "BOSS": Competitive Effects Analyses in *Staples/Office Depot*

BY MATTHEW J. REILLY AND CHETAN SANGHVI

ON MAY 10, 2016, A FEDERAL DISTRICT court in the District of Columbia issued a preliminary injunction blocking Staples' proposed acquisition of Office Depot,[1] resolving litigation that required several months of discovery and a two-week hearing that began on March 21, 2016. Shortly thereafter, Staples and Office Depot followed through on their prior public statements and abandoned their transaction. This ended a regulatory process that began more than 15 months earlier, when Staples had announced its proposed acquisition of Office Depot on Feb. 4, 2015.[2]

The merging parties vigorously contested the definition of the relevant product market, challenged the reliability of the FTC's market share estimates, and placed the expansion and repositioning of Amazon.com at the center of their defense. At the core of the dispute was the FTC's decision to limit the relevant product market to "consumable office supplies" (corresponding to what we know colloquially as traditional office supplies and paper) sold to "large" business-to-business customers (defined by the FTC as customers buying more than $500,000 annually in "consumable office supplies").[3] The parties argued that the FTC's alleged market bore little resemblance to business realities. In the end, however, the court was not persuaded to allow the transaction to close.[4] The opinion granting a preliminary injunction found that the FTC had alleged a well-defined relevant product market, accepted the FTC's market share estimates, and found that Amazon's expansion would be both insufficient and unlikely to mitigate the alleged competitive harm.[5]

After two weeks of contesting the FTC's case and cross-examining its witnesses, the defendants rested without calling any witnesses of their own. They contended that the FTC had failed to show that the share of the combined firm in the alleged market was high enough to establish the *Philadelphia National Bank* (rebuttable) presumption of competitive injury,[6] so that no rebuttal was required.

While there is little value in re-litigating the credibility of the FTC's market share estimates at this juncture, it remains fruitful to discuss the competitive effects analyses used in this matter. The FTC's prosecution of this case raises important questions regarding competitive effects and market definition analyses. Is the mere fact that a customer conducts a procurement auction sufficient to conclude that competition to sell the products at issue is restricted to the bidding process? What losses of sales volume matter when evaluating the profitability of a price increase in the course of performing the hypothetical monopolist test and competitive effects analyses? We show here that the answers to these questions can reverse the inferences one reaches regarding the likely competitive effect of a merger.

The FTC's Case[7]

The FTC's case centered on inferences drawn from the parties' bidding histories. The FTC used bid data to estimate the extent to which the proposed merger would internalize diversions that kept the parties from raising prices in the pre-merger world. It concluded that the pre-merger diversions between the parties were high enough to find the proposed acquisition a likely Section 7 violation. Because the bid data showed that the merging parties appeared in and won a large percentage of bids to supply "targeted customers" (while third parties did not), the FTC also believed that the bid data reinforced its claim that the parties had a high share of the alleged product market.

The FTC then sought to validate its analyses of the bid data with a variety of qualitative evidence. It offered a narrative in which the parties were the only meaningful competitors in a well-defined relevant market composed of the sale of consumable office supplies to targeted customers. Third parties were depicted as no more than marginal competitors unable to meet the targeted customers' requirements (e.g., they lacked

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a national distribution infra-structure or were unable to provide the requisite delivery and information technology services). Even Amazon.com was characterized as falling short of these requirements and thus not a credible alternative to Staples and Office Depot. Importantly, Amazon.com was described as unwilling or unable to generate credible responses to a request-for-proposal (RFP), an activity that the FTC claimed was necessary to compete in the relevant market.

Some Questions About the FTC's Case

Notwithstanding the district court's acceptance of each of the FTC's arguments outlined above, the FTC's case raises three broad questions regarding competitive effects:

(1) Is competition to sell consumable office supplies to targeted customers restricted to the bidding or RFP process? Must a vendor win an RFP in order to exert competitive influence on the sale of consumable office supplies to targeted customers?

(2) Which diversions constrain the pricing of consumable office supplies?

(3) What is the antitrust relevance of the parties having recently reinvented themselves as suppliers of products other than consumable office supplies?

Marketplace Institutions and Dynamics

Declining Demand, Increasing Competition.[8] While Staples and Office Depot grew impressively from their inception in the mid-1980s through their peak in the mid-2000s, their office supplies businesses have declined in recent years (see below). The technological progress that has enabled us to digitize documents has decreased demand for a variety of traditional office supplies relating to the creation, organization, and storage of paper documents (e.g., paper, ink/toner, binder clips, binders, boxes, etc.).

The parties have also been challenged by competitors seeking to expand their sales of office supplies. At the retail level, "channel blurring" has led to growth by brick-and-mortar competitors that have expanded their office supply offerings (e.g., Walmart, Target, and Costco). Readers who purchase from Amazon.com have direct insight into how the development of the Internet (e.g., search engines and e-tailing) and associated improvements in delivery logistics have facilitated new competition from low-cost competitors.

Similar forces have affected contract sales to commercial customers. For example, the ink and toner sales that were mainstays of Staples' and Office Depot's sales to commercial customers are now subject to competition from the "managed print services" (MPS) programs of printer and copier manufacturers, leading the FTC to conclude that the proposed merger posed no risk of lessening competition for ink and toner sales.[9] Consequently, the relevant product market that the FTC pleaded excluded ink and toner, even though customers and suppliers (including the FTC's own witnesses) testified unequivocally that ink and toner are consumable office supplies.[10]

The development of the Internet has also impacted the parties' commercial contract business. The development of search engines has lowered corporate customers' costs of searching for the lowest prices while improvements in delivery logistics have enabled them to make credible their threat to purchase products from third parties. Finally, regional contract players have expanded significantly. (W.B. Mason is the pre-eminent example in this regard.)

These developments have challenged the parties' top line revenues. Over the five years between 2011 and 2015, the parties lost about $8 billion in revenue while continuing to bear the costs associated with their legacy high-fixed-cost distribution and retail sales business model. By itself, Office Depot (including OfficeMax) lost more than $10 billion in revenue over the eight years between 2008 and 2015.[11]

In response, the parties initiated new strategies predicated on leveraging their two most significant assets: extensive distribution infrastructures and acceptance as vendors to large commercial customers. Each party began initiatives to move Beyond Office Supply Sales (BOSS) to enhance their sales base by selling to their corporate customers a variety of additional product lines, such as break room supplies, janitorial/sanitation supplies, technology products, print and graphics services, and promotional items.[12] BOSS product lines already account for about half of Staples' contract revenues.[13] Given the need for new revenue sources, the expansion into BOSS is a key strategic initiative for both Staples and Office Depot.

Procurement and Pricing Institutions. The targeted customers organize their RFP processes so that suppliers bid to provide them with a bundle of goods and services. Each customer thereby aggregates all the products it intends to buy from a vendor, leveraging the power of its purchasing volume. Bundling allows the supplier to quote lower prices that take into account the benefits of serving the full purchasing volume of that customer. The requirement that the winning bidder provide a host of delivery and utilization review services was central to the FTC's concerns regarding the credibility and thus competitive relevance of third party suppliers.[14]

During the RFP process, customers typically establish the scope and scale of the RFP by providing bidders with extensive data on how much of each item they have purchased historically. Customers also identify their "core" items, which are the highest volume and most important items that they purchase. They demand the lowest pricing on these items, and suppliers generally oblige with deep discounts. Importantly, core items are not restricted to consumable office supplies and often include BOSS products, such as break room or janitorial/sanitation items. Customers essentially never issue an RFP for just the products in the FTC's market. The bundle they seek nearly always spans multiple product lines, including BOSS.

Suppliers use the purchase history of the customer to predict how much of each item the customer will purchase under the contract. With that information in hand, they undertake price optimization exercises to set the price of each item to meet the customer's expectations of low prices for core items while also reaching a target level of profitability for the account as a whole.[15] To be clear, while each item is obviously assigned its own price, that price is not independent of the pricing of other items. Instead, the price of each item depends on how many and which other items the customer purchases and the expected profitability of those products. Thus, the RFP process yields prices that are inextricably linked to one another, and the purchase of non-core items effectively cross-subsidizes the low prices offered on core items.[16]

The fact that pricing is linked across items in the bundle regardless of whether the items are within the FTC's claimed relevant product market raises a fundamental question. For Staples' proposed acquisition of Office Depot, the FTC's case and the court's decision revolved around the pricing of a small subset of items subject to RFPs and actually purchased by some customers. But if the pricing of these items, particularly the low prices on core items that are so attractive to customers, is linked inextricably to the pricing and purchase of other items purchased by the same customer (items not alleged to be subject to a substantial lessening of competition), is it sensible to posit that a supplier could raise its pricing for consumable office supplies regardless of what happens to the pricing and sales volume of the other items?[17]

Does the RFP Process Circumscribe Competition?

Because the FTC's primary evidence was derived from bids submitted pursuant to the RFP process, the FTC's case was premised on the assertion that the most critical aspects of competition were within the boundaries of the RFP process. Indeed, the primary evidence that the FTC offered to substantiate its contention that Amazon.com was competitively irrelevant was that Amazon had been unwilling to submit, or ineffective in submitting, credible and competitive responses to RFPs from large customers.

To corroborate its belief that the combined firm would have a market share high enough to establish a presumption of competitive injury, the FTC used bid data to showcase the high rate at which Staples and Office Depot won bids (or to highlight the relative paucity of third-party wins). The bid data were also used to estimate the diversions between the merging firms that the merger would internalize and thus to infer whether the combined firm would have an incentive to raise prices. Thus, the RFP process was simultaneously the source of the data that led the FTC to challenge the proposed merger and the market institution that defined what the FTC perceived as the boundaries of affected competition.

The centrality of the RFP process to the FTC's case raises the question of whether third parties really need to win an RFP in order to limit the combined firm's ability to raise prices. It was not disputed that the merging parties competed head-to-head in the RFP process. But it takes more than just that to show that the proposed merger was likely to injure competition. The antitrust question hinged on whether third parties, inside or outside the RFP process, presented only distant competitive constraints to the combined firm (relative to those that the merging parties presented to each other). Thus, if the evidence showed that the winner of an RFP still had to compete with third parties, and if competition outside the RFP caused the winner of the RFP to lower its prices below the levels established during the RFP (or was otherwise "baked into" the RFP response itself), then the head-to-head competition between Staples and Office Depot during the RFP process would have only limited probative value to the ultimate antitrust question.

In this regard, it is important to note that Staples' and Office Depot's contracts with customers do not require the customer to purchase exclusively through the contract. Instead, a contract simply provides customers with a menu from which they can choose to order. Regardless of any contract that they may have signed, customers retain the right to purchase any items, in any volume, from any supplier.[18]

It should also be noted that the impact of competition (in this context from third parties) can be manifested in two ways: by losing sales volume or by erosion of margins when prices are lowered to meet ex-RFP competition and thereby preserve the sale. The merging parties referred to the former—sales volume lost to competitors outside of an RFP—as "leakage."

Two sets of data are telling in this regard: first, data that compare sales that Office Depot actually made to targeted customers with the sales it expected to make; second, data on instances in which Office Depot had to reduce prices to the targeted customers to match lower quotes that the customers obtained after signing an Office Depot contract. When looking at both sides of the coin (loss of sales volume and erosion of margins upon lowering prices to retain a sale), about 70 percent[19] of Office Depot's contract sales to large customers are subject to more rigorous competition after and outside the RFP process than within the RFP process.

To Office Depot, it was self-evident that competition was not restricted to narrow segments and channels and that competition continued unabated after the conclusion of the RFP process. Both propositions are evidenced by the fact that contractual prices are often adjusted in response to prices found contemporaneously on the Internet, thereby enabling contract customers to benefit from ex-RFP pricing that is indisputably subject to competition from Amazon.com, Walmart, Target, and Costco.

The marketplace reality is that winning an RFP does not end the competition for sales to a customer. Instead, even the RFP winner must take post-RFP competition into account and regularly either lower its prices below the levels required to win the RFP or lose the sale. This is why Staples and Office Depot perceive contracts as only "hunting licenses" rather than protected revenue streams. Indeed, post-RFP competition with third parties leads to lower prices on items covering a large swath of consumable office supply sales to targeted customers so that head-to-head competition between the merging parties during the RFP stage does not meaningfully constrain the prices of those items.

Thus, in order to conclude that the proposed merger was anticompetitive, the district court first had to conclude that competition was restricted to the RFP process. But was this inference drawn because third-party competition outside of RFPs does not really exist? Or was it because the competitive inquiry underestimated the impact of third parties that declined to adopt the parties' legacy business model and instead simply worked around the RFP process in order to approach the targeted customers?

Which Diversions Matter?

We have already discussed the hazard associated with estimating diversions within the RFP process: failing to recognize that important price constraints on items accounting for about 70 percent of the targeted customers' purchases of consumable office supplies came from outside the RFP process. But there is also another conceptual concern regarding the FTC's diversion-based competitive effects and market definition arguments.[20]

To demonstrate this, we begin with the basic intuition underlying why diversions are probative of a merger's likely competitive effect. The reason that each merging party does not raise prices in the premerger world is that it would lose so much sales volume following a price increase that it would lose more profit than it gains. The merger changes this calculus because some lost sales would have been directed to the other merging party, and what would have been a lost sale in the premerger world is instead captured within the combined firm. Because a post-merger price increase would cause it to lose fewer sales, and thus lose fewer profits, the combined firm may have an incentive to raise prices, all things being equal.

The problem with the application of diversions in this matter arises from the fact that the FTC and its expert restricted their measure of diversions to the loss of consumable office supplies. This would not be a problem if the parties sold nothing but consumable office supplies to the targeted customers. But about half the revenues that Staples earns from commercial customers comes from BOSS product lines. Yet the FTC and its expert simply assumed that the profits it realized by selling BOSS products would be unaffected if it raised its prices for consumable office supplies.

We noted above (with regard to the contention that competition is restricted to the four corners of the RFP process) that the germane antitrust question is not the route a third party takes to make a sale but rather whether a third party is able to make a sale at the price margin (and thus constrain the merged firm's ability to raise prices). Similarly, the manner in which customers adjust their purchase decisions to defeat the profitability of a price increase on consumable office supplies does not matter as long as the changes in purchase decisions are caused by the posited price increase and would indeed make it unprofitable.

Importantly, even though the litigants vigorously contested many issues, there was no dispute as to whether the targeted customers had ample alternatives for their purchase of ink and toner and BOSS product lines. The FTC's complaint did not even allege that the proposed merger risked injuring competition for the sale of ink and toner or BOSS items. In fact, both the FTC and its expert agreed that customers could, and would, move all their BOSS purchases to third parties if doing so yielded more favorable pricing on consumable office supplies. Nor did the FTC or its expert suggest that there were any frictions impeding the redirection of BOSS sales to third parties.

Competitive Effects Analysis Meets (the) BOSS

The parties sought to grow their sales of BOSS items to increase revenues in the face of declining demand to sustain businesses with significant fixed costs. But at the same time, their customers gained significant bargaining clout on the pricing of legacy product lines (i.e., consumable office supplies).

To see this, assume that the combined firm, or a hypothetical monopolist, obtains market power in the FTC's alleged market—i.e., over the sale of "consumable office supplies" to the targeted customers. For expositional ease, assume further that the demand for consumable office supplies is perfectly inelastic. Now consider the profitability of imposing a small but significant non-transitory increase in the price (SSNIP) of consumable office supplies. By construction, the seller would realize higher profits on consumable office supplies. Given the market shares that it had estimated, the FTC argued that this market definition thought exercise was sufficient to resolve the antitrust question and enjoin the proposed merger and the district court evidently agreed.

But an important competitive effect was neglected in this line of thinking. Could customers redirect their purchase of BOSS products from their consumable office supplies vendor to the point that the posited price increase on consumable office supplies became unprofitable?

A numerical example illustrates this point. Suppose that the combined firm sells $1 billion each of BOSS product lines and consumable office supplies to the targeted customers. Suppose further that the combined firm earns a margin of 20 percent on its sale of BOSS products. Now consider the profitability of a 5 percent SSNIP on consumable office supplies (while continuing to assume, for expositional ease, that the demand for consumable office supplies is perfectly inelastic). Profits on consumable office supplies would increase by 5 percent, so profits would increase by 5 percent of $1 billion, or $50 million. But customers could redirect their entire purchase of BOSS product lines to third parties, causing the combined firm to lose all of its BOSS profits. That translates to a loss of 20 percent of $1 billion, or $200 million. Thus, even assuming that the targeted customers have no other option as to where they can buy consumable office supplies and would not forgo consumable office supplies altogether, the presence of BOSS in the bundle leads a posited SSNIP on consumable office supplies to turn from being quite profitable (to the tune of + $50 million) to being strongly unprofitable (to the tune of – $150 million).[21]

Potential Rejoinders

The agencies often reject the contention that the redirection of "out of market" purchases will discipline pricing "within the market" in the context of hospital mergers. Why, then, might the argument be more credible when it comes to paper clips than it has been with regard to general acute care services provided on an inpatient basis? The key to understanding this difference may relate to the credibility of arguing that customers will be able to redirect their purchase of "out of market" products and services.

Insurers' ability to discipline the pricing of a hospital's inpatient services by redirecting its purchase of outpatient services hinges critically on their ability to steer consumers' choice of where they obtain outpatient care. The problem here is twofold. First, unlike office supplies customers, health insurers often face an "all or nothing" negotiation with their major suppliers (i.e., healthcare systems that offer general acute care as well as outpatient and other services), so they may be unable credibly to threaten to purchase healthcare services on an unbundled, piecemeal basis from a variety of suppliers.

Second, there is the usual agency problem that is endemic to healthcare marketplaces: the person who pays and bargains with providers (i.e., the insurer/payor) is not the same as the person who selects the providers (i.e., the patient). There are a variety of reasons why consumers may not be willing to switch their outpatient service provider in a manner that permits insurers to harness the bargaining power that this redirection could generate. For example, patients may be unwilling to settle for "second best" outpatient care decisions because they may not perceive any benefit to themselves even if their insurer obtains lower prices on inpatient care.

But this consideration does not apply to large corporate customers' purchases of paper clips, snacks, and cleaning supplies. They make the decisions as to where they purchase each product line, and so their ability to "break the bundle" and redirect their purchases is not in question.

While the FTC and its expert did not contest that customers could, and would, redirect their purchases of BOSS in order to discipline the pricing of consumable office supplies, they disputed the notion that this phenomenon disposed of the antitrust concern regarding Staples' proposed acquisition of Office Depot. The FTC's expert testified that the leverage conferred by customers' ability to redirect BOSS purchases was already factored into marketplace pricing and would not change as a result of the merger. Consequently, the ability to redirect BOSS purchases provided no incremental leverage in the post-merger world.

But even if the ability to redirect BOSS purchases yields no incremental leverage after the consummation of a merger between suppliers, if the ability to redirect BOSS purchases provided sufficient leverage to discipline the pricing of consumable office supplies in the pre-merger world, that leverage continues to protect fully the pricing of consumable office supplies in the post-merger world. Consequently, the combined firm would remain unable to raise the prices of consumable office supplies even if it obtained a very high share of those products. As long as customers had viable alternative third-party vendors for BOSS items, they would always be in possession of a bargaining tool sufficiently powerful to ensure competitive prices for consumable office supplies. Ignoring this market reality—whether in this case or in other purported "bid markets"—presents the risk of reaching the wrong conclusion and failing to predict accurately a transaction's likely competitive effects.

Conclusion

We undertake competitive effects analysis to recognize and uncover latent dynamics that direct the flow of competition in the marketplace. When the concept of diversions initially began to take hold in competitive effects analysis, the idea was to let marketplace facts speak for themselves on the extent to which two products constituted good substitutes for each other rather than relying on market shares (which could, or could not, be good indicators of the closeness of competition).

Having proven its utility, diversion analysis became increasingly common in antitrust practice. As often happens when novel concepts and tools mature, there is a risk that they begin to be applied as a matter of rote. But competitive effects analysis must evolve organically from the facts if it is to provide useful antitrust inferences.

Diversion is obviously a useful concept to understand the incentive to raise prices. We certainly do not contest the validity of the diversion concept. But how diversion is measured and interpreted can make a big difference. In this matter, including or excluding the loss of profit dollars due to ex-RFP competition or to customers redirecting to third parties their purchase of BOSS items following an increase in the price of "consumable office supplies" had a material impact on the antitrust inferences that can be drawn from the bid data.

Staples' proposed acquisition of Office Depot illustrates that the proper evaluation of the profitability of a price increase when performing the hypothetical monopolist test, or when evaluating competitive effects, requires us to consider the loss of profit dollars in all forms. This is so regardless of which stage in competition or which product lines are thereby affected as long as the profit loss is caused directly by actions flowing from the posited price increase. ■

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[1] FTC v. Staples, Inc., No. 15-2115, 2016 WL 2899222 (D.D.C. May 17, 2016).

2 Press Release, Office Depot, Staples, Inc. Announces Acquisition of Office Depot, Inc. (Feb. 4, 2015), http://news.officedepot.com/press-release/corporatefinancial-news/staples-inc-announces-acquisition-office-depot-inc.

3 For the remainder of this article we will refer to the FTC's market as "consumable office supplies" sold to "targeted customers."

4 *Staples*, 2016 WL 2899222, at *26.

5 *Id.* at *14–15, 20, 24.

6 *See* United States v. Phila. Nat'l Bank, 374 U.S. 321, 363 (1963).

7 Fed. Trade Comm'n, FTC v. Staples/Office Depot (May 10, 2016), https://www.ftc.gov/enforcement/cases-proceedings/1510065/ftc-v-staplesoffice-depot (listing the FTC's filings in this litigation).

8 Jim Haddadin, *Staples Sees Future "Beyond Office Supplies,"* MetroWest Daily News (Oct. 18, 2014), http://www.metrowestdailynews.com/article/20141018/News/141016358 (summarizing the marketplace developments described here).

9 *Staples*, 2016 WL 2899222, at *14–15.

10 The FTC and its expert admitted that because ink and toner are supplied extensively by third parties, the inclusion of ink and toner in the relevant product market would reduce substantially the parties' estimated market share, albeit not to the extent that the market share of the combined firm would necessarily fall below the *Philadelphia National Bank* hurdle.

11 These calculations are based upon SEC 10-K filings by Staples, Office Depot, and OfficeMax.

12 "BOSS" is a term used by Staples that became shorthand during the litigation to refer to products sold by Staples and Office Depot that were outside the FTC's product market. Office Depot refers to these products as "adjacencies." In the remainder of this article, we will use the term "BOSS" in the same sense, i.e., products that Staples and Office Depot sold to their customers that are outside the relevant product market alleged by the FTC.

13 *Staples' (SPLS) CEO Ronald Sargent on Q4 2015 Results—Earnings Call Transcript*, Seeking Alpha (Mar. 4, 2016), http://seekingalpha.com/article/3955686-staples-spls-ceo-ronald-sargent-q4-2015-results-earnings-call-transcript ("Over the past few years we've added nearly 300 specialists to drive growth in categories beyond office supplies . . . . We achieved double-digit growth and breakroom supplies and promotional products; and high single-digit growth in facility supplies . . . . [C]ategories beyond office supplies grew in the low single-digits during the fourth quarter and now account for approximately half of our entire contract sales mix.").

14 Plaintiffs' Proposed Findings of Fact at 17–24, FTC v. Staples, Inc., https://www.ftc.gov/system/files/documents/cases/160420staplesfindings.pdf

15 Different items sell at different margins, so not every dollar of revenue is equally profitable.

16 Because they are not discounted as steeply as core items, non-core items provide higher margins for the supplier.

17 Of course, the mere fact that customers purchase a bundle of products that include items outside the FTC's market does not by itself mean that the pricing and purchase volume of items outside the FTC's market must constrain the pricing of items within the FTC's market. Rather, it presents an empirical question that must be considered in the course of conducting competitive effects and market definition analyses.

18 It is possible that lowering the amount purchased from a particular supplier could cause a customer to fall to a lower step on that supplier's volume discount schedule. This is an empirical question. In the matter at hand, this did not appear to be a binding constraint on customers' purchase decisions.

19 This figure likely understates the competitive impact of third parties as it does not reflect all of the sales revenue that Office Depot could get from its customers by selling them additional products that were not specifically contemplated in the contract.

20 The FTC's expert linked diversions and market definition by indicating that the analytical basis for his conclusions regarding the relevant product market was due to his calculation of the critical "recapture rate"—i.e., the minimum internalized diversion required to render profitable a SSNIP imposed by a hypothetical monopolist. This comports with the basic antitrust intuition that, when done correctly, market definition is simply competitive effects analysis writ large.

21 This conclusion will only get stronger in the future as BOSS will represent an even greater portion of the parties' revenues and profits as they grow their BOSS sales while their consumable office supplies sales continue to decline. Furthermore, the impact of BOSS sales is understated by myopic profit maximization considerations. Retaining and growing the sale of BOSS product lines is of vital strategic importance to the parties because it is the linchpin of their survival strategy.

Price Discrimination Markets in Merger Cases: Practical Guidance from *FTC v. Sysco*

BY IAN SIMMONS, SERGEI ZASLAVSKY, AND LINDSEY FREEMAN

IN HIS ACCLAIMED BOOK, *THE RULE OF LAW*, Tom Bingham[1] quotes Lord Mansfield, who, over 250 years ago, wrote describing the need for businesses to have clearly established rules: "The daily negotiations and property of merchants ought not to depend upon subtleties and niceties; but upon rules easily learned and easily retained"[2] and that "[i]n all mercantile transactions the great object should be certainty; and therefore, it is of more consequence that a rule should be certain, than whether the rule is established one way or the other."[3]

Merger enforcement is a fact-dependent exercise due to the need to predict the risk of future competitive injury in the relevant market using artificially constructed "but-for-worlds" or simulations. Nevertheless, effective rule of law requires that courts and enforcers follow a common understanding of the standards used in analyzing antitrust cases—and preferably analysis that has become settled and supported by sound economic theory. The focus here is on narrow "price discrimination markets" that enforcement agencies are asserting in a growing number of merger investigations and enforcement actions, based on the merged firm's alleged ability to target vulnerable customers with post-merger price increases that other customers buying the same products or services will not face.

The discussion below offers practical guidance on the factual predicates for analyzing price discrimination markets in government merger enforcement. The FTC's challenge to the proposed Sysco/U.S. Foods merger serves as a case study where, in the authors' view, the requisite factual predicates did not exist and the court departed from settled standards and economic theory to accept the FTC's narrow price discrimination market as a basis to block the transaction.

Settled Standard for Price Discrimination Markets and the Departure in Sysco

In *R.R. Donnelley & Sons Co.*,[4] the FTC stated factual predicates for when it is proper to define a narrow relevant market ("price discrimination market" or "targeted customer market") that is limited to customers who may be "vulnerable" to selective post-merger price increases: the merged entity must be able to correctly identify customers to target with price increases and segregate them from other customers. If the merged entity is unable to identify those customers, there is the possibility the entity will miscalculate and suffer a net loss of sales and profits by raising prices to customers who can switch to competing suppliers.[5] Consistent with this logic, the FTC required proof that: (1) customers are purchasing the "same" product (price discrimination by definition applies when the products are the same or similar, otherwise the seller cannot be said to be discriminating between purchasers); (2) the merged firm can identify a segment of targeted customers with "sufficiently inelastic demand" for that product; and (3) the merged firm will actually be able to "selectively and profitably increase prices" to those targeted customers.[6] In *R.R. Donnelley*, the FTC required proof that the inelastic customers could be accurately identified and that a post-merger price increase targeted to those customers "likely would be profitable,"[7] and ruled that complaint counsel had failed to meet this burden.[8]

The 2010 Horizontal Merger Guidelines track the factual predicates for a price discrimination market that the FTC applied in *R.R. Donnelley*. The Guidelines require evidence that customers vulnerable to a discriminatory post-merger price increase must be identifiable based on "observable characteristics."[9] This is an objective standard that the court can apply to analyze evidence submitted by the government to support a segmented price discrimination market in a merger challenge. The Guidelines provide an example to illustrate the type of observable characteristics that may meet this requirement:

> Suppliers can distinguish large buyers from small buyers. Large buyers are more likely than small buyers to self-supply in response to a significant price increase. The merger may lead to price discrimination against small buyers, harming them, even if large buyers are not harmed. Such discrimination can occur even if there is no discrete gap in size between the classes of large and small buyers.[10]

The FTC relied on a price discrimination market in *FTC v. Sysco Corp.*[11] to support its challenge to the Sysco/U.S. Foods merger. Each company is a "broadline" foodservice dis-

The authors, who were trial counsel to Sysco Corp. in FTC v. Sysco, Inc., *are attorneys at O'Melveny & Myers LLP, where Simmons is Co-Chair of the Antitrust & Competition Practice, and Zaslavsky and Freeman are associates within that Practice Group. Ian Simmons is an Associate Editor of Antitrust.*

tributor that "sells and delivers a 'broad' array of food and related products to just about anywhere food is consumed outside the home," including restaurants, hotels, hospitals, and group purchasing organizations (GPOs).[12] The FTC initially asserted a price discrimination market of "national broadline customers" whose nationwide footprint meant the customer preferred nationwide delivery from the same food-service distributor.[13] These customers ostensibly were vulnerable to a post-merger selective price increase due to their inability to switch to regional or local suppliers. The FTC argued that the merger parties' internal classification of "national customers" was an observable characteristic, but the parties showed that a number of these customers were not national or even multi-regional in scope, and others who were national in scope chose to use a mix of local or regional distributors.[14]

The FTC then argued that the merged firm could use "individualized negotiations" to identify customers that were vulnerable to a price increase. Although the FTC in *Sysco* did not follow *R.R. Donnelley*'s guidance that it provide a "methodology [that] allows an accurate identification of inelastic end uses and, thus, [predicts] that a price increase within the identified category likely would be profitable,"[15] the district court was satisfied that some group of national broadline customers could be harmed and granted a preliminary injunction.

This approach for determining a narrow price discrimination market was a marked departure from the standard and from the underlying economic theory applied in *R.R. Donnelley* and articulated in the Horizontal Merger Guidelines. The basic tenets of economic theory on price discrimination, as used to define relevant markets, require that price differences apply to the same products and services sold to both vulnerable and non-vulnerable customers, and that the vulnerable customers can be identified in advance. If the first condition is not met, price differences do not show that customers who are charged "higher" prices for different products are in fact "vulnerable." If the second condition is not met, attempted price increases may be defeated by customers who shift to other suppliers.

The Rigorous Analysis Required by *R.R. Donnelley*

Price discrimination occurs when a seller can increase profits by selectively increasing prices (for the same product) to an identifiable segment of its customers. In *R.R. Donnelley*, the Commission recognized that "[i]t is an economic truism that buyers do not have homogeneous preferences or demand elasticities for a given product within a relevant market."[16] But the Commission did not abandon price discrimination theories of harm altogether. Instead, the Commission reasoned that: "Th[e] risk [inherent in defining markets under a price discrimination theory] requires [(1)] a particular rigor in examining the conceptual basis for distinguishing the allegedly inelastic customers and [(2)] the factual basis for the prediction that price discrimination with respect to those customers is likely."[17]

Donnelley was the largest supplier of commercial printing services, and sought to acquire one of its largest rivals. Complaint counsel alleged that the relevant price discrimination market was "high volume publication gravure printing,"[18] and described the "core" of this market as "gravure print jobs with at least ten million copies, more than thirty-two pages, and fewer than four four-color versions."[19] According to complaint counsel, "[A] hypothetical gravure printing monopolist could profitably impose a discriminatory price increase on customers whose printing demand fit these parameters."[20] The Commission ruled that the market was not as narrow as complaint counsel alleged because customers could—and often did—turn to alternative printing methods, such as offset printing.[21] Thus, complaint counsel failed to prove that the merged party could profitably target customers in its proposed market.

The Commission examined evidence offered to show the "conceptual basis for distinguishing the allegedly inelastic customers"[22] (i.e., customers with sufficiently "inelastic demand for gravure printing" who would not switch to offset printing in response to a 5 percent price increase).[23] Complaint counsel introduced a "breakeven analysis" that estimated the production volume at which offset printing becomes a less viable alternative to "inelastic" customers as the number of copies increases, and used this analysis to argue that the merged firm could identify and target these customers with a discriminatory price increase.[24] The Commission, however, found that the break-even analysis was a poor means of differentiating customers based on elasticity of demand because "increased productivity and efficiency" of offset printing made it difficult to tell at what point (if at all) offset printing became a less viable alternative to gravure printing.[25] As a result, the Commission noted it would be difficult if not impossible for the merged firm to identify and thus target customers based on this data alone.[26]

The Commission similarly determined that the number of "versions" of a particular print job was actually "an important variable of competition between gravure and offset," not a fixed observable characteristic as complaint counsel alleged.[27] Examining actual market conditions, the Commission found that "[a]s the relative prices of gravure and offset printing change[d]" based on different variations of the job (including the number of versions), "printing customers can and d[id] substitute from gravure to offset."[28] Thus, by defining the market as "fewer than four four-color versions," complaint counsel ignored a great deal of substitution that was already occurring prior to the merger. Complaint counsel argued that customers should be treated as having exited the relevant market if they increased the number of versions of a print job and switched from gravure to offset printing to avoid the greater cost of versioning in gravure printing. The Commission found that this argument overlooked print volume and page counts that were "not only within complaint counsel's proposed relevant market," but also "well within the 'core'" of allegedly targeted customers—customers who, in reality, had no problem substituting to an alternative print method and thus were not vulnerable to a price increase.[29]

As a result of these findings, the Commission rejected complaint counsel's prediction that price discrimination with respect to the "targeted" customers was likely, noting that substitution between gravure and offset printing currently taking place in the market "provide[d] the strongest evidence that additional marginal substitution is likely to occur in response to a supracompetitive price increase."[30] Again, the parties could point to several large print customers who were currently using offset printing for jobs falling within the exact specifications of complaint counsel's alleged market.[31] Because complaint counsel offered "[n]o evidence in the record . . . to suggest that high volume customers using offset are inframarginal, economically irrational, or otherwise irrelevant to market definition,"[32] there was nothing to rebut the strong evidence that substitution was occurring and would likely increase in the face of a price increase.

Sysco's Departure from the Principles of *R.R. Donnelley*

The 2015 decision in *FTC v. Sysco* does not reflect the language in *R.R. Donnelley* that a special "rigor" must be applied when determining a market based on evidence of potential post-merger price discrimination: the court did not find that the targeted and non-targeted customers all purchased the same or similar products; the court did not closely scrutinize evidence on how the merged firm could identify inelastic customers based on observable characteristics; and the court faced shifting positions on the identity of targeted customers (i.e., first national customers identified in internal documents, then a subset of those customers identified through trial and error in individualized post-merger contract negotiations).

In its complaint, the FTC attempted to establish a market consisting of "national customers," i.e., those that "require or typically contract with a broadline distributor that offers consistency of pricing, service, ordering, and products across all of their geographically dispersed locations."[33] The complaint further noted that "[a]s a result, many National Customers are most effectively served by a broadline foodservice distributor that has the capability to provide nationwide coverage" and that "Defendants are the only two single-firm broadline distributors that meet these requirements."[34] Once it became clear that national customers were already sourcing from alternatives, including regional distributors and specialty distributors, the FTC changed its definition to suggest that national customers were those who could be targeted through individual negotiations with the parties.[35]

Despite these shortcomings and evidence that some national customers may have preferred to use a single national distributor but would have the practical ability to substitute regional/local distributors in the event of attempted post-merger price increases, the court ultimately embraced the FTC's position on a narrow price discrimination market and blocked the proposed merger.[36]

Using *Sysco* as a case study, the discussion below provides guidance on issues that may arise on each of the factual predicates for using a narrow price discrimination market in merger cases.

Same or Similar Products. Fundamental to the definition of price discrimination is that price increases for targeted customers relative to others are for the same product.[37] Hotel rooms offer a prototypical example. A hotel may have identical rooms next to each other; the occupant in 107 paid \$200, and the occupant in 108 paid \$350. The guest in 107 booked a month in advance (revealing himself likely to be a bargain-hunting leisure traveler); the guest in 108 booked two days prior to her stay (revealing herself likely to be a less price-sensitive business traveler). Thus, there is an identical product, two customers with different elasticities of demand, and a seller who can tell the two apart based on the observable characteristic of when the purchaser made the reservation in relation to the period of the accommodation.

The Horizontal Merger Guidelines track this reasoning: "When examining possible adverse competitive effects from a merger, the Agencies consider whether those effects vary significantly for *different customers purchasing the same or similar products*. Such differential impacts are possible when sellers can discriminate, e.g., by profitably raising price to certain targeted customers but not to others."[38] The products must be the same (or at least similar) because price differences on different products would not reveal differences in the customer's elasticity of demand and, in turn, the vulnerability of those with inelastic demand to post-merger price increases. While it is possible to look at margins rather than prices to identify differential treatment of customers, that approach is frequently infeasible in practice:

> [W]hen the product differs . . . estimating marginal cost can often be an extremely difficult task. It is well known among economists that estimating true marginal cost from a firm's accounting cost data is, at best, extremely difficult. Any error in the marginal cost estimate could lead to the incorrect conclusion that price discrimination existed.[39]

The Commission's recent *McWane* decision further illustrates that the same product must be involved to infer inelastic demand from evidence that targeted customers may be charged higher prices than others.[40] McWane was the only domestic ductile iron pipe fittings manufacturer, while two other companies sold imported fittings in the United States. When fittings buyers issued bid specifications, they specified either domestic or open-source (imported or domestic) fittings. When McWane priced a bid, it knew whether the customer required domestic fittings or would also accept imported products. McWane filled bids with identical U.S.-made fittings to both groups of buyers. But because it was the only domestic fittings manufacturer, McWane targeted buyers who specified domestic fittings with prices that were 20 to 95 percent higher than it charged for identical fittings when the contract was open-source. "This price differentiation reflected McWane's ability to target customers with domestic-only project specifications who could not avoid the higher prices by substituting imported fittings . . . even though the fittings themselves are functionally identical."[41]

Unlike the identical fittings in *McWane*, the products and delivery services sold by the merger parties in *Sysco* were highly differentiated. The FTC acknowledged that individual customers purchased "a different basket of goods and services," but argued that evidence "does not require defining separate markets for each product and service, particularly where such 'distinctions would be 'impractical' and 'unwarranted.'"[42]

The court accepted the FTC's narrow market definition in *Sysco* despite evidence of dissimilarity in the products and services purchased by different customers. The *Sysco* court stopped the merger because it found that "Defendants engage in individual negotiations with their national customers" and that "[p]rice discrimination can occur in such a marketplace."[43]

But even under the individualized negotiations rubric, product differentiation can undermine the application of a price discrimination theory of harm. Consider this example: a flower grower may negotiate individual contracts with two seemingly similar flower shops. Shop A negotiates for weekly deliveries, and buys long-stemmed roses. Shop B requires daily deliveries and buys tulips. The shops receive different services and buy different products, so their prices will necessarily be different. The reason, however, is not due to price discrimination stemming from these individual negotiations but rather the different services and products required by each shop. Similarly, if Shop A had engaged in past negotiations for daily deliveries of tulips but now requires weekly deliveries of roses (for some reason unknown to the distributor that the distributor could not predict), prices would again be different, but the price change would be due to changes in the services and products that Shop A now purchases, not the distributor's individual negotiations with Shop A as a "vulnerable" customer.

The *Sysco* decision does not mean that this factual predicate—establishing the same or similar products—is no longer important to justify defining narrow price discrimination markets. The way in which the parties debate that issue may vary. As in *Sysco*, merger parties may attempt to rebut these allegations with evidence that the *products*—in addition to the customers—are different. In short, even if suppliers engage in individual negotiations with some or all customers in the broader market, the merger parties may show that these contracting practices do not allow suppliers of highly differentiated products and services to identify in advance the customers who will turn out to be vulnerable to discriminatory price increases, and in turn that the resulting uncertainty of lost sales may deter potential post-merger price discrimination.

Observable Characteristics of Targeted Customers. The Commission in *R.R. Donnelley* noted that "[i]t is an economic truism that buyers do not have homogeneous preferences or demand elasticities for a given product within a relevant market,"[44] which means that pockets of less elastic demand will exist in virtually any market. If normal dispersion in customer preferences was enough to establish a narrow price discrimination market, even for a small subset of customers, that evidence could "swallow up the market definition principles established by the federal courts and the Commission . . . ."[45] The Commission in *R.R. Donnelley* eschewed this outcome, ruling instead that rigorous analysis is required to find evidence that supports a narrow price discrimination market: "The Commission will recognize the possibility of price discrimination as a means of defining a relevant market if there is *a conceptually sound methodology, supported by the record*, by which a hypothetical monopolist can identify the alleged inelastic customers."[46]

In *Sysco*, the FTC initially asserted that the observable characteristic that identified target customers was the merger parties' internal classification of national customers (i.e., customers on Sysco's "corporate multi-unit" (CMU) customer list and U.S. Foods' "parent multi-unit" (PMU) customer list). However, rebuttal evidence showed that being on the list was merely an administrative label (i.e., the customer would deal with corporate headquarters staff rather than a regional unit),[47] and that many customers with multiple (and often widely dispersed) outlets were not on these lists, among other discrepancies.[48]

Rebuttal evidence also called into question whether national customers had inelastic demand indicative of vulnerability to a price increase. The FTC's theory depended on the assertion that national customers had to purchase from distributors with a nationwide footprint, but rebuttal evidence showed that customers with truly national footprints were already sourcing from regional and local suppliers.[49] There was nothing to indicate that other similarly situated national customers could not follow suit if faced with an attempted price increase.[50] Thus, there was nothing to separate the customers who bought regionally from the customers who bought nationally,[51] and the observable characteristic needed for a price discrimination theory proved indeterminate.

The FTC then changed course and asserted that the merger parties negotiated individually with national customers, and therefore they could single out the vulnerable customers through negotiations.[52] The FTC also argued (and the court accepted) that because both firms have a "know-your-customer" business method and substantial information about their customers, the parties would be able to predict which customers have inelastic demand.[53]

Federal courts, however, have rejected the know-your-customer approach to market definition in the past. In *Sungard* the Department of Justice sought to enjoin a merger that it claimed would lead to a 71 percent combined share in the market for shared hotsite services,[54] "a widely-used disaster recovery system sold by vendors to companies that depend on mainframes and other high-end platforms."[55] As in *Sysco*, "the government's market contain[ed] an extremely hetero-

The rebuttal evidence used in *Sysco* provides guidance for merger parties challenging narrow price discrimination markets based on internal customer classifications.

geneous group of customers,"[56] some of whom could switch to alternatives other than shared hotsites in the event of an attempted price increase, and some of whom could not.[57] Also, as in *Sysco*, the government did not segregate the elastic customers (who could switch) from the inelastic ones (who could not). The government also argued that the parties knew their customers well enough to identify those vulnerable to a price increase: "[P]laintiff has demonstrated that shared hotsite providers invest a great deal of time and money in gathering information about their customers and are typically aware of those clients that could switch to an alternative solution."[58]

In *Sungard*, in contrast to *Sysco*, the court "found that plaintiff ha[d] failed to meet its burden of establishing the relevant product market."[59] Without more, the fact of individualized negotiations does little to establish that individual customers will have inelastic demand, and that negotiations will allow the merger parties to identify this inelastic demand with sufficient precision to make a price increase profitable.

The rebuttal evidence used in *Sysco* provides guidance for merger parties challenging narrow price discrimination markets based on internal customer classifications. These classifications often reflect internal business processes more than the customers' elasticity, and historic records may be used to show differences in how similarly classified customers make purchase decisions as well as differences in prices and other contract terms, all of which may rebut the inference that these classifications show inelastic demand.

Ability to Profitably Implement Price Increases to Targeted Customers. Both economic literature and case law confirm that what ultimately matters with price discrimination conduct is not merely whether merging parties can identify vulnerable customers but whether they can actually increase profits by targeting them with a price increase. In other words, the targeted customers must truly have inelastic demand, rather than a malleable preference for a particular method of procurement.

Jerry A. Hausman,[60] Gregory K. Leonard, and Christopher A. Vellturo succinctly stated the issue in a 1996 article: "[T]he hypothetical monopolist will generally not be able to perfectly identify the inframarginal customers who have high willingness to pay" and "[a] sufficient number of wrong guesses can make the attempt to price discriminate unprofitable."[61] These predictions may be made with high accuracy when there is an observable characteristic that reliably and consistently predicts inelastic demand and vulnerability to a price increase. "Situations in which the condition is met usually involve different end uses by the customers."[62] Relying on "customer knowledge" gained from prior individualized negotiations to accurately predict demand elasticity is more difficult, and thus risky for the supplier. Customers "have the incentive to disguise their preferences precisely because they want to avoid becoming targets for higher prices."[63] Customers' ability to negotiate strategically is particularly relevant where the customers are large sophisticated companies with buyer power and business acumen.

These concerns animated the district court in *Oracle*,[64] where the court analyzed evidence through the lens of "differentiated products unilateral effects"[65] rather than price discrimination, but the analysis translates easily to the price discrimination context. As in *Sysco*, the plaintiffs in *Oracle* proposed a market definition that was based on both product and customer characteristics: "HRM [Human Resource Management] and FMS [Financial Management Services] integrated [software] suites sold to large complex enterprises ('high function FMS and HRM market')."[66] The theory of harm also bore a close resemblance to that in *Sysco*: customers within the defined market would supposedly be vulnerable to a post-merger price increase because the merging parties' offerings were sufficiently differentiated from other alternatives and sufficiently preferable to those alternatives that the customers would rather pay more than switch. Nevertheless, the court ruled that mere preference for the merging parties' products was not enough: "'Customer preferences towards one product over another do not negate interchangeability . . . . [T]he issue is not what solutions the customers would *like or prefer* for their data processing needs; the issue is what they *could* do in the event of an anticompetitive price increase by a post-merger Oracle.'"[67]

The missing element in proof of the relevant market was that "other products must be sufficiently different from the products controlled by the merging firms that a merger would make a small but significant and non-transitory price increase profitable for the merging firms."[68] Defining the market based on customer preferences risks an unjustifiably narrow market definition: "There will almost always be classes of customers with strong preferences . . . but to reason from the existence of such classes to a conclusion that each is entitled to . . . a separate narrow market definition grossly overstates the market power of the sellers."[69] An overly narrow market definition makes resulting market shares an unreliable predictor of harm: "The inability clearly to define a market suggests that strong presumptions based on mere market concentration may be ill-advised."[70]

R.R. Donnelley again is instructive. The Commission identified the question of whether "the hypothetical monopolist can selectively and profitably increase prices to [allegedly vulnerable] gravure customers" as an explicit precondition for finding a price discrimination market, above and beyond the requirement that the merging parties are capable of identifying the vulnerable customers.[71] Complaint counsel performed a break-even analysis quantitatively to identify the threshold volume at which offset printing would cease to be an economically feasible substitute for gravure printing.[72] Although this evidence had a logical tie to underlying economic theory, it was not consistent with real-world observations.[73] The Commission reasoned that, if substitution to offset printing was already occurring at current prices, additional substitution would likely occur if the merging parties tried to raise prices on high volume gravure printing, which implied that complaint counsel "ha[d] not accurately identified inelastic uses of gravure."[74]

In *Sysco*, the merger parties presented expert evidence inconsistent with inelastic demand, showing historical substitution in response to price increases based on the detailed transaction databases that the parties actually use in the ordinary course of business. Where third-party data was available on the totality of a customer's location—in the case of restaurants, hotels, and some group purchasing organizations (GPOs)—comparing these locations to the locations where they bought from the merger parties painted a picture of substitution on a regional basis that was inconsistent with a narrow market comprised of some large national accounts. Comprehensive location data was not available for some customers (some GPOs and foodservice management companies (FSMs)), but the merger parties showed that for every customer that was not currently sourcing on a regional basis, there was a similarly situated customer that did so.[75]

Timothy Bresnahan, an expert for the defendants, also investigated substitution over time. Specifically, he identified each national customer location in the Sysco data and checked whether at any point the particular location stopped being served by Sysco. He determined whether the location had permanently or seasonally closed, or whether it had moved its business to U.S. Foods. By process of elimination, if the location still operated but was not buying from U.S. Foods, then it must be buying its foodservice items from a different distributor.[76] This substitution analysis showed that customers within the "national broadline" customer segment could and did substitute away from the merging parties at current prices.

As in *R.R. Donnelley*, this evidence suggested that customers who were sourcing partially from suppliers other than the merging parties could increase their purchases from alternative regional suppliers if faced with a price increase, and also that similarly situated customers who were not yet sourcing from alternative suppliers at current prices could also switch sufficient volume to other suppliers to make an attempted price increase unprofitable. Given this evidence, it should not matter that some "national" customers procured the majority of their foodservice distribution needs from the merging parties at current prices.[77] Substitution at current prices among would-be targeted customers does not have to be universal to show that demand is elastic. In *R&R Donnelley*, for example, the Commission credited evidence that "[s]everal," not most or all, large print buyers used offset printing for high volume jobs,[78] and that "offset accounted for 13.5%," far from a majority, of print jobs in "the 'core' of complaint counsel's proposed market."[79]

Connection Between Defined Market and Theory of Harm. The decision in *Sysco* reflects an issue concerning the connection between the defined market and the theory of competitive harm that may not be inherent in the use of price discrimination markets in merger cases, but, nevertheless, warrants consideration. The court ruled that "broadline distribution to national customers" was a relevant product market based on application of *Brown Shoe* factors[80] and what it describes as a SSNIP test,[81] although the court conceded that within this market "there [was] great variety in the customers' servicing needs and requirements."[82] Customers that the court found to be vulnerable to post-merger discriminatory price increases in the course of individual negotiations were presumably a part of the relevant market, but the court made no finding as to the identity, number, or relative share of the market comprised of those customers. This lack of direct connection between the relevant market and the risk of competitive harm that the court found due to targeted post-merger price increases presented both theoretical and practical issues for the merger parties in *Sysco* that parties in future merger cases should address.

The theoretical issue is that economic evidence the FTC submitted was based on quantitative models that were not specified to focus on the subset of targeted customers within the relevant market. Absent these specifications, defense experts may not be able to test whether assumptions and predictions in the model used by the FTC's expert conform with real world observations of the marketplace, in particular on whether the targeted/vulnerable customers had viable options with regional and local distributors to fall back on if faced with post-merger discriminatory price increases. As stated by the Commission in *R.R. Donnelley*, the best test of persuasiveness is whether the factual/historical evidence agrees with predictions from theoretical models used by economic experts. Where the model is based on a broader market that does not specify the subset of targeted customers who may be vulnerable to post-merger price increases, the model's predictions may become virtually unrebuttable.

The practical issue in *Sysco* arose from specifications in the English Auction model used by the FTC's economic expert as the basis to predict competitive harm. The major input data for the model was each foodservice distributor's national market share. The model guessed at how customers ranked potential suppliers in "Request for Proposal" (RFP) competitions: the winner was known, but the model ranked the rest of the firms based on national market shares.[83] These rankings were crucial to the analysis: the purpose of the model was to identify situations where the merging parties were the top two options, with the supposed harm occurring when the second-best option was removed by the merger and a less desirable third-place option became the new runner-up, putting less competitive pressure on the auction winner.

The practical issue with the model was that rankings of distributors based on national market shares essentially assumes the desired conclusion, by placing one of the merger parties in second position regardless of whether a mix of regional and local distributors would be a viable and acceptable option for each customer analyzed by the model. For example, assume four equally sized regions: Alpha has 20 percent share in each region, and thus 20 percent national share, while Beta has 40 percent share in the East region, and 0 percent share in the other three regions, for a 10 percent national share. Using the premise that a supplier's ranking in an auction is based on its market share, if a customer is sourcing regionally and soliciting bids in the East, in the real world, Beta has twice the market share of Alpha and thus would earn a higher ranking in the English Auction model. In the world that presupposes that national market shares drive customer selection of suppliers, the situation is reversed and Alpha is assumed to be twice as strong a competitor, even if the RFP is limited to the East region.

With the merging parties having a national presence and many of their competitors having a more regional focus, the expert's model had a built-in bias. The model placed one of the merger parties rather than regional distributors in second position in the auction model (based on national market share). This placement was used to predict a threat of competitive harm if the merger eliminated this option, even though many (perhaps most) customers, in the individual negotiations ultimately used as a basis for the finding of competitive harm, would be willing and able to substitute regional/local suppliers and thus defeat a threatened post-merger price increase.

The *Sysco* court found a threat of competitive harm based on the merged firm's perceived ability to selectively identify and target an unspecified subset of large national customers through individual contract negotiations. Merger parties that face similar theoretical and case-specific issues to those that arose in *Sysco* must, as the *Sysco* parties did, present rebuttal evidence and expert analysis (within the confines of compressed discovery and hearing schedules for merger cases) to show that the models used by the agency's economic expert do not fit the proposed relevant market (and thus are unreliable to predict competitive harm), and that evidence of previous and potential future substitution to alternative suppliers refutes the factual predicates for the agency's expert analysis.

Price Discrimination Markets in *Staples*: A Cautionary Tale on Return to the Standards Applied in *R.R. Donnelley*

In *FTC v. Staples, Inc.*,[84] the FTC sought to enjoin the merger of two suppliers of office consumables on the theory that the merging parties would target large business-to-business (B-to-B) customers post-merger with discriminatory price increases. The FTC argued, as in *Sysco*, that regional and local suppliers were not viable options for large B-to-B customers. The court did not resort to the individualized negotiations approach used in *Sysco*, but rather defined the targeted customer market in terms of objective observable characteristics: "large B-to-B customers who spend $500,000 or more on office supplies annually."[85] This approach still presents issues on whether customers who meet these specifications have inelastic demand, but it is a step in the right direction to define a market composed of customers who are all deemed to be vulnerable to a discriminatory post-merger price increase, rather than a broader market that includes an unidentified subset of vulnerable customers.

The *Staples* court's use of *Brown Shoe* factors to define a price discrimination market, however, is a cautionary tale in its own right. *Brown Shoe* identified a general set of "practical indicia" that courts frequently reference in defining the relevant market: "industry or public recognition of the submarket as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors."[86] In the context of price discrimination markets, the main (perhaps sole) analytical question on which these practical indicia should focus is whether customers in the proposed market have observably inelastic demand that will allow the defendant to successfully target these customers with a post-merger price increase. Data for empirical analysis is not always available, and economic experts are often at odds on the implications of this kind of analysis, so these practical indicia may serve as a useful backup or confirmatory tool. But scholars have long been concerned that "practical indicia sometimes have been applied blindly, without reference to the goals of identifying buyer and seller substitution possibilities,"[87] which can lead to inappropriately narrow markets or markets gerrymandered to fit plaintiff's case. As with empirical analysis of data, focused analysis is warranted to assure that the practical indicia from *Brown Shoe* address the core issue of inelastic demand that is the theoretical basis for narrow price discrimination markets.

On this point, the decision in *Staples* is decidedly mixed. The court found that "B-to-B customers require specialized vendors that offer value-added services,"[88] which could be indicative of inelastic demand if backed by sufficient evidentiary support. Other factors, however, appear to be less useful in serving the ultimate analytical task to support a narrow price discrimination market. For example, the court identified "sensitivity to price changes" as one of the practical indicia it used to define the targeted customer market,[89] finding that "large B-to-B customers are extremely price sensitive" and using this finding as support for the conclusion that these customers could be successfully targeted for a price increase post-merger.[90] On its face, a finding of high elasticity of demand is not an observable characteristic of customers whose inelastic demand would make them vulnerable to selective price increases.

Staples serves as a hopeful sign that agencies and courts will return to the standard of using observable characteristics, and the other factual predicates in *R.R. Donnelley* and the Horizontal Merger Guidelines, to define price discrimination markets. However, it is also a necessary reminder that the mere invocation of the correct framework is no guarantee for sufficient analytical rigor in the application of that framework.

Conclusion

Price discrimination markets may be a useful analytical tool in merger analysis, but as the Commission cautioned in *R.R. Donnelley*, if this tool is used without the proper restraint and safeguards, there is "potential for this approach to swallow up the market definition principles established by the federal courts and the Commission."[91] Tying the concept of price discrimination to observable characteristics allows for a straightforward approach where litigating parties join issue in determining whether (1) a subset of customers share an observable characteristic, (2) that characteristic is indicative of inelastic demand, and (3) the merged company will be able to profitably raise prices to the subset of customers sharing that characteristic.

Shifting from the observable characteristic approach to the individualized negotiation standard, particularly as applied in *Sysco*, creates a real risk that enforcement will be unencumbered by a limiting principle, as most business-to-business markets are characterized by individualized negotiations and customers who have varying degrees of preference for the merger parties' products. The elasticity of our antitrust common law is commendable, but it should not and need not come at the expense of well-established and predictable enforcement standards that are necessary to guide business decisions and a proper analysis of complex market information in merger enforcement. ■

1 Tom Bingham, The Rule of Law (2010). Bingham was the only person to have served in office successively as Master of the Rolls, Lord Chief Justice of England, and Senior Law Lord.

2 *Id.* at 38 (quoting Hamilton v. Mendes (1761) 97 Eng. Rep. 787 (PC) 795).

3 *Id.* (quoting Vallejo v. Wheeler (1774) 98 Eng. Rep. 1012 (KB) 1017.

4 R.R. Donnelley & Sons Co., 120 F.T.C. 36 (1995).

5 *Id.* at 158. For a good discussion of the economic conditions necessary for price discrimination, including price discrimination based on "observable customer characteristics," see B. Douglas Bernheim & Michael D. Whinston, Microeconomics 626–59 (2d ed. 2014).

6 *R.R. Donnelley*, 120 F.T.C. at 158.

7 *Id.* at 159–60.

8 *Id.* at 137–38.

9 U.S. Dep't of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines 6 (2010) [hereinafter Guidelines], https://www.ftc.gov/sites/default/files/attachments/merger-review/100819hmg.pdf.

10 *Id.* Some may read the Guidelines as endorsing a price discrimination market definition based not on observable characteristics that allow the identification of inelastic customers but on nothing more than the fact that parties may conduct individualized negotiations with customers and thereby obtain some information about the customers' elasticities. Whether or not such an interpretation was intended by the Guidelines' authors, it is wrong both as a matter of precedent and policy. *R.R. Donnelley* requires "a conceptually sound methodology, supported by the record, by which a hypothetical monopolist can identify the alleged inelastic customers." 120 F.T.C. at 159 n.66. Reliance on nothing more than the potential for individualized negotiations to reveal "targeted" customers (through trial and error) falls far short of that test, and allows the government to establish a price discrimination market in most industries involving business-to-business sales, which are typically accompanied by individualized negotiations.

11 FTC v. Sysco Corp., 113 F. Supp. 3d 1 (D.D.C. 2015).

12 *Id.* at 15.

13 *Id.* at 37–38.

14 Defendants' Proposed Findings of Fact and Conclusions of Law at 23–24, 65–67, FTC v. Sysco Corp., 113 F. Supp. 3d 1 (D.D.C. 2015) (No. 1:15-cv-00256-APM).

15 *R.R. Donnelley*, 120 F.T.C. at 159–60.

16 *Id.* at 159.

17 *Id.* (footnote omitted).

18 *Id.* at 160. Gravure printing is "typically used for long runs of magazines, newspaper inserts and catalogs." *Id.* at 38.

19 *Id.* at 157.

20 *Id.*

21 *Id.* at 176.

22 *Id.* at 159.

23 *Id.* at 158.

24 *Id.* at 160.

25 *Id.* at 164.

26 *Id.* at 164–67.

27 *Id.* at 169.

28 *Id.* at 168 (footnote omitted).

29 *Id.* at 168–69.

30 *Id.* at 172 (footnote omitted).

31 *Id.*

32 *Id.* at 175.

33 Complaint for Temporary Restraining Order and Preliminary Injunction at 5, *Sysco*, 113 F. Supp. 3d 1 (No. 1:15-cv-00256-APM).

34 *Id.*

35 Transcript of Evidentiary Hearing Proceedings at 912–13, *Sysco*, 113 F. Supp. 3d 1 (No. 1:15-cv-00256-APM).

36 *Sysco*, 113 F. Supp. 3d at 24, 46, 48.

37 *See, e.g.*, Daniel J. Gifford & Robert T. Kudrle, *The Law and Economics of Price Discrimination in Modern Economies: Time for Reconciliation?*, 43 U.C. Davis L. Rev. 1235, 1237 (2010) (defining price discrimination as "[t]he practice of selling the same good at different prices"); *R.R. Donnelley*, 120 F.T.C. at 157 n.57 ("Price discrimination consists of obtaining different economic profits from different customers for similar products." (quoting testimony by FTC's experts)).

38 Guidelines, *supra* note 9, at 6 (emphasis added).

39 Jerry A. Hausman et al., *Market Definition Under Price Discrimination*, 64 Antitrust L.J. 367, 372 (1996) (footnote omitted). It bears noting that the parties disputed the correct calculation of marginal cost in *Sysco*. *See, e.g.*, Transcript of Evidentiary Hearing Proceedings at 1954–56, *Sysco*, 113 F. Supp. 3d 1 (No. 1:15-cv-00256-APM).

40 *McWane, Inc.*, 2014 WL 556261, FTC Docket No. 9351 (Jan. 30, 2014).

41 McWane, Inc. v. FTC, 783 F.3d 814, 829 (11th Cir. 2015).

42 Plaintiffs' Corrected Proposed Findings of Fact and Conclusions of Law at 267, *Sysco*, 113 F. Supp. 3d 1 (No. 1:15-cv-00256-APM) (citations omitted).

43 *Sysco*, 113 F. Supp. 3d at 46.

44 *R.R. Donnelley*, 120 F.T.C. at 159.

45 *Id.*

46 *Id.* at 159 n.66 (emphasis added).

47 The evidence showed that there were "National" customers who shared the same characteristics as "Local" customers and vice-versa. Transcript of Evidentiary Hearing Proceedings at 1158–73, 1565–66, *Sysco*, 113 F. Supp. 3d 1 (No. 1:15-cv-00256-APM).

48 *Id.* at 1158–73, 1568–69.

49 *See, e.g.*, *id.* at 1173–78, 1199, 1210–12, 1218–25, 1405–12.

50 *See, e.g.*, *id.* at 2114–19.

51 *See, e.g.*, *id.* at 2119 ("Yes, this is the substitution by regionalization. These customers could have chosen to buy the way the FTC describes, to buy from one national vendor, and they did choose, at least in some places, to buy from Sysco or USF. Everywhere else they made another choice.").

52 *See* Plaintiffs' Corrected Proposed Findings of Fact and Conclusions of Law at 272–73, *Sysco*, 113 F. Supp. 3d 1 (No. 1:15-cv-00256-APM) (citations omitted).

53 *Sysco*, 113 F. Supp. 3d at 45–46.

54 United States v. SunGard Data Sys., Inc., 172 F. Supp. 2d 172, 181 (D.D.C. 2001).

55 *Id.* at 175.

56 *Id.* at 182.

57 *Id.* at 191.

58 *Id.* at 190 n.21. In *Sysco*, the court accepted the government's "know-your-customer" theory based on limited evidence: "Here, the evidence is clear that Defendants engage in individual negotiations with their national customers and possess substantial information about them. Indeed, the fact that Defendants employ substantially more sales representatives than other broadliners . . . and assign full-time dedicated employees to some of their largest customers is indicative of the 'know-your-customer' philosophies of both firms." *Sysco*, 113 F. Supp. 3d at 46 (internal citations omitted). The *SunGard* court, 172 F. Supp. 2d at 190 n.21, actually found that the parties "are typically aware of those clients that could switch to an alternative solution," but the *Sysco* court, in contrast, merely observed that the parties employ a large sales staff and practice a know-your-customer philosophy, findings that are likely applicable to a high percentage of well-run business-to-business companies in the United States.

59 *Sungard*, 172 F. Supp. 2d at 193 n.25. The *Sysco* court distinguished *SunGard* by arguing that, while *SunGard* entailed "'conflicting evidence relating to customer perceptions and practices,'" in *Sysco* "the industry . . . perceive[d] broadline to be a separate mode of food distribution." 113 F. Supp. 3d at 32 (quoting *Sungard*, 172 F. Supp. 2d at 182–83). Even if there was evidentiary support for this conclusion, the distinction applied only to the broadline foodservice distribution market, not to the narrower national broadline customer market asserted by the FTC.

60 Professor Hausman was an expert witness for the merging parties in *Sysco*; the cited article was published years before the litigation.

61 Hausman et al., *supra* note 39, at 373.

62 *Id.* at 372.

63 *Id.* at 373.

64 United States v. Oracle Corp., 331 F. Supp. 2d 1098 (N.D. Cal. 2004).

65 *Id.* at 1117.

66 *Id.* at 1125.

67 *Id.* at 1131.

68 *Id.* at 1117–18.

69 *Id.* at 1131 (quoting *R.R. Donnelley*, 120 F.T.C. at 54 n.65 (quoting Robert Pitofsky, *New Defninitions of the Relevant Market and the Assault on Antitrust*, 90 Colum. L. Rev. 1805, 1816 (1990))). The logical connection between *Oracle*'s differentiated product unilateral effects analysis and price discrimination markets is corroborated by *Oracle*'s citation of a price discrimination case, *R.R. Donnelley*, for the key proposition that mere preference for the merging parties' products does not make a customer a part of a separate market, whether that market be termed a targeted customer market or a differentiated product market.

70 *Oracle*, 331 F. Supp. 2d at 1121.

71 *R.R. Donnelley*, 120 F.T.C. at 158 (footnote omitted).

72 *Id.* at 161. Complaint counsel argued that the gravure printing process is characterized by high fixed costs and low variable costs; the converse is true for offset printing. Hence, theoretically, as printing volume gets higher, offset printing becomes less and less economically attractive in relation to gravure printing.

73 Complaint counsel's theory was contradicted by the "substantial historical and existing use of offset printing within the proposed market," *id.* at 160, and evidence that "[s]everal of the largest print buyers in the United States use the offset process for high volume publication printing." *Id.* at 172.

74 *Id.*

75 *See* Transcript of Evidentiary Hearing Proceedings at 2125, *Sysco*, 113 F. Supp. 3d 1 (No. 1:15-cv-00256-APM).

76 *Id.* at 2135–39.

77 *Sysco*, 113 F. Supp. 3d at 46–47.

78 *R.R. Donnelley*, 120 F.T.C. at 172.

79 *Id.* at 153.

80 Brown Shoe Co. v. United States, 370 U.S. 294, 325 (1962).

81 *Sysco*, 113 F. Supp. 3d at 40. The FTC's economic expert conceded that he did not perform a SSNIP on the national customer lists, which were used to define the national broadline customer market. Transcript of Evidentiary Hearing Proceedings at 1155–56, *Sysco*, 113 F. Supp. 3d 1 (No. 1:15-cv-00256-APM).

82 *Sysco*, 113 F. Supp. 3d at 46.

83 Transcript of Evidentiary Hearing Proceedings at 1251, *Sysco*, 113 F. Supp. 3d 1 (No. 1:15-cv-00256-APM).

84 FTC v. Staples, Inc., No. 15-2115, 2016 WL 2899222 (D.D.C. May 17, 2016).

85 *Id.* at *8.

86 *Brown Shoe*, 370 U.S. at 325 (footnote omitted).

87 Jonathan B. Baker, *Stepping Out in an Old Brown Shoe: In Qualified Praise of Submarkets*, 68 Antitrust L.J. 203, 206 (2000) (footnote omitted) (citing previous literature on the subject).

88 *Staples*, 2016 WL 2899222, at *12.

89 *Id.* at *9.

90 *Id.* at *10.

91 *R.R. Donnelley*, 120 F.T.C. at 159.

ESSAY

Four Roles for the Defense Economist in Merger Litigation

BY DANIEL M. WALL

IN MY ROLE AS A LAWYER FOR THE DEFENSE IN merger trials brought by the government and private parties, I have come to recognize that the expert economists are often the star witnesses. In part that is because some of the biggest names in the field tend to get hired for merger litigation, and they are experienced, polished, and persuasive witnesses. They are at ease in the courtroom, which is certainly not something that can be said of most lay witnesses, and they understand merger analysis at a deep and nuanced level. In the dynamics of a trial, where the judge is likely to appreciate credentials and expertise, the expert economist will naturally stand out.

But personal characteristics and credentials aside, it is the structural characteristics of a merger trial and the economist's role in it that tend to put the spotlight on the moments when each side's expert economist testifies. Think about all of the different sources of proof that we lawyers use in merger analysis and litigation. There are internal documents, data of various kinds, industry analyst reports, party testimony, customer testimony, competitor testimony, perhaps industry experts, and then economic experts. It can be an overwhelming body of evidence for a judge who is likely not expert in antitrust analysis, and yet as the sole trier of fact in a bench trial is called upon to make one of the more complicated decisions that the field presents.

The expert economist plays a special role in the merger trial because he or she is the witness who is uniquely capable of "putting it all together," in other words, using the entire body of proof in conjunction with a theoretical analysis to tell a persuasive story about the merger's likely competitive effects. The only other participant in the trial with a similar ability is trial counsel, but obviously what counsel says is not received in the same way as any witness under oath, let alone a witness that is a highly credentialed expert.

There are four functions that expert economists can perform in the merger trial that, generally speaking, no other witness can, certainly not comprehensively.

(1) *Teaching rigorous analysis:* They can teach, and therefore demystify, merger analysis.

(2) *Presenting formal economic analysis:* They can conduct formal economic analyses such as critical loss studies, UPP analysis, and so forth.

(3) *"Telling the story":* They can "tell the story" for and against the merger by integrating their formal work with documents and testimony that support the desired conclusion.

(4) *Rebutting the opposing expert:* They can answer the opponent's expert.

Teaching rigorous analysis. When the government decides to litigate against a merger, it almost always tries to portray the case as a simple one, presumptively problematic because of the change in industry structure, and with all doubts removed by "the documents" and what customers have to say about the deal. While I may think the documents are always cherry-picked, as are the testifying customers for that matter, I don't doubt the logic behind this "formula" for prosecuting a merger challenge. In combination with the fact that one of the expert antitrust agencies has concluded the deal is anticompetitive, it can win a lot of cases.

My side (the defense) is therefore often required to socialize the judge in the rigor of merger analysis. The message is: "Hold on a moment, it's not so easy." The process begins in the opening statement by defense counsel, which in a bench trial is not constrained by the "just the facts" requirements of a jury trial, and therefore can and should get into the economic and theoretical foundations of the defense case. But it is the defense's expert economist who can most effectively carry this message. The economist can explain that coming to the conclusion that a merger is anticompetitive requires a basis for concluding that a lot of market mechanisms that might protect consumers will fail. It is not just structure, bad documents and, customer complaints; one must consider demand substitutes, supply substitutes, entry and contestability, obstacles to coordination, repositioning possibilities, etc., and perhaps ultimately efficiencies (although that is a tough way to win a merger trial). Furthermore, the expert can say the government's case can fall apart anywhere along that path.

Of course the object is not to make things confusingly complex. To the contrary, the economist must both sell and present in a simple and straightforward way the rigor of merger analysis. Consider the case where market definition is the key issue. Experienced antitrust lawyers may think of market definition as one of the more basic antitrust concepts, but in practice many judges find it hard to understand why we need to do this and how to undertake a market definition. The economist is the one witness who can teach the judge about the purpose and importance of this part of the analysis. The economist can say things like: "We are trying to sort out who matters and who does not matter to rivalry because it is a grave error to leave out anyone that matters." And, "There are ways to test for this, so we don't have to guess, and one of the tools is this thing called critical loss analysis. Here's how it works." Or consider unilateral effects analysis, which can be puzzling to anyone, regardless of experience. The economist can put it in simple terms like, "Is the loss of rivalry between the merging parties a big deal or not, considering who else is out there? If it is, is there someone else out there who

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can replace that rivalry by moving a couple of steps to the right or left?"

As it happens, most of the expert economists who testify in merger cases have day jobs as teachers. So let them teach.

A particularly important role for the defense economist is to sell the resiliency of competition. The meta-question in any merger trial is whether it's really necessary for the government to intervene in the marketplace, given our common belief that for the most part markets police themselves. The defense economist can expound on this issue and explain how markets tend to self-correct. Some of this will be relatively high level, such as explaining entry, repositioning, and longer-term dynamics, such as innovation. But it can also get quite technical, as with explaining cross-elasticity or the critical principle that the marginal consumers tend to protect the inframarginal consumers—the group from whom the government's complaining customers will always be drawn. Addressing the resiliency of the market is critically important level-setting in the merger trial, and the defense economist is the witness to do it.

Presenting formal economic analysis. The expert economist is the one witness who can conduct and present the econometric and other formal economic studies that are used in merger litigation. In this day and age, it is hard to imagine that the defense in a merger trial would not have one or more formal economic analyses to present. The last thing the defense wants to do is to get into a "he said, she said" battle with the FTC or DOJ. If that is how the court perceives the dispute, the government is going to win most of the time. Testability has got to be a key theme of the defense. Only the expert economist can credibly say, "Your Honor, the government is just speculating about this; we tested and found much more reliable answers."

This is true even in the case of market definition, where one might think that traditional methods of proof (witness testimony, documents, win/loss records) could suffice. The reason is simply because there is always so much evidence the government can choose from to tell its story, irrespective of who is right and who is wrong about the definition of the relevant market. That is, there are always documents that can support a narrower market definition. There are always customers who say they have fewer choices than they really have. It is just not that hard for the government to gather those up and present them in its case in chief, and since the government goes first it will likely be a fairly effective presentation.

The defense has got to change the conversation, not just provide witnesses who say the opposite of what the government's witnesses have said. I can still recall the government complaining that in the *Oracle/PeopleSoft* trial, I was trying to "change the subject" in various ways. Well, of course I was. The defense needs to change the subject from impressionistic testimony and hand-picked documents the government offers and towards something that is more scientific and predictive. That is no different than in any other trial. The defense economist is a key part of that effort.

Which formal analyses to use is beyond the scope of this article. That will vary from case to case. The point here is that it will be a rare case when the defense will correctly choose not to use any of the available formal tools.

"Telling the story." Trials are for the most part mosaics. Witnesses come on and lay a tile or two, but not enough to reveal any bigger picture. Industry experts are an exception to that, and most likely the defense will put on at least one lay witness tasked to address the broad competitive landscape, but even those witnesses are constrained by personal knowledge rules to stick to the facts. They would not be heard to say, "and therefore the relevant market includes X."

The economic expert is the clear exception, the one witness who can and typically will speak directly and broadly to the question of whether the merger is likely to be anticompetitive. It is a unique position. In most trials the witnesses who can speak most directly and authoritatively to the matter at hand are in that position because they were active participants in whatever conduct led to the trial, e.g., the person who negotiated the contract (and can testify to its intent) or was in the car accident (and can say he was not negligent). There is no such witness in the merger trial, given the predictive, economics-infused nature of the exercise. So the economists assume that role. The competing "stories" that the government and defense economists tell make for some of the biggest moments in merger litigation.

Scripting the direct examination of one's economist is a key part of merger trial preparation. It begins with the key decision of whether to call your economist relatively early in the case, as a "table setter," or relatively late, as the person who puts it all together. Lawyers disagree over this, and many will use two economists to avoid having to make the choice. But where the defense has only one economist, late tends to be better. There is great persuasive potential in being able to incorporate the trial record into the economist's testimony, along with the material that would have been used anyway. Plus there is the "primacy-recency" principle—that we tend to remember and be influenced by what we hear first and last. There is nothing the defense can do about the fact that the government goes first and therefore owns primacy. It needs to make as much as it can out of recency.

In all events, the direct examination of the expert economist (for either side) can and should be a kind of interactive closing argument, in which evidence is used to advocate for conclusions. Consider the example of a merger challenged for unilateral effects. The defense economist will want to start with some teaching about the theory of unilateral effects and how an adverse effect requires particular structures and an absence of markets responses like repositioning. He will want to review the government's unilateral effects theory, highlighting of course its weak spots and vulnerabilities. Indeed, the defense will often want to frame an outcome determinative issue that it can win, such as whether a market participant that the government is marginalizing is in fact a constraining force. The defense economist can do so directly: "Your honor, the simple question here is whether the government is right in its contention that Acme does not compete as effectively for this customer group as either of the parties. If it does, this merger is not a problem." And then,

The last thing the defense wants to do is to get into a "he said, she said" battle with the FTC or DOJ. If that is how the court perceives the dispute, the government is going to win most of the time. Testability has got to be a key theme of the defense.

critically, the economist can bring the entire record to bear on that issue—not just his own formal work, but the best documents, testimony, data, and so forth. Use it all to paint a complete picture. Tell the judge directly that different kinds of proof lead to the same conclusion, and then present them. And then present the conclusion, confidently and without equivocating.

This is not a function reserved solely to economists in merger challenges. It happens in jury trials as well, where the antitrust expert collects and presents evidence with jury appeal, and in other bench trials and evidentiary proceedings, such as the class certification hearing where experts are allowed to testify. But the one-on-one dynamic of the economist talking to the judge who will decide the fate of the merger about the economics of merger analysis is different. Merger testimony is usually a much higher-level conversation than is typically appropriate for a jury trial, and judges tend to feel they need it more than in, say, a class certification hearing. Indeed, plaintiffs in antitrust jury trials often attempt to denigrate expert testimony as much as they can, because they want the jury to focus on other things like fairness concerns or inflammatory documents. Judges in merger trials tend to look forward to the experts' testimony, understanding that it may present the best opportunity to learn what they need to decide the case. And then there is the opportunity for a personal connection between your economist and your judge. A good story told directly to the judge with credibility and connection is gold in any bench trial, but especially when the judge will appreciate the witness' greater expertise on a challenging subject.

Rebutting the opposing expert. Merger trials are also contests between testifying economists. If you are defending the merging parties, it is essential to undermine the government's economist. That is not just for the obvious reason that if her story holds up then the story is likely to prevail. It is also because in the theater of a merger trial, an unscathed government economist is a disaster for the defense. It creates a sense that the defense does not have answers that can carry over throughout the rest of the trial. Judges are people as affected by these sorts of impressions as anyone.

Fortunately, there is usually ammunition to do the two things you need to do: first, conduct an effective cross-examination, and second, put on compelling rebuttal evidence.

The defense economist is a crucial resource in preparing cross-examination. He or she can provide invaluable insights as to errors and methodological issues that impeach the government economist, or set-up rebuttal. Many of these go unnoticed by counsel because the evidence is buried in work papers or is only evident to those with special training. In *Oracle-Peoplesoft*, an excellent economist testifying for the government presented a bidding analysis that, our economists noticed, included many bids that would not fall within the government's proposed relevant market. Confronting the government economist with those bids made for an extremely effective cross. I have also seen instances in which my economists found evidence buried in work papers that plainly refuted the government's case, but which I would never have understood. The defense economists can also play the role of the government economist in practicing cross-examination. Most likely, they will have the same instincts as to how to slip out of a line of cross as the actual government economist.

Much of the defense economist's trial testimony will be straight rebuttal. There must be an extensive segment on errors and omissions by the government economist. It cannot be simply that the government economist's good work is not as persuasive as the defense case, as that sets up the "he said, she said" dynamic mentioned earlier, which is all to the government's advantage. It has to be that the government has missed something, tried to ignore something important, or gotten something plain wrong. This means that one needs to hire an economist who is willing to be somewhat direct and confrontational. I am a firm believer that, much as ties go to the runner in baseball, ties go to the government in merger litigation. They are expert agencies that don't challenge that many mergers. The defense needs to undermine the government's case, not just outrun it, and the defense economist is key to that effort.

The reality is also that some errors can only be explained by the defense economist, e.g., problems with a regression or merger simulation. That is becoming a bigger issue with the integration of merger modeling and the likes of UPP analysis into most cases. This is difficult material to confront effectively, even with the smartest of judges, and good cross-examination opportunities are few and far between. The defense economist therefore gets called upon to identify understandable problems with the government's econometrics and respond accordingly. Where possible, "flip" the government's evidence—that is, correct errors to come to different conclusions that support the defense. That tends to be easier for the court to understand than frontal attacks on the methodology and its implementation by the government. If a correction leads to a different outcome, the judge can focus on that, and does not need to master everything else.

Overcoming the government's natural advantages in merger litigation calls on the full array of trial skills. One needs to use documents and data to bring the dynamics of competition into the courtroom. Customer witnesses need to be marginalized and called out for their bias towards the status quo and for the fact they have more market choices than they acknowledge. But, beyond that, one needs to use the defense economist to teach a rigorous antitrust analysis, sell the resiliency of markets, and attack the government's case hard. It is a unique platform for a witness that must be used to its full potential. ■

ESSAY

Effective Presentation of Expert Testimony for the Government in a Merger Litigation

BY STEPHEN MOHR AND SOPHIA VANDERGRIFT

IN MERGER ENFORCEMENT ACTIONS, EXPERT economic analysis is typically a critical component of the government's case. In order to meet its burden of market definition, the government generally depends on complex data analysis and econometric work in conjunction with other types of evidence.[1] Beyond this initial hurdle, government experts often contribute heavily to an analysis of a merger's likely competitive effects, and to an assessment of any potential efficiencies the merger generates. Ultimate success can turn on effective presentation of the expert witness through each stage of the process, from formulating the expert's underlying work, to presenting the work in the expert reports, to putting the expert on the stand at trial.

For a variety of reasons, however, data are rarely perfectly suited for empirical analyses in merger challenges. A data set may represent the best available source of knowledge, yet still be vulnerable to attack as theoretically unsuitable, methodologically unsound, or simply unreliable. Making use of real-world data often requires approximations and assumptions, and analytical principles may come into tension with practical outcomes. Each of these all too common challenges can leave an expert—and the case itself—exposed to criticisms. But the fact that data within a given industry are complex, voluminous, or messy should not in itself prevent the government from bringing a successful enforcement action.

FTC v. Sysco[2] involved the proposed merger of the nation's two largest broadline foodservice distributors. The government sued to enjoin the merger pending an administrative adjudication. Following a nine-day preliminary injunction hearing, which featured extensive expert economic testimony, the district court issued a preliminary injunction to enjoin the transaction.

Stephen Mohr and Sophia Vandergrift are attorneys in the Mergers I and Mergers IV divisions of the Federal Trade Commission's Bureau of Competition, and both were members of the Sysco trial team. The views expressed herein are solely those of the authors and do not necessarily represent the views of the Commission or any individual commissioner. The authors appreciate the helpful review by Debbie Feinstein.

Sysco provides an opportunity to examine the analytical challenges that may arise when the government seeks to challenge a merger in an industry where the available data are complex and disorderly. Ultimately, *Sysco* demonstrates that if properly handled and addressed through effective expert testimony, such data challenges need not prevent the government from prevailing.

Sysco v. US Foods

In December 2013, the two largest broadline foodservice distribution companies, Sysco Corporation and U.S. Foods agreed to merge for $8.2 billion. Sysco and USF are in the business of broadline foodservice distribution, which the court defined as "[the sale and delivery of] a 'broad' array of food and related products to just about anywhere food is consumed outside the home."[3] Although the two companies account for approximately $51 billion of the overall $231 billion food distribution industry, the Federal Trade Commission alleged a separate market for "broadline foodservice distribution services sold to National Customers," (i.e., those with a number of geographically dispersed facilities), in addition to more than 30 local broadline markets in which the defendants competed for the "business of local customers," (e.g., independent restaurants that purchased distribution in a limited local or regional area).[4] Sysco and USF entered into a divestiture agreement that the Commission rejected as inadequate. In February 2015, the Commission and 12 state attorneys general sought a preliminary injunction in federal district court in Washington, DC.

Nearly every issue in the litigation was contested, and both sides introduced in-depth economic evidence on nearly every element of the case. Specifically, the parties' economic experts testified on product market definition, whether there were national customers to support a national market definition, the contours of local geographic markets, the calculation of markets shares and concentration figures within the alleged markets, competitive effects in the local and national markets, entry, the adequacy of the proposed divestiture, and alleged efficiencies.[5]

Although there was a large volume of industry data available, it did not come to the government ready-made for analysis. The broadline foodservice distribution industry lacks a formal mechanism for data reporting or recording (unlike, for instance, the hospital industry in which state agencies collect uniform data from each hospital on an annual basis). Even the parties' own records of their bids for national account business, available in droves throughout their ordinary course business correspondence and analysis, were disaggregated and required manual compilation.

A main focus of expert reports, expert discovery, and expert testimony during the hearing, was the calculation of market shares for the national broadline market based on the available data sources, including bid records, the defendants' sales data, and sales data subpoenaed from third-party distributors. The Commission alleged that post-merger, Sysco would control approximately 75 percent of the market for broadline distribution services sold to national customers (or 70 percent after the divestiture).[6] As the court observed, "In some cases the merging

[W]hen the data or methodology required assumptions, the Commission's expert ensured that all embedded assumptions were conservative in the defendants' favor, or, in other words, tended to understate, rather than overstate, the competitive impact of the merger.

parties' market shares and post-merger HHIs are seemingly uncontroversial. Not so here."[7]

In the remainder of this article, we detail the various approaches the Commission and its expert, Mark Israel, took in order to reach trustworthy results, rebut the defendants' criticisms, and ultimately convince the court of the reliability of the data and methodology underlying the national market shares.

Approaches for Imperfect Data

To estimate national market shares and HHIs in the absence of industry-recognized data sources, the Commission and its expert used transaction data from the merging parties and third-party distributors to calculate the parties' national customer revenue (i.e., the numerator) and the universe of all revenue generated from sales to national customers (i.e., the denominator).[8] The numerator was calculated based on the merging parties' own national customer designations within their sales data.[9] The denominator was calculated using two different methods: (1) the expert first summed the national sales of the three principal national competitors—Sysco, USF, and Distribution Market Advantage (DMA) (the national market's third-largest competitor, which is a consortium of regional distributors formed for the purpose of allowing such distributors to compete for national accounts)—and then added in another share equal in size to DMA's;[10] (2) the expert also used an entirely separate data source—revenue data obtained from the other large broadline distributors during the merger investigation. The figures were adjusted to reflect the proposed divestiture to Performance Food Group (PFG) and subjected to various sensitivity analyses, yielding six different estimates of national market shares ranging from 59 percent to 71 percent.

Although it is not uncommon for opponents in a merger challenge to disagree about the contours of the relevant market, and thus the operative market concentration levels, the disagreement over market shares in *Sysco* extended to the very data used and the assumptions employed to calculate the shares themselves. Specifically, the defendants alleged that the Commission's national market shares were unreliable because the data did not allow accurate approximation of either the merging parties' sales to national customers (i.e., the numerator) or the greater universe of national account sales (i.e., the denominator). The defendants argued that the numerator was overstated because it included sales to customers that were not truly national or who were not broadline customers, while the denominator excluded competitors' sales to such customers. The defendants also argued that the data used for the denominator were unreliable for a variety of reasons, including how it was collected by the FTC and how it was kept and reported by third-party distributors. Finally, the defendants claimed that the denominator was inconsistent with an estimate of the market's overall size made in the ordinary course of business and excluded billions of dollars in sales.

To counter these criticisms the Commission and its economic expert engaged in four primary strategies.

Use Ordinary Course Definitions

First, when processing and classifying data for economic analysis in *Sysco*, to the extent possible, the Commission sought shelter in the defendants' (and third parties') ordinary course business definitions and data-keeping methods. To establish the numerator of the national market shares estimates, FTC Staff and their expert had to discern which sales within defendants' transactional-level sales database belonged in the national market.

In theory, an economist could approach this task several different ways, including use of a third-party's neutral definition of what constitutes a national customer (e.g., the FTC's analysis in *Staples* focused on Fortune 100 companies);[11] applying neutral criteria to distinguish between national and local customers; or relying on the defendants' internal business classifications. The Commission and its expert opted for the third approach, relying on the defendants' customer classifications, in large part because other evidence showed that the companies' internal designations were a good estimate of the national customers appropriate for analysis.[12]

This approach also served to avoid the criticism that discretion and subjectivity had been injected into the data analysis and shifted the attention to the defendants to explain why their national account designations were not a good indicator of which customers were, in fact, national. As the Commission's expert testified:

> [T]here's these multiple documents where the companies say we have basically two different service models, two different pricing models. They call them local and national. And they indicate what it is that makes a national customer fit the national model, and they list things like a single contract, coordination across markets, presence in multiple regions.[13]

Although the defendants sought to dismiss their internal data classifications as labels used merely for administrative convenience, the court placed importance on the fact that the defendants "coordinat[e] the marketing, negotiating, and managing of these customers through their 'national account' teams" in finding that there was, in fact, a nationwide geographic market.[14] As a logical extension of this finding, the court also accepted the use of the defendants' classification to estimate national broadline revenue as the numerator for the national market shares.

Use Conservative Assumptions

Second, when the data or methodology required assumptions, the Commission's expert ensured that all embedded assumptions were conservative in the defendants' favor, or, in other words, tended to understate, rather than overstate, the competitive impact of the merger. For example, some regional broadline distributors reported "national customer" revenue even though they clearly lacked sufficient distribution locations to provide service on a nationwide basis. The Commission and its expert included revenue from these competitors in the national broadline market, which had the effect of reducing the market share of the defendants. Including the distributors' self-designated "national" revenue also had the benefit of being consistent with the principle of using businesses' ordinary course definitions and helped avert the criticism that competitors arguably capable of serving national broadline customers were improperly excluded from the competitive landscape.

The Commission's expert also calculated an alternative market share estimate assuming that the other broadline distributors—none of which had a national broadline footprint—had the same national-local sales ratio as the defendants. This method seemed to give the court comfort that the merger warranted a presumption of harm in the national broadline market:

> Most convincing to the court was Dr. Israel's final method of calculating shares using the CID data . . . . That approach yielded a low-end market share of 59 percent and an HHI increase of 1,500 points . . . . This variation almost certainly underestimated Defendants' market shares, as smaller broadline distributors are unlikely to have a ratio of national-local sales comparable to Defendants' ratio.[15]

Perform Multiple Sensitivities

Third, the Commission's expert performed multiple alternative calculations that showed that the results were not sensitive to the assumptions employed or dependent on the specific data used. These alternatives included using two completely different data sources (data collected from Civil Investigative Demands issued to third-party distributors and national customer RFP win-loss data produced by the defendants), which produced market share estimates that differed only by one percent.[16] To respond to the defendants' argument that market share estimates were biased "given that distributors may use different criteria to define a national customer,"[17] the Commission's expert used six different methodologies to classify third-party distributors' sales as either national or local, ranging from using the distributors' self-reported classifications to including the distributors' broadline and non-broadline distribution sales, to attributing the defendants' national/local business split to all of the smaller distributors. The resulting market shares ranged from 59 percent to 71 percent.[18] The court credited these robustness checks in finding that the government's share estimates were a sufficiently reliable approximation under the case law.[19]

Present Empirical Results Alongside Ordinary Course Documents

Fourth, presenting empirical evidence alongside ordinary course documents and testimony is an effective strategy to link the expert evidence to undeniable commercial realities of an industry. Numerous antitrust decisions over the past several years have emphasized the importance of party documents being consistent with different aspects of an expert's conclusions.[20]

In *Sysco*, the defendants claimed that meaningful conclusions could not be gleaned from analysis of the companies' win-loss reports or from their sales force databases, which company employees used to track business opportunities.[21] When faced with such issues in using ordinary course records and data, consideration is warranted about the business practices associated with the records: (1) How does the business use the data in the ordinary course of business? (2) Do employees rely on it? (3) Was it presented to the board, or otherwise considered by high level executives? (4) Is it used for compensation purposes? (5) Is it used to generate internal reports? (6) Is it the basis for any internal decision-making? FTC Staff and their expert determined that the win-loss reports and sales force databases were the best available source of information regarding the companies' bidding histories, and therefore, incorporated the data into the analyses, but also checked that the bidding analyses were consistent with other evidence on likely competitive effects of the merger.[22]

The court noted that the bidding records suffered from the shortcomings the defendants highlighted,[23] but found that "when evaluated against the record as a whole, Dr. Israel's conclusions are more consistent with the business realities of the food distribution market than [Defendants' expert]."[24] The court further emphasized the importance of the expert work aligning with the larger record, noting "[a]nother reason Defendants' arguments do not sway the court is that other evidence in the record supports Dr. Israel's calculations."[25] These findings demonstrate the importance of presenting analyses based on imperfect data in the broader context of consistent evidence in the factual record.

Conclusion

Expert work and testimony are often integral to, if not the lynchpin for, the government's efforts to meet its burden under Section 7 of the Clayton Act and obtain a preliminary injunction to block an anticompetitive merger. As the decision in *Sysco* demonstrates, data flaws need not bar the government from establishing a presumption of competitive harm, as "[t]he FTC need not present market shares and HHI estimates with the precision of a NASA scientist."[26] Indeed, if shares are carefully and credibly constructed, "[t]he closest available approximation often will do."[27]

By relying on definitions used in the ordinary course of business in the industry, using conservative assumptions, running multiple sensitivities, and buttressing empirical results with ordinary course qualitative evidence, an expert witness can successfully preempt criticism, maintain his or her credibility, and ultimately convince the judge of the reliability and robustness of the empirical analyses. ■

1 For example, when defining product markets, courts consider both the *Brown Shoe* factors as well as "expert testimony in the field of economics." FTC v. Sysco Corp., 113 F. Supp. 3d 1, 33 (D.D.C. 2015).

2 *Id.*

[3] *Id.* at 15.

[4] Complaint at ¶¶ 6, 8, *Sysco*, 113 F. Supp. 3d (No. 15-cv-00256).

[5] The FTC proffered a separate expert to analyze the alleged efficiencies. The FTC's economic expert relied on the specific determinations of the efficiencies expert in order to weigh competitive harm against cognizable benefits.

[6] Complaint at ¶ 58, tbl. 1, *Sysco*.

[7] *Sysco*, 113 F. Supp. 3d at 53.

[8] Preliminary Injunction (PI) Hrg. Tr. at 1031–32 (Israel Direct).

[9] *Sysco*, 113 F. Supp. 3d at 53.

[10] PI Hearing Tr. at 1033–34 (Israel Direct). Under this method, the Commission's expert attributed a share equal to DMA's to all other competitors because, based on the parties' data from RFPs, he estimated that all other broadline distributors combined to sell an amount that is approximately equal to DMA's sales to National Broadline Customers.

[11] FTC v. Staples, Inc., No. 1:15-cv-02115-EGS, at *48 (D.D.C. May 17, 2016) ("Dr. Shapiro estimated Defendants' market shares by using data collected from Fortune 100 companies.").

[12] PI Hearing Tr. at 923 (Israel Direct) ("I strictly followed the parties' segregations. So for our Sysco customers, [Corporate Multiunit Customers] are defined as national customers . . . . but the other customers are defined as local, following the split in their documents, including the McKinsey documents. For USF, they have a designation of national and local, and I used that designation.").

[13] PI Hearing Tr. at 1267. Additionally, the defendants' organizational structures reflected internal divisions between national account executives and local business executives and employees.

[14] *Sysco*, 113 F. Supp. 3d at 49.

[15] *Id.* at 54–55. Other conservative assumptions included double-counting sales made by certain selling conglomerates of regional distributors and their individual members, including sales by distributors with only a few locations even though the top ten largest distributors accounted for the vast majority of all broadline sales (and thus, an even higher proportion—if not all—national broadline sales), and assuming the proposed divestiture buyer (PFG) would retain 100% of the business going through divested US Foods distribution centers. PI Hearing Tr. at 1039, 1040.

[16] *Id.* at 2342–43.

[17] *Id.* Tr. at 1268.

[18] *Sysco*, 113 F. Supp. 3d at 53–54.

[19] *Id.* at 55, 70.

[20] In *United States v. Bazaarvoice Inc.*, the court found it "persuasive" that in the ordinary course of business, the merging parties recognized that Ratings and Reviews platforms—the government's proposed relevant product—"comprise a distinct market." No. 13-CV-00133-WHO, 2014 WL 203966, at *22 (N.D. Cal. 2013). Similarly, the government's expert in *United States v. H&R Block Inc.* "concluded from his review of the defendants' business documents that they viewed DDIY as a discrete product market when competing in the ordinary course of business." 833 F. Supp. 2d 36, 60 (D.D.C. 2011). The court agreed. *Id.* at 65.

[21] *Sysco*, 113 F. Supp. 3d at 36.

[22] *See, e.g.*, PI Hearing Tr. at 1078:13–1079:6 (Israel Direct).

[23] *Sysco*, 113 F. Supp. 3d at 36–37.

[24] *Id.* at 37.

[25] *Id.* at 55.

[26] *Id.* at 54.

[27] *Id.* at 55 (internal quotation omitted).

ESSAY

Economic Testimony in Mergers

BY TIMOTHY F. BRESNAHAN

ANTITRUST ANALYSIS IS A COLLABORATION between the disciplines of law and of economics. During a merger investigation at one of the agencies, the participants are the attorneys and economists working for the agency and the parties. These attorneys and economists work in an environment that is explicitly legal, but where the applicable economics is familiar to the attorneys; where the applicable law is familiar to the economists; and where interdisciplinary antitrust analysis is familiar to all. The discussions between the agency and parties revolve around an overarching economic question that is easy to state but hard to answer: will the proposed merger likely lessen competition substantially? All sides are aware of the partial codification of antitrust analysis in the Horizontal Merger Guidelines, which contains a long list of specific economic questions that break the analysis down into parts. The discussions between the agency and parties typically narrow the range of any disagreement and typically lead to either the abandonment or the completion of the merger (sometimes with an accompanying consent decree).

On rare occasions, however, potential mergers are contested in court, and court is a different world entirely. While the overarching economic question is the same, and many of the participants are the same, almost everything else is different. A new and very different participant has been added—the court. From the court's perspective, a case about a potential merger is often unfamiliar and is always a complex and fact-dense business litigation in an arcane and analytical corner of the law. And it is the court itself that must ultimately answer the overarching economic question that the agency and parties were wrestling with. From a world where antitrust analysis is familiar, the matter moves to a world where antitrust is often strange. Further, it is not the easy-to-decide mergers that go to court; rather, negotiations between two well-informed parties have broken down. Finally, the rules of adversary process come in to play.

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An enormous scholarly literature in economics and another in law is devoted to the antitrust analysis of mergers. I am delighted to have the opportunity, in this short essay, to add to that literature by considering how the collaboration between law and economics changes when it moves to the courtroom. I shall emphasize the practical questions that come up when preparing for, deciding the scope of, and ultimately presenting and attacking expert economic testimony in a merger hearing. Most of my experience in these matters comes from my days in the Antitrust Division, though the same questions tend to arise (in my more limited experience) on the defense side.

Direct Examination/Testimony

The expert economist's first duty is to the truth and to rigorous and correct analysis. The team of economists and examining attorneys have to then make that rigorous and correct analysis accessible to the court. An analysis that the court does not understand and embrace will not matter, however rigorous and correct it may be.

Because merger matters so rarely come to trial, there often is a role for the expert economist to explain to the court how antitrust analysis works. The attorneys for both sides will have made some effort to educate the court during their opening statements. Nonetheless, the question the court must answer has a lot of economics in it, and the basic analytical framework of antitrust analysis will typically be unfamiliar. As a result, testimony from the expert economists about when mergers are harmful to competition, when they are not, and how to tell the difference will be welcomed by most courts. Such testimony can also lay the groundwork for the expert's own analysis of why the merger in this particular industry of these particular firms is (or is not) harmful to competition by explaining the links between analysis and conclusion.

It is at this point that the close relationship between testimony in the courtroom and classroom teaching becomes obvious. The expert is explaining a complex line of analysis. While the analysis will be familiar to those attorneys who do it every day, it is often not familiar to the court. Command of, even leadership in, the research literature in Economics on the causes and consequences of market power and of market concentration is helpful in deciding on and undertaking the right line of analysis in a merger matter. But of all the economics experiences I've had, the ones most immediately and directly relevant to clarity and conviction in the courtroom are the teaching experiences that led to my teaching award.

Another central role for the interdisciplinary team of attorneys and economists working on direct examination is preparing a narrative of the direct testimony. It is important that the direct testimony present a view of the way competition works in this industry and a view of how that will change with the merger (for better or for worse). This is not a last minute "trial preparation" task. It is essential to create a common understanding of the whole narrative between attorneys and economists, and especially between the particular attorney who will conduct the examination and the economist who will testify. This is harder than it sounds, and calls for a great deal of effort in preparation.

Industries are different from one another, and the direct testimony should explain the unique facts about competition in the industry at hand and how the competition is likely to change as a result of the merger. This means that antitrust analysis is very fact-dense. Fortunately, much research in industrial organization economics in recent decades has been industry studies. An economist who has experience teaching or in research about the industry at hand or similar industries often has an easier time in preparation. A trial is often the clash between two different views of how competition works, with subsidiary clashes about the sources of information best relied upon, the appropriate techniques of analysis, and so on. Without a long time to prepare, prior knowledge is quite helpful. (I note that this way to classify economists is different than "has worked with me"/"has testified"/"tends to the defense side.")

When preparing testimony, tables, charts, analysis like upward pricing pressure indexes, diversion ratios and other quantitative matters deserve special attention, as do higher level questions like market definition. (Market definition ideally follows from a careful analysis of the competitive effects highlighted by the quantitative matters, though many attorneys seek to hide those foundations to make it "simpler.") The more junior members of the team of economists and attorneys have a great deal of work to do to ensure that the expert direct testimony on these matters serves its legal purpose, is well founded and defended, and is correct as a matter of economics. A terrific quantitative demonstrative can carry the narrative in court. Similarly, an attack on a quantitative demonstrative, even an attack that would be laughed off in an economics seminar, such as an error in a single data point, can destroy the narrative.

One reason that it is essential to involve the wider interdisciplinary team in the preparation of testimony is that the narrative must also explain the foundation for the opinion. A contested merger case is likely to have a large number of pieces of evidence, some of which favor one side's view and some the other's, and the wider team is essential for making sure that everything important has been examined and that the judgments about what to rely on are sound. The agency review process is not just effective at producing knowledge about the potential merger, it is stunningly effective at producing documents, emails, all kinds of records of the thinking of industry participants, and so on. The varied pieces of evidence have every different imaginable amount of probative weight, and there can be a wide gap between what they say and what they might be construed to say. The foundation for an opinion that there will be, or that there will not be, a material decline in competition from a merger almost always depends on paying more attention to some of these pieces of evidence than others. Explaining those decisions in a compelling way—even if the decision is actually trivial—is important in court.

Antitrust analysis, as practiced in the enforcement agencies, has done a terrific job of bringing in results from the relevant research fields in economics. Somewhat surprisingly, only some of this advance has been brought into antitrust law itself. I assume this is because so few merger cases are litigated, but the why does not much matter. What matters is that the economic framework of antitrust practiced in the courts is antiquated, while the economic framework practiced before the agencies and in academics has been evolving and improving. For example, the support in the industrial organization economics literature for a "structural presumption" collapsed before I entered the profession some 40 years ago, and not many active scholars could today tell you what that support was. (It comes up for a minute in the first lecture of some industrial organization economics courses as ancient history, but even that is disappearing as the body of teachers of those courses turns over). This adds another degree of difficulty to trial preparation. The discussions between the merging parties and the agency earlier on were within broadly the same analytical frame. Typically, the two sides will have narrowed their differences in the investigatory period. Now, in court we move to an adversary process and the two sides may present analyses that are not only different on the facts but very different on the relevant frame.

[T]he economic framework of antitrust practiced in the courts is antiquated, while the economic framework practiced before the agencies and in academics has been evolving and improving.

Cross-Examination

Cross-examination is an asymmetrical contest. The expert has a responsibility to the truth, and the attorney has a responsibility to the client. The expert typically knows the economics far better than the cross-examining attorney. The attorney, however, knows what matters legally, and has the added advantage of having weeks to write questions which must be answered in seconds.

From an expert's perspective, preparing for cross-examination involves some very obvious steps. Know your report. Know the other side's criticisms of your report. Know your deposition—attorneys are very risk-averse creatures and love to ask a question they have already asked. Know—and here at last is something that is just like getting ready for an economics seminar—what your most important conclusions are and what your foundation for them is. A challenge in preparing an economist for cross examination is that a telling criticism in court is radically different from a telling criticism in economics.

Although it is perhaps less obvious, it is also important in cross-examination for an expert to be able to address a number of border areas:

- The long list of things which are not part of the expert's opinion but which, to a non-economist, sound like they might be.
- The things in the testimony that are analytically precise in economics but which, if translated badly into plain English, sound

weird or mushy or otherwise bad. (It is essential for both economists and attorneys to work on this list.)

- The things that sound like they ought to be true as a matter of principle but which actually depend on facts.
- Ambiguous questions carefully crafted to sound like real questions.

Regarding the ambiguous questions—well, there can be deep water under thin ice. If the expert translates an ambiguous question into economic terms and answers it precisely in that language, which is likely foreign to the court, or if the expert calls for clarification, it can sound evasive or worse. If the expert swears to an ambiguous statement, the opposing side will invariably emphasize the other meaning of the statement—the one the expert never imagined. The wider team of attorneys and economists, perhaps including a "red team" to focus on weaknesses, has an important role in preparing for cross-examination in these border areas, and that work should be undertaken before the scope of direct testimony is finalized.

Preparing an attorney to depose or cross-examine an opposing expert economist is another difficult interdisciplinary task. Suppose there is a screaming error somewhere in the testimony, or that the opposing expert has taken a position contrary to what he is famous for in academic life, or that the expert's work involves an unstated and completely incredible assumption—all the kinds of things that would come out in seconds in an economics seminar. Certainly, it is an excellent practice for the economists on the team to explain these errors to the attorneys on the team, and to try to help design a set of questions that will bring the problem to the surface. But designing a set of questions is not the same as determining that they should be used in cross-examination. Sometimes establishing the simple fact of an error can take an enormous amount of time in court. Given the limited time allowed for cross-examination, the team must make both strategic and tactical decisions about what to pursue and what not to pursue.

At first glance, the simple cross examination goals of reining in the testimony—making clear what the expert merely assumed, what has a basis in fact, and what the factual basis actually is—appear mundane. When the opposing expert uses highly technical methods, these simple goals can be particularly difficult for an attorney to achieve in cross-examination. More complex strategies of having the expert on one side undertake simple-to-understand analyses that reveal the limitations of the opposing expert's strategy may be necessary.

Conclusion

I have emphasized some of the more difficult aspects of economic testimony in a merger hearing and proposed some practical ways to deal with them. I do not mean to imply that the process is problematic. Most proposed mergers arrive at a decision through the highly effective and efficient agency review process. Only the most difficult cases make it to court, and we should be sympathetic to the judges who have to hear them. Effective presentation of economic expert testimony from both sides increases the likelihood the court will find the right answer. ■

Views from the Bench On Merger Issues

BY LISA C. WOOD

THE YEAR 2016 WILL BE REMEMBERED AS remarkable for many reasons, one of which may be of particular interest to antitrust lawyers. As of this writing, six merger trials have either taken place or are scheduled to take place before year end. This is an anomaly; merger trials are rare. How fortunate, then, that three judges with merger trial experience participated in a continuing legal education program presented by the ABA Section of Antitrust Law at the 2015 Fall Forum and again at the 2016 Spring Meeting. In this column, I recount the judges' observations on key issues that arise in any merger trial, using a transcript of the Spring Meeting program.

Three judges participated in the Spring Meeting's "Views from the Bench on Merger Cases": Judges John D. Bates and Amit P. Mehta of the U.S. District Court for the District of Columbia, and Judge Lynn Winmill of the U.S. District Court for the District of Idaho.

Judge Bates was appointed to the bench in 2001. He previously served as an Assistant U.S. Attorney for the District of Columbia, and as Deputy Independent Counsel for the Whitewater investigation. He served as a judicial member of both the U.S. Judicial Conference Committee on Court Administration and Case Management and the U.S. Foreign Intelligence Surveillance Court, including as the Presiding Judge from 2009 to 2013. He served as Director of the Administrative Office of the United States Courts and presently chairs the Advisory Committee on Civil Rules. Judge Bates presided over the *Arch Coal* merger trial.[1]

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Judge Mehta was appointed to the bench in December 2014. He previously worked both in private practice and as a public defender with the D.C. Public Defender Service. Judge Mehta presided over the FTC challenge to Sysco's proposed acquisition of US Foods in 2015.[2]

Judge Winmill was appointed to the bench in 1995, and since 1999 has been the Chief Judge of the District of Idaho. He previously worked in private practice in Colorado and Idaho. Since becoming a judge, he has taught in many capacities, including as a professor at Idaho State and the University of Idaho School of Law, as a mentor judge for district court judges, and as a trainer to judges from other countries. In 2014, Judge Winmill presided over the FTC challenge to the consummated St. Luke's transaction.[3]

Each judge made an opening statement about the merger case over which he presided, which are quoted in full here.

Judge Bates

> I was on the bench a little over two years when I was assigned the *Arch Coal* case, so I was an old hand as a judge, unlike Judge Mehta, who got the *Sysco* case in his first year on the bench. *Arch Coal* was a great case for a new judge or a more experienced judge to handle. It was exceptionally well presented by both sides. It went to trial on the preliminary injunction request; it was an FTC case, so we were dealing with a preliminary injunction initially. I tried it during that summer and decided it in August, I believe, of 2004.
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> The market definition was an issue somewhat, but not a big issue in the case. It took some time to explore that, both in terms of the product market and the geographical market, although the two basically merged because the product was really coal from a specific area, the Southern Powder River Basin in the Wyoming area.
>
> The questions in the case were various. I did look quite extensively at the Merger Guidelines and the HHI and used that as a framework, I would say, for examining and deciding the case and looking at the possible anticompetitive effects.
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> The FTC was trying out a fairly new theory of tacit coordination on production, rather than on price. We did explore those issues quite a bit. There were efficiency issues in the case that came up.
>
> But some of the most important facts as they evolved included that there were five producers to start with and five producers post-merger. While the [market share] percentages changed a little bit and one producer exited, another one came in by picking up one of the two coal mines that Arch Coal

was acquiring, but then divesting itself of one and another company picking it up.

Arch Coal's [market share] certainly increased, but it wasn't changing that much. The increase in the HHI, while meaningful and measurable, was not nearly as dramatic as was true in a lot of other cases of this sort.

All of that, I think, flavored the case so that the FTC while making out its *prima facie* case was not necessarily in a position of having made out a very strong case that then had to be rebutted.

Experts were very, very important. Indeed, in most of these cases I think the expert testimony is important.

But ultimately, as most, if not all, of you know, I decided not to enjoin the proposed merger and the merger went forward.

The case ended with me. It did not result either in a trial before me or in meaningful appellate proceedings. The merger occurred after the preliminary injunction was denied.

Judge Winmill

My case was really quite different. It originally started out as a lawsuit brought by Idaho's second-largest hospital in an effort to enjoin St. Luke's, which was Idaho's largest hospital by quite a bit, from acquiring what was called Saltzer Medical Group, the largest primary care physicians' group in Idaho.

The case started as, of course, just a preliminary injunction hearing. But I denied the injunction based upon St. Luke's assurances that they had structured the deal so that it could be unwound regardless of the final outcome of the case. It seemed to me that there was simply no way that the second-largest hospital could actually show irreparable harm because of that.

I recognized very early, though, that that preliminary decision on whether I issue or do not issue a preliminary injunction would cause one party or the other to probably drag their feet in preparing for trial. So one of the first things I did was to insist upon a Rule 16 conference before I decided the preliminary injunction hearing, and had a commitment from both sides that we would try the case on an expedited schedule within nine months. We, in fact, set the trial date before I even issued the preliminary injunction ruling. I think that was a very good decision.

Thereafter the Federal Trade Commission joined the lawsuit, along with the State of Idaho Attorney General's Office. I consolidated both cases for trial, but with the understanding that we would try the case on that expedited schedule.

What had occurred, by way of background, is that St. Luke's had gotten into an acquisition mode in which they had acquired a number of other hospitals in eastern Oregon and southern Idaho. They had been acquiring practice groups and had something on the order of 750 physicians that they had actually hired and taken out of private practice.

There were really two critical issues at the trial.

One, of course, is the geographic market. I think perhaps, unlike Judge Bates' case, that definition of the market was critical because it really had to do with whether Nampa, Idaho, which is a suburb of Boise, was really its own standalone [market] or was part of the larger market within Boise.

It really was an interesting process of going through and trying to determine where patients would go for their primary care physicians. That became complicated by the fact that really the issue was: could an insurance company put together a network of primary care physicians covering people from a small community or suburb of Boise but force them to go for their primary care treatment to Boise, Idaho, which was thirty or forty miles away?

My conclusion was, after looking at that, that in fact it was a much smaller market, and that had a huge impact upon my decision at the end of the day. Under the HHI, a market is regarded as highly concentrated if it's above 2500. In our case it was over 6200, and the merger increased the HHI by 1600 points, which made it presumptively anticompetitive under Section 7.

I think the other issue that really was important in the case was that we had statistical evidence that when St. Luke's had been involved in this string of acquisitions that there had been a resulting increase in the reimbursement rates which it could exact from the insurance companies; and that, in turn, I think, clearly showed a true anticompetitive effect, even apart from the HHI standard.

The second big issue was an efficiency defense put forward by St. Luke's. That played out against the background of the requirements of the Affordable Care Act and the push to require hospitals and care providers and insurance companies to focus more on risk-based, rather than fee-based, compensation models; and also the requirement of broadening the sharing of information, which St. Luke's said they could only do by growing into a larger healthcare provider through acquisition.

Ultimately, I was not persuaded that they could not have achieved those same results without, in fact, the acquisition. I concluded that, although St. Luke's probably had the best of intentions, I was simply not persuaded that they could not have obtained the same results without a full-blown acquisition or merger. As a result, I granted the injunction, ordered St. Luke's to unwind the acquisition, and spent a fair amount of time, of course, hearing arguments about the challenges of unwinding that.

The case was appealed to the Ninth Circuit. I was affirmed. That essentially is what wrapped up the case.

Judge Mehta

FTC v. Sysco was litigated last spring. The case was brought by the FTC against Sysco and US Foods, which are the two largest food distribution companies in the country. The FTC had moved for a preliminary injunction to prevent the merger from happening until there was an administrative trial before an FTC judge.

The FTC's theory was that the proposed combination would essentially reduce the competition in two product markets: One, in the product market for broadline food distribution. Broadline food distribution is, as the name implies, a distribution company that provides a whole wide array of different types of food and food products to, basically, anywhere in the country that serves food—schools, restaurants, stadiums, healthcare operations—you name it. If you have eaten outside your house, you have probably been served by a broadline food distributor. The largest two are US Foods and Sysco.

The second product market under the FTC's theory was that there was a national product market for national customers of broadline foodservice. It struck me as an interesting theory that you would craft a product market around a customer. That became an interesting legal issue that we may touch on later.

The FTC's geographic markets were two: both a national market for the national customers; and local markets for local customers—smaller restaurants and smaller buyers of foodservices in smaller cities. I cannot remember the exact number of cities, but the FTC had identified, probably, fifteen to twenty different local markets in which they claimed that competition would be lessened by the merger.

There was a host of evidence that the FTC relied upon. Obviously, there was live testimony. But, in addition to that, there was a substantial amount of documentary evidence—I think we had 3500-plus exhibits entered into evidence; there was, of course, deposition testimony; and then the expert testimony, which I know we will all talk about a little bit later.

The companies' defense was primarily threefold. Really where the rubber met the road was in the market definition.

The companies vehemently and aggressively challenged the FTC's definition of the market. First, they claimed that broadline foodservice was not the proper market; rather, foodservice in general was the proper marketplace. They also challenged the existence of a national customer market.

As far as the geographic markets go, they also aggressively litigated those. In particular, with respect to the local markets, the issue was: how broadly should they be drawn? In the companies' views, the FTC had drawn them too narrowly and, as a consequence, the percentages that the respective companies had in those markets in the companies' views were too high.

I had an eight-day injunction hearing last March. That was followed by a substantial briefing of both facts and findings of law. I ultimately ruled and granted the injunction in favor of the FTC, really across the board, on their theory that the combination would lessen competition both in the national product market and in the local markets.

Generalist Judges. To set the table for the remainder of the program, which featured tips to lawyers handling merger trials, all three judges emphasized that most judges are generalists and do not come to the bench with much if any antitrust expertise.[4] The judges nevertheless advised that this lack of antitrust familiarity should not dissuade counsel from presenting the evidence and arguments they think they need to present. The judges explained that they handle a wide range of exceedingly complex matters, and that, in general, judges are adept at developing the knowledge necessary to understand the complex factual and legal issues before them. This is not a job however, for the court alone. Judges will work hard to gain the necessary understanding *if* counsel educates the court sufficiently. Judge Bates repeated an apt remark he made years ago to the City Bar of New York in a lecture later published in the *Columbia Business Law Journal*:

> The challenge of a judge is to engage and immerse him or herself in the unfamiliar issues head on, while the challenge of the advocate is to take the complicated issues and explain or present them in a clear fashion to someone who in all probability is not an expert in the field. In a truly complex case "—and I would put most of these antitrust cases, including merger cases, in that category"—the judge will start at some point near incomprehension, the advocate will start at some point near incomprehensible, and, ideally, they will advance towards each other and meet somewhere in the middle.[5]

Judge Winmill encouraged counsel to simplify presentations in a merger case to make them understandable to a generalist judge. He favors the use of primers and tutorials to educate the court, explaining by way of example that the parties in the St. Luke's case spent the first several days of the four-week trial providing the court with background information through expert testimony on the healthcare industry and the impact of the Affordable Care Act.

Use of Pretrial Hearings. Judge Mehta observed that, while all antitrust cases are inherently complex, merger cases are particularly challenging because they must be resolved in a compressed time frame. On the other hand, there are benefits to the compressed schedule because counsel can use the pretrial proceedings to educate the court on the key issues that will be addressed at the fast approaching trial. Judge Mehta scheduled bi-weekly telephone status hearings with counsel, which were used not only to keep the parties on track with pretrial deadlines, but also as opportunities for the court to gain insight about the key factual and legal issues.

Streamline Evidence and Pleadings. Judge Bates agreed that the compressed schedule in a merger case presents challenges to the court and counsel, and recommended that counsel streamline both pretrial filings and the evidence at trial and avoid repetition. In light of the compressed schedule, he worked closely with counsel in pretrial hearings to assure that they would not present more witnesses—fact and expert—than they needed. Judge Mehta remarked that the page-limited preliminary injunction briefing was extremely helpful. The over 1000 pages of expert reports was less helpful, and he counseled lawyers to submit shorter expert reports. The judges acknowledged the desire to introduce a full range of evidence to build a good record, but cautioned that counsel must be realistic about how much information one human being can digest during a compressed trial schedule.

The judges had similar comments about post-trial submissions of proposed findings of fact and conclusions of law: these documents were important aids for the court to weigh the large volume of evidence, but their value diminished if the filings were too long and unwieldy. The judges urged counsel to emphasize a small number of key exhibits in these filings and include hyperlinks to assist the court in reviewing the actual evidence.

Schedule of Proceedings. The judges cautioned that the parties must inform the court up front about the timetable built into the deal and how the parties think this will impact the litigation timetable. The judges also counseled that the parties need to demonstrate to the court that they will cooperate throughout the proceedings to maintain the schedule set by the court.

Expert Evidence. The judges agreed that expert testimony is key in a merger case, but this evidence must be balanced with fact testimony about the industry from the parties and other market participants. Counsel also need to ensure that expert and fact testimony reinforce one another and do not work at cross purposes. Judge Winmill found it "reassuring" when the fact testimony he received about a prior merger by St. Luke's was supported by a showing of the actual anticompetitive effects it had on reimbursement rates demanded from and received from insurance companies. This fact testimony similarly supported what the FTC economists were predicting about the likely anticompetitive effects of the challenged merger.

Judge Mehta agreed that real-world business evidence must reinforce the expert's conclusions. He recounted the difficult task he had in deciding which equation to use for the aggregate diversion analysis. Although the two opposing economic experts were both "terrific well-accomplished folks," his task became less daunting once he compared the experts' views against the non-expert evidence:

> In one case, one of the experts attested that he thought the analysis led to the conclusion that if every single broadline food distributor in the country were to merge that there would not be a price impact. That did not really jibe with all the other testimony I was hearing from industry executives and also from the business records of the companies.

The judges cautioned counsel that when selecting expert witnesses, counsel should avoid experts who present extreme views or advance opinions that are part of a larger social or political agenda. As Judge Winmill explained:

> One thing that became clear in my case was that there were clearly two schools of thought among those who work in health-care economics about whether consolidation in merger is both good and necessary because of the requirements of the Affordable Care Act, or whether that actually is counterproductive and very ineffective. It became pretty clear in my case that I had the strongest advocates for both positions.
>
> But when they come into the Court with already kind of an agenda, I think that undermines their effectiveness. I am not sure that is going to be true in every case. But it would be one thing to be careful about. If your case involves something where there are clearly defined schools of thought with real advocates, with almost a social agenda or a political agenda that they are pursing, that really can undermine, I think, the credibility of the experts.

None of the judges had considered retaining his own expert to assist in understanding the issues, and did not think a merger case would be the ideal setting to do so given the compressed schedule inherent in any merger case. Instead, the court must rely on counsel to present qualified experts who are understandable and helpful to the court. Judge Mehta made the following observation about counsel suggesting the court retain its own expert:

> I think I would be careful if it is something you are even contemplating to propose to a judge. At least for me, hearing about the non-expert evidence was as critical as hearing from the experts. You do not want to overshadow the importance of the non-economic evidence by emphasizing the experts disproportionately, it seems to me.

Customer Evidence. The judges had different observations about the utility of customer testimony, a common facet of the government's premerger investigation. Judge Bates did not find this type of evidence persuasive:

> But one thing that both in the *Arch Coal* case I found and Judge Vaughn Walker found in the *Oracle* case, decided just about the same time, was that the testimony from customers on the anticompetitive effects, what would happen in the marketplace, did not turn out to be all that helpful. Certainly, that testimony was helpful to the extent that it was explaining some things that went on in the market, how purchases transpired, etc. But to the extent that it was speculating about the effects of the merger on the market, I think that kind of customer testimony was very unhelpful. It just was speculation.
>
> Unless it is well-founded testimony based on facts—and it really wasn't—or based on economic expertise—and the customers really didn't have that—it really did just boil down to stating obvious conclusions—"less competitors mean perhaps anticompetitive effects"—but it was not really very helpful in deciding the case.

Judge Winmill countered that testimony from the five to six major insurers who negotiated reimbursement rates with St. Luke's hospital probably played a bigger role in his trial, but still was not as important as evidence of the effect of past conduct.

> I think customer information in my case took mostly the form of Blue Cross/Blue Shield, and others who were negotiating insurance contracts with the hospitals. So it is not quite the same as just someone who is consuming the product.
>
> We only had maybe five or six major players in that negotiation process. So they probably played a little more important role than they otherwise might, but it still was not nearly as critical as data we could actually look at, and in our case we could actually see the anticompetitive effect of a prior merger.

Judge Mehta found customer testimony helpful in understanding the industry, but counseled caution when introducing customer testimony about the expected effects of the merger.

> In my case the customer testimony—and there was both testimony and lots of affidavits and depositions—was helpful. Particularly, live testimony was helpful in informing me of how the industry operates and the way it works. So it really was helpful to have different types of customers explain how they contracted for food distribution services, who they viewed as the competitors in the marketplace.
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> But in terms of the consequences of the proposed merger, for every customer who said that the merger would have anticompetitive consequences, the companies were able to find a customer who would say there would not be a problem with it.
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> So I think you want to just be careful or be sensible about how you are using customer testimony.

The judges also explained that the sheer volume of customer affidavits submitted either in support of or in opposition to a particular transaction is not important.

Depositions and Affidavits. Despite encouraging counsel to streamline evidence, none of the judges favored use of deposition testimony or affidavits in lieu of live testimony at trial for the most important witnesses. The judges explained that they want the opportunity to question both the fact and expert witnesses.

Horizontal Merger Guidelines. All three judges considered factors enumerated in the Horizontal Merger Guidelines, including the HHI, but did not rely solely on that calculation. The judges commented that the Guidelines were helpful in filling in gaps left by the dearth of case law, and noted that the parties in each of their cases cited the Guidelines in pleadings.

Offer of Remedies. The judges discussed whether a "fix" proposed by the defendants is an effective defense to raise during the merger trial. Judge Mehta explained:

> This was an issue in *Sysco*, where the companies did litigate the fix. Ultimately, what I looked at is whether the divestiture would in fact have restored the competition, perhaps not precisely, but certainly in a way that would have satisfied me that the market would have remained competitive and vigorous and within a reasonable amount of time. Those were the two key issues that I looked to.
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> There was sort of an interesting element to this in this particular case. The divestiture partner had actually gone in and presented to the FTC about the marketplace well before they became the divestiture partner. So there was already evidence that the FTC had locked in about what the divestiture partner thought it would take to create a competitive environment post-merger. So I had something to compare the actual divestiture against to determine whether it actually measured up to what they thought it would actually take prior to becoming the divestiture partner.

Judge Bates explained that while the *Arch Coal* trial did not include evidence about a particular fix, the merger transaction involved the acquisition of two coal mines, one of which would be divested to a new entrant. This feature of the transaction was important to the court's assessment of the market pre- and post-merger.

Efficiencies Defenses. Each judge expressed a willingness to hear efficiencies evidence, but they agreed it is a hard defense to establish. As Judge Winmill explained, "The standard is that unless you can show that without this specific merger certain efficiencies cannot be obtained or can only be obtained through something that would be equally anticompetitive. I think that is really a tough standard to meet."

> In this case they would have had to persuade me that the efficiencies which they felt they needed, creating kind of an integrated information warehouse mandated by the Affordable Care Act, really could not be accomplished without large conglomerated healthcare-providing entities, like HMOs and large integrated networks of healthcare providers.
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> I simply was not persuaded that you could not achieve that through something short of a complete merger. That was the critical problem.

The judges agreed that, while efficiency evidence may be helpful to consider the competitive effects of a particular transaction, (defense) counsel belabored and often exaggerated the likely efficiencies, thereby undermining their credibility overall. As Judge Mehta explained:

> We had an efficiencies defense in *Sysco* as well. Ultimately, my sense is that it is a hard defense, period. The standard is extraordinary efficiencies and they have to be merger-specific. It struck me in this case that this would be a hard standard to meet, no matter what context you are in.
>
> If it is a defense you want to advance, you better make sure you've got some good facts to back it up. Otherwise, I think, you may risk detracting from your defense if you push it too hard.

Key Takeaways

- *Remember your audience is a generalist judge.*
- *Simplify the evidence.*
- *Streamline your presentations.*
- *Be upfront about the transaction's timing challenges.*
- *Cooperate with opposing counsel.*
- *Look for opportunities to educate the court throughout the proceeding.*
- *Do not focus exclusively on expert evidence.*
- *Make sure the expert evidence is consistent with the fact evidence, and make sure to introduce that fact evidence as context.*
- *Buttress opinion evidence about the likely future competitive effects of the transaction with factual evidence of the effects of past transactions, industry trends, and the parties' internal planning documents.*
- *Avoid extreme positions and high horses.*

Conclusion

The judges' remarks regarding how best to try a merger case are extremely helpful reminders of the gear shifting merger parties and their counsel must go through when moving from a pre-merger antitrust investigation into litigation challenging the proposed merger. After spending months advocating your position before government lawyers and economists who are antitrust specialists, one must recalibrate the advocacy for a generalist judge who will also most likely be unfamiliar with the transaction or the markets in which the parties compete. The judge will also not enjoy the luxury of time in getting up to speed on the matter, or in resolving it.

The judges had many excellent suggestions in light of these observations. First, and perhaps most importantly, it is critical that counsel simplify the evidence. Counsel must also resist the urge to bombard the court with thousands of pages of expert reports, briefs, or exhibits not even a superhuman could digest. Instead, counsel must streamline all presentations. Be upfront with the court about the timing challenges presented by the deal terms, and then cooperate with opposing counsel to make what will undoubtedly be an accelerated schedule workable. Take advantage of every pretrial filing and appearance to educate the court about the case, and develop additional education opportunities in consultation with the court, including primers and tutorials.

The judges' commentary about experts was also instructive. Do not focus exclusively on the expert evidence. Fact evidence is extremely important to the court, and it is important not to overshadow it with an undue emphasis on the expert evidence. It is also critical to stress test the expert evidence to make sure it is not at cross purposes with the factual evidence. Judges will be more comfortable accepting expert evidence about the likely future effects of the transaction if it can be tied to fact evidence of past transactions, industry trends, and the parties' internal business planning documents. Counsel and experts must also avoid extreme positions, and counsel must be very careful not to select an expert whose opinion is part of a larger political or social agenda. ■

1 FTC v. Arch Coal, Inc., 329 F. Supp. 2d 109 (D.D.C. 2004).

2 FTC v. Sysco Corp., 113 F. Supp. 3d 1 (D.D.C. 2015).

3 St. Alphonsus Med. Ctr.–Nampa, Inc. v. St. Luke's Health Sys., No. 1:12-CV-00560, 2014 U.S. Dist. LEXIS 9264 (D. Idaho Jan. 24, 2014), *aff'd*, 778 F.3d 775 (9th Cir. 2015).

4 Lisa C. Wood, *Trying Antitrust Cases Before Generalist Judges*, Antitrust, Fall 2006, at 85.

5 John D. Bates, *2004 Milton Handler Annual Antitrust Review: Customer Testimony of Anticompetitive Effects in Merger Litigation*, 2005 Colum. Bus. L. Rev. 279, 290 (2005).

ABA SECTION OF ANTITRUST LAW

COUNCIL HIGHLIGHTS 2015–2016

1. Pursuant to its mandate under the Section's bylaws, the Council provided general supervision and control of the affairs of the Section. The Council received regular reports from representatives from the Antitrust Division of the U.S. Department of Justice, the Federal Trade Commission, the Multistate Antitrust Task Force, the Judiciary, the ABA Board of Governors, the Canadian Bar Association, the International Bar Association, the ABA Young Lawyers Division, and the ABA Law Student Division.
2. The Council approved the Business Torts & Civil RICO Committee to be renamed to Competition Torts.
3. The Council approved the Civil Redress Committee to be renamed to Global Private Litigation.
4. The Council approved the appointment of Irving Scher to complete the unexpired Council term held by Parker C. Folse (ending August 2016).
5. The Council approved the Application Form for ABA Amicus Curiae Brief in Support of Petitioner in *Boehringer Ingelheim Pharmaceuticals, Inc. v. Federal Trade Commission*.
6. The Council approved the 2015–2016 Spring Meeting Proposed Session Slate.
7. The Council approved proposals for, or the publishing of, the following books: *2015 Annual Review of Antitrust Law Developments*; *Antitrust and Economics of Product Distribution, Second Edition*; *Antitrust Compliance Handbook: A Practitioner's Guide*; *Consumer Protection Compliance Manual, First Edition; Consumer Protection Law Developments, Second Edition*; *Department of Justice Civil Antitrust Practice and Procedure Manual, Second Edition*; *Indirect Purchaser Litigation Handbook, Second Edition*; *The Intellectual Property and Antitrust Handbook, Second Edition*; *Intellectual Property Misuse—Licensing and Litigation, Second Edition*; *International Criminal Cartel Handbook, First Edition*; *Model Jury Instructions in Civil Antitrust Cases, Second Edition*; *Private Equity Antitrust Handbook*; *Proving Antitrust Damages*.
8. The Council approved submission of 22 sets of comments to U.S. and international government agencies regarding draft guidelines, rules, or policy documents.
9. The Council approved the Report of the Task Force on Foreign Investment Review.
10. The Council approved the Section of Antitrust Law (SAL) to allow the Section of Intellectual Property Law to seek blanket approval with the understanding that SAL will not block the comments, and that they will not be submitted jointly with SAL on the DOJ's September 2015 Solicitation of Public Feedback Related to the Licensing of "Joint Works" by "Performing Rights Organizations."
11. The Council approved the Committee Long Range Plans for the Consumer Protection Committee (except the portion of the plan that discusses changing the name of the Section) and the Transportation and Energy Industry Committee.
12. The Council approved the following Committee Annual Plans: Advertising Disputes and Litigation, Agriculture & Food, Cartel and Criminal Practice, Civil Practice and Procedure, Competition Torts, Compliance and Ethics, Consumer Protection, Corporate Counseling, Distribution and Franchising, Economics, Exemptions and Immunities, Federal Civil Enforcement, Global Private Litigation, Health Care and Pharmaceuticals, Insurance and Financial Services, Intellectual Property, International, Joint Conduct, Legislation, Media and Technology, Membership and Diversity, Mergers and Acquisitions, Pricing Conduct, Privacy and Information Security, State Enforcement, Trade, Sports, and Professional Associations, Transportation and Energy Industries, Trial Practice, and Unilateral Conduct.
13. The Council approved the three-year term renewal of the co-sponsorship agreement with George Mason University Law and Economics Center for the Antitrust Law & Economics Institute for Judges.
14. The Council approved the 2016–2017 SAL Conferences (October: Masters Course, Antitrust Law & Economics Institute for Judges; November: Fall Forum; February: Consumer Protection Conference; March: Spring Meeting; June: Antitrust in Americas; and two to three Global Seminar Series programs).
15. The Council approved the 2017–2018 SAL Conferences (October: Mergers Workshop, Antitrust & Intellectual Property, and Antitrust Law & Economics Institute for Judges; November: Fall Forum; January: Next Generation Scholars; February: International Cartel Workshop; April: Spring Meeting; May: Antitrust in Healthcare; June: Antitrust in Asia; and two to three Global Seminar Series programs).
16. The Council approved the Long Range Publications Plans for FY 2016–2019.
17. The Council approved the Annual Business and Council Meeting Minutes and Post Annual Council Meeting Minutes.
18. The Council approved that Summary of Action Items Taken by Council Between the Post Annual Council Meeting and the Fall Council Meeting be included in the Fall Council Meeting Minutes.
19. The Council approved the Retrospective Analysis of Merger Decision Outcomes Award Committee recommendation granting the 2014–2015 First Place Award to the paper titled "Efficiencies Brewed: Pricing and Consolidation in the U.S. Beer Industry" by Orley C. Ashenfelter, Daniel S. Hosken, and Matthew C. Weinberg.
20. The Council approved the increase for the Spirit of Excellence Award level from $1,000 to $2,500 as suggested by the ABA Commission on Racial and Ethnic Diversity.
21. The Council approved a contribution by the Section in the amount of $10,000 to the LAMP Project.
22. The Council approved that the Section establish Fellowships for Diversity Law Students and Diverse Experienced Practitioners.
23. The Council approved the FY 2017 Reserves Projects proposed by Finance Officer, Kevin O'Connor (except for Best Practices for Antitrust Procedures).
24. The Council approved that the Section policy, Limitation on Spending in Any One Fiscal Year, be revised to replace the reference to "10%" with "15%."
25. The Council approved the Midwinter Council Meeting Minutes.
26. The Council approved that the Summary of Action Items Taken by Council Between the Midwinter Council Meeting and the Spring Council Meeting be included in the Minutes of the Spring Council Meeting.
27. The Council approved the Membership and Diversity Committee's proposed Diversity Strategic Plan.
28. The Council approved the Section of Antitrust Law on behalf of its Consumer Protection Committee co-sponsorship request to co-sponsor a series of panel discussions with the Global Advertising Lawyers Alliance ("GALA") during the remainder of FY 2016 and through FY 2017.
29. The Council approved the SAL on behalf of its Membership & Diversity Committee co-sponsorship request to co-sponsor a panel discussion and networking event with Corporate Counsel Women of Color® FY 2017.
30. The Council approved the SAL co-sponsorship request to co-sponsor the 2017 Consumer Protection Conference in Atlanta, GA with the Canadian Bar Association.
31. The Council approved the SAL to add a new Global Private Litigation Conference to the 2016–2017 CLE Conference line-up.
32. The Council approved the 2016 Spring Council Meeting Minutes.

AGENDA | CONSUMER PROTECTION CONFERENCE

GEORGIA AQUARIUM | FEBRUARY 2, 2017

Presented by the ABA Section of Antitrust Law and the Canadian Bar Association

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CONFERENCE CO-CHAIRS

■ Anita Banicevic ■ Christopher A. Cole ■ Patricia A. Conners

WEDNESDAY, FEBRUARY 1, 2017

6:30 – 9:00 PM **REGISTRATION**

6:30 – 9:00 PM **WELCOME PARTY AT WORLD OF COCA COLA**
The kick-off party will be a great opportunity to mingle and network with fellow conference attendees. The evening will begin with a presentation on the history of the Coca-Cola Company from guest speaker, Ted Ryan, Heritage Director, Coca-Cola. There will be live music, and appetizers and beverages will be served.

THURSDAY, FEBRUARY 2, 2017

7:30 AM – 5:00 PM **REGISTRATION**

8:00 – 8:15 AM **WELCOME REMARKS**

8:15 – 9:00 AM **CONSUMER PROTECTION AND ENFORCEMENT IN TOMORROW'S MARKETPLACE**
While innovation and globalization in marketing and advertising continues to unfold at a rapid pace, what are the key consumer protection enforcement issues and priorities? At this roundtable, you'll have the opportunity to hear directly from the Federal Trade Commission, Competition Bureau and the State Attorneys General about their enforcement agenda, trends and what issues to be on the lookout for now and in the months to come. What do recent enforcement decisions and/or guidelines mean for businesses?

9:00 – 10:00 AM **CORPORATE COUNSELOR ROUNDTABLE: MANAGING COMPLIANCE AND RISKS**
This roundtable of GCs will discuss how they manage and assess business risk created by consumer protection laws and litigation. In an increasingly international and constantly changing regulatory environment, how do companies stay on top of their compliance obligations? How do they balance risk with achieving business imperatives? In this interactive discussion, GCs will share their views directly with enforcement officials in attendance, who may be asked to respond! This session will include an ethics component.

10:00 – 10:15 AM **BREAK**

10:15 – 11:00 AM **DEALING WITH MULTIPLE ENFORCEMENT AND INVESTIGATIVE TECHNIQUES**
Agencies have a wide range of means at their disposal: from press releases and warning letters to searches, from informal guidance to published rules, from administrative litigation to federal court. When are these tools best used and to what end? What can and should subjects of agency scrutiny do to respond? What do you do when different agencies are pursuing the same conduct and seeking different remedies? This session will include an ethics component.

11:00 AM – 12:00 PM **INNOVATION MEETS REGULATION: IMPLICATIONS OF DISRUPTIVE TECHNOLOGIES**

The introduction of innovative services such as Uber and Airbnb into what typically have been heavily regulated industries has stirred up a debate as to how best to encourage innovation while still protecting consumers and ensuring fairness in a sharing economy. What are the key consumer protection issues that need to be considered? What can and should agencies do in response? Is more or less regulation the answer? How do we ensure fairness in the marketplace while maintaining competitiveness?

12:00 PM – 1:15 PM **LUNCH WITH KEYNOTE SPEAKER**

1:30 – 2:15 PM **CLAIMS SUBSTANTIATION IN NOVEL AND EVOLVING TECHNOLOGIES**

As new technologies come into the marketplace, how does one substantiate product claims where you have a novel product and novel testing? What about in an area where the standards are evolving? Is it sufficient to test to current standards? When and how often do you have to update your testing? What are the enforcer's perspectives on these issues?

2:15 – 3:00 PM **EVOLVING CONSUMER PROTECTION ISSUES IN FINTECH**

The dramatic growth in the availability of Fintech alternatives is changing the way financial products and services are offered and delivered to consumers. What are the key consumer protection issues that companies in this area and their partners need to be on the lookout for? What third-party liability issues could arise? And which enforcement agencies are involved? Are there too many "cooks in the kitchen" and what are the appropriate limits?

3:00 – 3:15 PM **BREAK**

3:15 – 4:00 PM **PRIVACY AND DATA PROTECTION IN A DIGITAL WORLD**

As advertisers continue to seek new ways to engage consumers with a variety of wearable devices and virtual reality, what are the privacy risks for consumers? What steps do companies need to take to ensure adequate disclosure and data protection? We'll discuss the latest learning from recent enforcement actions and hear from enforcers and companies what their key enforcement and compliance concerns are. We will also discuss whether it is desirable to seek international "convergence" on privacy and data security standards. Would convergence in this area enhance consumer welfare or does it matter? Is there a place for "privacy by design?"

4:00 – 5:00 PM **INTERNATIONAL ROUNDTABLE: CONSUMER PROTECTION AND CROSS-BORDER CO-OPERATION**

Representatives from Canada's Competition Bureau, Europe, and the FTC will discuss co-operation across agencies and provide practical recommendations for companies that advertise in multiple jurisdictions. When do enforcers co-operate, agree to disagree and where do we see the potential for further co-operation and/or collaboration? How can we achieve better transparency, uniformity and predictability regarding advertising-related consumer protection issues in a global economy? What's the international perspective on privacy and data security?

5:00 – 6:00 PM **TOUR THE GEORGIA AQUARIUM**

We will conclude the conference with a networking opportunity exploring the aquarium as we transition from CP to sea life!

INTERNATIONAL MERGER DEVELOPMENTS

The Use of Quantitative Economic Techniques in EU Merger Control

BY THOMAS BUETTNER, GIULIO FEDERICO, AND SZABOLCS LORINCZ

THE EUROPEAN COMMISSION'S Directorate General for Competition often relies on quantitative economic analysis in its review of complex mergers. This analysis is typically developed during in-depth investigations (so-called Phase II reviews). There is a range of economic techniques that can be applied to the competitive assessment of mergers. The choice of the relevant economic methodology depends on the features of the market at hand, on the key questions raised by the merger, and on the availability of suitable data.

Quantitative economic methods applied by the Commission to the assessment of mergers are often one of two broad types: merger simulation techniques and direct estimation methods. Merger simulations seek to approximate the effects of a merger on the main competitive variable of interest (typically price) through an internally coherent assumed model of competition in the industry which takes account of important observed or measured market features (such as substitution patterns and margins).

Direct estimation methods, on the other hand, seek to study the impact of past events in the markets at hand, using historical data. For example, direct estimation techniques can be used to measure the impact of past entry events (typically involving one or both of the merging parties) or past mergers. The insights from the direct estimation of past competitive events' impact can then be used to make inferences on the possible effects of the merger at hand.

In this article we review the Commission's recent application of these two families of quantitative economic methods in merger control.[1]

The authors are members of the Chief Economist Team, DG Competition, European Commission. *They thank Luca Di Martile, Gábor Koltay, Tommaso Valletti, and other colleagues in the Chief Economist Team for their contributions and comments on the issues covered in this article. The views expressed in this article are solely those of the authors and cannot be regarded as representing an official position of the European Commission.*

Merger Simulations

The Commission has relied on merger simulation techniques in a number of recent cases. There have been two main applications of these techniques: mergers in mobile telephony markets and two mergers in industrial commodities (specifically, in stainless steel and in the chemicals sector). In the first application (mobile telephony markets), the Commission applied simulation techniques that are suitable for pricing of differentiated products (as described in Section 6.1 of the U.S. Horizontal Merger Guidelines.)[2] In the second application, the Commission deployed a model that is more suitable to the analysis of competition in homogeneous product markets in the presence of fixed industry capacity (which is more closely related to issues described in Section 6.3 of the U.S. Merger Guidelines).

The main objective of merger simulations in these cases has been to obtain an estimate of the order of magnitude of the likely effect of the relevant mergers on prices, based on an internally coherent model of competition that is capable of reflecting several of the key competitive variables of each market. The use of these techniques allowed for extensive sensitivity analysis of the simulation based on an alternative set of input parameters and for direct balancing of the efficiency claims made by the merging parties.

While useful for a quantitative assessment of certain key features of the merger within a tractable model of the industry, simulation models necessarily abstract from some potentially relevant features. In all the cases where merger simulation techniques were employed, the results were hence integrated with the qualitative evidence on the likely effects of the merger (e.g., from the review of internal documents and from views of market participants), and read in conjunction with this evidence. The results of the merger simulations were therefore only one of the elements used by the Commission to come to its overall assessment of the relevant mergers.[3]

Pricing of Differentiated Products in Mobile Telephony Markets. The Commission has reviewed a series of horizontal mergers in mobile telephony markets since 2012, including mergers in Austria (2012), Ireland (2014), Germany (2014), Denmark (case withdrawn in September 2015), the UK (2016), and Italy (2016).[4] A merger raising similar issues in the Spanish telecommunication market was approved in 2015.[5] Each of these mergers implied a reduction in the number of mobile network operators, or infrastructure competitors, from four to three.

In each of these cases (with the exception of the first case in Austria in 2012[6]) the Commission used a merger simulation that estimated the likely impact of the merger on retail prices for each operator and for the market as a whole, on the basis of a number of inputs (including most notably profit margins and diversion ratios across competitors). These merger simulations can be seen as an application of the price pressure techniques described in Section 6.1 of the U.S. Merger Guidelines.[7]

The basic idea behind price pressure techniques is to approximate the unilateral effects of a horizontal merger. The incentive of the merged entity to increase prices flows from the fact that prior to the merger neither of the merging parties internalizes the fact that setting a higher price diverts sales and profits to the other party. This diversion is internalized by the merger, thus leading to an increased potential for higher prices. The incentive to raise price, and hence the predicted price effects by the parties, are greater the greater the diversion of sales between the parties (in reaction to a price increase) and the higher the profit margin on the additional units sold by each of the merging parties.[8]

Pricing pressure techniques are typically based on the assumption of Bertrand-Nash competition between firms offering differentiated products (i.e., the standard competition model for pricing of differentiated products). They can be applied just to the prices of the merging parties, but can also be extended to account for the additional effect on the pricing of non-merging parties (feedback or equilibrium effects), in order to approximate the overall impact of the merger on market prices.[9]

In the mobile telephony cases, the Commission used a merger simulation model based on this standard competition model. The number of competitors to the merging parties is fixed by assumption in this model, and therefore the simulation is not suited to analyze the issue of possible entry by other firms following the merger. When barriers to entry are high (as the Commission found in the mobile telephony market) this assumption is likely to be reasonable.

The model was populated with diversion ratios between each operator using number portability data available in each market. This data records the origin and destination operators for consumers who port their numbers when switching between operators (which does not necessarily capture price-based switching only). In some of the more recent cases, the Commission supplemented the portability data with the results of a consumer survey designed to measure diversion between the merging parties on the basis of hypothetical changes in price, to better approximate price-based substitution. Diversion between operators was computed at both the mobile network level and at the retail level (accounting for the presence of "virtual" network operators who access the infrastructure of mobile network operators). Diversion ratios at the retail level are lower by design than diversion ratios at the network level (since they include more competitors), and therefore predict lower likely price effects of the merger.[10]

The profit margins used in the simulation were derived from accounting data submitted by the operators (measuring both direct and contribution margins), supplemented by additional information on additional incremental costs (e.g., incremental network costs) provided by the merging parties and assessed by the Commission.

To estimate the likely impact of the merger on final prices, the model assumed that the demand faced by each operator is linear in price (that is, the change in quantity demanded in response to a change in price has a constant ratio). This assumption implies a lower degree of pass-on of any given upwards pricing pressure to the final price, and hence leads to lower estimates of the final effect of a merger on prices than many other standard assumptions on demand (e.g., constant elasticity demand or logit demand).[11] An assumption on aggregate demand elasticity (i.e., the reduction in total demand in response to higher prices) was also considered by the Commission in its merger simulations.[12]

To take a concrete example of this exercise, consider the merger between H3G and O2 in Ireland (cleared by the Commission subject to remedies in 2014). In its final decision[13] the Commission reported illustrative price rises (IPR) for the two merging parties (i.e., price increases by the parties assuming other firms hold their prices constant) in the range of 4–9 percent for the main segment of overlap (the post-paid private segment), based on sensitivities on the level of profit margins (using both contribution and incremental margins), and on the diversion to an outside good (considering a case with 0 percent diversion and 20 percent diversion).

The Commission also reported the results of the merger simulations accounting for equilibrium reactions by rivals. Under this scenario, the increase in prices of the two merging parties was higher than under the IPR (given that rivals respond to the merger by also increasing prices, thus making a further price increase by the merging parties profitable). The market-wide effect of the merger, considering both the price increase of the merging parties and that of non-merging parties, was computed to be in the range of 4–9 percent in the post-paid private segment, and 3–7 percent in the overall private segment (including both pre-paid and post-paid contracts). The Commission considered these price effects to be significant and not outweighed by the efficiencies substantiated by the merging parties.

The reliance on merger simulation techniques can yield several benefits, as illustrated by the Commission's experience in the assessment of the recent series of mobile mergers.

First, it provides a quantitative estimate of the impact of the loss of competition due to the merger, thus helping to substantiate whether a transaction may be expected to lead to a significant lessening of competition. The estimation of the likely price effects can be subject to extensive robustness analysis by considering different input assumptions (e.g., on the level of diversion ratios, on the level of margins, and on the aggregate elasticity of demand). This increases the reliability of a conclusion on whether the merger is likely to result in a significant lessening of competition.

Second, the quantification of price effects from a merger simulation can be useful to complement qualitative evidence on the effect of consolidation in mobile telephony markets, including the documentary evidence found in some of these cases on the "market repair" benefits of consolidation (effectively a euphemism for higher prices and profits), on expectation of more "rational pricing," and/or on the additional revenue expected from the merger by removing a competitor.[14]

Third, the merger simulation allows for a quantification of likely consumer harm which can be offset against substantiated efficiency claims. Merger simulations can deal with variable cost efficiencies in a straightforward way, given that the framework applies the same assumption to the pass-on of upward pricing pressure from a merger and to the pass-on of downwards pricing pressure from a cost reduction. This allows for an internally coherent balancing exercise.[15]

Pricing pressure models can in principle also allow for efficiencies in the form of quality increase following a merger.[16] In most of the recent mobile telephony mergers, the parties claimed that the transactions would lead to higher network quality (e.g., in terms of network coverage and speed), and therefore be procompetitive. In practice, the Commission did not use the prediction from the merger simulation in the mobile telephony cases to balance harm against the benefits from higher network quality, given that it concluded that the claims made by the parties were either not verifiable or not merger-specific (most notably because substantially the same benefits could be achieved by less restrictive alternatives, such as network sharing).[17]

Pricing of Homogeneous Goods in Commodity Markets. The Commission has also used a merger simulation model in two recent cases involving industrial commodities (Outokumpu/Inoxum[18] and Ineos/Solvay[19]).[20] The Commission chose a Bertrand-Edgeworth (BE) framework in these cases, which analyses price competition between firms offering homogeneous products subject to fixed production capacities for each firm.

In both cases the respective industry was characterized by overcapacity stemming from investment decisions made in the past under different market conditions. The level of plant capacities did not seem to be a major decision variable by firms at the time of the investigations. Moreover, consumers in these industries choose among competing suppliers largely on the basis of price. The BE framework hence seemed appropriate to assess these cases and preferable over alternatives models for homogeneous product markets, which assume that firms compete in quantities (directly or through capacity adjustments). The assumption of price competition in homogeneous products was also in line with the merging parties' submissions on the nature of competition in these industries.

Absent any capacity constraints (and assuming that firms do not coordinate), price competition between two or more firms in a homogeneous product market is predicted to be very intense. By the standard Bertrand logic, firms find it profitable to undercut each other's prices and capture the entire market until prices are driven down to marginal costs. However, in the presence of fixed capacity constraints, a degree of market power may be restored (as originally pointed out by Edgeworth). Firms whose competitors do not have enough capacity to supply the entire market cannot lose all customers to their competitors and hence have a "guaranteed" share of demand that they can exploit. This eliminates their incentives to price all the way down to marginal costs where profits would be zero. Instead, at some price level above marginal costs, these firms would stop undercutting their rivals as it is more profitable to set a high price, which allows them to extract positive profits from their 'guaranteed' share of demand. The BE framework formalizes this effect.

In this setting, a merger that results in a substantial consolidation of capacities can lead to an increase in the merged entity's market power. As the merged entity faces less capacity from competitors, it has a greater "guaranteed" share of demand which it can exploit compared to each of the merging firms pre-merger. This provides the merged entity with an incentive to stop undercutting earlier and may lead it to set overall higher prices.

The BE model needs to be populated with a number of inputs in order to generate a prediction on pre-merger and post-merger outcomes. These include the level of market demand at prevailing market prices, the level of capacity available to each competing firm and their variable costs, the price elasticity of aggregate demand, and the price responsiveness of sales by producers located outside the geographic area that is the focus of the analysis (e.g., imports into the EEA in the case of *Outokumpu/Inoxum*, and sales into a region defined by the Commission as "North-West Europe" in the case of *Ineos/Solvay*).

In *Outokumpu/Inoxum*, a merger between the two largest EEA producers of cold rolled stainless steel, the Commission used the BE model as a comprehensive and internally coherent framework to jointly test the main arguments made by the merging parties for why the transaction would not be expected to increase prices. The Commission took at face value the parties' arguments on the nature of competition, on the responsiveness of demand and imports to prices in the EEA, and on variable cost efficiencies resulting from the transaction and combined them with estimates of firms' (spare) capacity levels and costs to populate a BE model. The Commission found that: (1) the parties' arguments overstated the degree of competition in the industry pre-merger to a limited extent (as pre-merger margins predicted by the model were somewhat lower than observed margins); and that (2) even accepting the parties' arguments, the significant capacity consolidation brought about by the merger would still lead to a reduction in competition (as the model predicted a price increase in the range of 5–10 percent). The parties' arguments were hence not sufficient to dispel concerns on unilateral price effects resulting from the transaction. The transaction was ultimately cleared subject to substantial divestments.

In *Ineos/Solvay*, a transaction creating a joint venture between the first and second largest producers of commodity suspension polyvinyl chloride (S-PVC) in Northwest Europe (NWE), the BE model was initially presented by the merging parties to demonstrate that the efficiencies associated with the transaction, combined with the divestment of some productive capacity, would be sufficient to prevent a price increase. The Commission reviewed and adapted the model submitted by the parties, showing that absent efficiencies and remedies, the merger would likely lead to a significant increase in market power. This remained the case even if one accepted the entirety of the variable cost efficiency claim made by the merging parties (with prices still predicted to rise in the model by 5–20 percent in this case, depending on the calibration assumptions). In its final decision, the Commission cleared the merger with more extensive remedies than those initially submitted by the merging parties, due to concerns about both the competitiveness of some of the assets initially put forward, and the initial scope of the remedy package.[21]

Direct Estimation of the Impact of Past Events

In some recent merger cases, the Commission has relied on quantitative techniques to estimate directly the impact of past events. In what follows, we will focus on two main applications of these techniques: the industrial chemicals merger *Ineos/Solvay*, and a merger in the coffee industry. In the first application (industrial chemicals), the Commission carried out an ex-post evaluation of recent past mergers in the same industry to gain insight into the likely effects of a proposed merger as well as on a geographic market delineation question (see also Section 2.1.1 of the U.S. Merger Guidelines). In the second application (coffee systems in the *DEMB/Mondelēz* merger case[22]), the Commission estimated the impact of past entry events by one merging firm's coffee systems into various geographic markets on the pricing of the other merging firm's coffee system. This analysis focused on the closeness of competition between the different systems. (This type of evidence is also mentioned in Section 2.1.2 of the U.S. Merger Guidelines).[23]

The common trait of these applications is that they use information on markets affected by past events, such as entry or previous mergers, and compare these markets to other markets that were not affected by the events. This is to shed light on the competitive interaction between the merging parties. The markets to be compared can be different product or geographic markets. In the two cases discussed below, the Commission used different geographic markets as comparators.

The impact of an entry, exit, or past merger event can be used as evidence of the closeness of competition between different products or firms. If, for example, a new competitor enters a geographic market and offers a close substitute for the incumbent's product, the price of the incumbent product is expected to decrease following the entry. Hence, the evolution of the incumbent product's price before and after the entry can be a valuable source of information on the actual strength or closeness of competition between the incumbent's and the newly entered rival's products. The stronger the price decrease of the incumbent's product following the rival's entry, the stronger the likely competitive interaction.

While conceptually simple, the econometric measurement of such effects can be complex. Simple comparisons of the affected market's prices before and after an event might be misleading because the price changes can also be the result of other factors influencing market outcomes, such as changes in costs or demand conditions. For example, if prices have a decreasing tendency even before and independently of the event, one would falsely attribute the lower post-entry average price level as an effect of the entry—even if the entry did not actually impact prices.

The problem can be alleviated by a number of techniques that isolate the effect attributable to the event from the effect of other factors. One approach, which has been used in the recent cases discussed here, is based on comparing the evolution of prices in the affected market (the "treated" market) to the evolution of prices in other geographic markets for the same product—with otherwise similar demand and cost conditions—where no entry or other event occurred. These other markets are referred to as the "control" markets or control group.

The control group is assumed to represent how the treated market would have behaved had the entry (or exit or merger) event not happened. Importantly, the control markets form a valid basis of comparison if they have the same characteristics as the treated market but for the effect of the event studied. If the prices do not change significantly in the control markets when the event happens in the treated market, and the prices do change in the latter following the event, it is more likely that this price change is attributable to the event. Similarly (in the case of an entry event), if prices have already been decreasing in both markets, entry might result in a more rapid decrease of prices in the treated market compared to the control markets. If, however, the control markets' prices decrease similarly during the same time periods, the effect is less likely to be an entry effect. This methodology of double comparison (comparing first within-market pre-event prices with post-event prices, and second comparing these price changes across the different markets) is also called the "difference-in-differences" methodology.[24] The difference-in-differences methodology can also be used to measure the (average) effect of several events that take place in different geographic markets (at the same time or at different times).[25]

In a merger context, it is important to emphasise the proper interpretation of the outcomes of such difference-in-differences analyses. Even though the price effect estimates can be thought of as a direct quantification of the impact of the past merger (or entry or exit) events, care has to be taken in interpreting them as estimates of the effect of *future* mergers.[26] In the cases discussed below, the impact estimates of past events were rather used as evidence helping to establish whether conditions conducive to anticompetitive effects of the proposed transactions prevailed prior to them. These conditions could include close competition between the merging parties, existing market power of one or both of the parties, or market delineation patterns indicating the lack of sufficient competitive constraints on the markets where the merging firms are active.

As in the case of simulation methods discussed in the previous section, the results of the direct estimation methods were used in conjunction with the available qualitative information on file (market interviews, internal documents, etc.) to form the assessment of the proposed transactions.

Ex-post Analysis as a Merger Assessment Tool in the Chemicals Industry.[27] In *Ineos/Solvay* the Commission used, in addition to the Bertrand-Edgeworth simulation model (discussed in the first part of this article), a quantitative difference-in-differences analysis of past mergers in the industry. Prior to the transaction, the S-PVC industry had already seen two previous mergers, both involving Ineos. In particular, Ineos bought a competitor in 2008 with production assets in the UK and Scandinavia, and purchased another firm in 2011 with factories in the Benelux countries and France. As a result, by the time of the notified transaction Ineos had grown into the clear market leader.

Ineos' previous mergers made it possible to analyse the effect of consolidation on competition and prices in a direct effect estimation framework. The Commission collected detailed, transaction level datasets from both merging parties covering the 2007–2012 period on a monthly basis. The data included invoices, values and volumes of transactions, information on the location of customers and production plants, as well as technical characteristics of the products and their costs. The treated and control markets were defined geographically: the treated group was the set of transactions belonging to regions affected by the past mergers, while the transactions in non-affected regions formed the control group.

In particular, the difference-in-differences-based comparative analysis contributed to answering three key questions in the case. First, an issue to be investigated was whether Ineos already possessed market power prior to the proposed transaction, which would have made this merger more likely to be anticompetitive. Second, if the past mergers resulted in significant price increases, the analysis could provide evidence on the regional segmentation of the European market. In particular, the question was whether the NWE region was or was not sufficiently constrained by competition from the Rest of Europe (ROE). Third, an ex-post analysis of the previous mergers could indicate whether the assumptions that were made in the respective clearance decisions might have to be revisited. These assumptions mainly involved the existence of sufficient rival spare capacity, customers' ability to switch supplier, and EEA and import competition as effective competitive constraints on the merging parties.

The Commission used two versions of the difference-in-differences analysis. The first version compared Ineos's prices in the NWE region to those in the ROE regions, and calculated how much the price difference between the two regions increased after the two previous mergers. Hence in this version, the previous mergers focused on the NWE region so customer transactions in this region formed the treated group, and those from the ROE regions were the control group. The second version compared Ineos's price premium relative to Solvay between NWE and ROE, and analyzed whether the regional difference in the price premium increased after the mergers. The second version of the methodology is likely to underestimate the effect of the past mergers, as Solvay might have reacted to these transactions by increasing its prices due to the reduced overall competition in the market. As such, finding a merger effect on the price premium would be considered strong evidence of merger-induced unilateral price effects.

The results indicated that past consolidation (in particular the previous Ineos/Tessenderlo merger) led to price increases, both in an absolute sense (first version), and on the Ineos price premium relative to Solvay's prices (second version). These results, combined with the evidence on volume changes in the treated market, led to the conclusion that Ineos already had a degree of market power prior to the proposed transaction; that the NWE region was a separate geographic market;[28] and, as a result, the assumptions that allowed the Commission to clear the previous mergers (spare capacity, customer switching, and strong EEA and import competitors) could not be relied upon in the assessment of the proposed transaction.

As already mentioned, the impact estimates of past merger events cannot be conclusively interpreted as estimates of the effect of future mergers. Accordingly, as described above, the evidence was rather used to establish existing market power and conditions conducive to anticompetitive effects of the proposed transaction. This finding and a large body of other qualitative and quantitative evidence (including extensive documentary evidence on the impact of past consolidation, data on the evolution of volumes after past consolidation, evidence on limited spare capacity by rivals, as well as the simulation modelling discussed in the first part of this article) jointly provided the basis for the conclusion that the proposed merger would lead to a significant impediment to effective competition.

Entry and Exit in the Coffee Systems Markets

In *DEMB/Mondelēz*, a joint venture case between two leading coffee manufacturers, one of the important issues was competition between coffee systems.[29] Traditionally, coffee was mostly prepared as "multi-serve" drinks (such as drip filter coffee using ground coffee powder) with several cups of coffee brewed simultaneously. More recently, single-serve systems, which generally brew only a single cup of coffee at a time, have also become popular. Such "coffee systems" are comprised of coffee machines and coffee consumables (e.g., capsules and filter pads) that can be used only with the specific machine. In Europe, several coffee systems belong to this segment, most prominently Nestlé's Nespresso, Nestlé's Dolce Gusto, DEMB's Senseo, and Mondelēz's Tassimo.[30]

Single-serve coffee systems are differentiated with respect to the type of coffee they make (from filter style coffee to espresso style); whether they are limited to black coffee or whether they produce milky or flavored variations; and whether the system is closed or open (i.e., whether or not consumables can also be bought from third-party providers). The qualitative evidence (from internal documents and market participants) indicated that the Tassimo brand was primarily competing with Dolce Gusto, while Senseo (which is closer to filter coffee) was a more distant competitor to these two brands and Nespresso. The merging parties also argued that their two systems did not exercise a strong competitive constraint on each other. However, Nestlé, a complainant, argued that the Senseo and Tassimo brands were closer competitors to each other than Tassimo and Dolce Gusto.

To assess the issue, the Commission complemented its qualitative analysis by a quantitative study of the entry of Mondelēz's Tassimo into several countries. While the merging firms are directly active in the "aftermarket" or "secondary market" for consumables, they are only indirectly active in the "primary market" for machines, through long-term design and development co-operations to various extents with machine manufacturers.[31] Nevertheless, coffee manufacturers can and do influence machine prices indirectly through promotional activities and subsidies. Hence, the Commission investigated the merger's potential impact on the market for single-serve machines. The quantitative assessment focused on the sale of machines to shed light on the degree of competition between coffee systems. This assessment was complemented by a qualitative analysis of the links between the primary and after markets.[32]

The data collected covered 21 European countries for the period 2004 to 2014. During this period the Tassimo system was introduced in eight countries, Nestlé's Dolce Gusto was present in 20 countries, and DEMB's Senseo was present in ten. The Commission used two separate econometric models to assess the impact of Tassimo's entry on (1) Dolce Gusto and (2) Senseo machine prices, respectively. In the Dolce Gusto analysis the treated geographic markets were those countries where a Tassimo entry event happened in a given month, while the control group included those countries where Dolce Gusto was present but there was no Senseo entry at the same time. A similar structure was used for the Senseo analysis.

These econometric models used the difference-in-differences methodology comparing the average percent price drop for Dolce Gusto (or Senseo, respectively) machines following the Tassimo entry with the evolution of the average Dolce Gusto (or Senseo, respectively) machine prices during the same period in the countries where no such entry happened.

The results showed that the entry of Tassimo was associated, on average, with a decrease in the prices of both Senseo machines and Dolce Gusto machines. These estimated price responses were statistically significant for Dolce Gusto machines but not for Senseo machines. Hence, these quantitative outcomes indicated that Tassimo represented some competitive constraint for both types of rival machines, but with the effect of Tassimo's entry on Dolce Gusto's prices being stronger than on Senseo's prices (both in terms of magnitude and statistical significance).[33] Hence, these findings were consistent with Tassimo being closer to Dolce Gusto than to Senseo, as indicated by the qualitative evidence. These results proved robust when subject to extensive robustness checks.[34]

As the merging firms are primarily active in the aftermarkets, the results of the quantitative analysis were not directly indicative of the likely effect of the merger on the single-serve machine market. Rather, they showed which particular single-serve systems compete more vigorously with each other. In this respect, the merging firms were not necessarily each other's closest competitors. The qualitative and descriptive evidence obtained by the Commission further documented that other factors, such as the incentive to increase the penetration of machines, especially in the case of more recent entrants, such as Tassimo, implied that the incentive to raise machine prices following the merger would likely be muted. This finding was further reinforced by the degree of contractual independence of the machine manufacturers from the coffee firms and their incentive to increase machine penetration.

Overall, the Commission concluded that both the qualitative and quantitative evidence indicated that the merger would not lead to a significant loss of competition in the segment of single-serve coffee machines. The transaction was cleared without commitments related to machines.

Conclusion

In this article we have described the use of merger simulations and direct estimation techniques by the European Commission in recent merger cases. These quantitative techniques can be useful to assess certain key features of proposed mergers in an internally coherent quantitative approach.

For example, merger simulation techniques can provide quantitative indications on whether observed measures of substitutability between the products in the market are such that the elimination of competition through the merger is likely to lead to significant unilateral price effects; whether spare capacities by non-merging firms are likely to exert a sufficient competitive constraint on the merged entity; or whether claimed efficiencies are likely to offset an increase in market power resulting from a merger.

Direct estimation of the effects of past entry events or mergers can also be informative on competitive interactions or on whether past mergers have led to increased market power.

The Commission selects quantitative techniques which are suited to quantitative analysis of particular markets, both in terms of data availability and in terms of the applicability of the basic premises underlying the analysis (e.g., the presence of high barriers to entry in the case of merger simulation techniques or the comparability of the treated and control markets in the case of the direct estimation techniques).

While such techniques may allow a quantitative assessment of certain key aspects of a proposed merger, they typically cannot take account of all important features of the industry and require reliable data to derive their predictions. The Commission therefore reads the results of such quantitative techniques in conjunction with a careful analysis of the available qualitative evidence. ■

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[1] For a comprehensive review of the Commission's use of economic evidence in merger analysis as of 2011, see OECD: Policy Roundtables, Economic Evidence in Merger Analysis, DAF/COMP(2011)23, July 27, 2012, at 245, http://www.oecd.org/daf/competition/EconomicEvidenceInMergerAnalysis2011.pdf. Some other quantitative techniques also used by the Commission have included: (1) analysis of bidding data, both in a descriptive or regression modeling framework (e.g., Case M.7278—GE/Alstom, Comm'n Decision (Sept. 8, 2015), http://europa.eu/rapid/press-release_IP-15-5606_en.htm; Case M.7802—Amadeus/Navitaire, Comm'n Decision (Jan. 19, 2016), http://ec.europa.eu/competition/mergers/cases/decisions/m7802_817_8.pdf; Case M.7555—Staples/Office Depot, Comm'n Decision (Feb. 10, 2016), http://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=2_M_7555), (2) reduced form regression modeling of prices and company size (e.g., Case M.6458—Universal/EMI, Comm'n Decision (Sept. 21, 2012), http://ec.europa.eu/competition/mergers/cases/decisions/m6458_20120921_20600_3188150_EN.pdf), or prices and concentration (e.g., Case M.6570—UPS/TNT Express, Comm'n Decision (Jan. 30, 2013), http://ec.europa.eu/competition/mergers/cases/decisions/m6570_20130130_20610_4241141_EN.pdf), and (3) partial correlation analysis of prices (e.g., Case M.4439—Ryanair/Aer Lingus, Comm'n Decision (June 27, 2007), http://ec.europa.eu/competition/mergers/cases/decisions/m4439_20070627_20610_en.pdf; Case M.6663—Ryanair/Aer Lingus III, Comm'n Decision (Feb. 27, 2013), http://ec.europa.eu/competition/mergers/cases/decisions/m6663_20130227_20610_3904642_EN.pdf). Adina Claici, Daniel Coublucq, Giulio Federico, Massimo Motta & Lluís Saurí, *Recent Developments at DG Competition 2015/2016*, 2016 Rev. Indus. Org. (published online Oct. 22, 2016).

[2] U.S. Dep't of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines (2010), https://ftc.gov/sites/default/files/attachments/merger-review/100819hmg.pdf.

[3] While merger simulation models typically cannot capture all important features of a market, their price predictions provide a useful and easy-to-interpret summary statistic of the complex interaction of important factors that they do take into account. (In simulations for differentiated product markets this typically includes the degree of substitutability between products in the market and the intensity of pre-merger price competition). This can provide a more concrete basis for the assessment than a more abstract discussion of individual inputs (for example, a discussion of whether observed diversion ratios are such that the transaction would likely lead to significant effects). The price predictions of merger simulations can also be useful as a tool to provide a certain degree of comparability across cases.

[4] Case M.6497—Hutchison 3G Austria/Orange Austria, Comm'n Decision (Dec. 12, 2012), http://ec.europa.eu/competition/mergers/cases/decisions/m6497_20121212_20600_3210969_EN.pdf; Case M.6992—Hutchison 3G UK/Telefónica Ireland, Comm'n Decision (May 28, 2014), http://ec.europa.eu/competition/mergers/cases/decisions/m6992_20140528_20600_4004267_EN.pdf; Case M.7018—Telefónica Deutschland/E-Plus, Comm'n Decision (July 2, 2014), http://ec.europa.eu/competition/mergers/cases/decisions/m7018_6053_3.pdf; Case M.7419—Teliasonera/Telenor/JV (withdrawn Sept. 11, 2015), http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:C:2015:316:FULL&from=EN; Case M.7612—Hutchison 3G UK/Telefónica UK, Comm'n Decision (May 11, 2016), http://europa.eu/rapid/press-release_IP-16-1704_en.htm; Case M.7758—Hutchison 3G Italy/Wind/JV, Comm'n Decision (Sept. 1, 2016), http://europa.eu/rapid/press-release_IP-16-2932_en.htm.

[5] Case M.7421—Orange/Jazztel, Comm'n Decision (May 19, 2015), http://ec.europa.eu/competition/mergers/cases/decisions/m7421_3082_3.pdf.

[6] In the Austrian case (Case M.6497—*Hutchison 3G Austria/Orange Austria*, *supra* note 4), a simpler computation of illustrative price rises by each of the merging parties was presented by the Commission.

[7] A similar technique was applied by the Federal Communications Commission in its review of the AT&T/T-Mobile transaction in 2011. *See* FCC, Staff Analysis and Findings, WT Docket No. 11-65, http://www.wirelessestimator.com/publicdocs/ATT-TMO-FCC.pdf; *see also* Stanley Besen et al., *An Economic Analysis of the AT&T-T-Mobile USA Wireless Merger*, J. Competition L. & Econ. (2013). Price pressure techniques were used in a different context by the DOJ's expert witness in the recent *GE/Electrolux* merger. *See* Michael Whinston, GE-Electrolux Merger Analysis, United States v. AB Electrolux, 1:15-cv-01039-EGS (D.D.C.) (Nov. 23, 2015), https://www.justice.gov/atr/file/ge-px02015/download.

[8] Eur. Comm'n, Guidelines on the Assessment of Horizontal Mergers Under the Council Regulation on the Control of Concentrations Between Undertakings 2004/C 31/03, ¶ 28 [hereinafter European Commission HMG], http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52004XC0205(02)&from=EN.

[9] Following a price increase by the merging parties, non-merging parties can also be expected to increase prices, given the reduced competitive pressure exercised by the merging parties. *Id.* ¶¶ 24–25.

[10] For a review of the role of diversion ratios in measuring closeness of competition and likely price effects, see Thomas Buettner, *Closeness of Competition from an Economic Perspective*, J. European Competition L. & Practice (forthcoming).

[11] An assumption on the form of the demand function or the pass-on is required for the computation of the price effect. This is because the gross pressure to increase prices (as measured by the product of the diversion ratio and the profit margin, net of any efficiency) following a merger can be thought of as an effective "tax" on each merging party to induce it to set the optimal retail price post-merger. The degree to which this tax is passed on to final prices depends on the curvature of the demand curve. *See, e.g.*, Joseph Farrell & Carl Shapiro, *Antitrust Evaluation of Horizontal Mergers: An Economic Alternative to Market Definition*, B.E. J. Theoretical Econ., Vol. 10: Iss. 1 (Policies and Perspectives) (2010), http://faculty.haas.berkeley.edu/shapiro/alternative.pdf; E. Glen Weyl & Michal Fabinger, *Pass-Through as an Economic Tool: Principles of Incidence Under Imperfect Competition*, 121 J. Pol. Econ. 528 (2013).

[12] The method described above (relying on observed diversion ratios, profit margins, and assumptions on the demand function) is referred to as *calibration*. An alternative method to quantify the parameters of a merger simulation model is through *demand estimation*. Here, the diversion ratios and demand elasticities are estimated using econometric methods from data on prices, quantities, and product characteristics. Using the Bertrand-Nash assumptions, these demand estimates are used to calculate the implied pre-merger equilibrium margins. The merger simulation is then performed in a similar way to the calibrated case. In some of the mobile telephony cases (Case M.7018—*Telefónica/E-Plus*, *supra* note 4; Case M.7419—*Teliasonera/Telenor*, *supra* note 4), as a complement to the calibration based models, the Commission also relied on the results of demand estimation-based merger simulation models. For details and comparison, see Annex A of Case M.7018—*Telefónica/E-Plus*, *supra* note 4. This second technique is however more complex and burdensome than a calibrated merger simulation.

[13] Case M.6992—*Hutchison 3G UK/Telefónica Ireland*, *supra* note 4 (see, in particular, Annex I).

[14] *E.g.*, Case M.6992—*H3G/O2 Ireland*, *supra* note 4, ¶¶ 315, 578, 582; Case M.7018—*Telefonica/E-plus*, *supra* note 4, ¶ 493; Case M.7421—*Orange/Jazztel*, *supra* note 5, ¶¶ 334 and 360.

[15] The Commission used its merger simulation to balance the variable cost efficiencies in Case M.7421—*Orange/Jazztel*, *supra* note 5. For a more general discussion of the Commission's recent practice on efficiencies, see Benno Buehler & Guilio Federico, *Recent Developments in the Assessment*

of Efficiencies of EU Mergers, Competition L. & Pol'y Debate, Mar. 2016.

16 *See* Robert Willig, *Unilateral Competitive Effects of Mergers: Upward Pricing Pressure, Product Quality, and Other Extensions*, 39 Rev. Indus. Org. 19 (2011).

17 The Commission's framework for the assessment of possible efficiencies is set out in European Commission HMG, *supra* note 8, ¶¶ 76–88.

18 Case M.6471—Outokumpu/Inoxum, Comm'n Decision (Nov. 7, 2012), http://ec.europa.eu/competition/mergers/cases/decisions/m6471_14897_2.pdf.

19 Case M.6905—INEOS/Solvay/JV, Comm'n Decision (May 8, 2014), http://ec.europa.eu/competition/mergers/cases/decisions/m6905_8118_2.pdf.

20 For more details on the Commission's assessment of Case M.6471—*Outokumpu/Inoxum*, *supra* note 19, see Thomas Buettner, Giulio Federico, Kai-Uwe Kühn & Dimitrios Magos, *Economic Analysis at the European Commission 2012–2013*, 43 Rev. Indus. Org. 265 (2013); for more details on the Commission's assessment of Case M.6905—*Ineos/Solvay*, *supra* note 19, see Benno Buehler, Gábor Koltay, Xavier Boutin & Massimo Motta, *Recent Developments at DG Competition: 2013–2014*, 45 Rev. Indus. Org. 399 (2014); and Andrea Amelio, Andrea Cilea & Massimiliano Kadar, *INEOS/Solvay/JV: Yet Another P(ractically) V(ery) C(omplex) Merger*, Competition Merger Brief, 2/2015, http://ec.europa.eu/competition/publications/cmb/2015/cmb2015_002_en.pdf. The Commission's approach in both cases is also set out in Thomas Buettner, Andrea Cilea & Massimiliano Kadar, *Horizontal Mergers in Homogeneous Goods Industries: When Is Spare Capacity Sufficient to Offset Unilateral Effects?*, 39 World Competition 57 (Mar. 2016).

21 For more information on some of the Commission's economic considerations in the assessment of remedies in Case M.6905—*Ineos/Solvay*, *supra* note 19, see Giulio Federico, Massimo Motta & Penelope Papandropoulos, *Recent Developments at DG Competition: 2014*, 47 Rev. Indus. Org. 399 (2015).

22 Case M.7292—DEMB/Mondelēz/Charger Opco, Comm'n Decision (May 5, 2015), http://ec.europa.eu/competition/mergers/cases/decisions/m7292_3753_2.pdf.

23 An entry/exit analysis with a similar quantitative methodology was used in the earlier Commission decision of June 27, 2007, in Case M.4439—*Ryanair/Aer Lingus*, *supra* note 1. This case involved a merger between airline companies with an analysis of the impact of entry and exit on the pricing of airline tickets of the merging carriers.

24 *See, e.g.*, Guido M. Imbens & Jeffrey M. Wooldridge, *Recent Developments in the Econometrics of Program Evaluation*, 47 J. Econ. Lit., Mar. 2009, at 5; Orley Ashenfelter & Daniel Hosken, *The Effect of Mergers on Consumer Prices: Evidence from Five Selected Case Studies*, 53 J.L. & Econ. 417 (2010); *see also* Luca Aguzzoni, Benno Buehler, Luca Di Martile, Georg Ecker, Ron Kemp, Anton Schwarz &Robert Stil, *Ex-Post Analysis of Two Mobile Telecom Mergers: T-Mobiletele.ring in Austria and T-MobileOrange in the Netherlands* (joint work of the Commission, the Austrian Regulatory Authority for Broadcasting and Telecommunications (RTR), and the Netherlands Authority for Consumers and Markets (ACM)), http://ec.europa.eu/competition/publications/reports/kd0215836enn.pdf.

25 Difference-in-differences models are most often implemented via econometric estimation of linear regressions. In a simple entry example, the (logarithms of) product prices are regressed on indicator variables of countries, time periods, as well as an indicator of whether the entrant had already entered the given market. The coefficient on the entry indicator is interpreted as the average percent price change due to the entry event. Econometric estimation can further extend the difference-in-differences method by including control variables when available and relevant (for example GDP or GDP per capita, exchange rates, or other measures of demand and cost conditions). Further variations might include for example market specific or time varying event impacts. (The latter case also allows inclusion of market specific time trends as control variables, *see, e.g.*, Justin Wolfers, *Did Unilateral Divorce Laws Raise Divorce Rates? A Reconciliation and New Results*, 96 Am. Econ. Rev. 1802 (2006).)

26 Mergers and entry/exit events are the outcomes of the strategic interaction between market players and the relatedly changing market conditions. It follows that, unlike in the case of "natural experiments," direct extrapolation from the impact of these past competitive events to those of future events may not be adequate. Rather, the Commission combines the direct estimation results with the other qualitative and quantitative evidence to assess the likely merger effects. For more on the academic debate on impact estimation and simulation models, see Joshua D. Angrist & Jörn-Steffen Pischke, *The Credibility Revolution in Empirical Economics: How Better Research Design Is Taking the Con out of Econometrics*, J. Econ. Persp., Spring 2010, at 3; and Aviv Nevo & Michael D. Whinston, *Taking the Dogma out of Econometrics: Structural Modeling and Credible Inference*, J. Econ. Persp., Spring 2010, at 69.

27 For more details on the Commission's assessment of Case /M.6905—*Ineos/Solvay*, *supra* note 19, see Buehler et al., *supra* note 20; Amelio et al., *supra* note 20, at 5.

28 The Commission also used the transaction data in a separate quantitative analysis of the price divergence between the NWE and ROE regions. It was found that prices diverged significantly with the NWE prices increasing relative to those in ROE during 2007–2012, even after controlling for costs and customer composition effects. Moreover, during the same period, ROE producers' volume sold into NWE decreased. These findings, also corroborated by the qualitative evidence, indicated that the geographic market differentiation was strong enough that NWE and ROE be defined as separate markets within the EEA.

29 For more details on the Commission's assessment of Case M.7292—DEMB/Mondelēz, *supra* note 22, *see also* Luca Di Martile, Szabolcs Lorincz, Jean-Christophe Mauger, Mauro Sibila & Katarzyna Tosza, *Some Like It Hot!—Coffee Merger Between DEMB and Mondelēz*, Eur. Comm'n, Competition Merger Brief, 2/2015, at 12, http://ec.europa.eu/competition/publications/cmb/2015/cmb2015_002_en.pdf.

30 We will focus, for present purposes, on the aspects of the case related to single-serve coffee machines. The investigation, nevertheless, also involved an in-depth analysis of some of the multi-serve consumables markets, such as roast-and-ground (R&G) coffee, as well as the markets for filter pads and Nespresso-compatible coffee capsules. The merging firms offered commitments in the form of divesting important brands, licensing some others, and manufacturing capacity to address competition concerns in the Austrian, French, Danish and Baltic geographic markets of consumables.

31 DEMB owns the Senseo trademark, while the corresponding machines are developed, produced, and marketed by Philips, with a Partnership Agreement with DEMB. Mondelēz created and owns the Tassimo trademark and system, with Bosch producing and marketing the machines. Nestlé owns and partly markets the Nespresso and Dolce Gusto trademarks and corresponding machines, using various machine manufacturers with various degrees of independence on design and development issues.

32 The Commission defined an antitrust product market for single-serve coffee machines, and separate antitrust product markets for each machine's consumables. (The geographic scope of each of these markets was found to be national.) The Commission then identified competition concerns on some of the single-serve consumables markets (filter pads, N-capsules). These concerns, inter alia, were addressed by the commitments offered by the merging firms. *See supra* note 30.

33 A statistically significant estimation result refers to an estimation outcome that is unlikely to be due to chance or sample randomness alone. The Commission performed a series of robustness checks using various methods to calculate the statistical significance (applying the so-called robust-, cluster-robust, classic- and wild bootstrap methods of standard error calculation; the standard error is a measure of the accuracy of the estimate with higher standard error implying weaker statistical significance). The effects on Dolce Gusto were always statistically significant and stronger than those on Senseo. The effects on Senseo for some cases were statistically significant while for others non-significant. This further reinforced the conclusion that the main competitive constraint on Tassimo came from the Dolce Gusto systems.

34 First, the effect of adding one or more country-specific control variables to the regression model was tested (exchange rate, coffee market overall price index, GDP, and GDP per capita). Second, to control for the relative strength of Senseo and Dolce Gusto, additional regression models were estimated where each observation was weighted by the population-proportional installed base of the respective system. This is to account for the possibility that a given type of machine's price reacts differently to the entry event in those countries where it already has a stronger position. Third, as discussed (*supra* note 33), the calculation of statistical significance was subject to robustness checking.

INTERNATIONAL MERGER DEVELOPMENTS

Convergence and Divergence in the EU And U.S. Approaches To Document Requests In Complex Mergers

BY VANESSA TURNER AND MAX KAUFMAN

IN RECENT YEARS, THE EUROPEAN Commission's document production practices with regard to complex mergers have moved increasingly towards the Second Request procedures used by the Federal Trade Commission and the Antitrust Division of the Department of Justice, most notably in the scale and nature of the requests for documents made to parties.[1] Indeed, whereas previously the European Commission would request hundreds, more rarely thousands of documents, in recent cases there has been an increase by a factor of ten and, in some cases, of a hundred.

As a result, the document production demands in complex mergers in the European Union, which, in many cases, may also be subject to a Second Request in the United States, are becoming, at least superficially, increasingly similar in both jurisdictions. Stopping the analysis here, however, would be far too simplistic. First, this development has the potential to impact the timelines of international transactions. Second, this apparent convergence belies significant procedural and legal differences between U.S. and EU document request practices and procedures. These differences are of practical importance for companies and lawyers involved in complex mergers. They are also areas in which EU law and practice is likely to develop in the coming years, building on both the U.S. experience and the procedural law of the European Union.

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In the following sections, we examine these EU developments and compare them to U.S. practice and experience. First, we set out the procedure and process by which the EU makes document requests to parties in complex cases (Internal Document Request) and compare this with the Second Request Procedure. We then discuss points of divergence, in particular relating to EU rules on legal professional privilege, the conduct of reviews, and the limitations of the current procedural rules in relation to disclosed documents and consider the practical implications of these for merging parties. Lastly, we consider the likely areas of debate and development in EU procedural law that this convergence with the Second Request process might foreshadow.

The Internal Document Request and Second Request Procedures

The Internal Document Request Procedure. Under the EU's merger control regime, the European Union Merger Regulation (EUMR),[2] the European Commission (EC) ordinarily obtains internal documents either by way of what are known as 5(4) documents, which are provided as part of a notifying party's formal filing, or by way of requests for information. The latter can be made during pre-notification (although these do not have the same formal status as those issued post-filing), or in Phase I or Phase II of the EU merger control process.

Typically, the Internal Document Request will be made, in cases likely to go to Phase II, early in the initial part of Phase I.[3] But this is not always the case. There have been instances of complex mergers that were cleared in Phase I following a lengthy pre-notification period where the process—including both responding to the Internal Document Request and the finding of a remedy—were front-loaded to meet the Phase I timeline. These were cases where the transactions would have almost certainly been subject to a Phase II investigation had the remedy not been approved by the EC.

The EC is not limited in the number of requests for information it may make. Follow-up document requests may be made at any point during the EU merger control process.

The Internal Document Request typically will take the form of a list of questions directed to custodians identified by the EC as being likely to have the requested information (custodians having been identified through questions on the merging parties' corporate structures sent in pre-notification or very early in Phase I). The scope of the Internal Document Request may vary and, for example, relate only to documents or also include the contents of the relevant custodians' inboxes. Based on these questions, the merging parties and their advisers, will usually prepare a list of search terms and search rules (including connectors, proximity rules and, potentially, also exclusionary search terms) that, coupled with the scope of the search, will often be the subject of extensive discussion with the EC and subsequent revision. This, however, is not always the case. The EC has also sent both questions and search terms simultaneously without providing parties with the opportunity for significant discussion or revision. In other cases, the EC has requested that the parties conduct the relevant searches and then provide the EC with a list of all search terms and any other search methodology used.

The parties usually will be obliged to provide all non-privileged material responsive to the search terms (whether or not this is actually responsive to the relevant question rather than just to a search term) by the end of Phase I or the beginning of Phase II, so that the EC can draw on these materials for its Statement of Objections in complex cases (should the case not be resolved or satisfactory remedies found by that juncture). Further, in addition to a report setting out how the material was processed and searched, the EC is increasingly requiring parties to provide, alongside their submission, a log of the documents for which legal professional privilege is claimed.

Given the fixed timelines of the EU merger review process and the limited flexibility that this gives to the EC's case teams, unless the Internal Document Request is started early enough in pre-notification (and, indeed, that advisors have already laid the groundwork for the Request), this can make large scale document searches quite challenging within the available time. Moreover, in some cases, the EC has made an Internal Document Request during its review process with very short time limits; in the *Huntsman/Rockwood* case, the EC stopped the clock on the merger clearance process for over a month in light of the parties' inability to respond to a large scale Internal Document Request within a 12-day time limit.[4]

While there are strict time limits for document production because of the Phase I and Phase II time limits imposed on the EC, there is no fixed procedure for the EC's approach which, while not wholly discretionary, can vary, sometimes significantly, between cases, sectors, and even case teams. We have encountered cases in the same sector giving rise to similar issues in which one case team made a wide-ranging and significant Internal Document Request, including the contents of custodians' inboxes generating hundreds of thousands of responsive documents. The other case team's approach led to only a few hundred additional documents being disclosed due to the limited scope, numbers of custodians, and search terms used. Similarly, the questions forming the basis of the Internal Document Request tend to be driven by the facts of a particular case and can thus also vary significantly from case to case.

Second Request Procedure. By contrast, although also subject to significant case-by-case modification, both the timing and the process of the Second Request are well established, with the DOJ and FTC both providing models of the Second Request itself and the DOJ providing a Model Second Request Timing agreement.[5] At the same time, depending on the scale and scope of the request, the Second Request process is more temporally flexible and open ended, taking typically between four and seven months (although occasionally up to nine) for "substantial compliance" to be achieved before the waiting period commences.

Following the issuance of the Second Request, the agency will often require parties to agree to a so-called "timing agreement" to allow the agency additional time to review the transaction in exchange for the agency's continued engagement with the parties and certain other limitations to the Second Request (such as search terms and custodians). The agreement may also address the timing for production of documents and interrogatory responses, as well as the schedule for depositions and white papers, may require the parties to give advance notice of substantial compliance and even address jurisdictional and procedural issues for trial. In addition to any constraints imposed by the timing agreement, the timing of substantial compliance will depend on other factors, such as the number of product or geographic markets involved, the complexity of the issues, and the number of custodians who need to be searched.

Merging parties and their advisers will need to bear in mind the contrasting approaches of the EU and U.S. in relation to the timing and scope of a potential Internal Document Request when planning their clearance processes in transatlantic and other international mergers. It would also be helpful for the EC to consider whether the more established U.S. procedures can be built into the EUMR process to complement the increasing scale and scope of the EC's Internal Document Request despite the stricter EUMR time limits.

Points of Divergence: Privilege and the Conduct of Reviews in Second Requests and Internal Document Requests

Despite increasing convergence between certain procedural aspects of EU and U.S. merger control, there remain important points of difference. This section will focus on some of the most marked and potentially significant issues in relation to the EU rules on legal professional privilege and in the conduct of the search and review process entailed in responding to these Requests.

Privilege in Internal Document Requests. In broad terms, the accepted grounds of legal professional privilege under EU law (and thus far accepted by the EC in Internal Document Requests as being sufficient for withholding documents on grounds of privilege) are as follows:

- Written communications with an independent (i.e., not in-house), EU-qualified lawyer made for the purposes of and in the interests of the exercise of the parties' rights of defense.[6] This privilege can extend to earlier written communications between a lawyer and her client that relate to the subject matter of the procedure;[7]
- Internal notes circulated within a company that are confined to reporting the text or the content of communica-

tions with an independent EU-qualified lawyer which contains legal advice;[8] and,

- Working documents and summaries prepared by the client even if not exchanged with an independent EU-qualified lawyer or not created for the purposes of being sent to an EU-qualified lawyer, provided they were prepared for the purposes of seeking legal advice from such a lawyer (although the fact that a document has been discussed with a lawyer is not sufficient to generate legal professional privilege).[9]

In the context of international mergers, where parties are often not EU-based and may not have solely consulted EU-qualified lawyers, these rules are potentially problematic. This issue has been amplified by document requests in which, given the volume of documents in question, the numbers of documents containing legal advice which may not fit strictly within the categories of legal professional privilege as set out above, can run to the hundreds if not thousands.

U.S. law takes a broader approach to the protection of privilege than EU law. For example, it is significant that under U.S. law (and unlike EU law), the attorney-client privilege extends to communications between in-house counsel and staff of the company and may also extend to communications among counsel of the two parties, pursuant to a common interest privilege. Moreover, unlike the position under EU law, attorney-client privilege is recognized regardless of where an attorney is qualified to practice. Although this does tend to result in significantly larger volumes of documents in the privilege review process in the U.S. than in the EU, it also arguably ensures that legal advice given in the context of a merger is treated more consistently, and gives the parties greater comfort and certainty on the question of the privileged status of the advice they have received in relation to the merger transaction. Having set out the strict legal position, it should be noted, however, that to date the EC has, in the authors' view, generally taken a pragmatic approach and in practice has not challenged U.S. or other non-EU lawyers' advice as not being privileged in EU merger control proceedings. The EC has, however, requested in-house lawyers' documents in non-merger antitrust cases.

Further potential complications arise from these differences in approach to privilege as a result of the bilateral agreements between the EC and non-EU regulators (most notably the Department of Justice and Federal Trade Commission) to share information in relation to a particular transaction under investigation (subject to the granting of a waiver by the parties). Parties may have to conduct additional reviews to ensure that material which would be covered by privilege in one jurisdiction is not accidentally obtained by authorities in that jurisdiction from the EC as a result of the differences between approaches to privilege.

This may also be a point of some concern for the EC as, under the model waiver permitting the EC to share information with non-EU regulators, the European Union is under an obligation not to disclose information with respect to which the parties assert privilege under the rules of the non-EU jurisdiction.[10] The U.S. agencies have, in their practices, recognized this risk, and have built into their model confidentiality waiver (to facilitate the exchange of confidential information between U.S. and non-U.S. competition authorities), an explicit provision that the FTC and DOJ will not seek information that is protected by U.S. legal privilege. If information privileged under U.S. law is received by the U.S. agencies from a non-U.S. competition authority, the agencies will treat that information as inadvertently produced privileged information. Indeed, consistent more generally with the approach of the U.S. agencies to inadvertently produced privileged information (described below), that material will also not be produced to non-U.S. authorities or, if already produced, the agencies will request its return.[11]

The issue of EU privilege is also likely to give rise to practical issues where the EC is now frequently requiring parties not only to conduct a relatively complex privilege review, but also to provide privilege logs giving the basic information about allegedly privileged documents, including the grounds of privilege claimed. This follows the approach suggested by the General Court in the antitrust context in *Akzo*[12] and appears to be in response to recent cases where the EC was concerned that materials that may not have been privileged were incorrectly treated as privileged by notifying parties. While most, if not all, Second Requests similarly require production of a privilege log, to address the same concerns as those raised by the EC, the parties may have greater flexibility and ability to negotiate the content and timing of the privilege logs.

Although understandable given the EC's concern in relation to the withholding of non-privileged material, this new approach adds to the burden put on parties in collecting and reviewing responsive material, particularly for Internal Document Requests that are broad in scope, requiring production of thousands or even tens or hundreds of thousands of documents in a very short time. To conduct the necessary privilege review in addition to the normal substantive reviews, large review teams have, in a similar manner to the process in a U.S. Second Request, been required to meet the EC's ambitious deadlines. However, unlike a U.S. Second Request process, we understand that the EC has yet to accept the use of "Technology-Assisted Review" in merger control, which is increasingly being accepted by the U.S. agencies.

Technology-Assisted Review in the United States and the European Union. Technology-Assisted Review entails use of a computer software algorithm to search a party's electronic records to identify documents that are substantively relevant and a subset of those documents that are privileged. Such review typically is based on a predictive coding protocol agreed upon with the agency conducting the merger review. The protocol may include the definition of the data, sample size, batches, control set, reviewers, confidence level, and margin of error for a population of documents (i.e., documents from selected custodians, for a specified time period,

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and in some cases, which are identified by way of specified electronic keyword searches). A proprietary software system is "trained" using a "seed set" to determine privilege or relevance based on the review of a sample of the total document population by a human reviewer, usually a lawyer involved in the matter. The output of this process can then be put through quality control exercises based on random sampling and reviewed by lawyers to bring the dataset within the agreed tolerances in the predictive coding protocol.

Since 2012, the DOJ has made provision for the use of Technology-Assisted Review in its Model Second Request, recognizing that it both lowers costs for parties and reduces the size of the document production received by the DOJ, while still providing the agencies with a comprehensive set of documents to fully and fairly assess the competitive effects of the transaction. Similarly, in the FTC's Model Second Request issued in August 2015, the FTC made provision for the use of Technology-Assisted Review by disclosing parties. In the case of the DOJ, between 2012 and 2014, it has negotiated around a dozen Technology-Assisted Review protocols with parties, many of them in merger investigations.[13]

The DOJ has expressed some concerns about combining Technology-Assisted Review with search terms (indeed, in our experience, the DOJ has a strong preference for parties to use one or the other method, but not both) and also with foreign language or certain other types of materials (such as databases, Internet material, spreadsheets, images, audio or video files). Nonetheless, in the DOJ's view, the document sets produced via Technology-Assisted Reviews have been generally smaller and more responsive, with substantial benefits for both the DOJ and the parties.[14] The DOJ has noted that producing parties still prefer to use manual reviewers, particularly for privilege reviews, despite concerns about accuracy and consistency. Nonetheless, Technology-Assisted Review appears to be one way in which timing challenges posed by the Internal Document Request could be met.

Outside the antitrust field, courts in several EU Member States have accepted Technology-Assisted Review as an appropriate means of conducting disclosure exercises in litigation matters. In 2016 the English High Court approved the use of Technology-Assisted Review in *Pyrrho Investments v. MWB Property Ltd & Ors*,[15] with the judge noting that there was no evidence that Technology-Assisted Review leads to less accurate disclosure (adding that there was, in fact, some evidence to the contrary), that its use will lead to greater consistency, and that in a case, where the number of documents was large (over 3 million), the cost of manual search would have been enormous by comparison with Technology-Assisted Review. This decision relied, in part, on a similar finding by the Irish High Court in *Irish Bank Resolution Corporation Ltd & Ors v. Quinn & Ors*,[16] where Mr. Justice Fullam noted that studies indicated that Technology-Assisted Review was more effective than manual review and, even if only as effective as manual review, was still more expeditious and economical.

Developments in the United States and, indeed, in a non-antitrust context in EU Member States point to one way in which the EC could consider squaring the circle of increasing the scope and scale of the Internal Document Review in a manner similar to the U.S. Second Request without affecting the long-established timeline under the EUMR. In the meantime, parties and their advisers need to be aware of and take into account the differences in approach across jurisdictions.

Claw-back of Inadvertently Disclosed Privileged Material. Whether or not Technology-Assisted Review is used to provide responsive materials to the EC's Internal Document Requests in the future, there remains the risk that privileged material may be inadvertently disclosed to the EC by parties. In the U.S. context, this does not give rise to concerns because of the ability of a disclosing party to "claw-back" any inadvertently disclosed privileged material from the DOJ and the FTC. Consistent with Federal Rule of Civil Procedure 26(5)(B), it is the DOJ's and FTC's policy to either sequester or return any inadvertently privileged material disclosed by a party.[17]

By contrast, the European Union does not have a similar rule for inadvertently privileged material disclosed in the context of proceedings under the EUMR. Where such disclosure happens it is at the discretion of the case team or the Hearing Officer as to whether such materials are returned to the parties or whether the EC considers privilege to have been waived in such materials.[18] The former has, to the knowledge of the authors, been the approach taken by the EC. However, this does not preclude the latter approach being taken in future cases. This has been a point of concern for disclosing parties in proceedings under the EUMR. To avoid any uncertainty in this regard, particularly given the increasing numbers of documents being produced and the consequent increased risk of inadvertent disclosure, the public adoption of a similar rule or best practice could be a straightforward means for the EC to solve this issue.

Potential Issues Under EU Procedural Law with Internal Document Requests

The EC's evolving approach to the Internal Document Request has further potential implications for parties and their advisers in transatlantic mergers, in particular in relation to the provision of potentially misleading or incomplete information and parties' rights of defense.

Provision of Misleading or Incomplete Information. Given the scale and scope of the Internal Document Requests that the EC appears increasingly to send to parties, there is a concomitantly increased risk that, in the time available, incomplete or inconsistent documents may be submitted to the EC's case team. In the former situation, as has happened in several cases, the EC may consider that the submission is incomplete. This may be due to a party's data retention policies or the document/e-mail management approach of particular custodians. Nonetheless, if the EC is not satisfied with a party's explanation of why the information is not complete, under Article 11(3) EUMR, it has the power to stop-the-clock on the merger clearance process, thereby extending the clearance deadline if the information is necessary and has not been provided. The EC will not restart the clock until the receipt of complete information, which can cause significant delays to merger proceedings.

Where the EC is concerned that the information supplied by a party is inconsistent with the contents of its notification to the extent that the latter was misleading, the EC, under Article 14 EUMR, has the power to impose fines of up to 1 per cent of the aggregate global turnover of the party concerned if it has at least negligently provided incorrect, misleading, or incomplete information in a notification (or, indeed, has not provided the information within the required time limit).

This issue arose in *Munksjö/Ahlstrom* where, following the EC's approval of the merger in 2013, the EC opened a proceeding in May 2014 due to differences between information on the relevant market/market shares in the original notification and in internal documents submitted later.[19] In that case the investigation was closed without further sanction, but it points to a real risk where increasingly large document sets are being disclosed to respond to the EC's Internal Document Requests.

Companies can and should take steps to ensure that such situations do not occur by improving document management systems well in advance of important merger transactions (particularly where a company is involved in many mergers), as the EC's concerns appear likely to grow in tandem with the size of the Internal Document Request. For parties, the risk of the EC using its powers to stop-the-clock under Article 11(3) EUMR should not be discounted. Indeed, in complex mergers in which an Internal Document Request is likely, that risk may need to be factored into the overall timeline for the transaction to minimise the potential negative impact of such an event.

More generally, parties should consider—if they are concerned that there may be significant inconsistencies between, for example, the board level materials likely to accompany a notification and internal materials found in the course of the Internal Document Request review process—whether it is worthwhile to conduct a pre-notification search and review. This should identify inconsistent materials for which the party may need to provide explanations. To do so early in the process would furthermore avoid the post-notification time pressures and potential clearance delays.

Rights of Defense. The EC's approach to Internal Document Requests in more recent times also has the capacity to give rise to concerns in relation to a party's rights of defense, which may not arise in quite the same way under U.S. law. (This may be attributable, as some have argued, to the differences between the European system, where the EC is both prosecutor and judge, and the U.S. system, where the agencies are required to persuade a court to enjoin a transaction from being completed).[20]

The question of rights of defense has not, it appears, been at issue in previous cases in relation to the Internal Document Request. However, in bringing the system under the EUMR closer to both the U.S. Second Request and, arguably, to the requests for documents made to parties in EU non-merger antitrust proceedings, there seems an increased likelihood that large-scale Internal Document Requests could give rise to questions in relation to the provision of reasons for seeking such evidence, the proportionality of doing so, and the fair and objective treatment of such evidence:

- Given the scale and scope of Internal Document Requests being made by the EC, recent case law on requests for information in the context of non-merger antitrust proceedings indicates that the EC may be required to give a fuller statement of reasons in requesting such information from parties. At present, in the authors' experience, the reasons given are brief and may fall foul of the requirement, as described in Advocate-General Wahl's opinion in *Schwenk Zement KG v. European Commission*, that measures adopted by the EC "must disclose clearly and unequivocally the reasoning followed by the institution which adopted that measure in a way that enables the persons concerned to ascertain the reasons for it and enables the EU Courts to review the legality of those reasons."[21] In *Schwenk* (which related to antitrust proceedings under Article 101 Treaty on the Functioning of the European Union (TFEU) on anticompetitive agreements between undertakings), the EC sent a request for information to a third party (Schwenk Zement) which Advocate-General Wahl described as having questions which were "extraordinarily numerous" covering "very diverse types of information." The Court of Justice of the European Union (CJEU), following Advocate-General Wahl, held that the request was inadequately reasoned, and the relevant decision by the EC was annulled. Given the similarity between Article 18(3) of Regulation 1/2003 (which applies to requests for information sent in matters concerning Articles 101 and 102 TFEU) and Article 11(3) EUMR (which applies to requests for information sent in merger cases), it is likely that the CJEU's decision could also be held to apply to Internal Document Requests, giving rise to a potential obligation on the EC to sufficiently explain its reasoning in sending the request.
- The Internal Document Request may also give rise to

questions about the proportionality of the EC's decision. As per the terms of Article 11(3) EUMR, such a request must, of course, be necessary. Given the margin of investigative discretion afforded to the EC, it is not likely that necessity would be in issue, but it cannot be excluded that an unduly broadly scoped or large Internal Document Request could give rise to questions on this point. A request must, additionally, be proportionate, and this is likely to become an issue where the requested information is difficult to obtain, particularly because of its volume. As the General Court (at the time, the Court of First Instance) stated in *SEP v. Commission* (in the context of antitrust proceedings):

> It is not enough for the information requested to be connected with the subject matter of the inquiry. What is also necessary is that an obligation imposed on an undertaking to supply an item of information should not constitute a burden on that undertaking which is disproportionate to the requirements of the inquiry.[22]

Given that the principle of proportionality underpins all investigations undertaken by the EC, it is suggested that this principle is just as readily applicable to proceedings under the EUMR and may thus become more significant for future Internal Document Requests.

■ In reviewing the evidence, particularly given the large number of documents likely to be disclosed in responding to an Internal Document Request, the EC is under an obligation to treat the evidence provided objectively and fairly. This means, in essence, that, although not tasked with rooting out all exculpatory evidence on behalf of a party, the EC should investigate all the facts and circumstances of the evidence provided, whether inculpatory or exculpatory.[23] This follows from the approach taken by the General Court (at the time, the Court of First Instance) in *Airtours v. Commission*.[24] In that case, the Court held that the EC's findings in its merger decision were based on an incomplete and incorrect assessment of the material submitted, both in misreading the particular piece of evidence at issue and in not taking the exculpatory evidence of the parties into account. The Court's guidance may, in the authors' experience, create some tension with the approach taken by the EC where there has been a tendency to primarily use the inculpatory material found, following the EC's review of the response to the Internal Document Request, to support the theory of harm in relation to a particular transaction.[25]

While the above are all important issues of principle, any disputes between notifying parties and the EC are very unlikely to be resolved by the European Courts within the strict EUMR clearance time limits (which may incentivize parties in many cases to accept burdensome or disproportionate requests rather than seeking to challenge them). Legal challenges on the grounds of these principles are thus not likely to be effective in the actual clearance process such that parties, for practical purposes, will need to find a way through these issues in cooperation with the EC.

Conclusion

Based on current trends, Internal Document Requests will become an increasingly important part of the EU's investigatory process in complex mergers and thus a potential source of delay in the clearance process. Advisers in international mergers will consequently need to take into account the practical, timing, and legal implications discussed above.

At the same time, the EC could usefully seek to ensure greater methodological convergence with the DOJ and the FTC, drawing on the experience of the Second Request process in the United States, while also considering the implications of EU procedural law for such requests to avoid increasing legal and procedural issues for the EC and for notifying parties. Both merging parties and the EC are, in many senses, likely to be engaged in a very interesting process over the coming years to discover best practices for Internal Document Requests. ■

1 The EC also increasingly requests significant volumes of economic data in complex merger cases. While this may also have implications for merging parties, it will not be discussed further in this article.

2 Council Regulation (EC) No. 139/2004, 2004 O.J. (L 24) (on the control of concentrations between undertakings).

3 Phase I is comparable to the initial waiting period under the HSR and lasts 25 working days unless commitments are offered, in which case it is extended to 35 working days. Phase II is comparable to the Second Request stage under the HSR, and the EUMR provides for a standard investigation period of 90 days. If parties offer commitments more than 55 days from the start of Phase II, this will extend the investigation period to 105 working days. The parties (within the first 15 days of Phase II) or, at any time, the EC (with the consent of the parties) may also extend the investigation period by 20 working days.

4 Case M.7061—Huntsman Corporation/Equity Interests Held by Rockwood Holdings, Comm'n Decision, ¶ 16 (Sept. 10, 2014) (summary at 2015 O.J. (C 67) 7), http://ec.europa.eu/competition/mergers/cases/decisions/m7061_20140910_20600_4133655_EN.pdf.

5 For a DOJ Model Second Request Process and Timing Agreement, see U.S. Dep't of Justice *Merger Review Process Initiative—Model PTA Letter*, https://www.justice.gov/atr/merger-review-process-initiative-model-pta-letter (updated June 25, 2015). For an FTC Model Second Request, see FTC Premerger Notification Office, *Model Request for Additional Information and Documentary Material (Second Request)* (2010), https://www.ftc.gov/sites/default/files/attachments/premerger-introductory-guides/guide3.pdf.

6 Case 155/79, AM&S Europe Ltd. v. Comm'n, 1982 E.C.R. 1575, ¶ 21 (Eur. Ct. Justice).

7 *Id.* ¶ 23; Joined Cases T-125/03 & T-253/03, Akzo Nobel Chems. Ltd v. Comm'n, 2007 E.C.R. II-3523, ¶ 117 (Ct. First Instance).

8 Case T-30/89, Hilti Aktiengesellschaft v. Comm'n, 1990 E.C.R. II-163, ¶ 18 (Ct. First Instance).

9 *Akzo*, 2007 E.C.R. II-3523, ¶ 123.

10 *See* European Comm'n, Confidentiality Waiver, ¶ 6 (5), http://ec.europa.eu/competition/mergers/legislation/npwaivers.pdf.

11 *See* Federal Trade Comm'n, Model Waiver of Confidentiality [For use in civil matters involving non-U.S. competition authorities], https://www.ftc.gov/system/files/attachments/international-waivers-confidentiality-ftc-antitrust-investigations/model_waiver_of_confidentiality.pdf.

12 *Akzo*, 2007 E.C.R. II-3523, ¶ 80.

[13] *See* Tracy Greer, Senior Litigation Counsel E-Discovery, U.S. Dep't of Justice Antitrust Div., *Technology-Assisted Review and Other Discovery Initiatives at the Antitrust Division* at 2 (Mar. 26, 2014), https://www.justice.gov/sites/default/files/atr/legacy/2014/03/27/304722.pdf.

[14] *Id.* at 5.

[15] [2016] EWHC (Ch) 256, *followed in* David Brown v. BCA Trading Ltd & Ors [2016] EWHC (Ch) 1464.

[16] [2015] IEHC 175.

[17] *See* Federal Trade Comm'n, Statement of the Federal Trade Commission's Bureau of Competition on Guidelines for Merger Investigations (Dec. 22, 2002), https://www.ftc.gov/system/files/documents/public_events/114015/ftc_statement_on_guidelines_for_merger_investigations_12-22-02_2.pdf; Greer, *supra* note 13, at 5.

[18] The Hearing Officer is the EC official mandated to be the arbiter of any issue in relation to the procedural rights of the parties during the EC's review of a transaction.

[19] Press Release, European Comm'n, Mergers: Commission Sends Warning to Munksjö and Ahlstrom for Providing Misleading Information in a Merger Case (Feb. 25, 2014) (IP/14/189).

[20] *See* Donna E. Patterson & Carl Shapiro, *Transatlantic Divergence in GE/Honeywell: Causes and Lessons*, ANTITRUST, Fall 2001, at 18.

[21] Case C-248/14 P, Schwenk Zement KG v. Comm'n, Opinion of Advocate General Wahl, ¶ 47 (Eur. Ct. Justice Oct. 15, 2015), http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:62014CC0248&qid=1475261924028&from=EN (citing Case C?37/13, Nexans and Nexans France v. Comm'n, ECLI:EU:C:2014:2030, ¶¶ 31, 32 (Eur. Ct. Justice June 24, 2014)).

[22] Case T-39/90, Samenwerkende Elektriciteits-produktiebedrijven NV v. Comm'n, 1991 E.C.R. II-1497, ¶ 51 (Ct. First Instance).

[23] *See* Nicholas Levy, *Evidentiary Issues in EU Merger Control*, *in* INTERNATIONAL ANTITRUST LAW & POLICY: FORDHAM COMPETITION LAW 2008, at 81, 86 (Barry E. Hawk ed., 2009) (citing, in the context of Article 102, Emil Paulis, *The Burden of Proof in Article 82 Cases*, *in* INTERNATIONAL ANTITRUST LAW & POLICY: FORDHAM COMPETITION LAW 2006, at 469 (Barry E. Hawk ed., 2007)).

[24] Case T-342/99, Airtours plc v. Comm'n, 2002 E.C.R. II-2585, ¶¶ 127–133 (Ct. First Instance).

[25] It is not clear whether the EC always has the resources to fully review increasingly large volumes of materials. It should be noted that, due to the differences between the EU and U.S. merger clearance process, the selective use of inculpatory evidence is not such a significant concern for parties in the U.S., where, even if the agencies take this approach to inculpatory evidence, they will still have to face a rebuttal case in court on a preliminary injunction motion.

Sending the Wrong Message? Antitrust Liability for Signaling

BY PAULA W. RENDER, J. BRUCE MCDONALD, AND THOMAS YORK

ANTITRUST CHALLENGES TO invitations to collude and other "signaling" communications are increasing. In the last several years, both U.S. antitrust agencies have launched extensive investigations and the Federal Trade Commission has obtained consent decrees in multiple actions arising from unilateral statements by business executives. The private bar is close behind, having filed two dozen lawsuits in just the last year alleging the major airlines have violated the antitrust laws through signaling.

This article reviews the use of antitrust law to address conduct that does not necessarily seem at first glance to implicate the antitrust laws. Courts have been disciplined in refusing to find that a unilateral statement by a competitor, without more, can provide the basis for an "agreement" under Sherman Act Section 1. Courts have, almost always, rejected claims that signaling can support a monopolization claim under Sherman Act Section 2. And the federal courts have not substantiated the FTC's challenge to signaling under FTC Act Section 5. Despite this questionable statutory authority, the Department of Justice and FTC continue to pursue this unilateral conduct.

The absence of clear authority, the acknowledged ambiguity of the conduct in question, and the lack of competitive harm suggest the need to consider an alternative to the current enforcement program. The agencies' enforcement approach raises two questions for debate: Is signaling unlawful under the antitrust laws? Should it be?

What Is a Signal?

We define signaling as a firm's unilateral statement on competitive topics, likely to be heard by a competitor, but without an agreement. Signaling may include invitations to collude or just public statements that do not seek explicit assent. While the FTC has for at least 30 years taken the position that signaling is unlawful, the agencies recently have stepped up enforcement efforts. Antitrust enforcement actions targeted at signaling conduct historically were limited to "invitations to collude," whereby one firm solicits a horizontal competitor to enter into anticompetitive coordination. Recent investigations and enforcement efforts have not been so limited and have targeted unilateral disclosures of competitive information that could not be characterized as the solicitation of an agreement. We consider both forms of conduct to be signaling for the purpose of this article.

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Signaling is not defined in the antitrust statutes or, given the limited case law, by the courts. However, one might get a consensus among antitrust advisors that a signal is defined as:

(1) a unilateral statement,
(2) likely to be heard by a competitor,
(3) that communicates intended or proposed pricing, output, customer terms, or other dimensions of competition.

Each of these elements is important to distinguish signaling from other types of conduct within the antitrust mainstream. First, a signal is unilateral. Bilateral "signals" between firms can be analyzed as a potential Section 1 agreement. Second, a signal must be heard by a competitor for there to be any potential competitive harm, whether communicated privately (e.g., by telephone or email) or publicly (e.g., investor presentations). Third, a signal must contain some information that, when received by a competitor, potentially could lessen competition between the firms.

This definition of signaling captures all types of unilateral statements that have been challenged by the antitrust agencies and private plaintiffs. For example, a signal can include:

- A private invitation to collude by one competitor to another via telephone call.[1]
- A public invitation to coordinate on an earnings call.[2]
- A complaint about prices to a competitor/distributor.[3]
- Letters to trade publications regarding future pricing.[4]

Antitrust enforcers today might challenge any of these types of signaling conduct, even if unreciprocated. All raise the same risk that the signal will lead to coordination or will otherwise facilitate a Section 1 "agreement." But even among invitations to collude—seemingly the category of signaling conduct most likely to give rise to anticompetitive harm—such communications can also involve legitimate business communications to customers or investors, even if they might also be suspected signals to competitors. Therefore, the entire range of signaling conduct can be analyzed together, even though there may be qualitative differences between a bare invitation to raise prices and an analyst discussion on forward-looking production plans.

Potential Antitrust Liability for Signaling

U.S. antitrust enforcers have tried many statutory vehicles to combat signaling. The DOJ has challenged signaling under

Sections 1 and 2 of the Sherman Act. The FTC has pursued signaling under Section 5 of the FTC Act, going beyond the reach of the Sherman Act. Private plaintiffs have relied on Sections 1 and 2 to seek damages. We review each statutory theory below.

Signaling Under Sherman Act § 1. The DOJ most frequently has pursued signaling conduct under Section 1, which prohibits "[e]very contract, combination . . . or conspiracy" in unreasonable restraint of trade.[5] To prove a Section 1 violation, a plaintiff must show the existence of an "agreement" that unreasonably restrains trade and that affects interstate commerce.[6] Like any contract, proving a Section 1 "agreement" often requires showing both an "offer" and "acceptance" by a competitor. In a typical Section 1 signaling case, a plaintiff uses the "signal" as evidence an offer was made, and then relies upon subsequent statements or conduct by a competitor to show "acceptance" of the offer.[7]

A Section 1 challenge to signaling presents two hurdles for the plaintiff. The first is determining that a public statement was an actual offer to enter into an anticompetitive agreement. Almost all companies make public statements or engage in some public chatter that likely is reviewed by competitors, whether at trade association meetings, in investor presentations, and even through pricing activities. Most always these statements are part of the company's legitimate, ordinary business activities. Companies describe their capabilities to customers, announce price changes, and inform investors of plans and financial results.[8] To prevail on a Section 1 claim, the plaintiff and later the factfinder must sift through this overwhelming volume of routine communications to discern a clear "signal" that cannot be reconciled with legitimate business conduct.

Several courts have dismissed Section 1 claims where the alleged "signaling" was ambiguous. For example, in *Hall v. United Air Lines*, a putative class of travel agent plaintiffs alleged that several U.S. airlines conspired to cut or eliminate travel agent commissions through signaling.[9] Plaintiffs pointed to a series of trade press articles, trade interviews, and letters to trade publications as signals among airlines to eliminate commissions. The court rejected the allegation these statements were "signals" sufficient to support a claim under Section 1, noting the airlines had legitimate purposes for the communications that were "sufficient to rebut any implication that the letters were an attempt to communicate with competitors."[10] Without an "offer," there could be no Section 1 agreement.

The second hurdle for Section 1 plaintiffs is finding evidence of a competitor's *acceptance*. If a competitor does not respond to a signal, there is no Section 1 liability because there is no "agreement."[11] For example, in *United States v. American Airlines*,[12] a federal district court rejected the DOJ's attempt to hold American Airlines liable under Section 1 for unilateral statements by its then-CEO. In what today would be labeled an "invitation to collude," the CEO suggested to his counterpart at Braniff Airlines that both carriers should raise prices by 20 percent. Braniff's president not only declined, but reported the conversation to the DOJ. In the DOJ challenge to this conduct, under both Sections 1 and 2, the district court rejected the Section 1 claim because Section 1 only prohibits actual *agreements* among competitors; "it does not reach attempts."[13]

Most signals are less explicit. For example, the *Hall* plaintiffs alleged "signals" made in news interviews and correspondence with trade publications.[14] The DOJ's ongoing airline investigation apparently was triggered by executives' public statements on "capacity discipline."[15] In such cases, it is hard to determine with confidence that there was a signal or offer or to discern whether recipients "accepted" a signaled offer or just made parallel actions backed by independent business justifications. As the Supreme Court has recognized, leader/follower behavior and "conscious parallelism" are bona fide competitive interaction and do not alone violate Section 1.[16] Showing "acceptance" to a signal requires something more than similar conduct, it requires showing conduct that cannot be justified or explained as independent.[17]

The district court in *In re Delta/AirTran Baggage Fee Antitrust Litigation* struggled with these problems in deciding the defendant airlines' motion to dismiss.[18] The putative class of passenger plaintiffs claimed Delta and AirTran conspired, through public signals on earnings calls and at industry conferences, to implement a first-bag fee and reduce capacity on routes in and out of Hartsfield-Jackson Atlanta International Airport. While the court declined to dismiss the plaintiffs' Section 1 claims, it noted the difficulties these plaintiffs will face in proving an agreement due to Delta's "potentially legitimate and lawful justifications" for imposing a first-bag fee following its merger with Northwest Airlines, which already had implemented a fee.[19] The court also noted that the airlines may have cut capacity due to the "uncertain economic climate" in 2008 and not because of any anticompetitive motivation, which would "provide Defendants a viable defense" to plaintiffs' claims.[20] Thus, even if the plaintiffs could show a signal, the defendants potentially could escape liability if they can demonstrate legitimate business justifications for their subsequent behavior.

These two critical issues demonstrate that Section 1 is ill-suited for asserting antitrust liability based upon unilateral signaling conduct. Even if there is an explicit "offer" via signaling conduct, there can be no Section 1 liability if a competitor does not "accept." Section 1 does not prohibit unilateral behavior, so the unilateral act of sending a signal cannot itself violate Section 1.

Signaling Under Sherman Act § 2. Plaintiffs and the antitrust enforcement agencies also have challenged signaling conduct under Section 2, which prohibits the acquisition and maintenance of monopoly power by anticompetitive conduct, or the dangerous probability of doing so for an attempted monopolization claim.[21] Unlike Section 1, a Section 2 claim does not require a plaintiff to prove an "agreement" to establish liability.

The DOJ pursued a Section 2 theory for unilateral signaling in the American-Braniff case mentioned above.[22] At the time that American's CEO made his call to Braniff's CEO, these were the two largest airlines at Dallas/Fort Worth airport. On the call, American's CEO suggested that the carriers both raise prices by 20 percent, citing potential entry by Delta.[23]

The district court dismissed the DOJ's Section 2 theory,[24] but the Fifth Circuit found the invitation could violate Section 2.[25] The court noted that American and Braniff jointly had a high share in a market with high entry barriers and that the two CEOs had the power to implement the proposed price-fixing plan, thus creating a dangerous probability it would have been successful had Braniff agreed.[26] Remanded to the district court, the case settled before a court could determine whether a Section 2 violation actually had occurred.

The American-Braniff case is the exception, for obvious reasons. First, Section 2 requires that the defendant have at the time or will gain monopoly power as a result of the conduct at issue (or that there is a dangerous probability the conduct will cause the defendant to acquire monopoly power).[27] Few firms actually have a monopoly, so demonstrating monopoly power is difficult. The allegation that the defendant would have benefited from signaling rivals suggests it in fact could not control prices or exclude competitors. The failure to establish monopoly power condemns many Section 2 cases.[28]

To address this problem, plaintiffs sometimes have used a "shared monopoly" or "joint monopolization" theory, arguing that multiple competitors that collectively possess market power can be held liable for joint monopolization. This was the DOJ's approach in the American-Braniff case. But the vast majority of courts have rejected "joint monopolization" on the grounds that collective action is governed by Section 1 and thus Section 2 is meant only to capture unilateral conduct.[29] While the American-Braniff case may technically remain good law, it is unclear whether even the Fifth Circuit would follow it today.

Second, even if a court accepted a joint monopolization theory, a plaintiff would have to show how competitor signaling resulted in the acquisition or maintenance of monopoly power. If anything, a monopolist's raising prices should invite entry to undercut supracompetitive pricing, not strengthen the monopoly power. Had Braniff agreed to increase prices, it is hard to imagine that somehow would enhance an American-Braniff joint monopoly, much less exclude rivals.[30]

These deficiencies, coupled with private plaintiffs' lack of success in pursuing Section 2 claims for signaling, suggest Section 2 is poorly suited to challenge signaling conduct. In this light, the American-Braniff case is best viewed as a historical anomaly. Since that decision in 1984, neither the DOJ nor the FTC has brought a signaling challenge under Section 2.

The Federal Trade Commission has also challenged signaling under Section 5 of the FTC Act, which prohibits "unfair methods of competition." While the scope of the FTC Act is subject to debate, the FTC repeatedly has used Section 5 to address signaling.

Signaling Under FTC Act § 5. The Federal Trade Commission has also challenged signaling under Section 5 of the FTC Act, which prohibits "unfair methods of competition."[31] While the scope of the FTC Act is subject to debate, the FTC repeatedly has used Section 5 to address signaling.

The FTC first challenged signaling under Section 5 in *E.I. du Pont de Nemours & Co. v. FTC*, alleging four chemical companies each adopted practices to signal pricing to each other, leading to sales at uniform prices. The FTC alleged the chemical companies used press releases to announce price changes, giving greater advance notice of price increases than required by contract, and employed "most favored nation" clauses for more pricing uniformity.[32] In its administrative proceedings, the FTC concluded that the cumulative effects of these practices substantially lessened competition by facilitating "price parallelism" at prices higher than might have otherwise existed, despite no evidence of tacit or express collusion.[33] On appeal, the Second Circuit vacated the FTC's order, finding that Section 5 requires at least some "indicia of oppressiveness," such as evidence of anticompetitive intent or the absence of an independent, legitimate business reason for the conduct.[34] As each of the chemical companies provided legitimate justifications for the alleged signaling and the FTC otherwise failed to prove collusion, the Second Circuit vacated the FTC's order.

More recently, the FTC has settled a number of other signaling cases through consent decrees. For example, in *Valassis Communications*, the FTC claimed Valassis signaled to its largest competitor in freestanding newspaper inserts through quarterly analyst calls. The FTC cited statements by Valassis's CEO that it would "submit bids at a level substantially above current prices," "seek to retain its current share . . . but not to encroach upon [its competitor]'s position," and "monitor [its competitor]'s response to this overture."[35] To settle the FTC charges, Valassis agreed to refrain from similar unilateral, public statements.[36]

The FTC challenged similar statements in *U-Haul International*. There, U-Haul's CEO told analysts that it was "exercis[ing] price leadership" by raising rates and would maintain the higher rates so long as its competitor, Budget, did not respond by price cutting.[37] To settle the FTC's Section 5 claims, U-Haul also agreed to refrain from colluding or inviting collusion.[38] The FTC has settled through consent decrees a number of other cases alleging direct invitations to collude in the last few years, including *Drug Testing Compliance Group*,[39] *Step N Grip*,[40] and *Nationwide Barcode*.[41]

Most recently, the FTC challenged a signaling case in which the "signal" was not as explicit. In *Fortiline*, a pipe manufacturer using a dual distribution model complained to a distributor-competitor after that firm reduced its prices significantly. Fortiline called the behavior "irrational" and suggested that the distributor-competitor's approach would lower the prices Fortiline could charge.[42] The Commission claimed these communications amounted to signaling in violation of Section 5, though one Commissioner dissented on the grounds that the alleged "signal" was ambiguous.[43]

These cases are instructive. First, it is notable that the FTC has not yet convinced an Article III court that signaling constitutes a Section 5 violation, instead relying on consent decrees. In one of the few cases to consider the reach of Section 5, the Ninth Circuit in *Boise Cascade Corp. v. FTC* held that the FTC must show "either collusion or actual effect on competition" to support a Section 5 claim.[44] The FTC itself applies the same principle in its enforcement of Section 5.[45] By definition, unilateral signaling does not have an effect on competition, because it does not result in a Section 1 agreement. It then is not surprising that the only court that considered a Section 5 challenge to signaling rejected it.[46] Since unilateral signaling is not unlawful under Sections 1 or 2 of the Sherman Act, there is a real question whether Congress authorized Section 5 to reach that far.

Second, assuming that signaling conduct can in fact violate Section 5, in each case the FTC still should have to prove that a particular "signal" did not have independent business justification.[47] For example, the *du Pont* court rejected the FTC's Section 5 claim on the grounds that the defendants showed legitimate business reasons, including customer demand, for each of the challenged practices.[48] If a Section 5 signaling case were to be tried, a court would need to balance any legitimate business justifications for the alleged signaling against any actual or potential anticompetitive harm that resulted from the signals. Moreover, a court would need to analyze whether a signal was purposeful or merely incidental to a legitimate business conduct, such as communications with potential investors.

In sum, while the FTC has had success in securing consent decrees in connection with enforcement challenges brought under Section 5 of the FTC Act, the federal courts have not substantiated the FTC's theory that Section 5 reaches unilateral signaling conduct.

Is Signaling Unlawful? Should It Be?

This review of signaling challenges under Section 1, Section 2, and Section 5 demonstrates the uncertainty as to whether signaling is unlawful. A unilateral signal lacks the "agreement" element for a Section 1 violation and lacks the exclusionary conduct requirement for Section 2. And while the FTC has challenged unilateral signaling conduct under Section 5, no Article III court has held that Section 5 extends so far beyond the Sherman Act.

Perhaps the better question is whether unilateral signaling *should* be unlawful. Both antitrust agencies have staked a strong pro-enforcement position by challenging signaling under all these statutes. And it is a valid policy goal to discourage conduct that could facilitate anticompetitive coordination. On the other hand, conduct that may be labeled signaling also may be procompetitive. Firms often have legitimate reasons to communicate competitive information: informing customers about future pricing, disclosing financial details to investors, and interacting with parties with which it has both a vertical and horizontal relationship.

The difficulty with the current approach, in particular FTC's use of Section 5, is that it creates significant uncertainty as to when a unilateral statement may later be seen to violate the antitrust laws. For example, a company may need to describe to investors its future plans for improving revenue or decreasing costs, but too much candor might be seen as unlawful.[49] Likewise, if a firm is contemplating a significant price increase, notifying customers well in advance may be in the customers' best interest, particularly if the customer will seek to pass on the increase to downstream customers; but the agencies have challenged instances where too much notice potentially is anticompetitive.[50] And while the FTC has a string of consent decrees resulting from bare invitations to collude, even the Commissioners sometimes disagree over whether a statement is an "invitation" or not.[51]

Rather than relying on Section 2 or the undefined Section 5 to target signaling conduct, we think enforcers and courts should analyze signaling exclusively under Section 1: if the signal results in an anticompetitive agreement, then the signal may be challenged; otherwise, the unilateral communication should not be actionable under the antitrust laws. This would be authorized by the antitrust statutes and would cover the conduct most likely to be anticompetitive, while providing clarity and avoiding enforcement actions that potentially could capture or deter procompetitive business activity. There are several reasons to think this is preferable to the current approach.

First, if the conduct goes beyond signaling, where there is both an invitation to collude and acceptance, then it will violate Section 1. An agreement proved by direct or circumstantial evidence can support a Section 1 claim.

Second, robust enforcement against Section 1 agreements should deter competitors from signaling with illegitimate intent. A signal can suggest to an antitrust agency or private plaintiff that an unlawful conspiracy has taken place, drawing an investigation. For example, Valassis's (very public) earning calls signal that it would not compete for competitor's customers immediately led to an antitrust investigation for potential collusion. Similarly, the major airlines today currently face antitrust risk as they respond to a lengthy investigation and litigation over "capacity discipline" statements (already in somewhat ambiguous territory). Even if no "agreement" was actually formed, and therefore no Section 1 case can be brought, the costs and risk offer a significant deterrent against signaling.

Third, focusing on Section 1 would ensure that signaling enforcement actions would not chill lawful, procompetitive conduct. As courts and the agencies have recognized, firms have legitimate reasons to ensure their investors, customers, and suppliers are informed. However, the FTC's aggressive use of Section 5 has created significant ambiguity as to when a unilateral statement could be unlawful. Analyzing signaling solely under Section 1 provides immediate clarity to companies seeking to discuss pricing or other sensitive topics with third parties.

Fourth, the absence of evidence of assent, explicit or implicit, suggests there was no coordination, without which there has been no consumer harm. With only Section 1, bare invitations to collude would not be unlawful. But that does not leave consumer harm unremedied. To paraphrase the Ninth Circuit, "No harm, no foul."[52]

Signaling remains a complicated issue, and firms using "signals" to communicate competitive intentions should expect scrutiny and risk antitrust challenge, even where the plaintiffs must prove an agreement. An enforcement program that did not reach beyond the established authority of Section 1 would bring benefits of authority, clarity, and focus only on certainly anticompetitive conduct.

1 United States v. Am. Airlines Inc., 743 F.2d 1114, 1116 (5th Cir. 1984).

2 Complaint ¶¶ 20–26, U-Haul Int'l, Inc., FTC File No. 081-0157 (July 20, 2010).

3 Complaint ¶¶ 16–21, Fortiline, LLC, FTC File No. 151-0000 (Aug. 9, 2016).

4 Hall v. United Air Lines, Inc., 296 F. Supp. 2d 652, 672 (E.D.N.C. 2003).

5 15 U.S.C. § 1. *See* Standard Oil Co. v. United States, 221 U.S. 1, 58 (1911) (Section 1 prohibits only agreements that restrict competition unreasonably.).

6 *Standard Oil*, 221 U.S. at 58.

7 *E.g.*, *In re* Delta/AirTran Baggage Fee Antitrust Litig., 733 F. Supp. 2d 1348, 1352 (N.D. Ga. 2010) ("Plaintiffs allege that AirTran invited Delta to collude (through a series of earnings calls with industry analysts and speeches/break-out sessions at industry conferences) so that both airlines could increase prices to consumers without losing any market share. Plaintiffs allege that Delta accepted this invitation and that the two airlines engaged in anticompetitive conduct by increasing prices through capacity reductions and imposing a first-bag fee.").

8 *See, e.g.*, *id.* at 1362 (denying defendant airlines' motion to dismiss plaintiffs' Section 1 claim, although noting "[t]he complaint has its weaknesses. For example, as Defendants highlight, many of Plaintiffs' allegations are based upon statements made by Defendants' executives *in response* to analysts' questions. . . . Obviously, the fact that some of the alleged collusive communications came in response to questions may weaken the probative value of those statements."); *see also* United States v. Citizens & S. Nat'l Bank, 422 U.S. 86, 113 (1975) ("[T]he dissemination of price information is not itself a per se violation of the Sherman Act.").

9 296 F. Supp. 2d 652.

10 *Id.* at 672.

11 Copperweld Corp. v. Indep. Tube Corp., 467 U.S. 752, 768 (1984) ("Section 1 of the Sherman Act, in contrast, reaches unreasonable restraints of trade effected by a "contract, combination . . . or conspiracy" between separate entities. It does not reach conduct that is 'wholly unilateral.'") (citations omitted).

12 743 F.2d 1114.

13 United States v. Am. Airlines Inc., 570 F. Supp. 654, 657 (N.D. Tex. 1983), *rev'd on other grounds*, 743 F.2d at 1119 (noting "our decision that the government has stated a [Section 2] claim does not add attempt to violations of Section 1 of the Sherman Act").

14 *Hall*, 296 F. Supp. 2d at 672.

15 Roger Yu, *Justice Department Opens Probe of Airlines for Possible Collusion*, USA Today (July 1, 2015), http://www.usatoday.com/story/news/2015/07/01/doj-opens-collusion-investigation-of-airlines/29578399/ (reporting that the DOJ opened an investigation into the airline industry for collusion after frequently discussing "capacity discipline" with investors).

16 Theatre Enters. v. Paramount Film Distrib. Corp., 346 U.S. 537, 541 (1954) ("[T]his Court has never held that proof of parallel business behavior conclusively establishes agreement or, phrased differently, that such behavior itself constitutes a Sherman Act offense."); *see* Brooke Grp. Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 227 (1993) (noting that "[t]acit collusion, sometimes called oligopolistic price coordination or conscious parallelism" is "not in itself unlawful").

17 Monsanto Co. v. Spray-Rite Serv. Corp., 465 U.S. 752, 768 (1984) ("The correct standard [for Section 1] is that there must be evidence that tends to exclude the possibility of independent action. . . . That is, there must be direct or circumstantial evidence that reasonably tends to prove that [the parties] had a conscious commitment to a common scheme designed to achieve an unlawful objective.").

18 733 F. Supp. 2d at 1352.

19 *Id.* at 1362–63.

20 *Id.* at 1363.

21 15 U.S.C. § 2.

22 743 F.2d at 1120.

23 *Id.* at 1116.

24 *American Airlines*, 570 F. Supp. at 659 (The "proposition to [Braniff] was a unilateral invitation to affect a change in prices. . . . [T]he remedy does not lie in the antitrust laws.").

25 *American Airlines*, 743 F.2d at 1121–22.

26 Id. at 1118–19.

27 Verizon Commc'ns, Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398, 407 (2004).

28 *E.g.*, *Delta/AirTran Baggage Fee Antitrust Litigation*, 733 F. Supp. 2d at 1366 ("Given the twenty-two-percent market share that AirTran is alleged to possess in the narrowest of route grouping proposed by Plaintiffs and the absence of any alleged conduct through which AirTran could oust Delta from any route, AirTran could not unilaterally achieve monopoly power.").

29 *See id.* at 1366 n.14 ("The fact that a separate offense (a conspiracy claim) exists under the [Sherman Act] for concerted action pertaining to monopolization suggest that any joint monopoly theory must be brought pursuant to that subsection of the statute rather than pursuant to the 'attempted monopolization' prong."); Flash Elecs., Inc. v. Universal Music & Video Distrib. Corp., 312 F. Supp. 2d 379, 396–97 (E.D.N.Y. 2004) ("The idea of a 'shared monopoly' giving rise to Section 2 liability repeatedly has been received with skepticism by courts who have squarely addressed the issue.") (collecting cases).

30 Note that the Fifth Circuit's decision in *American Airlines* related solely to the defendant's Rule 12(b)(6) motion to dismiss for failure to state a claim, not the ultimate merits determination. 743 F.2d at 1122.

31 15 U.S.C. § 45.

32 729 F.2d 128, 130 (2d Cir. 1984).

33 *Id.*

34 *Id.* at 139.

35 Complaint ¶¶ 11–16, Valassis Commc'ns, Inc., FTC File No. 051-0008 (Apr. 28, 2006).

[36] Decision and Order ¶¶ II.A–B, Valassis Commc'ns, Inc., FTC File No. 051-0008 (Apr. 28, 2006).

[37] Complaint ¶¶ 21–26, U-Haul Int'l, Inc., FTC File No. 081-0157 (July 20, 2010).

[38] Decision and Order ¶¶ II.A–C, U-Haul Int'l, Inc., FTC File No. 081-0157 (July 20, 2010).

[39] *See* Complaint ¶¶ 7–9, Drug Testing Compliance Grp., LLC, FTC File No 151-0048 (Jan. 29, 2016) (challenging a unilateral "First Call Wins" proposal in which firms would not compete for one another's customers).

[40] *See* Complaint ¶¶ 6–9, Step N Grip, LLC, FTC File No. 151-0181 (Dec. 16, 2015) (challenging email sent by one competitor to another suggesting they both sell their products at identical prices on Amazon.com).

[41] *See* Complaint ¶¶ 10–22, 680 Digital, Inc., FTC File No. 141-0036 (Aug. 29, 2014) (challenging email solicitations requesting barcode competitors match one another's prices).

[42] Complaint ¶¶ 16–22, Fortiline, LLC, FTC File No. 151-0000 (Aug. 9, 2016).

[43] Dissenting Statement of Maureen K. Ohlhausen, Fortiline, LLC, FTC File No. 151-0000 (Aug. 9, 2016).

[44] 637 F.2d 573, 582 (9th Cir. 1980); *see also du Pont*, 729 F.2d at 141 (Section 5 violation requires a showing that "competition has been substantially lessened").

[45] *See* Fed. Trade Comm'n, Statement of Enforcement Principles Regarding "Unfair Methods of Competition" Under Section 5 of the FTC Act (2015) [hereinafter FTC Section 5 Statement] (taking position that "Section 5's ban on unfair methods of competition encompasses not only those acts and practices that violate the Sherman or Clayton Act but also those that contravene the spirit of the antitrust laws and those that, if allowed to mature or complete, could violate the Sherman or Clayton Act"), https://www.ftc.gov/system/files/documents/public_statements/735201/150813section5enforcement.pdf. For more on this much-debated topic, see ABA Section of Antitrust Law, Antitrust Law Developments 660–69 (7th ed. 2012).

[46] *du Pont*, 729 F.2d at 141–42.

[47] *See* FTC Section 5 Statement, *supra* note 45.

[48] *du Pont*, 729 F.2d at 133.

[49] *See, e.g.*, Dissenting Statement of Commissioner Orson Swindle, Stone Container Corp., FTC File No. 951-0006 (June 3, 1998) ("I am concerned that the Commission's decision in this case may deter corporate officials from making useful public statements (*e.g.*, in speeches to investors or presentations to securities analysts) that candidly address industry conditions, individual firms' financial situations, and other important subjects.").

[50] *See, e.g.*, United States v. Airline Tariff Publ'g Co., 836 F. Supp. 9 (D.D.C. 1993) (approving consent decree in DOJ challenge to major airlines' use of computerized fare exchange system to signal future pricing intentions); cf. Reserve Supply Corp. v. Owens-Corning Fiberglas Corp., 971 F.2d 37, 54 (7th Cir. 1992) (advance price announcements necessary in the construction industry because customers "bid on building contracts well in advance of starting construction" and so required 60 days' or more notice of price changes).

[51] *See* Dissenting Statement of Maureen K. Ohlhausen, Fortiline, *supra* note 43 ("The evidence regarding whether Fortiline made an invitation to collude . . . is ambiguous."); Dissenting Statement of Commissioner Orson Swindle, Stone Container Corp., *supra* note 49 ("I do not believe that the facts unearthed and presented in the investigation support the allegation that Stone Container . . . invited its competitors 'to join a coordinated price increase.'").

[52] *Boise Cascade*, 637 F.2d at 582 ("[T]he weight of the case law, as well as the practices and statements of the Commission, establish the rule that the Commission must find either collusion or actual effect on competition to make out a section 5 violation."). Similarly, in many industries, a public "signal" will duplicate information learned elsewhere. For example, in *du Pont*, while the FTC believed that certain press releases and similar conduct relating to prices constituted signaling, the Second Circuit observed that "regardless of the practices, competitors learned of each other's prices anyway within hours." 729 F.2d. at 142.

Time to Stop Digging: Failed Attacks on FTC Authority to Obtain Consumer Redress

BY DAVID C. VLADECK

COMMON SENSE DICTATES THE FIRST law of digging holes: When in one, stop digging. That lesson has escaped lawyers who for decades have argued that the Federal Trade Commission has no authority to force wrongdoers to pay back ill-gotten gains to consumers. For the most part, these arguments are not based on moral or policy grounds, but rather on the claim that the Federal Trade Commission Act does not authorize courts to order monetary relief at all, or if courts have that authority, it is limited to "fraud" cases—a category of cases that does not exist under the FTC Act.

The time has come for the digging to stop. The "no authorization" argument has been repeatedly and uniformly rejected by every court to address it, and that is not going to change. Section 13(b) of the FTC Act authorizes courts to grant injunctions, and that grant of authority empowers courts to order the full range of equitable remedies, including restitution and disgorgement. The "no authorization" argument contends that Section 19 of the Act—which authorizes the FTC to seek monetary redress in court after final judgments in FTC administrative cases—limits the relief available under Section 13(b). But Section 19 explicitly preserves the agency's remedial authority under Section 13(b), and in rejecting the fallback argument that monetary relief is authorized only in "fraud" cases, courts have ordered redress in the full range of Section 13(b) cases. Congress too has signaled its agreement with this plain-text reading of the Act, yet an additional reason why the digging should end.

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Section 13(b) Authorizes Courts to Order Monetary Relief

In bringing enforcement cases challenging unfair or deceptive acts or practices under Section 5 of the FTC Act, the FTC ordinarily can choose its forum. Section 5(b) authorizes the Commission to file administrative complaints and adjudicate cases before the Commission itself, subject to judicial review by an appropriate court of appeals.[1] The Commission has no authority to order interim injunctive relief or monetary relief in Section 5 cases. To provide an alternative, Congress in 1973 enacted Section 13(b), which authorizes the Commission to file cases alleging violations of Section 5 directly in district courts. Section 13(b) empowers courts to issue preliminary injunctive relief and "in proper cases the [FTC] may seek, and after proper proof, the court may issue, a permanent injunction."[2] This grant of injunctive authority has long been construed to encompass a broad range of equitable remedies, including asset freezes, the appointment of receivers, restitution, rescission, and the disgorgement of ill-gotten gains.[3]

The Supreme Court has repeatedly held that these equitable powers are inherent in the grant of injunctive authority and permit courts to order ancillary equitable relief, including monetary relief, when needed to secure "complete justice." *Porter v. Warner Holding Co.*,[4] decided decades before Section 13(b) was added to the FTC Act, remains the key case. There the Court held that the Emergency Price Control Act of 1942, which authorized the Administrator to seek a "'permanent or temporary injunction, restraining order, or other order,'" empowered district courts to order not simply injunctive relief, but monetary relief as well.[5] In so ruling, the Court began by driving home the broad powers that are bound up in a grant of equitable relief: "Unless otherwise provided by statute, all the inherent equitable powers of the District Court are available for the proper and complete exercise of that jurisdiction."[6] The Court added that

> the comprehensiveness of this equitable jurisdiction is not to be denied or limited in the absence of a clear and valid legislative command. Unless a statute in so many words, or by a necessary and inescapable inference, restricts the court's jurisdiction in equity, the full scope of that jurisdiction is to be recognized and applied. "The great principles of equity, securing complete justice, should not be yielded to light inferences, or doubtful construction."[7]

The Court then turned to monetary relief and ruled that the "comprehensiveness of this equitable jurisdiction" plainly encompasses the authority to issue monetary relief, including disgorgement.[8] The Court explained that a disgorgement order "may be considered an equitable adjunct to an injunction decree. Nothing is more clearly a part of the subject matter of a suit for an injunction than the recovery of that which has been illegally acquired and which has given rise to the necessity for injunctive relief."[9] The Court added that "where, as here, the equitable jurisdiction of the court has properly been invoked, for injunctive purposes, the court has the power to decide all relevant matters in dispute and to award complete relief even though the decree includes that which might be conferred by a court of law."[10]

The Supreme Court followed its ruling in *Porter* in *Mitchell v. Robert DeMario Jewelry, Inc.*,[11] holding that the Fair Labor Standards Act, which authorizes district courts to "restrain violations" of the Act, empowers courts to award back-pay to employees who have been unlawfully discharged. The Court acknowledged that the Act had recently been amended to include a proviso that stripped district courts of authority "to order the payment to employees of unpaid minimum wages or unpaid overtime compensation or an additional equal amount as liquidated damages in such action."[12] In reconciling the two provisions of the Act, the Court held that "[r]ather than expressing a general repudiation of equitable jurisdiction to order reimbursement to effectuate the policies of the Act, we think that the [proviso evidences] a purpose to make only limited modifications in the nature and extent of the Secretary's power to obtain reimbursement of unpaid compensation" and there was thus "no warrant for construing" the proviso "as wholly to eradicate any jurisdiction to restore wage losses to employees discharged."[13]

The principle announced in *Porter* and reaffirmed in *Mitchell* that "the comprehensiveness of [the district court's] equitable jurisdiction is not to be denied or limited in the absence of a clear and valid legislative command," applies with full force to actions brought under Section 13(b).[14] By authorizing courts to issue injunctive relief, Section 13(b) empowers courts to employ their full equitable jurisdiction, including money judgments. Redress is therefore permitted because once equitable jurisdiction is invoked, "the court has the power . . . to award complete relief."[15] Every court of appeals to consider the question has agreed that the equitable jurisdiction conferred by Section 13(b) is comprehensive and includes monetary redress. Here are the most recent appellate decisions on the issue:

FTC v. Commerce Planet, Inc.[16] The Ninth Circuit reaffirmed its prior rulings that Section 13(b) "empowers district courts to grant 'any ancillary relief necessary to accomplish complete justice,' including restitution."[17] After quoting extensively from *Porter*, the court observed that

> [u]nder *Porter* and our cases applying it, district courts have the power to order payment of restitution under § 13(b) of the FTC Act. The equitable jurisdiction to enjoin future violations of § 5(a) carries with it the inherent power to deprive defendants of their unjust gains from past violations, unless the Act restricts that authority. We see nothing in the Act that does.[18]

FTC v. Kristy Ross.[19] In rejecting Ross's argument that Section 13(b) did not empower district courts to issue monetary judgments, the Fourth Circuit held that

> precedent dictates otherwise: the Supreme Court has long held that Congress' invocation of the federal district court's equitable jurisdiction brings with it the full "power to decide all relevant matters in dispute and to award complete relief even though the decree includes that which might be conferred by a court of law."[20]

The court added that

> *Porter* and its progeny thus articulate an interpretive principle that inserts a presumption into what would otherwise be the standard exercise of statutory construction: we presume that Congress, in statutorily authorizing the exercise of the district court's injunctive power, "acted cognizant of the historic power of equity to provide complete relief in light of statutory purposes."[21]

The court then applied "this principle to the present case" to "illuminate[] the legislative branch's real intent. That is, by authorizing the district court to issue a permanent injunction in the Federal Trade Commission Act, 15 U.S.C. § 53(b)(2), Congress presumably authorized the district court to exercise the full measure of its equitable jurisdiction."[22] For these reasons, the court held that "absent some countervailing indication sufficient to rebut the presumption, the court had sufficient statutory power to award 'complete relief,' including monetary consumer redress, which is a form of equitable relief."[23] The court found nothing in the Act undermined the presumption of completeness.

FTC v. Bronson Partners, LLC.[24] In upholding a substantial monetary judgment against the defendants, the Second Circuit pointed out that "courts have consistently held that the unqualified grant of statutory authority to issue an injunction under [S]ection 13(b) carries with it the full range of equitable remedies, including the power to grant consumer redress and compel disgorgement of profits."[25] The court then announced that "[w]e join these courts and hold that Section 13(b) of the FTC Act permits courts to grant ancillary equitable relief, including equitable monetary relief."[26]

Commerce Planet, *Kristy Ross*, and *Bronson Partners* are only the most recent decisions by circuit courts affirming the FTC's redress authority in Section 13(b) cases. They build on a line of cases that stretches back more than three decades. In 1982, the Ninth Circuit held that monetary relief is available in Section 13(b) cases in *FTC v. H.N. Singer, Inc.*[27] The Seventh Circuit followed *Singer* in 1989 in *FTC v. Amy Travel Services, Inc.*,[28] the Eighth Circuit joined the choir in 1991 in *FTC v. Security Rare Coin and Bullion Corp.*,[29] and the Eleventh Circuit followed suit in 1996 in *FTC v. Gem Merchandising Corp.*[30] More recently, the Tenth Circuit in 2005 in *FTC v. Freecom Communications, Inc.*,[31] and the First Circuit in 2010 in *FTC v. Direct Marketing Concepts, Inc.*,[32] upheld an award of monetary redress under Section 13(b)—the company did not even bother challenging the FTC's authority. To date, the seven circuits that have ruled on this issue have uniformly held that disgorgement and restitution are available in Section 13(b) cases and another circuit has affirmed a redress order; no judge has dissented, and apparently no district court has concluded otherwise.[33]

Section 19 Preserves, Not Limits, Remedies Available Under Section 13(b)

Having gained no traction on the Section 13(b) "no redress" argument, defense counsel make a secondary argument that has fared no better. They contend that Section 13(b) should not be read to permit monetary redress because Section 19, enacted after Section 13(b), limits the equitable remedies that would otherwise be available under Section 13(b).

Section 19 authorizes district courts to hear suits brought by the Commission to seek monetary relief in cases that were brought administratively by the agency and have been litigated to a final judgment.[34] Under Section 19, the FTC can obtain redress when it "satisfies the court that the act or practice to which the cease and desist order relates is one which a reasonable man would have known under the circumstances was dishonest or fraudulent."[35] If that standard is met, the court may award "such relief as the courts find necessary to redress injury to consumers," including the "refund of money or return of property," and even the "payment of damages,"[36] traditionally a remedy available at law and not at equity.

Section 19 differs from Section 13(b) in important ways: (1) it authorizes district court jurisdiction in cases that seek redress where the case has already been litigated to final judgment administratively; (2) it has a short statute of limitations that makes sense when the case is brought solely for redress, but not for Section 13(b) cases (Section 13(b) contains no statute of limitations); (3) it does not, by its terms, authorize injunctive relief, no doubt because it permits the FTC to bring Section 19 cases only after the FTC has issued a cease and desist order; and (4) it authorizes the legal remedy of "damages."[37]

Proponents of the argument that Section 19 displaces remedies that would ordinarily be available under Section 13(b) have never clearly articulated a legal theory underlying the argument. But there are only two possible theories. One would be that Section 19, as the latter-enacted statute, worked an implied repeal of the equitable relief jurisdiction that inhered in Section 13(b)'s grant of injunctive authority, notwithstanding Section 19(e)'s preservation-of-remedies clause. The other possible theory would be that enactment of Section 19 in 1974 gives rise to the inference that, when Congress enacted Section 13(b) in 1973, it did not intend that provision to provide comprehensive remedial authority, even though it did not say so, and even though *Porter* and *Mitchell* had been established law for decades and required Congress to provide a "clear and valid legislative command" if it intended to limit equitable remedies that flow from Section 13(b)'s authorization to issue injunctions.

Neither theory holds water. The take-home message of these arguments is that Congress enacted Section 19 as the sole vehicle for monetary relief and quite deliberately left courts powerless to award consumer redress in cases brought under Section 13(b). There are multiple flaws in this argument, which is why it has been uniformly rejected.[38]

First, there is no logical reason why Congress would want to provide a range of remedies, including monetary relief and "damages," in the subset of cases in which the FTC has already obtained administrative orders, but deny any monetary redress in the mine run of Section 13(b) cases decided by judges. Indeed, where there is ongoing financial harm to consumers, the Commission ordinarily brings those cases under Section 13(b) so it can get interim injunctive relief to stop the harm from continuing during the litigation.

Nor is there any plausible reason why Congress would have decided to make the agency run the gauntlet laid out in Section 19 in order to obtain monetary relief in Section 13(b) cases. Under the Section 19 approach advocated by defendants, the only way the FTC can obtain monetary redress in a Section 5 case is to (1) bring the enforcement action administratively; (2) litigate the case to final judgment (including possible review by a court of appeals); (3) forgo any ability to obtain the interim relief that the Commission is powerless to impose (including preliminary injunctions, asset freezes, and the appointment of receivers); and then (4) years later, after the administrative case is "final," file an action in district court under Section 19 to get a disgorgement or restitution order, assuming that the defendant had not dissipated the assets in the meantime.[39]

Congress enacted Section 13(b) to expedite Commission consumer protection cases, not to hobble the Commission.[40] But under the defense bar's Section 19 theory, the FTC has at best a Hobson's choice: It can bring an enforcement case under Section 13(b) and get interim relief, but if it goes this route it forfeits any practical ability to force many defendants to give up the ill-gotten gains. Or, if disgorgement is the agency's primary goal, it can proceed administratively under Section 5 and forgo interim relief in the hope that someday the Commission might obtain a disgorgement order, assuming that there are proceeds left to disgorge. The idea that Congress intended to put the agency to this choice is unthinkable and, as demonstrated below, contradicted by the Act's structure and text.

Second, the argument that Section 13(b) does not authorize monetary relief cannot be squared with Congress's decision to include a preservation-of-remedies clause in Section 19(e). For courts, Section 19(e) is the show-stopper. For instance, the Second Circuit in *Bronson Partners*, said that "[w]e are unpersuaded" by the Section 19 argument. "Section 19 does not purport to limit Section 13(b)," in fact, "[q]uite to the contrary," Section 19 explicitly preserves the authority granted in Section 13(b).[41] Equally important to the court was that

> Bronson's suggested reading of Section 19 would impose an untenable restriction on Section 13(b) given that "[n]othing is more clearly a part of the subject matter of a suit for an injunction than the recovery of that which has been illegally acquired and which has given rise to the necessity for injunctive relief."[42]

The Ninth Circuit in *Commerce Planet* rejected the

Section 19 argument even more emphatically. The court acknowledged that the defendant "contends that § 19(b) . . . eliminates a court's power to award restitution under § 13(b)," but dismissed that argument, holding that "we have refused to read § 19(b) in that manner. For one thing, Section 19 itself states that the [r]emedies provided in this section are in addition to, and not in lieu of, any other remedy" provided in the Act.[43] The court also explained that "the Court in *Porter* rejected essentially the same argument [defendant] makes here."[44] In *Porter*, the court held that Section 205(a) of the Emergency Price Control Act authorized the government to bring suit for restitution. But the *Porter* Court rejected the defendant's claim that a separate provision of the Act—Section 205(e), which authorized suits by the government to recover *damages*—somehow superseded the authority of district courts to award *restitution* because restitution is a remedy that "differs greatly" from the award of damages.[45] The Ninth Circuit said that "[w]e think that the same can be said of the relationship between § 13(b) and § 19(b). While § 19(b) precludes courts from awarding damages when proceeding under § 13(b), it does not eliminate the court's inherent equitable power to order payment of restitution."[46]

Third, the argument that Section 19 somehow limits Section 13(b) fails to account for the significant differences between the provisions' purposes. Congress enacted Section 13(b) to provide an alternative to cumbersome administrative proceedings under Section 5. The Senate Report explained that, in situations like "the routine fraud case," where the FTC "does not desire to further expand upon the prohibitions of the [FTC] Act through the issuance of a cease-and-desist order," the Commission could "seek a permanent injunction" in district court.[47] The virtue of this option is that the agency could move quickly in district court to freeze assets (a form of ancillary, equitable relief) and secure preliminary injunctive relief preventing further injury to consumers as the litigation moved forward. At the end of the litigation, the court could impose permanent injunctive relief. The legislative history reveals no intention to restrict the scope of equitable relief that would be available, including monetary relief.

Advocates pressing the "no redress" theory of Section 13(b) claim that the "FTC has never explained why Section 19 would have been necessary if Section 13(b) were understood to provide for consumer redress at the time it was enacted."[48] But the answer is obvious. At the time Section 13(b) was enacted, the agency's enforcement cases were brought administratively under Section 5. And when Congress enacted Section 13(b), it correctly assumed that the FTC would continue to bring some enforcement cases administratively, particularly when it "desire[d] to further expand upon the prohibitions of the [FTC] Act through the issuance of a case-and-desist order."[49] After all, Commission orders form the backbone of FTC common law and are integral to the Commission's policy-making function. For these reasons, the agency still regularly brings cases administratively, especially when it seeks to flesh out legal standards or develop emerging policies.[50]

Prior to Section 19's enactment, there was no vehicle for the agency to obtain redress for consumers in administrative cases. Indeed, the agency had claimed the authority to order monetary relief in Section 5 cases, but that effort was rebuffed by courts because, unlike a court, an agency does not possess inherent injunctive authority.[51] Section 19 therefore fills an important gap. It allows the Commission to adjudicate cases administratively and shape the law, and then use a streamlined procedure to go to court to obtain remedies the agency cannot impose, including restitution, disgorgement, and even damages.[52]

Fourth, the Section 19 argument ignores the most salient obstacle, namely, that Section 19 includes a preservation-of-remedies clause. That provision would serve no purpose if other provisions of the FTC Act did not authorize similar remedies. Nonetheless, defense lawyers claim that Section 19 implicitly overrides the broad equitable authority conferred on the FTC by Section 13(b). Courts, however, are hostile to repeals by implication. In fact, the Supreme Court has warned that it "will not infer a statutory repeal 'unless the later statute "expressly contradict[s] the original act"' or unless such a construction 'is absolutely necessary . . . in order that [the] words [of the later statute] shall have any meaning at all.'"[53]

Here, there is no evidence, let alone "clear and manifest" evidence, that Congress intended Section 19 to be the sole source of monetary relief under the FTC Act, nor does Section 19 "expressly contradict" Section 13(b). To the contrary, the preservation-of-remedies provision in Section 19(e) makes clear Congress's intent that Section 19 co-exist with other provisions in the FTC Act setting out remedies, including Section 13(b).

Fifth, defendants' final theory similarly depends on inferences drawn from legislative history and not the Act's text. The argument is that the Congress that enacted Section 13(b) did not intend that its authorization of injunctive relief would extend to monetary relief, and that Congress reserved questions about monetary relief until they were finally answered, two years later, in Section 19. This argument is based on sparse legislative history (Section 13(b) was passed as an amendment to the Trans-Alaska Pipeline bill, and Section 19 was enacted as part of the Magnuson-Moss Warranty Federal Trade Commission Improvement Act), and has multiple flaws.

For one thing, the argument runs counter to the textualist approach that now dominates judicial interpretation of statutes. And courts are especially unwilling to use the legislative history of a statute to undermine its text. For example, in *Arlington Central School District v. Murphy*,[54] the plaintiff claimed that the fee-shifting provision in the Individuals with Disabilities Education Act (IDEA) authorized a prevailing plaintiff to recoup expert fees as well as attorney's fees.

IDEA's fee-shifting provision was similar to one in the Civil Rights Act, which the Supreme Court in *West Virginia*

University Hospitals, Inc. v. Casey,[55] interpreted to not authorize the payment of expert fees. But when IDEA's fee-shifted provision was enacted, the Conference Report accompanying the final legislation explicitly said that expert fees were compensable, and when both Houses of Congress took their final votes on the legislation, those votes were to approve the Conference Report, which included the text of the final bill. As Justice Breyer pointed out in his dissent, the Conference Report was conclusive on the issue: it "specified that 'the term "attorneys' fees as part of the costs" include[s] reasonable expenses and fees of expert witnesses and the reasonable costs of any test or evaluation which is found to be necessary for the preparation of the parent or guardian's case . . . .'"[56] Notwithstanding the clarity of the Report and Congress's vote to approve it, the majority found that the text prevailed, concluding that "where everything other than the legislative history overwhelmingly suggests that expert fees may not be recovered, the legislative history is simply not enough."[57] That reasoning would apply with equal force to the argument that Section 19 trumps Section 13(b), especially since that argument rests on far more ephemeral legislative history than the explicit Conference Report that Congress approved in *Arlington Central*.

In any event, the legislative history argument is unpersuasive on its own terms. Although meager, the legislative history of Section 13(b) is clear that Congress intended to grant district courts considerable injunctive powers,[58] including the power to impose asset freezes.[59] Given that Section 13(b) speaks in terms of injunctions and does not specifically mention any of the remedies available to a court of equity, the authority to impose an asset freeze must derive from the broad grant of authority to order injunctive relief, which equally encompasses other equitable remedies, including rescission, restitution, and disgorgement.[60] And that has been the FTC's position from the start. When the Bureau of Consumer Protection launched its "fraud program" in the early 1980s by bringing Section 5 cases in district courts under Section 13(b), it routinely sought interim injunctive relief—including assets freezes and the appointment of receivers—and then, at the close of the litigation, sought restitution or disgorgement. As already noted, the courts upheld the FTC's authority to obtain monetary relief in these cases.

In the course of the early Section 13(b) litigation, defense lawyers raised yet another argument, namely that, even if courts could order monetary relief in Section 13(b) cases, that power was limited to "fraud cases." In making this argument, defense lawyers invoked the language of Section 13(b)(2), which states that "in proper cases the Commission may seek, and after proper proof, the court may issue, a permanent injunction," to argue that only "fraud" cases are "proper" ones for redress.

But this argument has also been consistently rejected. Courts have uniformly held that a "proper case" under Section 13(b) is one that involves a violation of "any of the laws enforced by the Commission."[61] These rulings comport with the terms of the FTC Act, which makes no distinction between "fraud" and other conduct that violates Section 5. The word "fraud" does not appear in Section 5, and for good reason.[62] Section 5 directs the agency to "prevent" "unfair and deceptive acts or practices," and courts have consistently held that the FTC does not need to prove individual reliance as an element of Section 5, even though it is an element of common law fraud.[63]

The defense bar's lack of success in finding the golden nugget of a legal argument that shields their clients' ill-gotten gains from FTC redress orders is not a function of lackluster or half-hearted lawyering. Many of the smartest and most capable lawyers have taken their turn digging, only to come up empty. The courts have now spoken: the FTC may seek and courts may order monetary relief in cases brought under Section 13(b).

Congress Has Confirmed that Redress Is Available Under 13(b)

Two developments since Section 19 was added to the Act underscore Congress's continued commitment to monetary redress under Section 13(b) and affirm the unanimous view of the courts. First, in 1994, Congress again amended the FTC Act, and expanded the venue and service of process provisions of Section 13(b) so that the Commission could bring a single lawsuit against all defendants involved in an illegal transaction, even if they did not all live in the same district.[64] The Senate Report that accompanied the legislation recognized that, pursuant to Section 13(b), "[t]he FTC can go into court ex parte to obtain an order freezing assets, and is also able to obtain consumer redress."[65] If Congress had been dissatisfied with the Commission's use of Section 13(b) to obtain consumer redress, it presumably would have used this opportunity to limit Section 13(b).

Next, in 2006, Congress amended the FTC Act to better enable the agency to work with its international counterparts. The Safe Web Act amendments added a new subsection to Section 5, what is now Section 5(a)(4)(B), that provides: "All remedies available to the Commission with respect to unfair and deceptive acts and practices shall be available for acts and practices described in this paragraph, including restitution to domestic or foreign victims."[66] The legislative history of this provision explains that it expands the FTC's authority over foreign commerce to include unfair and deceptive acts or practices "that cause or are likely to cause injury within the United States or involve material conduct in the United States."[67] It goes on to say that "[t]his section would also make all remedies available to the Commission with respect to unfair and deceptive acts involving foreign commerce that may cause injury within the United States."[68]

Once again, the history confirms Congress's understanding that restitution is generally available in FTC consumer protection cases, and once again, had Congress been dissatisfied with consumer redress under Section 13(b), it presumably would have restricted the remedies available under Section 13(b) rather than incorporate the full breadth of these remedies, as consistently applied by courts, into the new provisions in Section 5.

Conclusion

Courts have consistently ruled that the statutory authorization in Section 13(b) encompasses the full scope of equitable remedies, including consumer redress and disgorgement. These rulings give effect to Section 13(b)'s textual authorization for courts to grant injunctive relief, and operationalize Congress's intent that courts be empowered to give complete relief to consumers who fall victim to unfair or deceptive acts and practice. After more than thirty years of digging to find a way to shield defendants from monetary liability in Section 13(b), all defense lawyers have to show for their efforts is a very large hole. Hope may spring eternal, but not a single judge has been persuaded, and courts are increasingly showing impatience with these long discredited arguments. Defense lawyers are likely to keep on digging, but their lack of success suggests that their energies might be better spent helping their clients comply with the law, or at least digging a different hole.[69]

[1] 15 U.S.C. § 45(b).

[2] 15 U.S.C. § 53(b).

[3] *See, e.g.*, FTC v. Gem Merch. Corp., 87 F.3d 466, 468–69 (11th Cir. 1996) (collecting cases); FTC v. Freecom Commc'ns, Inc., 401 F.3d 1192, 1202 n. 6 (10th Cir. 2005); *see also* FTC v. U.S. Oil & Gas Corp., 748 F.2d 1431, 1432 (11th Cir. 1984) (holding that district courts have "the inherent power of a court of equity to grant ancillary relief, including freezing assets and appointing a Receiver, as an incident to [their] express statutory authority to issue a permanent injunction under Section 13 of the Federal Trade Commission Act.").

[4] 328 U.S. 395 (1946).

[5] *Id.* at 399.

[6] *Id.* at 398.

[7] *Id.* (quoting Brown v. Swann, 35 U.S. 497, 503 (1836)).

[8] *Id.* at 398–99.

[9] *Id.*

[10] *Id.* The *Porter* Court added that its judgment could also be supported by the "other order" language in the Emergency Price Control Act, *id.* at 399, but made clear in *Mitchell v. Robert De Mario Jewelry, Inc.*, 361 U.S. 288, 291 (1960), that this basis for its holding was wholly independent of its holding on the nature of equitable relief.

[11] 361 U.S. 288 (1960).

[12] *Id.* at 289.

[13] *Id.* at 295–96.

[14] *Mitchell*, 361 U.S. at 291 (quoting *Porter*, 328 U.S. at 398).

[15] *Porter*, 328 U.S. at 399.

[16] 815 F.3d 593 (9th Cir. 2016). Although the Ninth Circuit upheld the district court's decision that restitution was available under §13(b), it remanded the case for clarification on whether the district court held the individual defendant jointly and severally liable for the company's unlawful conduct. *Id.* at 603. On remand, the district court rejected the defendant's argument that restitution should be limited to the unjust gains received by the defendant, modified its judgment and order to make clear that the defendant was jointly and several liable, and reinstated the $18.2 million judgment against the defendant. Order at 9, FTC v. Commerce Planet, No. 09-01324 (C.D. Cal. Aug. 25, 2016). As of the writing of this article, the defendant has filed a petition for certiorari, challenging the Ninth Circuit's decision. *See* Petition for Certiorari, Gugliuzza v. FTC, No. 16-345 (Sept. 15, 2016).

[17] *Commerce Planet*, 815 F.3d at 598 (quoting FTC v. Pantron I Corp., 33 F.3d 1088, 1102 (9th Cir. 1994) (quoting FTC v. H.N. Singer, Inc., 668 F.2d 1107, 1113 (9th Cir.1982)).

[18] *Id.* at 599.

[19] 743 F.3d 886 (4th Cir. 2014).

[20] *Id.* at 890 (quoting *Porter*, 328 U.S. at 399).

[21] *Id.* (quoting *Mitchell*, 361 U.S. at 291–92).

[22] *Id.* at 891.

[23] *Id.* (citing *Porter*, 328 U.S. at 399).

[24] 654 F.3d 359 (2d Cir. 2011).

[25] *Id.* at 365 (quoting *Gem Merchandising*, 87 F.3d at 468).

[26] *Id.*

[27] 668 F.2d 1107 (9th Cir. 1982).

[28] 875 F.2d 564 (7th Cir. 1989).

[29] 931 F.2d 1312 (8th Cir. 1991).

[30] 87 F.3d 466 (11th Cir. 1996). In so ruling, the Eleventh Circuit followed preexisting Circuit precedent, the Fifth Circuit's prior ruling in *FTC v. Southwest Sunsites, Inc.*, 665 F.3d 711, 717–19 (5th Cir. 1982) (holding that Section 13(b) permits courts to exercise the full range of equitable remedies). *See also Gem Merchandising*, 87 F.3d at 469 n.4 (pointing out that shortly after the Eleventh Circuit was carved out of the Fifth Circuit, the Eleventh Circuit formally adopted then-existing Fifth Circuit precedent in *Bonner v. City of Pritchard*, 661 F.3d 1206, 1209 (11th Cir. 1981) (en banc)).

[31] 401 F.3d 1192, 1202 n.6 (10th Cir. 2005).

[32] 624 F.3d 1, 14–15 (1st Cir. 2010).

[33] District courts in three of the remaining four circuits—the D.C., Third, and Fifth Circuits—have reached the same conclusion. *See, e.g.*, FTC v. Mylan Labs., Inc., 62 F. Supp. 2d 25, 36–37 (D.D.C. 1999); In re Nat'l Credit Mgmt. Grp., LLC, 21 F. Supp. 2d 424, 462 (D.N.J. 1998); FTC v. Kennedy, 574 F. Supp. 2d 714, 724 (S.D. Tex. 2008). Interpreting Section 13(b)'s grant of injunctive authority to carry with it the power to order monetary relief is consistent with rulings under other regulatory statutes that confer injunctive authority similar to that in Section 13(b). *See, e.g.*, United States v. Rx Depot, Inc., 438 F.3d 1052, 1053–58 (10th Cir. 2006) (Federal Food, Drug and Cosmetics Act); United States v. Lane Labs-USA, Inc., 427 F.3d 219, 223–26 (3d Cir. 2005) (Federal Food, Drug and Cosmetics Act); SEC v. Teo, 746 F.3d 90, 104–06 (3d Cir. 2014) (Securities Exchange Act); SEC v. First City Fin. Corp. Ltd., 890 F.2d 1215, 1230 (D.C. Cir. 1989) (Securities Exchange Act); CFTC v. Co Petro Mktg Grp., 680 F.2d 573, 583–84 (9th Cir. 1982) (Commodity Exchange Act); ICC v. B & T Transp. Co., 613 F.2d 1182, 1184–85 (1st Cir. 1980) (Motor Carrier Act).

[34] Section 19 also authorizes the agency to bring rule violation cases in district court. But because Section 19 does not explicitly confer injunctive authority on the court, and because rule violation cases can ordinarily be brought under Section 13(b), rule violation cases usually allege jurisdiction under both Section 13(b) and Section 19. *See, e.g.*, Complaint at 1, 7–9, United States v. ICONIX Brand Group, Inc., 1:09-cv-08864 (S.D.N.Y. Oct. 20, 2009), https://www.ftc.gov/sites/default/files/documents/cases/2009/10/091020iconixcompletecmpt.pdf (using Sections 5 and 19 to charge violations of, among other things, the Children's Online Privacy Protection Act).

[35] 15 U.S.C. § 57b(a)(2). Apart from the scienter requirement in Rule 19, it is hard to see any material difference between "dishonest and fraudulent" requirement of Section 19 and the "unfair or deceptive acts and practices" requirement of Section 5. After all, a "dishonest" act is by definition "unfair" and "deceptive" and the word "deceitful" means "not honest." *See, e.g.*, Merriam-Webster, Webster's Ninth New Collegiate Dictionary 329, 363 (Merriam Webster Co., 1983 ed.).

[36] 15 U.S.C. § 57b(b).

[37] *See* 15 U.S.C. §§ 57b(a)(2), (b) & (d). Although some lawyers conflate "damages" with equitable monetary relief, the terms are not interchangeable and there are important distinctions between the two forms of remedies. An authorization to award damages permits a court to order far more

sweeping relief than simply to return of ill-gotten gains. Damages may include pre-judgment interest, pain and suffering, loss of opportunity and other consequential injuries that are unavailable in equity. *See generally* FAA v. Cooper, 132 S. Ct. 1441, 1449–53 (2012) (discussing scope of damages in a variety of contexts). Even where the FTC obtains monetary relief, it is far from the "make whole" relief available as damages.

[38] *See, e.g.*, *Kristy Ross*, 743 F.3d at 891 (and cases cited therein); *Gem Merchandising*, 87 F.3d at 469–70.

[39] *See generally Bronson Partners*, 654 F.3d at 366–67 n.3 (discussing the practical limitations with Section 19 actions).

[40] *See* Stephen Calkins, *Civil Monetary Remedies Available to Federal Antitrust Enforcers*, 40 U.S.F. L. Rev. 567, 581 & nn.64–66 (2006) (summarizing the applicable legislative history).

[41] 654 F.3d at 367.

[42] *Id.* (quoting *Porter*, 328 U.S. at 399).

[43] *Commerce Planet*, 815 F.3d at 599.

[44] *Id.*

[45] *Id.*

[46] *Id.* As noted earlier, the same was true in *Mitchell*, where the Court rejected the argument that a statutory provision that stripped district courts of authority to order payment of unpaid minimum wages and overtime compensation displaced a separate provision of the Act authorizing courts to "restrain violations" of the Act, which the Court held carried with it the authority to order equitable relief, including back pay to employees unlawfully discharged.

[47] S. Rep. No. 93-151, at 30–31 (1973).

[48] J. Howard Beales III & Timothy J. Muris, *Striking the Proper Balance: Redress Under Section 13(b) of the Federal Trade Commission Act*, 79 Antitrust L.J. 1, 17 (2013). *See also* Brief of Appellant Charles Gugliuzza at *50–51, FTC v. Commerce Planet, No. 12-57064, 2013 WL 3554363 (9th Cir. July 5, 2013).

[49] Beales & Muris, *supra* note 48, at 12 (quoting S. Rep. No. 93-151, at 30–31 (1973)).

[50] *See, e.g.*, POM Wonderful LLC, 155 F.T.C. 1 (2013); LabMD, Inc., No. 9357, 2016 WL 4128215 (FTC July 26, 2016).

[51] Heater v. FTC, 503 F.2d 321, 321–22 (9th Cir. 1974).

[52] As noted, in so doing, the agency risks the dissipation of the defendant's assets, but that risk is tolerable when the defendant is an established company with ongoing operations and significant assets.

[53] National Ass'n of Home Builders v. Defenders of Wildlife, 551 U.S. 644, 663 (2007) (quoting Traynor v. Turnage, 485 U.S. 535, 548 (1988)). *See also* Morton v. Mancari, 417 U.S. 535, 551 (1974).

[54] 548 U.S. 291 (2006). The author served as counsel for the Respondents, Pearl and Theodore Murphy.

[55] 499 U.S. 83, 97 (1991).

[56] 548 U.S. at 308 (Breyer, J., dissenting) (quoting H.R. Conf. Rep. No. 99-687, at 5 (1986)).

[57] 548 U.S. at 304; *but see id.* at 308–10 (Breyer, J., dissenting).

[58] Beales & Muris, *supra* note 48, at 22–23 (reporting that in the FTC's early Section 13(b) cases, the Commission "sought consumer redress under that provision [Section 13(b)], rather than Section 19" in what the authors call "fraud" or "near fraud" cases). *See generally* Calkins, *supra* note 40, at 582–84 (2007) (rejecting the claim that the legislative history of Sections 13(b) and 19 undercut the remedial authority granted in section 13(b)).

[59] Beales & Muris, *supra* note 48, at 3–4 and nn.4–8 (and authorities cited therein).

[60] *See, e.g.*, *Singer*, 668 F.2d at 1113; *see also* SEC v. Manor Nursing Centers, Inc., 458 F.3d 1082, 1105–06 (2d Cir. 1972) (reaching similar conclusion on asset freezes under the SEC Act of 1934, based on a similar grant of injunctive power).

[61] *See, e.g.*, *Gem Merchandising*, 87 F.3d at 468; FTC v. Evans Prods. Co., 775 F.2d 1084, 1086–87 (9th Cir. 1985) ("In attempting to limit § 13(b) to cases involving 'routine fraud' or violations of previously established FTC rules, [Defendant] misreads both the case law . . . and the legislative history."); FTC v. Ameridebt, Inc. 373 F. Supp. 2d 558, 563 (D. Md. 2005); *Mylan*, 62 F. Supp. 2d at 36; FTC v. Va. Homes Mfg. Corp., 509 F. Supp. 51, 54 (D. Md.1981).

[62] The FTC Act's only reference to fraud comes in Section 19, which conditions redress on a showing that "a reasonable man would have known" that the violation of a cease and desist order "was dishonest or fraudulent." 15 U.S.C. § 57b(a)(2). But no court has ever suggested that Section 19's dishonesty or fraud standard has any bearing on the remedies available under 13(b).

[63] *See, e.g.*, Am. Home Prods. Corp. v. FTC, 695 F.2d 681, 687 (3d Cir. 1982); Trans World Account, Inc. v. FTC, 594 F.2d 212, 214 (9th Cir. 1979); Resort Car Rental Sys., Inc. v. FTC, 518 F.2d 962, 964 (9th Cir. 1975). Even if the Commission needed to draw a line between "fraud" cases and other deception cases, many of the Section 5 cases the agency brings would plainly fall on the fraud side of the line because they involve demonstrably false, material claims, deliberately made, and intended to induce reliance by consumers—the core elements of fraud. The only difference, as noted, is that Section 5 requires no proof of individual reliance. *See* Restatement (Second) of Contracts § 162 (1981); Restatement (Second) of Torts § 525 (1977).

[64] Federal Trade Commission Act Amendments of 1994, Pub. L. No. 103-312, § 10, 108 Stat 1691 (1994).

[65] S. Rep. No. 103-130, at 15–16 (1993).

[66] U.S. SAFE WEB Act of 2006, Pub. L. No. 109-455, § 3, 120 Stat. 3372 (2006).

[67] S. Rep. No. 109-219, at 6 (2006).

[68] *Id.*

[69] Beales & Muris, *supra* note 48, at 34–36, argue that as a matter of policy the FTC should not seek monetary redress in advertising substantiation cases. For a response to that argument, see David C. Vladeck, *Charting the Course: The Federal Trade Commission's Second Hundred Years*, 83 Geo.Wash. L. Rev. 2101, 2114–17 (2015).

U.S. Corporate and Individual Cartel Investigations: Navigating the Intersection of Antitrust and White Collar Enforcement

BY GRACIELA M. RODRIGUEZ, WENDY HUANG WASZMER, AND ALAN R. DIAL

IN THE PAST FIVE YEARS, THE U.S. Department of Justice's Antitrust Division has focused significant resources on the successful prosecution of corporations and individuals for violations not only of U.S. antitrust laws, but also of other federal criminal statutes.[1] Historically, the Antitrust Division has charged numerous individual defendants with both criminal antitrust and other offenses, in particular in bid-rigging cases in which fraud counts could be brought. Much less common, however, were large-scale investigations in which multiple corporate and individual defendants pleaded guilty or entered into other resolutions of criminal antitrust and fraud charges. Starting in 2010, the Antitrust Division has announced charges in several high-profile investigations—LIBOR, foreign exchange currency (F/X), and municipal bond derivatives, to name a few—in which some of the defendants were charged with both antitrust and non-antitrust crimes.

This scenario occurs frequently enough that practitioners must navigate antitrust and non-antitrust enforcement frameworks at the same time. Although some counsel may assume that federal non-antitrust charges generally trigger more severe fines and jail time than antitrust charges, the U.S. enforcement frameworks are not so simple.[2] Indeed, while individual defendants may be exposed to greater sanctions if charged with a fraud or other non-antitrust criminal offense, corporate defendants may discover that antitrust charges deal the more devastating blow. If U.S.-focused volume of affected commerce exceeds the amount that could be proven as a loss intended by a defendant, or if a defendant is a late-cooperator with the Antitrust Division, antitrust charges may present the more severe consequences.

In navigating antitrust and non-antitrust charges in U.S. investigations, there are several key distinctions and practice: points that counsel should know at the outset regarding (1) when U.S. authorities have pre-charging stage prosecutorial discretion with antitrust and non-antitrust charges; (2) the efforts the Antitrust Division has made to align some of its historical policies with other U.S. criminal prosecuting divisions; (3) differences in fine and jail time calculations; and (4) the increased role of U.S. regulators in these cases.

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Pre-Charging Prosecutorial Discretion: Corporate Leniency Policy vs. Other Criminal Enforcement

There are important distinctions in the scope and nature of prosecutorial discretion exercised in U.S. cartel investigations when compared with non-antitrust investigations. Cartel practitioners are by now very familiar with the U.S. Corporate Leniency Policy[3] and the significant consequences for companies that are not the first to report antitrust violations. That timeliness factor historically has been the dispositive factor in whether a company was prosecuted by the Antitrust Division, leaving every other company to negotiate the scope of a guilty plea, volume of commerce for a base fine, and any discounts that could be achieved.

In contrast, there are specific factors that guide the decision to prosecute a corporate defendant in a non-antitrust criminal case that do not apply to the Antitrust Division in a case that involves only cartel charges. These factors, which are described in further detail below, include pervasiveness of conduct, history of corporate wrongdoing, and effectiveness of an existing compliance program. While typically none of these factors alone is dispositive in determining whether a charge will be brought, the totality of the factors can result in the exercise of prosecutorial discretion not to charge a corporate defendant, or to agree to a less severe outcome than a guilty plea.[4]

U.S. Attorney's Manual—Prosecutions of Business Organizations. The Antitrust Division's Corporate Leniency Program is just one enforcement policy in the broader enforcement context of the DOJ, which has jurisdiction to prosecute criminal cases in numerous other areas of the law beyond cartel charges. This is particularly relevant in an era in which the Antitrust Division is prosecuting cases with other components of the DOJ, including the DOJ's Criminal Division and U.S. Attorney's Offices.

Although U.S. prosecutors make decisions to charge based on the facts and law as they apply to a particular defendant, the DOJ provides some basic guidance via the U.S. Attorney's Manual (USAM), regarding the factors it will consider in criminal investigations of corporate defendants. The USAM expressly notes, however, that these considerations may not be appropriate with antitrust violations, where the Antitrust Division has established a clear policy, understood in the business community, that credit should only be given to the first company to self-report.[5]

Section 9-28.300 of the USAM describes some of the DOJ's enforcement considerations when investigating criminal violations by corporate subjects. Specifically, Section 9-28-300 identifies ten discretionary factors that a prosecutor may evaluate in determining whether to bring charges and/or negotiate a plea or other agreement with corporate subjects.[6] It is common practice in the United States for practitioners representing corporate subjects to seek to address these factors prior to any charging decision by the case prosecutors.

While there are some parallels between the USAM factors and aspects of the Corporate Leniency Policy, for example, both involve serious consideration of the company's cooperation in an ongoing investigation,[7] there are significant differences. Overall, the most critical difference is that the USAM allows prosecutors discretion in cases where a company can demonstrate a lack of pervasiveness of wrongdoing, no history of wrongdoing, the existence of an effective compliance program, and other positive factors. However, a defense presentation on these factors in an investigation involving only antitrust charges would be off-point, as these factors historically have not been persuasive where a corporate subject failed to self-report early enough to be the leniency applicant. Indeed, many of these factors are not addressed at all in the Frequently Asked Questions (FAQs) or other enforcement guidance from the Antitrust Division.

Although the existence of a compliance program is not a factor the Antitrust Division considers in connection with its charging decisions, the Division recently has shown a willingness to consider the effectiveness of compliance programs in determining the amount of the proposed fine it will recommend to the court. This is a newer development in the Division's enforcement policy and appears to be focused on the effectiveness of changes made to an existing compliance program or the adoption of a new program upon discovery or as a result of the violation leading to the prosecution. That is, the Antitrust Division's view appears to be forward looking (credit to lower the otherwise appropriate fine for improvements in a company's compliance program), whereas the USAM's view is backward looking (whether the company's pre-existing compliance program—along with other factors—suggest that the company should not be charged at all).

The Department of Justice's "Yates Memo." A final distinction that is important is the assessment of individual employees in investigations in which the company is also a subject of potential criminal charges. A comparison of the Corporate Leniency Policy and the Division's enforcement history, and a 2015 memorandum issued by the Deputy Attorney General of the United States (DAG), the second-highest ranking official in the DOJ, reveals that prosecutors in both antitrust cases and non-antitrust criminal cases should be focused on charging individuals, a practice that the Antitrust Division has been following for decades. Indeed, the Antitrust Division over time has consistently sought to charge individuals in cartel investigations, and from 2006 through 2015, 560 individual defendants were charged, whether by indictment or guilty plea.[8] Of course, the Division will continue to agree not to prosecute current employees of a company that qualifies for corporate leniency under the Corporate Leniency Policy.

[B]ecause the Yates Memo appears to be a direction to all DOJ components to focus attention on investigating and prosecuting those culpable individuals responsible for corporate crime, a practice followed by the Antitrust Division for decades and facilitated by the Division's carve-out policy, it is likely that Division practice will not be significantly affected by the Yates Memo.

On September 9, 2015, Deputy Attorney General Sally Q. Yates released a memorandum (Yates Memo) setting forth key steps to ensure that federal prosecutors seek to hold individuals accountable for corporate wrongdoing.[9] The Yates Memo includes several specific policy statements regarding corporate investigations that involve potentially culpable individuals, including:

- Companies "must identify all individuals involved in or responsible for the misconduct at issue, regardless of their position, status or seniority, and provide to the Department all facts relating to that misconduct."[10] In short, corporations cannot pick and choose what facts to disclose.
- Criminal and civil corporate investigations should focus on individuals from the inception of the investigation.[11]
- Absent extraordinary circumstances or approved departmental policy, the DOJ will not release culpable individuals from civil or criminal liability when resolving a matter with a corporation.[12]
- Prosecutors should not resolve matters with a corporation without a clear plan to resolve related individual cases, and should memorialize any declinations as to individuals in such cases.[13]

The Yates Memo provides for few exceptions, and the Antitrust Division's Corporate Leniency Policy is one. The Corporate Leniency Policy is identified as an "approved" policy that is not contravened by the Memo's requirements. Although the Yates Memo expressly addresses the Corporate Leniency Policy, it does not discuss what, if any, implications there are for the Antitrust Division's practice of "carving out" or "carving in" individuals in corporate plea agreements of companies that were not the leniency applicant in a cartel investigation. However, because the Yates Memo appears to be a direction to all DOJ components to focus attention on investigating and prosecuting those culpable individuals responsible for corporate crime, a practice followed by the Antitrust Division for decades and facilitated by the Division's carve-out policy, it is likely that Division practice will not be significantly affected by the Yates Memo.

Antitrust Division Enforcement Policies Align with Broader Enforcement Approaches

Despite long-standing distinctions between cartel enforcement policies, such as the Corporate Leniency Policy and broader DOJ enforcement practices, there have been several developments in the Antitrust Division's approaches that promote greater alignment with other criminal prosecution units, such as the Criminal Division and U.S. Attorney's Offices.

The Antitrust Division's Carve-Out Policy. On April 12, 2013, two years prior to the issuance of the Yates Memo, Assistant Attorney General Bill Baer stated that the Antitrust Division would be revising its approach to individuals in corporate plea agreements. Previously, corporate plea agreements, where applicable, included a provision "offering non-prosecution protection to employees of the corporation who cooperate with the investigation and whose conduct does not warrant prosecution,"[14] The Division carved out employees who were believed to be culpable and, at times, also carved out employees who "refused to cooperate with the [D]ivision's investigation," employees "against whom the [D]ivision was still developing evidence," and employees with "potentially relevant information who could not be located."[15] The names of such carved-out employees were included in publicly filed corporate plea agreements.[16]

Under the Division's new approach to corporate plea agreements, the Division announced that it would continue to carve out employees who are believed to have been culpable and who are potential targets of the Division's investigation.[17] The Division will not, however, continue to carve out employees for "reasons unrelated to culpability."[18] Furthermore, the Division will no longer include the names of carved-out employees in the plea agreement.[19] Instead, the Division will list those names in an appendix and subsequently seek leave to file the appendix under seal.[20]

This development brought the Division's policy closer to broader DOJ approaches in at least two ways: (1) It is closer to the policy of not naming "unindicted co-conspirators" in criminal investigations, as is set forth in the DOJ's Grand Jury Manual;[21] and (2) it treats the category of carved-out employees in a way that is closer to the "subject" and "target" definitions of the USAM,[22] rather than as a third, different category that could include individuals who are not suspected of any wrongdoing.

Credit for Compliance Programs. While Division officials have long stressed the point that compliance programs are critical to identifying violations and a compliance "culture" must exist at the top,[23] the Division has made clear that the mere existence of a compliance program, without more, is not sufficient to "avoid prosecution, secure a non-prosecution agreement, or otherwise dramatically reduce the penalties for criminal antitrust violations."[24] The rationale, given the principles of the Corporate Leniency Policy, is that where a corporation participates in a cartel and yet fails to detect it until after the government investigation began, it is difficult for the corporation to argue that its compliance program was effective.[25] Under the Antitrust Division approach, however, if the compliance program is "effective" in detecting the violation and results in the company being eligible for leniency, the company qualifies for amnesty for itself and its cooperating employees, and that decision often is automatic and not subject to the government's discretion.

The Division's historical approach has therefore been different than the USAM's consideration of effective compliance programs as one of the express factors under Section 9-28.400 of the USAM in charging decisions in non-antitrust cases.[26] Under the USAM, the "existence of a compliance program is not sufficient, in and of itself, to justify not charging a corporation for criminal misconduct,"[27] but Section 9-28.800 includes a more in-depth discussion of the kinds of information prosecutors can assess in crediting an existing compliance program. For example, prosecutors may assess whether the corporation has provided sufficient staff to audit, document, analyze, and utilize the results of the corporation's compliance efforts, and whether the corporation's employees are adequately informed about the compliance program and are convinced of the corporation's commitment to it.[28] As a practical matter, this difference has meant that defense counsel devote less time building the record relating to the company's compliance program in antitrust cases, whereas in other corporate prosecutions, counsel may spend significant resources demonstrating the cost, attention, and priority that the compliance efforts were given during the relevant time period.

Despite the differences at the charging phase, the Antitrust Division has recently shown a greater willingness to consider a company's compliance program at the sentencing stage. Prior to 2015, the Division had not publicly given any sentencing credit for an effective compliance program.[29] However, in 2015, for the first time, the Antitrust Division awarded sentencing credit to two antitrust defendants as a result of the corporations' administration of effective compliance programs after the Division had initiated investigations.[30]

The Antitrust Division's view of compliance programs is an area to watch, as the cases show an evolution in enforcement policy.

Corporate Monitors. The imposition of compliance monitors as a condition of a guilty plea or other resolution is another development bringing Antitrust Division approaches closer to other federal criminal cases. Assistant Attorney General Baer announced that the Antitrust Division may consider increasing the use of third-party monitors as part of the terms of a negotiated plea or settlement agreement.[31] This measure, however, is likely to be considered only in the most egregious cases in which the Division sees a need to prevent recidivism.[32] The use of a monitor in an Antitrust Division case is a severe penalty associated with post-conviction sentencing, largely due to the potentially significant expense and intrusion into ongoing business operations.

There are just a few examples thus far of compliance monitors in cases brought by the Antitrust Division. *AU Optronics* is the only litigated corporate criminal case to date in which the Antitrust Division has sought a compliance monitor.[33] In addition, in a judgment and commitment order following a plea agreement entered into by NGK for a cartel on spark plugs, the court placed NGK on a two-year probation and ordered NGK to report semi-annually on NGK's compliance program and on individuals carved out of the protections of the company plea agreement.[34] Finally, in April 2015 in the joint investigation by the Criminal and Antitrust Divisions, Deutsche Bank AG entered into a deferred prosecution agreement in the LIBOR investigation in which it agreed to retain an independent compliance monitor for three years.[35]

U.S. Sentencing Guidelines Relating to Antitrust and Non-Antitrust Criminal Offenses

Sentencing is another aspect of U.S. practice in which there may be critical differences when investigations involve both potential cartel charges and other criminal charges—for example, fraud charges.[36] Although the U.S. Sentencing Guidelines are advisory and do not bind federal judges' determinations,[37] practitioners still assess corporate and individual exposure using specific guidelines, including Section 2R.1.1 relating to antitrust offenses, and other non-antitrust guidelines, such as 2B.1.1 relating to certain fraud-like offenses.[38] In addition, in any pre-charge discussion with the Antitrust Division, guidelines ranges are critical to understanding potential outcomes.

Among the most significant sentencing distinctions in investigations involving both antitrust and non-antitrust charges is that the guidelines calculation for a company or an individual can vary widely depending on whether Section 2R.1.1 or another provision such as Section 2B1.1 applies. One of the reasons for this variation is that guidelines calculations for antitrust offenses begin with a base fine that is a percentage of the volume of commerce.[39] For corporate defendants, the fines are calculated using 20 percent of the volume of affected commerce.[40] For an individual defendant, the volume of commerce attributable to that participant in a conspiracy is the volume of commerce "done by him or his principal in goods or services that were affected by the violation."[41] Specifically, an individual defendant may be fined 1–5 percent of the volume of commerce, though not less than $20,000.[42]

In contrast, for fraud offenses that fall under Section 2B1.1, the guidelines ranges are determined based on concepts of actual loss and intended loss.[43] The Guidelines define actual loss as "the reasonably foreseeable pecuniary harm that resulted from the offense."[44] Intended loss is "the pecuniary harm that was intended to result from the offense," which includes "intended pecuniary harm that would have been impossible or unlikely to occur."[45] In addition, the potential guidelines ranges that impact jail time for individuals are also different and can result in significant disparities in jail sentences under the Guidelines for essentially the same conduct depending on which offense guideline is applied. The maximum jail time for antitrust offenses is ten years,[46] and depending on the fraud charge and the amount of intended loss, jail time can far exceed ten years.[47]

There are a few potential implications for corporate and individual defendants in cases that could involve antitrust and other criminal offenses. As an initial matter, it may be that affected volume of commerce calculations vastly exceed intended or actual loss calculations in any particular case.

Proving volume of commerce and intended/actual loss may require some of the same evidence (e.g., trading or sales data), but in many cases, the analysis will not be identical. As a result, counsel should analyze early in a case what kind of data is relevant, in particular in responding to grand jury subpoenas with such data or otherwise providing information in the course of plea negotiations. For example, antitrust offenses do not require proof of specific intent to defraud, but if an investigation involved potential fraud charges, this is an area in which the presence or absence of e-mail or communications demonstrating a company's or individual's intent to cause an identifiable amount of pecuniary harm would be important to identify for a plea negotiation.

In addition, some fraud charges (e.g., securities or commodities based charges) may not routinely involve detailed negotiations relating to components of worldwide sales that are common in antitrust cases, so there may be different defenses to be evaluated in that regard. Finally, in any individual case, a plea to a fraud offense may expose the defendant to a higher guidelines range before the sentencing judge. Although rare, in at least one case, a sentencing judge has recognized this disparity in applying an upward variance in an antitrust case.[48]

Increased Participation of Non-Antitrust Regulatory Agencies

A final point that becomes critical in cases involving antitrust and non-antitrust offenses is that where there is potential fraud, regulatory agencies that have civil fraud jurisdiction may join with parallel investigations. Although these regulatory agencies have historically had some interaction with the Antitrust Division in its investigations, in the past five years, there has been much more significant investigatory activity, as can be seen in public resolutions in the LIBOR, foreign exchange currency, and other investigations.[49] Although international cartel practitioners are quite familiar with coordination among global antitrust enforcers, the addition of U.S. regulators, including the Securities and Exchange Commission, Commodities and Futures Trading Commission, FINRA, Office of the Comptroller of Currency, and New York Department of Financial Services, among others, can create additional levels of complexity in defending corporate and individual clients. Although some of these agencies can refer charges to the DOJ for prosecution, each of these agencies also has its own enforcement jurisdiction that is independent of any action by the DOJ. In addition, many of these agencies have regulatory powers to compel information and compliance that the DOJ does not have (e.g., banking regulators have sought privileged information), and may also have the ability to debar institutions and individuals upon a guilty plea or the agencies' own enforcement action.

Nor is there typically any specific coordination requirement under federal or state law between the DOJ and such agencies or obligation for such agencies to consider the amount of fines or sanctions issued by others. That said, informal and formal communications between agencies may still occur about these topics. Practitioners therefore cannot assume that an overall strategy to defend a cartel investigation will suffice for responding to related subpoenas and requests from these additional regulatory agencies, even if the requests seek information about the alleged collusion. In these scenarios, the most effective defense of a company and individuals will involve agency experts beyond the antitrust team.

Conclusion

This complex process of investigation of essentially the same conduct by multiple components of the DOJ and other U.S. regulators, as well as by prosecutors and regulators from other jurisdictions, appears likely to continue in the future. Because of, among other things, important differences in investigation and prosecutorial practices, the continuing evolution of Antitrust Division enforcement policy, and the distinctions in sentencing guidelines ranges, counsel must evaluate early on in an investigation whether it is more likely that antitrust charges form the basis for the overall case theory or whether they will be secondary to fraud or other criminal charges. Although it may be difficult to determine with certainty, close attention to this issue—through analysis of the feedback from prosecutors, the nature of information requested, and the identity of the targeted individuals—is essential to developing an effective strategy over the life of the case. ■

[1] U.S. Dep't of Justice, *Antitrust Division Spring 2016 Update—Criminal Program*, https://www.justice.gov/atr/division-operations/division-update-2016.

[2] *See* James Griffin, Wendy Huang Waszmer & Graciela Rodriguez, *Parallel Proceedings: Responding to Antitrust Division and Other Government Investigations with Related Litigation*, Cartel & Criminal Practice Committee Newsl. (ABA Section of Antitrust Law) (Issue 1), http://www.kslaw.com/News-and-Insights/PublicationDetail?us_nsc_id=7049.

[3] https://www.justice.gov/atr/corporate-leniency-policy.

[4] Other than a guilty plea, in which the defendant agrees to the filing of a charge in federal court, the DOJ has entered in deferred prosecution agreements (DPAs) and non-prosecution agreements (NPAs) in non-antitrust cases. DPAs often involve the filing of a statement of facts and agreement with the court that include the specific charge that could be reinstituted if the defendant fails to comply with the requirements of the agreement. NPAs are agreements that may involve a statement of facts and can include an admission of wrongdoing by the defendant, but may not be filed with a court.

[5] *See* U.S. Dep't of Justice, U.S. Attorneys' Manual § 9-28.400 (2014) (USAM) ("Special Policy Considerations," discussing that although in some cases, prosecutors take pre-indictment conduct into account (e.g., remediation), this would "not necessarily be appropriate in an antitrust investigation, in which antitrust violations, by definition, go to the heart of the corporation's business. With this in mind, the Antitrust Division has established a firm policy, understood in the business community, that credit should not be given at the charging stage for a compliance program and that amnesty is available only to the first corporation to make full disclosure to the government.").

[6] *See* USAM §§ 9-28.300-1000. The ten factors are: (1) nature and seriousness of the offense; (2) pervasiveness of wrongdoing within the corporation; (3) corporation's history of similar misconduct; (4) corporation's willingness to cooperate in the investigation of its agents; (5) existence and effectiveness of the corporation's pre-existing compliance program; (6) corporation's timely and voluntary disclosure of wrongdoing; (7) corporation's remedial actions; (8) collateral consequences; (9) adequacy of remedies; and (10) the adequacy of prosecution of individuals responsible for corporation's malfeasance.

[7] *See* Bill Baer, Assistant U.S. Att'y Gen., U.S. Dep't of Justice, Antitrust Div., Remarks as Prepared for the Georgetown University Law Center, Global Antitrust Enforcement Symposium—Prosecuting Antitrust Crimes (Sept. 10, 2014) [hereinafter Baer Remarks], http://www.justice.gov/atr/file/517741/download. To qualify for leniency, an applicant must engage in "complete and continuing cooperation with the [D]ivision throughout [its] investigation and resulting prosecutions." *See id.* Leniency applicants must "actually help [the Division] investigate and prosecute antitrust crimes." Leniency applicants are expected to conduct thorough internal investigations, provide "detailed proffers of the report conduct," produce foreign-located documents, prepare translations, and make witnesses available for interviews." *See id.* As such, speed is critical at the early stages of an investigation, and a corporation that "invests the time and the resources can typically satisfy the initial requirements for conditional leniency within a few months." *See id.*; *see also* Antitrust Division, Model Corporate Leniency Letter, ¶ 2 (describing cooperation requirements for leniency applicants), http://www.justice.gov/atr/model-corporate-conditional-leniency-letter.

[8] *See* U.S. Dep't of Justice, Antitrust Div., *Criminal Enforcement, Trends Charts Through Fiscal Year 2015*, http://www.justice.gov/atr/criminal-enforcement-fine-and-jail-charts.

[9] Memorandum from Sally Q. Yates, Deputy Att'y Gen., Dep't of Justice, to Assistant Att't Gen., Antitrust Div. et al. (Sept. 9, 2015), http://www.justice.gov/dag/file/769036/download.

[10] *Id.* at 3.

[11] *Id.* at 4.

[12] *Id.* at 4–5.

[13] *Id.*

[14] Press Release, U.S. Dep't of Justice, Statement of Assistant Attorney General Bill Baer on Changes to Antitrust Division's Carve-Out Practice Regarding Corporate Plea Agreements (Apr. 12, 2013), http://www.justice.gov/opa/pr/statement-assistant-attorney-general-bill-baer-changes-antitrust-division-s-carve-out (Press Release, Statement of Assistant Attorney General Bill Baer).

[15] *Id.*

[16] *Id.*

[17] *Id.*; *see also* Baer Remarks, *supra* note 7.

[18] Press Release, Statement of Assistant Attorney General Bill Baer, *supra* note 14.

[19] *Id.*

[20] *Id.*

[21] *See* USAM § 9-11-130(e).

[22] *See* USAM § 9-11-151.

[23] *See* Brent Snyder, Deputy Assistant Att'y Gen., U.S. Dep't of Justice, Antitrust Div., Remarks as Prepared for the International Chamber of Commerce/United States Council of International Business Joint Antitrust Compliance Workshop—Compliance Is a Culture, Not Just a Policy (Sept. 4, 2014) download [hereinafter Snyder Remarks], http://www.justice.gov/atr/file/517796/download ("If senior management does not actively support and cultivate a culture of compliance, a company will have a paper compliance program, not an effective one. Employees will pick up on the lead of their bosses. If the bosses take compliance seriously, the employees are far more likely to take it seriously. If they don't, the employee's won't. It's as simple as that.").

[24] Baer Remarks, *supra* note 7.

[25] *Id.*

[26] *See* USAM § 9-28.800 (describing prosecutor consideration of effective compliance programs in corporate prosecutions).

[27] *See* United States v. Basic Constr. Co., 711 F.2d 570, 573 (4th Cir. 1983) ("[A] corporation may be held criminally responsible for antitrust violations committed by its employees if they were acting within the scope of their authority, or apparent authority, and for the benefit of the corporation, even if . . . such acts were against corporate policy or express instructions.").

[28] *See* USAM § 9-28.800.

[29] While the Sentencing Guidelines provide for up to a three point reduction in the culpability score for a company compliance program, the Antitrust Division did not ask for such reductions. *See* U.S. Sentencing Comm'n, Federal Sentencing Guidelines Manual § 8C2.5(f)(3)(C) (2011). At least two rationales have been put forth by the Antitrust Division for the reluctance to seek a point reduction for compliance programs, including that: (1) there is a rebuttable presumption that the compliance program was not effective if an employee with substantial authority participated in, condoned, or was willfully ignorant of the offense; the majority of cartel cases investigated by the Antitrust Division involve company employees who are viewed by the Division as having a sufficiently high level of authority that credit will not be given under § 8C2.5(f)(3)(B)(i)–(ii); (2) if the company did not come forth as an amnesty applicant, the company cannot utilize the provisions of § 8C2.5(f)(3)(C) to avoid the rebuttable presumption; specifically, the program does not meet the requirement that "the compliance and ethics program detected the offense before discovery outside of the organization or before such discovery was reasonably likely." *Id.*

[30] Barclays PLC and the United States entered into a plea agreement in May 2015, where the recommended fine of $650 million was lower than the amount recommended by the U.S. Sentencing Guidelines. Plea Agreement at 15, United States v. Barclays PLC, No. 3:15-cr-00077-SRU-1 (D. Conn. May 20, 2015), ECF No. 6. The United States and Barclays PLC agreed that the lower amount was sufficient partly because the bank had made "substantial improvements to . . . [its] compliance and remediation program to prevent recurrence of the charged offense." *Id.* at 1. Similarly, in September 2015, Kayaba Industry Co. Ltd. (KYB) and the United States entered into a plea agreement. Plea Agreement at 9, United States v. Kayaba Industry Co., Ltd. d/b/a KYB Corporation, No. 1:15-CR-00098 (S.D. Ohio Sept. 16, 2015), ECF No. 9; Waiver of Indictment, KYB Corporation, No. 1:15-CR-00098 (Oct. 29, 2015), ECF No. 25; see also Press Release, U.S. Dep't of Justice, KYB Agrees to Plead Guilty & Pay $62 Million Criminal Fine for Fixing Price of Shock Absorbers (Sept. 16, 2015), http://www.justice.gov/opa/pr/kyb-agrees-plead-guilty-and-pay-62-million-criminal-fine-fixing-price-shock-absorbers), that discounted KYB's fine for price-fixing shock absorbers from the maximum $207 million. *See* Ron Knox, *KYB Memo Sheds Light on DOJ Compliance Credit*, Global Competition Rev. (Oct. 8, 2015); Leah Nylen, *Car Parts Maker KYB Becomes Second Company to Gain Compliance Credit in Antitrust Case*, MLex (Sept. 29, 2015). The Antitrust Division credited KYB's "forward-looking compliance efforts" in its decision to discount the corporation's fine and reaffirmed its willingness to award compliance credit where a company "has fundamentally taken steps to change its business culture and [the Division] can see actual results from the company's efforts in that regard." *Id.*

[31] Baer Remarks, *supra* note 7.

[32] *Id.*

[33] *See* Snyder Remarks, *supra* note 23.

[34] Plea Agreement at 9, United States v. NGK Spark Plugs Co., Ltd., Case No. 2:14-cr-20494 (E.D. Mich. Oct. 8, 2014 (ECF No. 11); Judgment at 2–3, NGK Spark Plugs, Case No. 2-14-cr-20494 (E.D. Mich. Oct. 8, 2014 (ECF No. 8).

[35] Baer Remarks, *supra* note 7.

[36] The LIBOR investigation is an example of an investigation that involved both antitrust and fraud charges. *See, e.g.*, United States v. The Royal Bank of Scotland Plc, No. 3:13-CR-74-MPS (D. Conn. 2013); United States v. RBS Sec. Japan Ltd., No. 3:13-CR-73-MPS (D. Conn. 2013); *see also* U.S. Dep't of Justice, Pending Criminal Division Cases, https://www.justice.gov/criminal-vns/case/pending-criminal-division-cases.

[37] *See generally* United States v. Booker, 543 U.S. 220, 244–45 (2005) (rendering federal Sentencing Guidelines "effectively advisory"); U.S. Sentencing Comm'n, Guidelines Manual (2015), http://www.ussc.gov/guidelines-manual/2015/2015-ussc-guidelines-manual [hereinafter 2015 U.S. Sentencing Guidelines Manual].

[38] For a discussion of corporate fine calculations, see James M. Griffin, Alan Dial & Wendy Huang Waszmer, *Determining Corporate Fines in Antitrust Criminal Cases* (2014) (on file with authors) (discussing that, in addition to Section 2R1.1, provisions of Chapter 8 of the Sentencing Guidelines apply to determine guidelines ranges of corporate defendants. *See* U.S. 2015 Sentencing Guidelines Manual, ch. 8).

[39] 2015 U.S. Sentencing Guidelines Manual, *supra* note 37, § 2R1.1.

[40] *Id.* § 2R1.1(d)(1)–(2).

[41] *Id.* § 2R1.1(b).

[42] *Id.* § 2R1.1(c).

[43] 2015 U.S. Sentencing Guidelines Manual, *supra* note 37, § 2B1.1 cmt. 3(A).

[44] *Id.* § 2B1.1 cmt. 3(A)(i).

[45] *Id.* § 2B1.1 cmt. 3(A)(ii).

[46] *See* Antitrust Criminal Penalty Enhancement and Reform Act of 2004, Pub. L. No. 108-237, § 213(b), 118 Stat. 665, 666 (codified as amended at 15 U.S.C. § 1 note). ACPERA was extended for 10 years in June 2010.

[47] Calculations of guidelines for fraud offenses require a specific amount of intended or actual loss, but as an example of potential exposure, under Section 2B.1.1, under the 2015 Sentencing Guidelines Manual, if a case involves $25 million or more in intended or actual loss, 30 points can be added to a base offense level, and that does not include points that can be added for other reasons. *See* 2015 U.S. Sentencing Guidelines Manual § 2B.1.1. Under the 2015 Sentencing Table, defendants with overall offense levels of 30+ can have guidelines ranges that vastly exceed ten years even if they have no criminal history. *See* U.S. Sentencing Guidelines Manual, Sentencing Table, http://www.ussc.gov/sites/default/files/pdf/guidelines-manual/2015/Sentencing_Table.pdf.

[48] *See, e.g.*, United States v. VandeBrake, 771 F. Supp. 2d 961, 1003 (N.D. Iowa 2011) (doubling the defendant's sentence from 21–27 months to 48 months because the harm caused by price fixing and bid rigging was at least as great, if not greater than, the harm caused by comparable conduct violating the fraud statutes, where "fraud schemes target only discreet segments of the general population while antitrust violations go to the heart of our economic free enterprise system because they have the possibility of negatively affecting the entire economy"), *aff'd*, 679 F.3d 1030 (8th Cir. 2012).

[49] For example, the DOJ's investigation of potential manipulation of global benchmark interest rates—including LIBOR and EURIBOR—also resulted in record-level fines in 2015. Deutsche Bank AG, Barclays, and the Royal Bank of Scotland are examples of entities that entered into resolutions with the U.S. Commodities and Futures Trading Commission.

What Is a "But-For World"?

BY JUSTINE S. HASTINGS AND MICHAEL A. WILLIAMS

A CENTRAL QUESTION IN ANTITRUST class actions is whether there exist common, well-accepted methodologies and evidence that reliably show that defendants' alleged conduct caused common impact (i.e., antitrust injury) and damages to all or substantially all class members. In many, perhaps most, antitrust class action cases, the plaintiff alleges that anticompetitive conduct caused prices to increase above competitive levels, and the task for economic experts is to analyze how actual prices compare to prices in a "but-for world" in which the alleged anticompetitive conduct did not occur. Since many class action antitrust cases concern prices paid for products or services, we will refer here to the outcome of interest in the but-for world as "prices." More generally, class actions also can involve analyses of factors that affect the value of market exchange to the class, such as prices paid by direct or indirect purchasers, wages paid, or the quantity or quality of items available for purchase.

What constitutes a proper "but-for world" and how one estimates "but-for" prices in that world are central points of contention in many antitrust class action cases. In this article, we provide an economic analysis of this important issue, and we accompany our analysis with real-world examples from our experience as testifying experts in recent cases.

Connecting Market Outcomes to the Challenged Conduct

A first step in the economic analysis of antitrust injury and damages is to connect the outcomes class members experienced to the challenged anticompetitive conduct, using data, economic models, and statistical estimation techniques. The economist must determine whether the alleged conduct resulted in increased prices, holding constant other competitively neutral factors that simultaneously affected prices. This is referred to as analyzing the causal impact of the alleged conduct on prices, conditional on observable market factors.

An expert economist generally begins the analysis of antitrust impact or damages by specifying the alleged anticompetitive conduct, e.g., colluding to fix prices, and what would have occurred in the absence of the alleged conduct. This "description of the defendant's proper actions in place of its unlawful actions and a statement about the economic situation absent the wrongdoing"[1] defines the but-for world that guides the economic and statistical modeling the economist will employ to estimate prices in the but-for world. Antitrust injury and damages can be analyzed by comparing actual and but-for prices. This requires an analysis of a but-for world that holds all factors constant with the exception of the alleged conduct.

This basic characterization of a but-for world has substantial support. In perhaps the first formal definition of causation, philosopher David Hume wrote in 1748: "We may define a cause to be an object followed by another . . . where, if the first object had not been, the second never had existed."[2] For example, in a cartel pricing-fixing case, if the cartel had not been, then the higher price would never have existed. In the many years since Hume's statement, economists and scientists more generally have developed sophisticated theories of causation.[3] In an important synthesis of the field, Nobel prize-winning economist James Heckman states:

> Causality is a very intuitive notion that is difficult to make precise without lapsing into tautology. Two ingredients are central to any definition: (1) a set of possible outcomes (*counterfactuals*) generated by a function of a set of "factors" or "determinants" [e.g., an economic model of the market] and (2) a manipulation where one (or more) of the "factors" or "determinants" is changed.[4]

For example, an assumption about the existence of a price-fixing agreement is changed from "present" to "not present" for the purposes of analyzing antitrust injury and damages. Then, as Professor Heckman states: "The outcomes are compared at different levels of the factors or generating variables. Holding all factors save one at a constant level, the change in the outcome associated with manipulation of the varied factor is called a causal effect of the manipulated factor."[5] For example, in an antitrust context, actual prices are compared to but-for prices.

Thus, the but-for world "differs from what actually happened only with respect to the harmful act,"[6] that is, the but-for world holds all other factors except one—the alleged conduct—the same in order to measure what prices would have been but for the alleged conduct. As discussed below, economic experts apply this fundamental approach to isolate price effects caused by alleged anticompetitive conduct. They do so by developing an economic model of the market that holds constant the effect of market factors unrelated to that conduct.

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Modeling Market Outcomes in the But-For World

In a but-for world, the economist generally assumes that the market would have been competitive in the absence of the alleged conduct, which in antitrust cases typically constitutes conduct that reduces or restricts competition, thereby increasing the ability of firms to exercise market power. The concept of a competitive market is fundamental in economics. One example of a competitive market is the canonical model of perfect competition,[7] in which many small firms sell a homogeneous product to many small buyers. Both buyers and sellers have perfect information regarding the marketplace, and there are no barriers to entering or exiting the market.[8] Any market that satisfies the criteria of this model of perfect competition will be competitive. Firms in competitive markets earn a competitive rate of return on their investments. Economists refer to this as zero economic profits. (A firm's economic profits equal its operating returns minus the opportunity cost of the capital employed, i.e., the value of that capital in its best alternative use.)

However, while markets that satisfy the assumptions of the canonical model of perfect competition are competitive, not all competitive markets satisfy these assumptions. Other examples of markets that can be, but are not necessarily, competitive include markets in which products are differentiated, markets with many sellers (monopolistically competitive markets), and markets that have a few number of sellers (i.e., oligopolies) but minimal barriers to entry and, thus, are subject to rapid entry by potential entrants (i.e., entrants can quickly enter in response to positive economic profits, thus the threat of entry keeps profits at competitive levels).

This concept of zero economic profits can be illustrated by considering a hypothetical farmer growing soy beans. If the price of soy beans falls relative to what the farmer could earn investing her land, time, effort, and resources in growing corn, she will move resources out of soy beans and into corn. The same can be said for a firm that invests in alternative lines of research and development for new products, i.e., investment capital moves to areas of higher return until the returns are equalized across all development lines. The beauty of the competitive market concept is that we only need to assume that arbitrage is possible, i.e., firms can observe and act on arbitrage opportunities to maximize profits by entering and exiting markets.[9] This force drives the economic profits of firms in a competitive market, on average, to zero.

In the context of analyzing antitrust injury and damages, the approach of assuming a competitive market in the but-for world is appealing for several reasons. Specifying the competitive market outcome as the outcome that would have happened in the but-for world does not require many rigid and specific assumptions about the exact market structure (e.g., number or identity of firms) that would exist in the but-for world. As discussed above, several different models of competition yield competitive outcomes. This is apparent empirically—most markets are sufficiently competitive that economic profits of the average firm are approximately zero despite having distinctly different market structures.

One of the co-authors of this article (Williams) and others have analyzed economic profits using a global database for the period 1999 through 2010 with 13,342 firms in 57 industries from 43 countries, and total 2010 revenues of $38.5 trillion (61 percent of world GDP).[10] They find that the median economic profit rate is –2.0 percent. That is, the median firm earned 2.0 percent less than the competitive, zero profit economic rate of return. For this reason, assuming that firms in a but-for world would earn the competitive, zero profit economic rate of return is generally a conservative assumption. If, to the contrary, the but-for world is one in which firms earn positive economic profits, the cash flow model can be adjusted (by increasing the but-for prices) so that the firm's operating returns exceed the opportunity cost of capital employed by an amount that equals the but-for level of positive economic profits. Such an adjustment would be based on a determination that, even in the absence of the allegedly anticompetitive conduct, conditions in the relevant market would enable a representative firm to earn positive economic profits during the damages period. Such a determination would require a case-specific analysis of the relevant market evaluating, for example, the presence of barriers to entry.

Because the concept of a competitive market outcome is not driven by a large number of assumptions but is instead a *general* concept, calculating the but-for price is simple, robust, and transparent. If the market in the but-for world is a competitive market, the data required to estimate but-for prices are input costs and a measure of the opportunity cost of the capital employed by the firm. By calculating input costs and opportunity costs of investments, the expert can provide an estimate of what the competitive outcome would have been in the absence of the alleged anticompetitive conduct in a transparent way that does not require specifying an exact model of competition in the but-for world.

An Example from the Cable Industry. Two recent antitrust tying cases in the cable industry illustrate this approach. In one case, Cox Cable was accused by a class of plaintiffs in Oklahoma City of illegally tying its premium cable television services to the rental of its set-top boxes.[11] In its decision on class certification, the court found that "there is direct, common evidence of classwide policies, practices, and statements that Cox customers had to rent a Cox set-top box in order to participate in the full panoply of digital services."[12] For the purposes of analyzing antitrust injury and damages, the plaintiffs' expert economist studied the nature of competition in the market for the retail sale of set-top boxes. The study focused on retail markets for the sale of similar electronic devices by retailers such as Best Buy, as well as retail markets in Canada for the sale of set-top boxes. (Canadian cable companies do not tie their premium cable television services to the rental of their set-top boxes.) The results of the study demonstrated that retail markets for the sale of set-top boxes are competitive.

Based on these results, the plaintiffs' expert estimated the but-for rental rates that Cox subscribers would have paid in the absence of the disputed tie. In the ordinary course of business, Cox had prepared spreadsheets calculating its rate of return on investments in set-top boxes. The spreadsheets analyzed the relevant cash flows, including up-front acquisition costs, periodic maintenance costs, and rental payments by subscribers over the expected lifetimes of different types of set-top boxes. The but-for rental rates were calculated using these same spreadsheets. The first step was to set the rate of return on investments in set-top boxes equal to Cox's own estimate of its opportunity cost, i.e., its cost of capital for investments in the retail rental of set-top boxes. This step ensured that in the but-for world, Cox's subscribers acquired set-top boxes at a competitive price, assuming that Cox's opportunity cost of capital was representative of opportunity costs for firms in the market. The second and final step was to hold constant Cox's acquisition and maintenance costs for each type of set-top box and calculate the rental rates that produced a rate of return equal to the competitive rate of return, i.e., Cox's cost of capital.

The second cable case involved a similar class action by subscribers of Cablevision in the New York City metropolitan area, alleging that the firm illegally tied its two-way cable services (i.e., (1) the interactive program guide, (2) the ability to order pay-per-view events using a remote control, (3) Video on Demand, and (4) iO Games), to the rental of its set-top boxes.[13] The plaintiffs' expert calculated but-for rental rates for set-top boxes using a similar cash flow model. Again, the critical economic element of the model was the requirement that in the but-for world, Cablevision's subscribers acquired set-top boxes in a competitive market.

An important aspect of both models is that they did not require the expert to specify detailed aspects of the but-for competitive markets in which subscribers acquire set-top boxes. For example, once the competitive rate of return has been specified, the expert need not determine which specific retailers in the but-for world would sell set-top boxes to which specific subscribers. Retailers' prices in the but-for world would be those that yield the competitive rate of return on investments in set-top boxes, reflecting the competitive nature of the but-for retail markets for set-top boxes.

The parties and their experts disagreed on whether numerous additional details, such as the following, must be specified to properly define the but-for world used to show common impact in support of class certification:

1. The video packages that the defendant cable company would offer to its subscribers.
2. The prices of those video packages.
3. The video package selected by each subscriber.
4. The manner in which set-top boxes compatible with the defendant's cable system would be distributed, e.g., through big-box retailers, the internet, and/or the defendant cable company.
5. The set-top box models that would be distributed.
6. The prices of those set-top boxes.
7. The set-top box model selected by each subscriber.
8. The manner in which each subscriber purchased the set-top box services, i.e., through lease, lease-to-own, or purchase.
9. How long each subscriber would keep a compatible set-top box (whether leased or purchased).
10. How, and to what degree, each subscriber would be affected by other changes in the but-for world, such as a change in the quality of the defendant cable company's video services offerings and/or set-top boxes.

The approach described above for deriving competitive price levels based on the competitive rate of return on investments in set-top boxes in the but-for world does not require specification of these features. Indeed, an effort to specify such features would require the use of highly technical methods from the field of "dynamic oligopoly games,"[14] but even these state-of-the-art techniques would be incapable of specifying the many features described above.

Briefly, dynamic oligopoly games are used to understand under what assumptions researchers can uncover the factors governing competition, profits, prices, and outputs with limited industry data, and then use those assumptions and factors to conduct simulations in counterfactual worlds (e.g., what would happen to prices if firms colluded). These approaches are used in academic research circles to push the bounds of economic theory, but are not necessary or appropriate for analyzing antitrust impact and damages. The models are generally complex and require substantial "structure," i.e., assumptions, on what firms believe, what potential actions they can take, and what statistical distributions govern each model component.

Thus, while dynamic oligopoly models push the boundaries of current computation and estimation techniques, they necessarily involve many assumptions. For example, what is a firm's belief regarding rivals' responses to its actions? What are the set of actions firms can take? What are the demand and profit functions? Assumptions regarding these and other features of a given model may not hold in any specific real-world market, but the assumptions are often required because computation has to be limited to a small set of possible outcomes. In sum, despite the limited ability of state-of-the-art industrial organization economics to specify counterfactual parameters, economists have argued that plaintiffs' expert economists in antitrust class actions must specify numerous characteristics of a but-for world that are both unnecessary (in the terms of counterfactual theories of causation), as well as impossible (in terms of the state-of-the-art in industrial organization economics).

Finally, some of the asserted features of the but-for world described above are literally impossible to calculate. Take for instance the assertion that one must determine what video packages the defendant cable company would offer to subscribers in the but-for world. The defendant cable company had over 570 all-digital channels. As a theoretical matter, the number of possible packages that can be formed using 570 channels approximately equals 3×10^{171}, which exceeds the number of atoms in the universe.[15] It is neither feasible nor necessary to compute all combinations of packages offered (existing and possible), all potential entrants, all technological innovations, all possible price discriminatory contracts, all actual and potential customers over a long time horizon, their choices in every permutation of the possible market place, and their welfare in all possible permutations.

In sum, specifying a general characteristic of a competitive outcome in the but-for world harnesses a fundamental and general economic principle of zero economic profits to transparently and robustly generate but-for prices. Supporting this assumption is often straightforward, as many diverse markets are characterized by competitive outcomes. Basic information on per unit costs and opportunity cost of capital allow for straightforward and transparent estimation and calculation.

Estimating Prices in the But-For World with Regression Analysis

The opportunity-cost-based approach to analyzing common impact and damages given in the cable example above is not always feasible. For example, the required input cost data may not be available or may not have a clear, per-unit relationship with output. In such cases, economists can use what is referred to as a "before-during" analysis. The before-during methodology can be applied in a number of ways, including (1) analyzing supply and demand conditions (discussed separately below), and (2) applying multivariate regression analyses to explain variation in observed prices as a function of cost and demand factors, and in turn to estimate what prices would have been, all else equal, in the damages period in the absence of the alleged anticompetitive conduct.[16]

With the regression approach, the economist is estimating in part how input costs relate to price in lieu of having actual per unit costs of production, coupled with information on the rate of return. The regression approach yields but-for prices that reflect the level of competition in the before period. If that competition yields a competitive outcome, then the implied rate of return would be the competitive rate of return, i.e., zero economic profits. If, instead, competition in the before period was between oligopolists earning supracompetitive profits, that would be reflected in the but-for prices.

Regression methods using the before-during model can be used to analyze common impact and damages issues. As discussed in the ABA monograph on econometrics, "Because econometric analysis can be used to control for numerous individual variables that affect pricing, it is widely recognized as an acceptable methodology for showing antitrust impact, or injury (i.e., determining the 'but for' price by isolating the effect of allegedly wrongful conduct on price)."[17] Effectively, prices in a time period before the alleged conspiratorial conduct occurred can be compared to prices during the conspiratorial conduct, holding constant a number of cost and demand factors. Explanatory variables included in the regression should measure marketplace fluctuations that are outside the influence of the cartel.[18]

Regression analysis presents inherent econometric challenges in demonstrating the existence of common impact,[19] but determining the common impact, if any, attributable to allegedly collusive behavior generally involves analyzing differences in actual and but-for prices. Two periods are typically identified. First, a damages or impact period is defined as the period in which the alleged collusion occurred. Second, a benchmark or control period is defined as the period in which the alleged collusion did not occur.

One critique of this regression approach is that, without a well-specified model of competition in the before period, the economist may not know which supply and demand control variables should be included in the regression; but there are well-established techniques to identify such variables. First, the economist can incorporate supply and demand factors present in the peer-reviewed literature as well as in documentary evidence and models produced by industry participants. Variables can be included even without specifying exact cost and demand functions. If parsimony is a question (concern over too many potential variables to include relative to the size of the data sample, or apparent contradictions in existing scientific and industry studies), well-established penalized regression models (e.g., Least Absolute Shrinkage and Selection Operator (LASSO)), can be used to select the strongest predictors of prices using predetermined routines that minimize the potential for including irrelevant or highly collinear variables.

Thus, the before-during approach is a robust and transparent method, grounded in industry facts and well-established economic principles, for estimating but-for prices and analyzing common impact and damages in ways that do not depend on the specific model of competition in the but-for world. Such regression models can be implemented in situations where per-unit costs and opportunity costs are not available or do not apply to the specific features of production and competition in the market.

Illustrating the Regression Approach with the* Fresh Potatoes *Price-Fixing Class Action Case. To illustrate the regression approach, we use the recently concluded *Fresh Potatoes* class action.[20] In that case, the defendants (including individual potato growers, owners, and packing sheds; marketing and shipping agencies working as agents of individual growers; and regional potato cooperatives), were alleged to have conspired to raise the price of fresh potatoes by illegally restricting the supply of potatoes through explicit agreements. The proposed class consisted of all persons residing in the United States who, at any time from June 2006 forward directly purchased fresh or process potatoes from defendants or their alleged co-conspirators. Since fresh potatoes are a commodity and sellers cannot price discriminate, all or substantially all buyers pay the same price for a given quality of fresh potatoes at a given point in time.

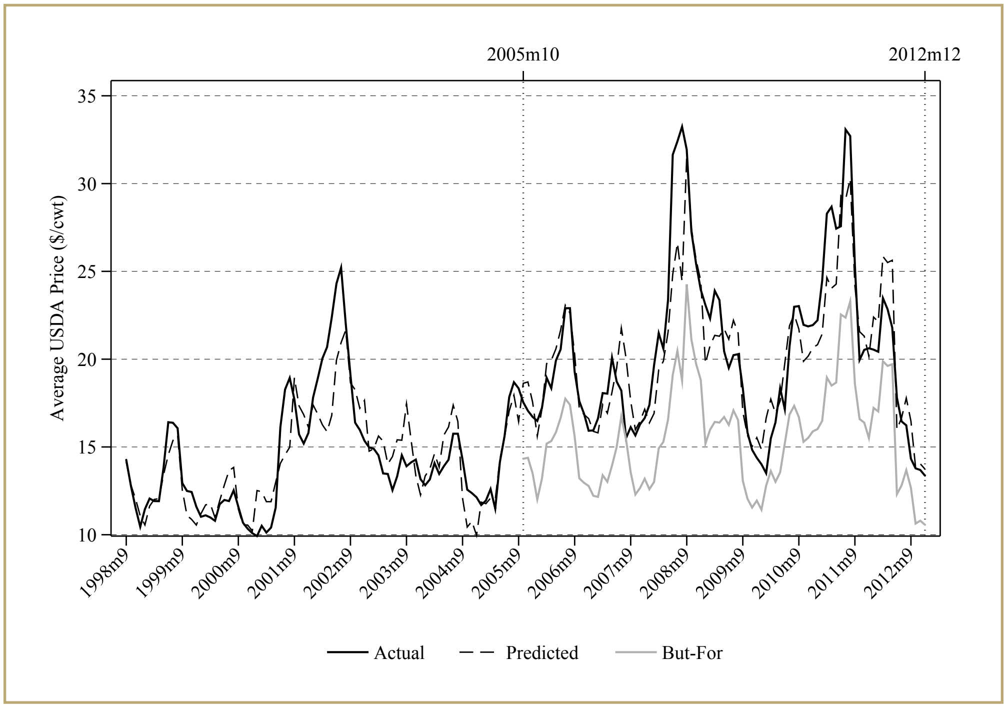


Figure 1. Actual, Predicted, and But-For Shipping Point Prices of Fresh Potatoes

Here, a production cost function was not known (unlike in cable where one set-top box purchased at wholesale with a known price produced one set-top box rental unit). Instead, the relationship between price and cost needed to be estimated while also controlling for demand factors that could influence price. Therefore, a regression model of price as a function of demand and cost factors was used to quantify damages. From an economic perspective, antitrust damages (in a given period) equal the difference between: (1) the price class members paid for the product in the actual world; and (2) the price that would have existed but for the alleged conduct, multiplied by the quantity purchased by class members. The coefficients in the estimated regressions were used to predict the but-for price for each month in the damages period. Figure 1 shows the actual, predicted, and but-for prices estimated using the regression models for fresh potatoes at the shipping point level.[21] (The shipping point level is the point in the distribution chain where growers sell their potatoes, generally at packing sheds.) The average overcharge at a national level attributable to the alleged collusion equals 30 percent for fresh potatoes. Note that this estimate falls within the range of estimates derived from analyzing supply and demand elasticities. (See discussion below.) The vertical dotted line indicates the start of the alleged damages period, October 1, 2005.[22]

Thus, in this approach, data from the benchmark and alleged damages periods were used to estimate a standard dummy-variable regression model. In such a model, the effect of collusion on price is measured by an indicator variable equal to one during the alleged collusion period and zero in the non-collusion period, hence the name "dummy variable."[23] The dummy-variable regression model utilized common evidence to estimate the prices that class members would have paid but for the alleged agreement. Again, this regression-based approach did not require the plaintiffs' expert economist to specify numerous, unnecessary characteristics of a but-for world, but instead relied on well-established economic principles, industry facts, and transparent statistical analysis. For example, this approach did not require counterfactual determinations of the number of pounds of potatoes shipped from individual packing sheds at each point in time. Thus, common impact was reliably demonstrated with the regression approach, noting again that fresh potatoes are a commodity over which sellers cannot price discriminate.[24]

Estimating Prices in the But-For World with Supply and Demand Elasticities

As noted above, an alternative approach to calculating but-for prices is to analyze supply and demand elasticities in the periods before and during an alleged conspiracy. The elasticity of demand for a product shows by how much the quantity demanded falls in response to a given increase in price. In particular, the elasticity of demand equals (1) the percentage change in quantity divided by (2) the percentage change in price. This approach may be followed when industry estimates of supply and demand elasticities are available, but reliable data on predictors of price are not, or to test statistical calculations and estimates derived from the prior two approaches.

Illustrating the Supply and Demand Approach with the* Fresh Potatoes *Price-Fixing Class Action Case. In the *Fresh Potatoes* price-fixing class action case, the empirical results of peer-reviewed research show that the elasticity of demand for potatoes is "inelastic," i.e., less than 1.0 in absolute value.[25] This means that a given percentage decrease in quantity demanded results from a much larger percentage increase in market price. For example, a price elasticity of –0.5 means that a 10 percent increase in price results in a 5 percent reduction in quantity demanded. Table 1 shows percentage price increases given (1) the estimated price elasticities of demand for potatoes in the peer-reviewed literature[26] and (2) different percentage reductions in the supply of potatoes caused by the alleged agreement.

Table 1: Percentage Increase in the But-For Price of Potatoes Caused By the Alleged Agreement

Percentage Reduction in Quantity Supplied	Elasticity of Demand			
	−0.14	−0.30	−0.40	−0.50
2	14.3	6.7	5.0	4.0
7	50.0	23.3	17.5	14.0

Note: The percentage increase in price equals (1) the percentage reduction in quantity supplied divided by (2) the elasticity of demand.

In June 2006, the United Potato Growers of Idaho cooperative concluded that its acreage reduction program had reduced the production of Idaho potatoes by approximately 8.4 million hundred weight.[27] The Idaho reduction equals 2.0 percent of total U.S. potato production in 2005.[28] Using the elasticity formula described above, the percentage reduction of 2.0 percent in quantity supplied resulting from the acreage restriction program implies price increases ranging from 4.0 percent to 14.3 percent. This calculation conservatively uses all potatoes as the denominator. However, the alleged cartel targeted fresh potatoes. The reduction of 8.4 million hundred weight amounts to 7.0 percent of total U.S. production of fresh potatoes. The percentage reduction of 7.0 percent in quantity supplied of fresh potatoes resulting from the acreage restriction program implies price increases for fresh potatoes ranging from 14.0 percent to 50.0 percent.

This application of the before-during methodology using the textbook model of supply and demand uses common evidence to show common impact given, as discussed above, that fresh potatoes are a commodity over which sellers cannot price discriminate. The analysis shows that class members paid higher prices as a result of the acreage reduction plan (which the plaintiffs asserted was put into place by the alleged agreement) than they would have paid but for that plan.

Moreover, this approach does not require the plaintiffs' expert economist to specify numerous characteristics of a but-for world that, as discussed above, are either unnecessary or impossible. For example, this approach does not require counterfactual estimates of the quantity of potatoes produced by each grower, as well as each grower's use of fertilizer, pesticides, labor, and capital. Thus, common impact can be proven with common evidence, based on a but-for world that "differs from what actually happened only with respect to the harmful act,"[29] i.e., the reduced output of potatoes.

Conclusion

The fundamental nature of a but-for world has been the subject of extensive research in the field of economics. For purposes of antitrust class action cases, the essential premise of this work is that a but-for world differs from the actual world only with respect to the harmful act. The examples and discussion above show how fundamental economic theory on industrial organization that relates prices to competition, cost, and demand factors, coupled with transparent statistical models, can be applied to identify market factors and common evidence that define the but-for world and provide robust, reliable evidence of common impact and damages in antitrust class action cases. In many such cases, reliable economic models can be developed and used that do not require specification and data analysis of numerous characteristics of a but-for world that are both unnecessary (in the terms of counterfactual theories of causation) as well as impossible (in terms of the state-of-the-art in industrial organization economics).

1 Mark A. Allen, Robert E. Hall & Victoria A. Lazear, *Reference Guide on Estimation of Economic Damages*, *in* Reference Manual on Scientific Evidence (Federal Judicial Center, National Research Council of the National Academies 425, 432 (2011)).

2 David Hume, *An Inquiry Concerning Human Understanding*, Section VII (1748) (Pearson (1995).

3 Important contributions include Trygye Haavelmo, *The Statistical Implications of a System of Simultaneous Equations*, 11 Econometrica 1 (1943); Jacob Marschak, *Economic Measurements for Policy and Prediction*, *in* Studies in Econometric Method 1 (W.C. Hood & T.C. Koopmans eds., 1953); David Lewis, *Counterfactuals*, Oxford: Blackwell (1973); Donald Rubin, *Estimating Causal Effects of Treatments in Randomized And Non-Randomized Studies*, 66 J. Educ. Psychol. 688 (1974); Donald Rubin, *Assignment to a Treatment Group on the Basis of a Covariate*, 2 J. Educ. Stat. 1 (1977); Paul Holland, *Statistics and Causal Inference*, 81 J. Am. Stat. Ass'n 945 (1986); Judea Pearl, *Causality*, Cambridge: Cambridge University Press (2000); Christopher Hitchcock, *The Intransitivity of Causation Revealed in Equations and Graphs*, 98 J. Phil. 273 (2001); and James Woodward, *Making Things Happen: A Theory of Causal Explanation*, Oxford: Oxford University Press (2003). *See generally* Peter Menzies, *Counterfactual Theories of Causation*, Stanford Encyclopedia of Philosophy (2014), http://plato.stanford.edu/entries/causation-counterfactual/.

4 James Heckman, *The Scientific Model of Causality*, 35 Sociological Methodology 1, 1 (2005) (emphasis added). *See also* James Heckman & Edward Vytlacil, *Econometric Evaluation of Social Programs, Part I: Causal Models, Structural Models, and Econometric Policy Evaluation*, *in* 6B Handbook of Econometrics, ch. 70, at 4780 (2007); James Heckman, *Econometric Causality*, 76 Int'l Stat. Rev. 1 (2008); James Heckman & Rodrigo Pinto, *Causal Analysis After Haavelmo*, 31 Econometric Theory 115 (2015).

5 Heckman, *The Scientific Model of Causality*, *supra* note 4, at 1.

6 Allen et al., *supra* note 1.

7 Jeffrey Church & Roger Ware, *Industrial Organization: A Strategic Approach*, Irwin McGraw-Hill, 22 (2000).

8 Preston R. McAfee, Hugo Mialon & Michael A. Williams, *What Is a Barrier to Entry?*, 94 Am. Econ. Rev. 461 (2004).

9 Of course, the presence of barriers to entry or exit can reduce the ability of firms to exploit profitable arbitrage opportunities.

10 Michael A. Williams, Grace Baek, Leslie Park & Wei Zhao, *Global Evidence on the Distribution of Economic Profit Rates*, 458 Physica A 356 (2016).

11 The authors served, respectively, as testifying and consulting experts for the plaintiffs. The jury unanimously found for the plaintiffs, but the court overturned the jury verdict. The case is currently on appeal. *See, e.g.*, Linda O'Brien, *Judge Sets Aside $6.31M Jury Verdict in Cox Cable Box Tying Suit*, Antitrust L. Daily (Nov. 12, 2015), http://www.dailyreportingsuite.com/antitrust/news/judge_sets_aside_6_31m_jury_verdict_in_cox_cable_box_tying_suit.

12 Memorandum Opinion and Order at 17, Healy v. Cox Commc'ns, Inc., Case No. CIV-12-481-C (W.D. Okla. Dec. 28, 2011). *See also* the FCC's Notice of

Proposed Rulemaking on set-top boxes: "FCC Chairman Proposal to Unlock the Set-Top Box: Creating Choice & Innovation. Ninety-nine percent of pay-TV subscribers are chained to their set-top boxes because cable and satellite operators have locked up the market. Lack of competition has meant few choices and high prices for consumers—on average, $231 in rental fees annually for the average American household. Altogether, U.S. consumers spend $20 billion a year to lease these devices. Since 1994, according to a recent analysis, the cost of cable set-top boxes has risen 185 percent while the cost of computers, televisions, and mobile phones has dropped by 90 percent. Congress recognized the importance of a competitive marketplace and directed the Commission to adopt rules that will ensure consumers will be able to use the device they prefer for accessing programming they've paid for." https://apps.fcc.gov/edocs_public/attachmatch/DOC-337449A1.pdf.

13 The authors served, respectively, as testifying and consulting experts for the plaintiffs. The case settled in December 2015. Class Action Settlement Agreement, Marchese v. Cablevision Sys. Corp., Civil Action No. 10-2190 (MCA) (MAH) (D.N.J. Dec. 7. 2015), http://tcllaw.com/wp-content/uploads/2016/04/Settlement-Agreement.pdf.

14 *See, e.g.*, Patrick Bajari, C. Lanier Benkard & Jonathan Levin, *Estimating Dynamic Models of Imperfect Competition*, 75 Econometrica 1331 (2007).

15 The number of packages equals $2^{570}-1$, which equals approximately 3×10^{171}. The number of atoms in the universe equals approximately 1×10^{80}. *See Number of Atoms in the Universe*, WolframAlpha, http://www.wolframalpha.com/input/?i=number+of+atoms+in+the+universe.

16 Justin McCrary & Daniel L. Rubinfeld, *Measuring Benchmark Damages in Antitrust Litigation*, 3 J. Econometric Methods 63 (2014).

17 ABA Section of Antitrust Law, Econometrics: Legal, Practical, and Technical Issues 341 (2d ed. 2014) [hereinafter ABA, Econometrics]. With respect to damages, the "before-during approach identifies the effect of the alleged conduct by using data from a period before the alleged conduct in combination with data from the period when the alleged conduct occurred. Comparing the values of the dependent variable in the before period to the value it took on in the during period may serve to identify the effect of the alleged conduct." *Id.* at 312 (citations omitted).

18 Halbert White, Robert Marshall & Pauline Kennedy, *The Measurement of Economic Damages in Antitrust Civil Litigation*, 6 Economics Committee Newsl. (ABA Section of Antitrust Law) 17 (2006).

19 *See, e.g.*, Kevin Caves & Hal Singer, *Econometric Tests for Detecting the Existence of Common Impact*, *in* The Law and Economics of Class Actions 135–60 (James Langenfeld ed., 2013).

20 *In re* Fresh and Process Potatoes Antitrust Litig., Civil Case No. 4:10-md-02186 BLW (E.D. Idaho). The authors served, respectively, as consulting and testifying experts for the plaintiffs. The case settled before defendants filed expert rebuttal reports.

21 The actual and predicted prices are "close" in the sense that the coefficient of determination (R^2) equals 0.87.

22 The United Potato Growers of Idaho was formed in 2004, Second Amended Class Action Complaint ¶ 22, *In Re Fresh and Process Potatoes Antitrust Litigation*, Civil Case No. 4:10-md-02186 BLW (Jan. 31, 2012), while the United Potato Growers of America was created in March, 2005, Timothy W. Martin, *This Spud's Not for You: Growing Co-Op of Farmers Seeks to Become OPEC of Potatoes by Controlling Supply*, Wall St. J., Sept. 26, 2006, at B1(2). We conservatively estimate the effect of collusion to begin on October 1, 2005. All of the data used in the regression shown in Figure 1 are publicly available.

23 *See, e.g.*, ABA, Econometrics, *supra* note 17.

24 For example, the defendants' potato prices were highly correlated with USDA nationwide prices.

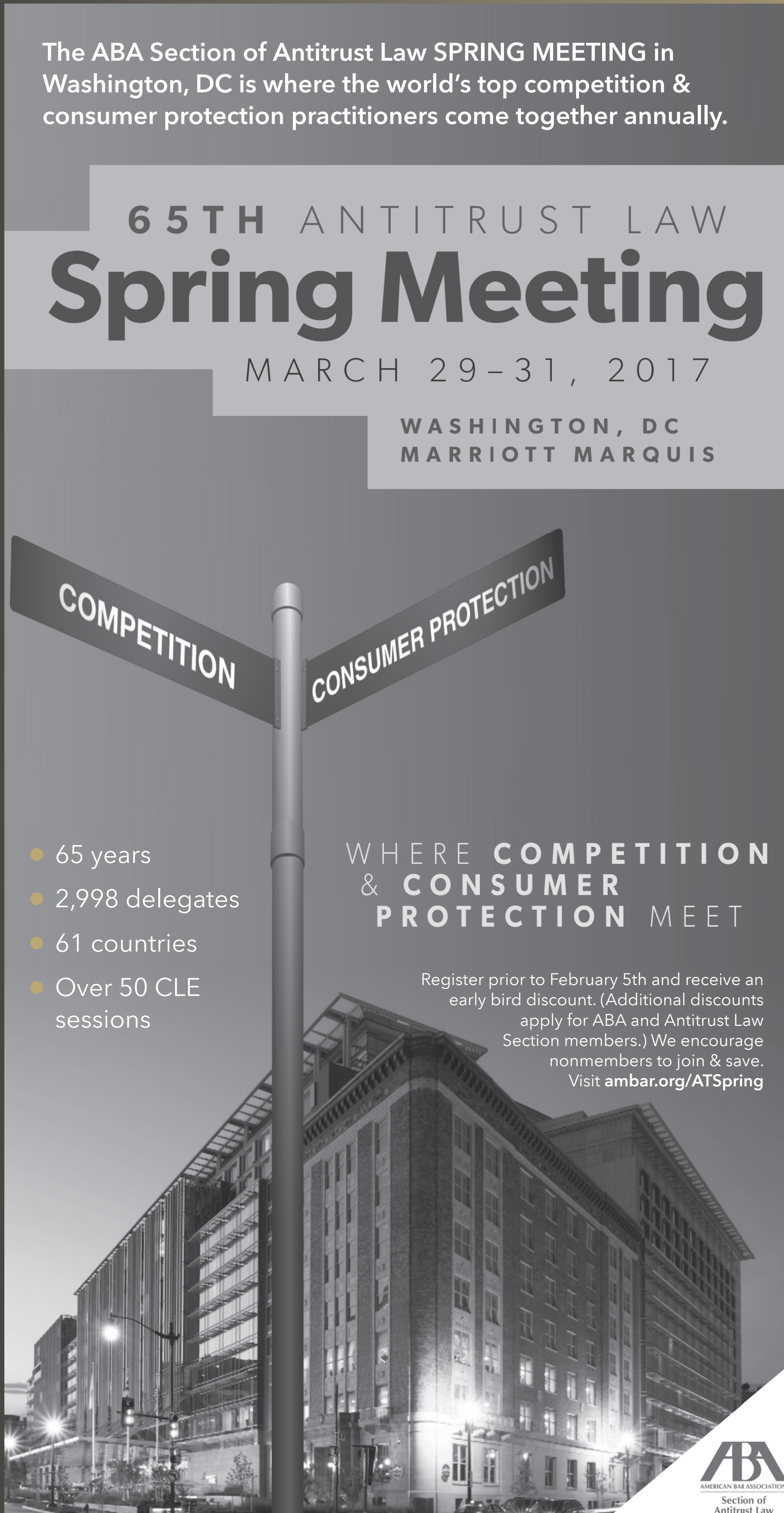
25 *See, e.g.*, Ronald Babula, Timothy McCarty, Douglas Newman & Stephen Burket, *Econometric Examination of U.S. Potato-Related Market Relationships: Findings from a Recent U.S. Trade Investigation*, 9 J. Int'l Food & Agribusiness Mktg. 35 (1998). The authors use a vector autoregression model to estimate the demand elasticity for fresh potatoes.

26 *Id.*

27 United Potato Growers of Idaho, 1 The Bulletin, June 2006, at 7, 2.

28 U.S. Dep't of Agriculture, Nat'l Agricultural Stat. Serv., *Potatoes 2005 Summary* 4 (Sept. 2006), http://usda.mannlib.cornell.edu/usda/nass/Pota//2000s/2006/Pota-09-21-2006.pdf.

29 Allen et al., *supra* note 1.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