MERGER ANTITRUST LAW

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READING GUIDANCE

This reading guidance is unusually extensive. It provides an overview of the legal principles in the Section 7 analysis of horizontal mergers outside of market definition. You do not need to understand and assimilate every nuance. Rather, try to get the basic ideas and then remember the guidance as a reference as you proceed through the course. You will see all of these concepts multiple times in our future case studies. Also, I have collected a number of case citations in the footnotes. I do not expect you to know what propositions they support, much less expect you to read the cases. Rather, again consider this a resource (more for practice than for the course).

Class 12 (October 7): Sanford Health/Mid Dakota Clinic (Unit 8)

After finishing anything we did not cover in Class 10, we will examine the proof of anticompetitive effect required in a Section 7 case and the use of the *Philadelphia National Bank* presumption. We will end the unit with an overview of the defenses to the prima facie case.

Proving Anticompetitive Effect.

Having delineated the product and geographic boundaries of the relevant market, the next step is to determine whether the transaction has the requisite anticompetitive effect. Section 7 of the Clayton Act prohibits mergers and acquisitions whose effect "may be substantially to lessen competition, or to tend to create a monopoly" (slide 4). Proof of a prima facie anticompetitive effect is the last part of Step 1 in the *Baker-Hughes* three-step burden-shifting approach in Section 7 law (slide 5).

Remember that in assessing the possible effects of a merger or acquisition on competition, the effect is measured on a *going-forward basis*, comparing what would likely happen with the transaction against what is likely to happen without the transaction. If prices are falling in the relevant market before the transaction, for example, the fact that they continue to fall after the transaction does not necessarily mean that the transaction is secure from a Section 7 challenge. Rather, the question is whether prices will fall at least as fast and as much as they would with the transaction than without it. If prices continue to fall with the transaction but at a slower rate than they would without the transaction, an anticompetitive price effect is present, even though prices after the transaction will be lower than they were before the transaction.[1]

For horizontal transactions, while some transactions are "mergers to monopoly" or otherwise aid in creating or maintaining a dominant firm's monopoly power, most transactions are assessed for

[1] *See* FTC v. Staples, Inc., 970 F. Supp. 1066, 1082 n.14 (D.D.C. 1997).

whether they "may be substantially to lessen competition." Two primary theories of anticompetitive harm have emerged under this leg of Section 7.

Coordinated effects (or *coordinated interaction*) occur when the merger facilitates tacit or explicit collusion among the remaining incumbent firms. This theory depends on competitors to the merged firm accommodating rather than resisting price increases or other anticompetitive conduct. In other words, coordinated effects require anticompetitive conduct by multiple firms in the market that is profitable for each of them only due to the accommodating reactions of the others.[2]

The 1992 DOJ/FTC Horizontal Merger Guidelines introduced a second theory of anticompetitive *unilateral effects* arising from transactions in differentiated product markets. The idea is that where a merger involves differentiated products that compete more closely with one another than with other products in the relevant market, the merger can eliminate local competition between the firms and enable the combined firm profitably to increase prices even if all other firms in the market maintain their premerger prices. The unilateral effects theory, as to which the 2010 Guidelines provide a further elaboration, has emerged at the primary theory of anticompetitive harm in agency merger analysis.[3]

The Philadelphia National Bank *presumption*. Independently of the theory, evidence of the acquiring company's intent or recognition, in testimony or business documents, that the transaction is likely to diminish price competition is likely to weigh heavily in finding the transaction anticompetitive.[4] But often there is no indication in the merging firms' documents or statements about the likely competitive effect of the merger.

In 1963, the Supreme Court in *Philadelphia National Bank*[5] created a presumption of anticompetitive effect based on the combined market share of the merging firms and the increase in market concentration resulting from the merger. The class notes (slides 41-53) provide a quick overview and this reading guidance provides a bit more detail.

When the Supreme Court decided *PNB*, the dominant theory in industrial organization was the "structure-conduct-performance" (SCP) paradigm. The idea was that market structure would determine how firms in the market behave, which in turn would determine how competitively the market would perform. As a special case, the paradigm held that as markets became more concentrated with fewer or more dominant firms, firms would compete less aggressively with one another, market equilibrium prices would increase, and the market would perform less

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[2] We will examine coordinated effects in Class 15 in the H&R Block/TaxACT case study.

[3] We will examine the unilateral effects theory in differentiated product markets in Class 16 in the H&R Block/TaxACT case study. The theory also applies in differential geographic markets as we will see in Class 17 in the Sysco/U.. Foods case study.

[4] *See, e.g.*, Polypore Int'l, Inc. v. FTC, 686 F.3d 1208, 1212 (11th Cir. 2012) (noting, among other things, that the president of the acquiring operating company put the acquired company on the top of his list of potential acquisitions to "eliminate price competition" and that the acquiring company's 2008 budget predicted it could increase prices if the acquisition occurred).

[5] United States v. Philadelphia Nat'l Bank, 374 U.S. 321 (1963).

competitively. This theory of oligopoly remains a mainstay in judicial antitrust opinions,[6] although the Horizontal Merger Guidelines have refined this theory into coordinated effects.

The *PNB* Court used this intuition to create a rebuttable presumption of the requisite anticompetitive effect whenever a horizontal transaction produces a firm with an "undue percentage" of the relevant market and results in a "significant increase" in market concentration:

> Specifically, we think that a merger which produces a firm controlling an undue percentage of the relevant market, and results in a significant increase in the concentration of firms in that market, is so inherently likely to lessen competition substantially that it must be enjoined in the absence of evidence clearly showing that the merger is not likely to have such anticompetitive effects.[7]

The Supreme Court explained that a merger with these characteristics "is so inherently likely to lessen competition substantially that it must be enjoined in the absence of evidence clearly showing that the merger is not likely to have such anticompetitive effects."[8] Once a relevant market has been established, the market shares and market concentration may be determined through the usual discovery tools, third-party statistics or market research reports, or regular course of business documents. Market shares do not have to be exact; a "reliable, reasonable, close approximation" of the relevant market share is sufficient for applying the *PNB* presumption.[9]

Without establishing a hard and fast threshold, the *PNB* Court held that a combined market share of 30% was "undue," and that an increase in the market share of the two largest firms from 44% to 59% and of the four largest firms from an unstated figure to 78% represented a "significant increase" in market concentration, so that the presumptive rule of illegality was triggered. The Court observed that because a 30% combined share presents a "clear" threat to competition, it was unnecessary to specify a minimum threshold, and emphasized that the fact

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[6] *See, e.g.*, Chicago Bridge & Iron Co. v. FTC, 534 F.3d 410, 432 (5th Cir. 2008); FTC v. H.J. Heinz Co., 246 F.3d 708, 71516 (D.C. Cir. 2001); FTC v. University Health, Inc., 938 F.2d 1206, 1218 n.24 (11th Cir. 1991) ("Significant market concentration makes it easier for firms in the market to collude, expressly or tacitly, and thereby force price above or farther above the competitive level.") (quotation marks omitted); FTC v. Elders Grain, Inc., 868 F.2d 901, 905 (7th Cir. 1989); FTC v. PPG Indus., Inc., 798 F.2d 1500, 1503 (D.C. Cir. 1986) (explaining that "increased concentration raises a likelihood of interdependent anticompetitive conduct ... [based] upon the theory that, where rivals are few, firms will be able to coordinate their behavior, either by overt collusion or implicit understanding, in order to restrict output and achieve profits above competitive levels") (citations and quotation marks omitted); FTC. v. CCC Holdings, Inc., 605 F. Supp. 2d 26, 60 (D.D.C. 2009); FTC v. Arch Coal, Inc., 329 F. Supp. 2d 109, 123 (D.D.C. 2004).

[7] *Philadelphia Nat'l Bank*, 374 U.S. at 363 (citing United States v. Koppers Co., 202 F. Supp. 437 (W.D. Pa. 1962)).

[8] *Id.*; *accord* United States v. General Dynamics Corp., 415 U.S. 486, 497 (1974); United State v. Phillipsburg Nat'l Bank & Trust Co., 399 U.S. 350, 366 (1970); United States v. Von's Grocery Co., 384 U.S. 270, 301 (1966); Polypore Int'l, Inc. v. FTC, 686 F.3d 1208, 1214 (11th Cir. 2012); United States v. Dairy Farmers of Am., Inc., 426 F.3d 850, 858 (6th Cir. 2005); FTC v. OSF Healthcare Sys., 852 F. Supp. 2d 1069, 1074 (N.D. Ill. 2012); FTC v. ProMedica Health Sys., Inc., 2011 WL 1219281, at *53 (N.D. Ohio 2011); FTC v. Lab. Corp. of Am., 2011 WL 3100372, at *14 (C.D. Cal. 2011).

[9] United States v. H&R Block, Inc., 833 F. Supp. 2d 36 (D.D.C. 2011) (citing FTC v. PPG Indus., Inc., 798 F.2d 1500, 1505 (D.C. Cir. 1986)).

that a merger results in a firm with less than 30% does *not* raise an inference that the combination does not violate Section 7.[10]

During the 1960s, the Supreme Court condemned several mergers between companies with combined market shares of 10% or less and observed that even lower shares would be sufficient to establish a violation of Section 7 in concentrated markets and markets showing a trend toward concentration.[11] Courts focused almost entirely on market share statistics, giving little or no weight to other economic factors, and accepted increasingly artificial definitions of product and geographic markets. By the end of the 1960s, the *PNB* presumption had become almost conclusive and significant horizontal mergers were all but per se unlawful.

With its 1974 decision in *United States v. General Dynamics Corp.*,[12] the Supreme Court returned to the admonition in *Brown Shoe* to look beyond market concentration statistics and reaffirmed that the *PNB* presumption was rebuttable, not conclusive.[13] The Court observed that while such statistics were "of great significance," they "were not conclusive indicators of anticompetitive effects."[14] In *General Dynamics*, the Court analyzed a merger between two leading coal producers, which resulted in a firm with approximately 23% of sales in the relevant market. The Court upheld the merger, however, because substantially all the reserves of the acquired company had been committed to long-term supply contracts and its future ability to compete was negligible. Accordingly, its removal from the market as an independent company could not adversely affect competition.

Today, although the precise thresholds of the *Philadelphia National Bank* presumption remain elusive, courts are likely to find that a combined market share of around 30% to 40% in a market with only four or five firms is sufficient to make out a *prima facie* case of anticompetitive

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10 *Philadelphia Nat'l Bank*, 374 U.S. at 364 ("Without attempting to specify the smallest market share which would still be considered to threaten undue concentration, we are clear that 30% presents that threat."). For applications of the *PNB* presumption, see, for example, FTC v. H.J. Heinz Co., 246 F.3d 708, 716 (D.C. Cir. 2001) (three to two merger increasing HHI by 510 points to 5285 created presumption of anticompetitive effects by a "wide margin"); FTC v. OSF Healthcare Sys., 852 F. Supp. 2d 1069, 1078, 1079-80 (N.D. Ill. 2012) (three to two merger creating firm with a combined share of 59.4% and increasing HHI by 1767 points to 5179); FTC v. Promedica Health Sys., Inc., No. 3:11 CV 47, 2011 WL 1219281 (N.D. Ohio Mar. 29, 2011) (four to three merger creating firm with a combined share of 58.3% and increasing HHI by 1323 points to 6854); United States v. H&R Block, Inc., 833 F. Supp. 2d 36, 72 (D.D.C. 2011) (three to two merger creating a combined firm with a 28.4% share and increasing the HHI by 400 points to 4691); FTC v. CCC Holdings Inc., 605 F. Supp. 2d 26, 44-45 (D.D.C. 2009) (three to two merger with a two-firm fringe creating a firm with a combined share of 69% and increasing the HHI by 2035 to 5685); FTC v. Swedish Match, 131 F. Supp. 2d 151, 166-67 (D.D.C. 2000) (creating a 60 percent combined market share and increasing the HHI by 1514 to 4733).

11 *See* United States v. Pabst Brewing Co., 384 U.S. 546, 550-52 (1966) (condemning merger with combined share of 4.49% in an industry marked by a trend toward concentration but with no significant barriers to entry); United States v. Von's Grocery Co., 384 U.S. 270, 281 (1966) (White, J., concurring) (noting that prohibited merger had a combined share of 8.9% in a market with a four-firm concentration ratio of 24.4%); *see also* Brown Shoe Co. v. United States, 370 U.S. 294, 343-44 (1962) (suggesting combined share of as low as 5% sufficient to create concern).

12 United States v. General Dynamics Corp., 415 U.S. 486 (1974).

13 *See* Hospital Corp. of Am. v. FTC, 807 F.2d 1381 (7th Cir. 1986) (noting that *General Dynamics* "casts doubt on the continued vitality of such cases as *Brown Shoe* and *Von's*" when read to hold that any nontrival acquisition of a competitor violates Section 7).

14 United States v. General Dynamics Corp., 415 U.S. 486, 498 (1974).

effect.[15] The presumption of anticompetitive effect becomes stronger as the number of the competitors remaining in the market postmerger becomes smaller. Not surprisingly, the presumption in a merger to a duopoly is especially strong.[16] Notably, both the enforcement agencies and the courts will examine more skeptically a merger that involves the acquisition of a "maverick" firm, that is, a uniquely aggressive competitor, for fear that the acquiring firm will dampen its aggressive procompetitive behavior.[17]

The preferred measure of market concentration today is the *Herfindahl–Hirschman Index* (*HHI*).[18] The HHI is the sum of the squares of the market shares of each of the firms in the

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15 *See* FTC v. OSF Healthcare Sys., 852 F. Supp. 2d 1069, 1078 (N.D. Ill. 2012); United States v. Oracle Corp., 331 F. Supp. 2d 1098, 1110 (N.D. Cal. 2004); FTC v. Arch Coal, Inc., 329 F. Supp. 2d 109, 129 (D.D.C. 2004); FTC v. Swedish Match, 131 F. Supp. 2d 151, 166 (D.D.C. 2000) (dictum); FTC v. Cardinal Health, Inc., 12 F. Supp. 2d 34, 52 (D.D.C. 1998); *see also* FTC v. University Health, Inc., 938 F.2d 1206, 1219 (11th Cir. 1991) (concluding that the FTC "clearly established a prima facie case of anticompetitive effect" where the merged entity would control approximately 43% of the general acute care inpatient services market with three remaining competitors); FTC v. Promedica Health Sys., Inc., 2011 WL 1219281, at *12 (N.D. Ohio 2011) (finding, "[b]y a wide margin," that the proposed acquisition was "presumptively anticompetitive" where the merged entity would control 58.3% of the general acute care inpatient market with two remaining competitors). *But see* United States v. Oracle Corp., 331 F. Supp. 2d 1098, 1110 (N.D. Cal. 2004) (finding that *PNB* presumption not triggered in a differentiated product market when the combined share of the merging parties is 35%). *See generally* FTC, Horizontal Merger Investigation Data, Fiscal Years 19962003 (Feb. 2, 2004); FTC and DOJ, Merger Challenges Data, Fiscal Years 19992003 (Dec. 18, 2003).

16 *See* FTC v. PPG Indus., Inc., 798 F.2d 1500, 1503 (D.C. Cir. 1986); FTC v. H.J. Heinz Co., 246 F.3d 708, 716 (D.C. Cir. 2001); FTC v. ProMedica Health Sys., Inc., 2011 WL 1219281, at *56 (N.D. Ohio 2011); FTC v. Cardinal Health, Inc., 12 F. Supp. 2d 34, 52-53 (D.D.C. 1998).

17 *See* New York v. Deutsche Telekom AG, 439 F. Supp. 3d 179, 237-39 (S.D.N.Y. 2020); United States v. H & R Block, Inc., 833 F. Supp. 2d 36, 79-80 (D.D.C. 2011); FTC v. Arch Coal, Inc., 329 F. Supp. 2d 109, 146-47 (D.D.C. 2004); FTC v. Libbey, Inc., 211 F. Supp. 2d 34, 47 (D.D.C. 2002); FTC v. Staples, Inc., 970 F. Supp. 1066, 1083 (D.D.C. 1997); Complaint, *In re* Charlotte Pipe & Foundry Co., No. C-4403 (FTC Apr. 2, 2013); Complaint, *In re* Amerigas Propane, L.P., No. C-4346 (FTC Jan. 11, 2012); Complaint, *In re* Lab. Corp. of Am., No. C-9345 (FTC Dec. 1, 2010); Complaint, Mahle GmbH, Mahle, Inc., No. C-3746 (F.T.C. Feb. 27, 1997).

18 *See, e.g.*, FTC v. H.J. Heinz Co., 246 F.3d 708, 716 (D.C. Cir. 2001) ("Market concentration, or the lack thereof, is often measured by the Herfindahl-Hirschmann Index (HHI)."); FTC v. University Health, Inc., 938 F.2d 1206, 1211 n.12 (11th Cir. 1991) ("The most prominent method of measuring market concentration is the Herfindahl–Hirschman Index (HHI)."); FTC v. PPG Indus., 798 F.2d 1500, 1503 (D.C. Cir. 1986) ("The FTC and the Department of Justice, as well as most economists, consider the measure superior to such cruder measures as the four-or eight-firm concentration ratios which merely sum up the market shares of the largest four or eight firms."); FTC v. OSF Healthcare Sys., 852 F. Supp. 2d 1069, 1078-79 (N.D. Ill. 2012); FTC v. Promedica Health Sys., Inc., 2011 WL 1219281, at *56 (N.D. Ohio 2011) ("Courts have . . . adopted and relied on the HHI as a measure of market concentration."); FTC v. Swedish Match, 131 F. Supp. 2d 151, 166 n.11 (D.D.C. 2000) ("As a more accurate measure of market concentration, economists have created and courts have consistently relied upon the HHI."); FTC v. Cardinal Health, Inc., 12 F. Supp. 2d 34, 53 (D.D.C. 1998) (noting that "the courts turn to the Guidelines for assistance and over the years have come to accept the HHI as the most prominent and accurate method of measuring market concentration"). Given its wide acceptance, many opinions today use the HHI without comment. *See, e.g.*, Chicago Bridge & Iron Co. v. FTC, 534 F.3d 410, 421, 431 (5th Cir. 2008); AlliedSignal, Inc. v. B.F. Goodrich Co., 183 F.3d 568, 574 (7th Cir. 1999); United States v. Baker Hughes Inc., 908 F.2d 981, 983 n.3 (D.C. Cir. 1990); United States v. H&R Block, Inc., 833 F. Supp. 2d 36, 71-72 (D.D.C. 2011); FTC v. Arch Coal, Inc., 329 F. Supp. 2d 109, 124 (D.D.C. 2004); FTC v. Libbey, Inc., 211 F. Supp. 2d 34, 50-51 (D.D.C. 2002); FTC v. Staples, Inc., 970 F. Supp. 1066, 1081-82 (D.D.C. 1997).

s_i,

then:

$$\text{HHI} = \sum_{i=1}^{n} s_i^2.$$

So, for example, if there are five firms in the market, with market shares respectively of 40%, 30%, 15%, 10%, and 5%, then:

$$\begin{aligned}\text{HHI} &= (40)^2 + (30)^2 + (15)^2 + (10)^2 + (5)^2 \\ &= 1600 + 900 + 225 + 100 + 25 \\ &= 2850\end{aligned}$$

The increase in market concentration, which is often called the "delta" and denoted by the Greek letter Δ, is simply the difference between the postmerger HHI and the premerger HHI:

$$\Delta = \text{HHI}_{postmerger} - \text{HHI}_{premerger}$$

So, in our example, if the second and third largest firms merged, the postmerger HHI would be:

$$\begin{aligned}\text{HHI}_{postmerger} &= (40)^2 + (30+15)^2 + (10)^2 + (5)^2 \\ &= 1600 + 2025 + 100 + 25 \\ &= 3750\end{aligned}$$

The delta then would be:

$$\begin{aligned}\Delta &= 3750 - 2850 \\ &= 900\end{aligned}$$

A simple way of calculating the delta is simply two times the market share of one of the merging firms times the market share of the other merging firm. In our example, the delta is $2 \times 30 \times 15 = 900.$ [19]

Beginning in 1982, the Merger Guidelines also operationalize the PNB presumption. The current 2010 Guidelines provide that mergers in markets with a postmerger HHI above 2500 and a delta of 200 or more "will be presumed to be likely to enhance market power" and be sufficient to predicate the *PNB* presumption.[20] Although the Guidelines are not binding on courts, modern courts frequently cite the Guidelines as supporting authority when finding that mergers that increase the HHI by 200 or more points and result in a postmerger HHI of 2500 or more as authority in finding that the merger satisfies the predicates for the *PNB* presumption.[21] The

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[19] If the merging firms have market shares of a and b, respectively, then their premerger contribution to the HHI was $a^2 + b^2$. After the merger, the combined firm's contribution to the HHI is $(a + b)^2$, which is equal to $a^2 + 2ab + b^2$. Consequently, the difference between the postmerger HHI and the premerger HHI is $2ab$.

[20] U.S. Dep't of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines § 5.3 (rev. 2010).

[21] *See, e.g.*, United States v. Anthem, Inc., 855 F.3d 345, 349 (D.C. Cir. 2017); FTC v. Penn State Hershey Med. Ctr., 838 F.3d 327, 347 (3d Cir. 2016); Saint Alphonsus Med. Ctr.-Nampa Inc. v. St. Luke's Health Sys., Ltd., 778 F.3d 775, 786 (9th Cir. 2015); ProMedica Health Sys., Inc. v. FTC, 749 F.3d 559, 568 (6th Cir. 2014); FTC v. Hackensack Meridian Health, Inc., No. CV 20-18140, 2021 WL 4145062, at *20 (D.N.J. Aug. 4, 2021)**;** United States v. Sabre Corp., 452 F. Supp. 3d 97, 144 (D. Del. 2020), *vacated*, No. 20-1767, 2020 WL 4915824 (3d Cir.

Guidelines also provide that in moderately concentrated markets (that is, markets with an HHI between 1500 and 2500), transactions that increase the HHI by more than 100 points "potentially raise significant competitive concerns and often warrant scrutiny." That said, as you can see from inspecting the table and chart on the HHI/delta allegations in successful DOJ and FTC cases, the federal enforcement agencies hardly ever bring litigated cases where the HHIs and deltas are anywhere close to the merger guidelines thresholds (slides 51-53). Consequently, when citing judicial authority, it is important to know the cases with the lowest HHI/delta statistics that the court found sufficient to predicate the *PNB* presumption.[22]

Defenses

After the Eighth Circuit concluded that the district court had properly found that the plaintiffs had made out a prima face case of a Section 7 violation, the court of appeals turned to the defenses advanced by the defendants. Recall that under Step 2 of the *Baker Hughes* burden-shifting approach, the merging parties have the *burden of production* on rebutting the prima facie case. The burden of production requires the defendants to adduce sufficient evidence to create a genuine issue of fact on at least one element of the plaintiffs' prima facie case. In other words, the defendants' evidence must be sufficient to permit the trier of fact to find in favor of the defendants when giving the defendants the benefit of all reasonable inferences and without judging credibility or weighing the evidence. You may think about this as analogous to the standard for defeating a motion for summary judgment.

Recall that there are two essential elements of a Section 7 prima facie case: (1) the relevant market, and (2) the requisite anticompetitive effect.[23]

July 20, 2020); New York v. Deutsche Telekom AG, 439 F. Supp. 3d 179, 206 (S.D.N.Y. 2020); Bradt v. T-Mobile US, Inc., No. 19-CV-07752-BLF, 2020 WL 1809716, at *2 (N.D. Cal. Feb. 28, 2020); Optronic Techs., Inc. v. Ningbo Sunny Elec. Co., 414 F. Supp. 3d 1256, 1263 (N.D. Cal. 2019); FTC v. Tronox Ltd., 332 F. Supp. 3d 187, 207 (D.D.C. 2018); United States v. Energy Sols., Inc., 265 F. Supp. 3d 415, 441 (D. Del. 2017); United States v. Aetna Inc., 240 F. Supp. 3d 1, 42, 90 (D.D.C. 2017); FTC v. Staples, Inc., 190 F. Supp. 3d 100, 128-29 (D.D.C. 2016); FTC v. OSF Healthcare Sys., 852 F. Supp. 2d 1069, 1079 (N.D. Ill. 2012); United States v. H & R Block, Inc., 833 F. Supp. 2d 36, 71 (D.D.C. 2011). For cases citing the guidelines thresholds favorably but without explicitly endorsing them, see, for example, FTC v. Peabody Energy Corp., 492 F. Supp. 3d 865, 902 (E.D. Mo. 2020); FTC v. RAG-Stiftung, 436 F. Supp. 3d 278, 310 (D.D.C. 2020); FTC v. Wilh. Wilhelmsen Holding ASA, 341 F. Supp. 3d 27, 59 (D.D.C. 2018); FTC v. Sanford Health, No. 1:17-CV-133, 2017 WL 10810016, at *12 (D.N.D. Dec. 15, 2017), *aff'd*, 926 F.3d 959 (8th Cir. 2019); FTC v. Advocate Health Care, No. 15 C 11473, 2017 WL 1022015, at *7 (N.D. Ill. Mar. 16, 2017) FTC v. Sysco Corp., 113 F. Supp. 3d 1, 52 (D.D.C. 2015); United States v. Bazaarvoice, Inc., No. 13-CV-00133-WHO, 2014 WL 203966, at *36 (N.D. Cal. Jan. 8, 2014).

[22] I would cite (in order of increasing deltas) United States v. UPM-Kymmene Oyj, No. 03 C 2528, 2003 WL 21781902 (N.D. Ill. July 25, 2003) (complaint alleging postmerger HHI of 2990; delta of 190); *In re* Evanston Northwestern Healthcare Corp., No. 9315, 2007 WL 2286195, at *4 (F.T.C. Aug. 6, 2007) (postmerger HHI of 2739; delta of 384); United States v. H & R Block, Inc., 833 F. Supp. 2d 36, 72 (D.D.C. 2011) (postmerger HHI of 4691; delta of 400); FTC v. H.J. Heinz Co., 246 F.3d 708, 716 (D.C. Cir. 2001) (postmerger HHI of 5285; delta of 510); United States v. Anthem, Inc., 855 F.3d 345, 351 (D.C. Cir. 2017) (postmerger HHI of 3000; delta of 537); and FTC v. CCC Holdings, Inc., 605 F. Supp. 2d 26, 46 (D.D.C. 2009) (postmerger HHI of 5460; delta of 545).

[23] As you know, there are other elements of a Section 7 prima facie case: there must be an acquisition, the acquisition must be of stock or assets, and the parties and the transaction must have the requisite connection to interstate commerce. *See* 15 U.S.C. § 18. But these other elements are almost always indisputably present in Section 7 challenges and therefore only infrequently are litigated. Market definition and competitive effect is where the action is.

Defenses to market definition. These defenses are always of the form of a simple denial: either the plaintiff applied the wrong legal principles in its attempt to define the relevant market, the plaintiff applied the correct legal principles but in the wrong way, or the plaintiff's evidence is insufficient to support a finding of the relevant market that the plaintiff is seeking to prove under the correct legal principles. Since the law of market definition are reasonably well-settled, defenses that the plaintiffs applied the wrong legal standard are rare. Sometimes defendants will argue a technicality that a particular economic tool used in market definition was improperly applied, but these types of arguments rarely change the outcome.[24]

By far, the most frequent defense to a prima facie case of market definition is that the plaintiffs' evidence is insufficient to support a finding of the alleged market. There are two types of defenses here: (1) an argument that the plaintiffs' evidence is legally insufficient without any attempt by the defendants to prove an alternative market definition, and (2) an argument that the plaintiffs' evidence is legally insufficient coupled with the defendants' proof of an alternative market definition in which there is no likely anticompetitive effect. The first argument relies solely on the allocation of the burden of proof. I have spoken to a number of judges about this, and they consistently say that, while they understand that a pure burden of proof defense is technically proper, they do not find it very compelling. The problem is that this type of argument goes only to the "mind" of the judge. If a judge is going to decide for the defendants over the government's evidence, the judge wants to be confident that the merger is in fact not anticompetitive. Thus, providing the judge with a strong argument of an alternative market definition and then showing within this market the merger is not anticompetitive goes to the "heart" of the judge as well as to the "mind."

Defenses to anticompetitive effect. Defenses to a prima facie case of anticompetitive effect have the same structure as a simple denial. Here again, the law of prima facie anticompetitive effect is well-established, so defendants rarely argue that the plaintiffs used the wrong legal principles. Since the thresholds to invoke the *PNB* presumption, however, are not particularly well-settled in the case law, one could imagine defenses that the plaintiffs improperly invoked the *PNB* presumption because the merger in the plaintiff's alleged relevant market produced a combined market share and a change in the level of market concentration that too low to trigger the presumption. These types of defenses are rare, however, because plaintiffs—especially the DOJ and FTC—almost always allege relevant markets in which the market share and concentration statistics far exceed the Merger Guidelines thresholds and fall within the range that courts previously have found the *PNB* presumption to be triggered (see slides 51-53).

But a very common and very effective form of defense to a prima facie case of anticompetitive effect is that the *PNB* presumption does not apply because the plaintiff failed to make out its prima facie case of market definition. Without a relevant market, there are no market shares or market concentration statistics to predicate the *PNB* presumption. As noted above, to make this defense even stronger, defendants typically argue for an alternative market definition that yields market shares and market concentration statistics that are too low to trigger the *PNB* presumption. We will see this form of defense in almost every case study we will examine.[25]

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[24] *See, e.g.*, FTC v. Sysco Corp., 113 F. Supp. 3d 1, 36 & n. 16 (D.D.C. 2015) (where the defendants' argued that the FTC's economic expert used the wrong formula in the critical loss analysis).

[25] We will not see this defense in *Sanford Health*. The product dimensions of medical provider markets are well-established in modern merger antitrust case law and are usually not challenged. We will see cases in which the

A second form of defense to a prima facie case of anticompetitive assumes (*arguendo* at least) that, even if the merger has some anticompetitive tendencies, other factors in the market counteract these gross anticompetitive tendencies and make the merger on balance competitively neutral or even procompetitive. These are called *downward pricing pressure defenses*. Say that the plaintiff's evidence of changes in market shares and market concentration was sufficient to trigger the *PNB* presumption and that the plaintiff adduced additional evidence that the merged firm will have an incentive to increase prices postmerger, that is, the merger creates some *upward pricing pressure*. Depending on the defendants' evidence, the defendant could argue that other factors in the market or with the merger create sufficient *downward pricing pressure* to counteract the upward pricing pressure, with the net result that the merger will not increase prices and may even decrease them.

There are four principal types of these downward pricing pressure defenses, and the defendants in *Sanford Health* argued each one of them: (1) power buyer, (2) entry, (3) efficiencies, and (4) failing firm/weakened company. All four defenses, which sought to rebut the plaintiffs' prima facie showing of anticompetitive effect, are recognized in the 2010 Horizontal Merger Guidelines and by the courts.

Power buyers defense. In some markets, large buyers may exist that, because of their bargaining power, can protect themselves from the anticompetitive effects that otherwise would result from a merger. These buyers, for example, may be a disruptive force that precludes effective coordinated interaction among incumbent upstream firms, or they may have sufficient bargaining power to block the unilateral exercise of market power by the combined firm. The courts and the Merger Guidelines recognize that the bargaining power of firms can play a significant role in assessing the competitive effects of a merger and may act, either alone or in conjunction with other defenses, to rebut a prima facie case of anticompetitive effect. While in a particular case, a power buyer defense may not be sufficient to rebut the prima facie case, that defense in conjunction with other defenses may be sufficient.

Simply because a buyer is powerful does not mean that it can discipline the collective or unilateral exercise of market power by suppliers postmerger to protect itself. The question here is two-fold:

1. *Self-protection*: Can the putative power buyer protect itself at all, and, if so, can it protect itself sufficiently to completely eliminate the anticompetitive effect of the merger on it? The courts have identified three self-protection mechanisms to prevent the exercise of market power against the putative power buyer, although proving these mechanisms actually operate in a particular case has been problematic: (a) *share-shifting*, where the power buyer can precipitate sufficient local competition among postmerger incumbent firms for its patronage to preserve its premerger prices; (2) *sponsoring entry*, where the power buyer can induce entry by a new supplier by committing to purchase enough output to load at least a minimum efficient scale plant; or (3) *vertical integration*, where

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geographic dimensions were challenged, but the geographic area in which the FTC in *Sanford Health* alleged the likely anticompetitive effect would occur was so isolated from other cities and towns in North Dakota that there was no credible defense that the FTC's geographic market was wrong (or, even if it was improperly drawn, that a proper geographic market could be readily proved on the evidence presented in which the *PNB* presumption applied)

the power buyer itself can supply itself by building at least a minimum efficient scale plant.[26]

2. *Protection of others*. Even one or more buyers can protect themselves from the exercise of market power, are there other, less powerful buyers in the market that cannot protect themselves, so that the result of the merger will be a regime of price discrimination where some buyers get hurt and others do not?

In the absence of a mechanism—and the incentive to use it—courts and the enforcement agencies have rejected a power buyer defense. Even when there is an arguable mechanism, the defense is likely to fail for lack of sufficient evidence if (1) the putative buyer does not support the defense, or (2) there is evidence of historical episodes where the putative power buyer (or a similarly situated firm) has not been able to prevent a merged firm from raising prices to it. This was the situation in *Sanford Heath*, where (1) a representative from Blue Cross (the putative power buyer) testified that postmerger Sanford Heath would be able to force Blue Cross to choose between paying a higher price or exiting the market and (2) there was evidence that Blue Cross in the past had been forced to pay higher prices to another near-monopolist in another part of North Dakota.

Equally, the court could have rejected the defense on the grounds that smaller firms would be left unprotected from the anticompetitive effects of the merger. Blue Cross had a statewide share of the commercial health insurance market of between 55% and 65%, leaving between 35% and 45% of the market for smaller commercial insurers. If the commercial health insurance market in the Bismarck, ND Metropolitan Statistical Area had similar shares, the power buyer defense would have failed even if Blue Cross could have protected itself.

Read Section 8 of the Horizontal Merger Guidelines (p. 125-26) and the class notes (slides 63-68) on the power buyer defense. Then read the excerpt from *FTC v. Wilh. Wilhelmsen Holding ASA* gives a good illustration of a court's analysis of the power buyer defense (pp. 127-29). Finally, read the Eight Circuit's treatment of Blue Cross as a power buyer in *Sanford Health* (pp. 59-60 and again on pp. 60-61). The second treatment was directed to the power buyer defense. I am not sure what was going on in the first treatment.[27] As a general rule, power buyer defenses are rarely, if ever, successful.[28]

Entry/expansion/repositioning defense. The merging parties argued that Catholic Health, a competitor of Sanford, was poised to enter and compete in the Bismarck-Mandan market (p. 61). This is an ease of entry/expansion/repositioning defense. In the last 25 years, "ease of entry" has become, after market definition, the most used defense for horizontal mergers and acquisitions,

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[26] In each situation, the cases also recognize the ability of groups of buyers to collaborate to achieve these outcomes.

[27] If you want to explore this further, take a look at the Opening Brief of Appellants Sanford Health, Sanford Bismarck, and Mid Dakota Clinic, P.C. (Jan. 30, 2018; Mar. 23, 2018; redacted version filed Jan. 23, 2019), in the supplemental materials.

[28] For cases rejecting the defense, see, for example, Chicago Bridge & Iron Co. N.V. v. FTC, 534 F.3d 410, 439-40 (5th Cir. 2008); FTC v. Wilh. Wilhelmsen Holding ASA, 341 F. Supp. 3d 27, 70-71 (D.D.C. 2018); United States v. Anthem, Inc., 236 F. Supp. 3d 171, 221 (D.D.C. 2017); FTC v. Sysco Corp., 113 F. Supp. 3d 1, 48 (D.D.C. 2015). *But see* FTC v. RAG-Stiftung, 436 F. Supp. 3d 278, 315 (D.D.C. 2020) (noting role of sophisticated customers in disrupting collusion or tacit coordination in a bidding market).

both before the agencies and before the courts.[29] The idea is that any effort by the merged firm to charge supracompetitive prices and earn supracompetitive profits will, in the absence of barriers to entry, attract new firms that will proceed to compete profits back down to competitive levels.[30]

In an Economics 101 sense, think of a firm increasing price by restricting its output: if the firm faces a downward-sloping demand curve, then the inframarginal customers who value the product the most will bid up the price to clear the market and eliminate the excess demand at the original, lower price. The ease of entry/expansion/ repositioning defense is premised on the ability and incentives of other firms—either new, unrelated entrants into the relevant market (entry), incumbent firms already in the relevant market (expansion), or firms in adjacent markets (repositioning)—expanding output in the relevant market to "fill the hole" in output that the merged firm tried to create to increase market price.

The ability and willingness of fringe competitors to expand their foothold in the market and/or reposition are essentially equivalent to new entry and the agencies and the courts treat entry, expansion, and repositioning in the same analytical fashion.[31] The general idea is that the firms in question (either individually or collectively) must have the ability and profit-maximizing incentive to produce additional output to fill the hole in market output. In particular, the Merger Guidelines require—and the courts have followed suit—that the output expansion be:

1. *Timely*, that is, "must be rapid enough to make unprofitable overall" the output reduction in the relevant market that otherwise would have created the increase in prices.

[29] *See, e.g.*, United States v. Baker Hughes Inc., 908 F.2d 981, 987-88 (D.C. Cir. 1990); United States v. Syufy Enterprises, 903 F.2d 659, 664-65 (9th Cir. 1990); California v. American Stores Co., 872 F.2d 837, 842-43 (9th Cir. 1989); United States v. Waste Management, Inc., 743 F.2d 976, 981-84 (2d Cir. 1984); United States v. Energy Sols., Inc., 265 F. Supp. 3d 415, 443-44 (D. Del. 2017) (but rejecting ease of entry defense on the merits); United States v. Anthem, Inc., 236 F. Supp. 3d 171, 221-22 (D.D.C. 2017) (same); Saint Alphonsus Med. Ctr. - Nampa, Inc. v. St. Luke's Health Sys., Ltd., No. 1:12-CV-00560-BLW, 2014 WL 407446, at *22-*23 (D. Idaho Jan. 24, 2014) (same), *aff'd*, 778 F.3d 775 (9th Cir. 2015); FTC v. Laboratory Corp. of Am., 2011 WL 3100372 , at *19-20, 34 (C.D. Cal. 2011) (same); FTC v. CCC Holdings, Inc., 605 F. Supp. 2d 26, 47 (D.D.C. 2009) (same); FTC v. Libbey, Inc., 211 F. Supp. 2d 34, 47-48 (D.D.C. 2002) (same); FTC v. Cardinal Health, Inc., 12 F. Supp. 2d 34, 54-58 (D.D.C. 1998) (same); FTC v. Staples, Inc., 970 F. Supp. 1066, 1086 (D.D.C. 1997) (same); United States v. Calmar Inc., 612 F. Supp. 1298, 1304-07 (D.N.J. 1985); *In re* Echlin Mfg. Co., 105 FTC 410, 1985 WL 668902 (1985); *see also* FTC v. Arch Coal, Inc., 329 F. Supp. 2d 109, 147-49 (D.D.C. 2004) (expansion by incumbent fringe firms).

[30] *See* United States v. Baker Hughes, Inc., 908 F.2d 981, 987 (D.C. Cir. 1990) ("In the absence of significant barriers, a company probably cannot maintain a supracompetitive pricing for any length of time."); FTC v. CCC Holdings, Inc., 605 F. Supp. 2d 26, 46-47 (D.D.C. 2009) ("Even in highly concentrated markets, if there is sufficient ease of entry, others might enter to compete and undercut the likely anti-competitive effects of a merger."); 1992 DOJ/FTC Horizontal Merger Guidelines § 3.0 (1992) ("A merger is not likely to create or enhance market power or to facilitate its exercise, if entry into the market is so easy that market participants, after the merger, either collectively or unilaterally could not profitably maintain a price increase above premerger levels."); *see also* Chicago Bridge & Iron Co. v. FTC, 534 F.3d 410, 427 (5th Cir. 2008) ("The Commission not only addressed whether existing entry is sufficient to constrain CB&I from raising prices but also used existing entry and the history of entry as evidence in determining whether future entry would be able to counteract a merger's anti-competitive effects, such as a supracompetitive price increase.").

[31] FTC v. CCC Holdings, Inc., 605 F. Supp. 2d 26, 57 (D.D.C. 2009); FTC v. Arch Coal, Inc., 329 F. Supp. 2d 109, 115 (D.D.C. 2004).

2. *Likely*, that is, sufficiently profitable when compared to alternative courses of action by the third-party firms that the firms have a high probability of actually expanding their output if the merging firms (and any other tacitly coordinating firms) attempted to reduce output in the relevant market, and
3. *Sufficient*, that is, that the magnitude of the timely and likely output expansion by these third-party firms will be enough to fill the hole.

Although not expressly a requirement, to be cognizable as a defense, the output expansion should be *in response* to the merger. Often (and perhaps as here), the potential entrant would have entered the market with or without the merger. Since competitive effects in merger antitrust law are assessed on a going forward basis, any output expansion that would have occurred in the absence of the merger should be taken as part of the "but for" world (i.e., the market without the merger) and should be part of the baseline against which the merger should be evaluated. For example, if the merger would cause a decrease of 20 units of production by the merging firms and its incumbent competitors and a potential entrant would have entered the market with 100 additional units of production regardless of the merger, the fact that output in the market will increase by a net 80 units postmerger should not be a defense to the merger because in the absence of the merger market output would have increased by 100 units. To be a defense, the potential entrant would have to increase its planned production by at least 20 units (for a total of at least 120 units) in response to the merger to offset the decrease in production resulting from the merger and to be a valid merger defense.

Although the Merger Guidelines are not technically binding on courts, the guidelines approach to entry as a defense to a *prima facie* case has been largely adopted in judicial opinions. While not citing the Merger Guidelines, the court's analysis of entry in FTC v. Staples, Inc. shows how courts apply the elements of the Guidelines to defeat an ease of entry defense.[32] In recent years, the DOJ and FTC have applied the Guidelines' entry defense requirements strictly and with great skepticism toward the evidence. The result is that entry defenses have rarely prevailed at the agencies and then in only the most obvious situations. If anything, the changes in the 2010 Guidelines raise the bar even higher on a successful entry defense at the agencies, and the Biden administration is likely to raise the bar further.

Read Section 9 of the Horizontal Merger Guidelines (p. 131-33) and the class notes (slides 54-60) on the power buyer defense. Then read the excerpt from *United States v. Energy Solutions, Inc.*[33] (pp. 134-36) as well as the treatment of entry by Catholic Health in *Sanford Health* (p. 61). We will examine the entry defense in more detail when we discuss the H&R Block/TaxACT merger in Unit 10.

Efficiencies defense. Efficiencies that permit a firm to lower its production costs, increase its product quality, or accelerate its rate of innovation or product improvement can make the market more competitive and increase consumer welfare. In the proper circumstances, efficiencies can negate the likelihood that a merger would be anticompetitive. Under this idea, the greater the

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[32] FTC v. Staples, Inc., 970 F. Supp. 1066, 1086-88 (D.D.C. 1997). For other judicial examples, see Chicago Bridge & Iron Co. v. FTC, 534 F.3d 410, 434-40 (5th Cir. 2008); FTC v. ProMedica Health Sys., Inc., 2011 WL 1219281, at *57 (N.D. Ohio 2011); FTC v. CCC Holdings, Inc., 605 F. Supp. 2d 26, 47-60 (D.D.C. 2009) (extensive analysis); FTC v. Cardinal Health, Inc., 12 F. Supp. 2d 34, 54-58 (D.D.C. 1998) (explicit use of Guidelines).

[33] 265 F. Supp. 3d 415 (D. Del. 2017).

magnitude of the likely anticompetitive effect in the absence of efficiencies, the greater the efficiencies must be to offset it. Likewise, the more certain the likelihood of an anticompetitive effect in the absence of efficiencies, the more certain the offsetting efficiencies must be.[34]

There is no accepted judicial rule as to whether, and in what circumstances, efficiencies can justify an otherwise anticompetitive merger or acquisition. Older courts rejected efficiencies as a defense.[35] Modern courts, however, if presented with the right case, probably would accept the defense.[36] The right case, however, has yet to appear.[37]

To be "cognizable" under the Merger Guidelines, efficiencies must be *verifiable*, *merger-specific*,[38] *sufficient in scope*, and *not result from an anticompetitive reduction in output or service*.[39] Cognizable efficiencies may include, for example, shifts in production among the facilities of the merging firms that enable the combined firm to reduce its marginal costs of production. Efficiencies relating to research and development may be substantial but are often difficult to verify and may result from anticompetitive reductions in output (presumably R&D output). Efficiencies related to procurement, management, or capital costs may not be verifiable, merger-specific, or substantial.

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34 *See* FTC v. University Health, Inc., 938 F.2d 1206, 1223 (11th Cir. 1991); FTC v. Arch Coal, Inc., 329 F. Supp. 2d 109, 150-51 (D.D.C. 2004).

35 *See* FTC v. Procter & Gamble Co., 386 U.S. 568, 580 (1967) ("[P]ossible economies cannot be used as a defense to illegality. Congress was aware that some mergers which lessen competition may also result in economies but it struck the balance in favor of protecting competition."); United States v. Philadelphia Nat'l Bank, 374 U.S. 321, 371 (1963) (observing that an otherwise anticompetitive merger "is not saved because, on some ultimate reckoning of social or economic debits or credits, it may be deemed beneficial.").

36 *See* FTC v. H.J. Heinz Co., 246 F.3d 708, 715 (D.C. Cir. 2001) (recognizing that "the trend among lower courts is to recognize the defense"); FTC v. University Health, Inc., 938 F.2d 1206, 1222 (11th Cir. 1991) (recognizing efficiencies defense but finding it inapplicable on the merits); FTC v. CCC Holdings, Inc., 605 F. Supp. 2d 26, 72-73 (D.D.C. 2009) (recognizing defense, but finding it inapplicable on the merits); FTC v. Cardinal Health, Inc., 12 F. Supp. 2d 34, 61-63 (D.D.C. 1998) (noting judicial uncertainty, but appearing to accept the principle of an efficiencies defense); United States v. Long Island Jewish Med. Ctr., 983 F. Supp. 121, 146-49 (E.D. N.Y. 1997) (factor in denying preliminary injunction); FTC v. Staples, Inc., 970 F. Supp. 1066, 1088-90 (D.D.C. 1997) (noting judicial uncertainty, but appearing to accept the principle of an efficiencies defense but finding it inapplicable on the facts); *see also* FTC v. Coca-Cola Co., 641 F. Supp. 1128, 1141 (D.D.C. 1986); United States v. Baker Hughes, Inc., 908 F.2d 981, 992 (D.C. Cir. 1990) (assuming the validity of an efficiencies defense but not ruling on it). *But see* FTC v. Procter & Gamble Co., 386 U.S. 568, 580 (1967) (possible economies cannot be used as a defense to illegality in Section 7 merger cases); RSR Corp. v. FTC, 602 F.2d 1317, 1325 (9th Cir. 1979). Properly construed, the *Procter & Gamble* ruling appears to be a correct one: efficiencies cannot be used as an affirmative defense to justify an anticompetitive merger, but they can be used as part of a negative defense to show that the merger will not be anticompetitive in the first instance.

37 *See* FTC v. ProMedica Health Sys., Inc., 2011 WL 1219281, at *57 (N.D. Ohio 2011) ("No court in a 13(b) proceeding, or otherwise, has found efficiencies sufficient to rescue an otherwise illegal merger.").

38 2010 DOJ/FTC Horizontal Merger Guidelines § 10 n.13 ("The Agencies will not deem efficiencies to be merger-specific if they could be attained by practical alternatives that mitigate competitive concerns, such as divestiture or licensing. If a merger affects not whether but only when an efficiency would be achieved, only the timing advantage is a merger-specific efficiency.").

39 2010 DOJ/FTC Horizontal Merger Guidelines § 10; 1992 DOJ/FTC Merger Guidelines § 4; *see* FTC v. ProMedica Health Sys., Inc., 2011 WL 1219281, at *57 (N.D. Ohio 2011); United States v. Oracle Corp., 331 F. Supp. 2d 1098, 1175 (N.D. Cal. 2004).

Agency practice since the 1997 Merger guidelines amendments makes clear that the federal enforcement agencies will consider efficiencies only to the extent that they ultimately benefit customers in the relevant market.[40] As a result, efficiencies that reduce costs, for example, will be considered only to the extent that the cost savings are passed on to customers. This adds another significant hurdle in establishing an efficiencies defense. The merging parties will have to show not only that the efficiencies exist but also that it is in the profit-maximizing interest of the combined firm to pass on some of the benefits of the efficiencies to customers in the form of lower prices or increased quality, as opposed to retaining the benefits for the combined firm's owners.[41] In at least one investigation, however, the Antitrust Division found it sufficient that the significant cost savings that likely result would enable the combined firm to compete more effectively.[42]

Experience teaches that the agencies view the efficiencies "defense" with hostility and are likely to reject the defense either because, in the view of the investigating agency, the putative efficiencies are not sufficiently verifiable,[43] they are not merger specific,[44] they are not sufficiently large to overcome the likely anticompetitive effect of the transaction,[45] or the

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[40] *See* 2010 DOJ/FTC Horizontal Merger Guidelines § 10 (recognizing efficiencies as a defense only to the extent that the "efficiencies likely would be sufficient to reverse the merger's potential to harm customers in the relevant market, e.g., by preventing price increases in that market.") (footnote omitted); 1992 DOJ/FTC Horizontal Merger Guidelines § 4 (same); *see also* FTC v. CCC Holdings, Inc., 605 F. Supp. 2d 26, 74 (D.D.C. 2009) (rejecting cost-savings efficiency defense where there was "no evidence to suggest that a sufficient percentage of those savings will accrue to the benefit of the consumers to offset the potential for increased prices"); FTC v. University Health, Inc., 938 F.2d 1206, 1223 (11th Cir. 1991) (holding that defendant asserting an efficiency defense "must demonstrate that the intended acquisition would result in significant economies and that these economies ultimately would benefit competition and, hence, consumers").

[41] The courts, to the extent that they consider efficiencies, are also adopting the view that efficiencies should be considered only to the extent that they benefit customers. *See* FTC v. Swedish Match, 131 F. Supp. 2d 151, 172 (D.D.C. 2000).

[42] *See* U.S. Dep't of Justice, Press Release, Statement of the Department of Justice's Antitrust Division on its Decision to Close its Investigation of the Joint Venture Between SABMiller plc and Molson Coors Brewing Company (June 5, 2008) ("In one of the key parts of the investigation, the Division verified that the joint venture is likely to produce substantial and credible savings that will significantly reduce the companies' costs of producing and distributing beer. These savings meet the Division's criteria of being verifiable and specifically related to the transaction and include large reductions in variable costs of the type that are likely to have a beneficial effect on prices. The large amount of these savings and other evidence obtained by the Division supported the parties' contention that the venture should make a lower-cost, and therefore more effective, beer competitor.") (paragraph break omitted).

[43] *See* FTC v. University Health, Inc., 938 F.2d 1206, 1223 (11th Cir. 1991) (noting that a defendant cannot "overcome a presumption of illegality based solely on speculative, self-serving assertions"); FTC v. H.J. Heinz Co., 246 F.3d 708, 721 (D.C. Cir. 2001) (noting that efficiencies evidence cannot be "mere speculation and promises about post-merger behavior").

[44] The D.C. Circuit apparently also takes the view that cognizable efficiencies must be merger-specific. *See* FTC v. H.J. Heinz Co., 246 F.3d 708, 721-22 (D.C. Cir. 2001); FTC v. CCC Holdings, Inc., 605 F. Supp. 2d 26, 75 (D.D.C. 2009) (finding that any efficiencies resulting from claimed increases by the combined firm in R & D spending are not merger-specific, since acquiring company could increase spending to a similar extent notwithstanding merger); *see also* FTC v. Arch Coal, Inc., 329 F. Supp. 2d 109, 150 (D.D.C. 2004) (noting that the Guidelines require efficiencies be merger-specific).

[45] *Cf.* FTC v. H.J. Heinz Co., 246 F.3d 708, 721-22 (D.C. Cir. 2001) (noting that efficiencies must be "extraordinary" to overcome the anticompetitive effect suggested by high postmerger concentration levels).

resulting benefits will not be passed on to customers sufficiently, if at all. Even when the efficiencies are cognizable, however, the parties would be well advised not to rely too heavily on an efficiencies defense. Indeed, the 1997 amendment to the DOJ/FTC Horizontal Merger Guidelines notes that, in the experience of the Antitrust Division and the FTC, efficiencies are most likely to make a difference in the analysis when the likely adverse competitive effects, absent the efficiencies, are "not great."[46] The amendment also observes that "[e]fficiencies almost never justify a merger to monopoly or near-monopoly."[47]

The efficiencies defense has fared no better in the courts. In the 1960s, the Supreme Court not only rejected the idea that efficiencies could be used to defend a merger or acquisition against a merger antitrust challenge, but also indicated that efficiencies could be part of the unlawful anticompetitive effect to the extent they threatened the viability of less efficient rivals.[48] Although courts today rarely take the view that efficiencies are irrelevant to the competitive effects analysis of a transaction, no decision yet has held that an otherwise unlawful transaction was excusable because of efficiencies.[49]

Read Section 10 of the Horizontal Merger Guidelines (pp. 137-39) and the class notes (slides 67-90) on the efficiencies defense. Then read the excerpt from Saint Alphonsus Med. Ctr.-Nampa Inc. v. St. Luke's Health System[50] and the accompanying notes. (pp. 140-43) as well as the Eight Circuit's treatment of the efficiency defense in Sanford Health (pp. 62-63). As you will see, the contours of the efficiencies are far from clear. Read Commissioner Wright's dissent in *Ardagh/St. Gobain* for a criticism of how the FTC applies the efficiencies defense in practice (pp. 144-51) and the majority commissioners' response to his criticism (pp. 152-54).

The failing company defense. In 1930, during the Great Depression, the Supreme Court in *International Shoe Co. v. FTC*[51] held that when the acquired company's resources were depleted, business failure was a grave possibility, and no noncompetitor was willing to purchase the failing

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[46] U.S. Dep't of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines § 4 (rev. Apr. 8, 1997

[47] *Id.*; *see* FTC v. H.J. Heinz Co., 246 F.3d 708, 721-22 (D.C. Cir. 2001).

[48] *See* Brown Shoe Co. v. United States, 370 U.S. 294, 344 (1962); *see also* FTC v. Procter & Gamble Co., 386 U.S. 568 (1967) ("[p]ossible economies cannot be used as a defense to illegality" in Section 7 merger cases); RSR Corp. v. FTC, 602 F.2d 1317, 1325 (9th Cir. 1979) ("RSR argues that the merger can be justified because it allows greater efficiency of operation. This argument has been rejected repeatedly."); International Tel. & Tel. Corp. v. General Tel. & Elecs. Corp., 518 F.2d 913, 936 (9th Cir. 1975) United States v. Rice Growers Ass'n of California, 1986 WL 12561 (E.D. Cal. 1986); United States v. Manufacturers Hanover Trust Co., 240 F. Supp. 867, 943 (S.D.N.Y. 1965); United States v. Kennecott Copper Corp., 231 F. Supp. 95, 102 (S.D.N.Y. 1964); United States v. Bethlehem Steel Corp, 168 F. Supp. 576, 617 (S.D.N.Y. 1958).

[49] For modern cases analyzing efficiencies, see, for example, FTC v. H.J. Heinz Co., 246 F.3d 708, 717 (D.C. Cir. 2001); FTC v. Tenet Health Care Corp., 186 F.3d 1045, 1054 (8th Cir. 1999); FTC v. University Health, Inc., 938 F.2d 1206, 1223 (11th Cir. 1991); FTC v. CCC Holdings, Inc., 605 F. Supp. 2d 26, 72 (D.D.C. 2009); United States v. Oracle Corp., 331 F. Supp. 2d 1098, 1175 (N.D. Cal. 2004); FTC v. Arch Coal, Inc., 329 F. Supp. 2d 109, 150-53 (D.D.C. 2004); FTC v. Swedish Match, 131 F. Supp. 2d 151, 171-72 (D.D.C. 2000); FTC v. Cardinal Health, Inc., 12 F. Supp. 2d 34, 61-63 (D.D.C. 1998); FTC v. Staples, Inc., 970 F. Supp. 1066, 1088-90 (D.D.C. 1997); FTC v. Butterworth Health Corp., 946 F. Supp. 1285, 1300 (W.D. Mich. 1996); FTC v. Alliant Techsystems Inc., 808 F. Supp. 9, 21 (D.D.C. 1992); United States v. Country Lake Foods, Inc., 754 F. Supp. 669, 680 (D. Minn. 1990).

[50] 778 F.3d 775 (9th Cir. 2015).

[51] International Shoe Co. v. FTC, 280 U.S. 291 (1930).

firm, an acquisition by a competitor that otherwise might threaten competition would not violate the Clayton Act.[52] The legislative history of the 1950 amendments to the Clayton Act specifically recognized this "failing company" defense.[53] In *General Dynamics*, the Supreme Court characterized the defense as a "lesser of two evils" approach, in which the possible threat to competition resulting from the acquisition was preferable to the adverse competitive impact and other losses that would be incurred if the failing company failed.[54]

The failing company defense is frequently invoked in transactions that are *prima facie* unlawful under the *Philadelphia National Bank* presumption, almost always without success.[55] Likewise, although the 2010 DOJ/FTC Horizontal Merger Guidelines acknowledge that the failing company doctrine is at least a factor in the competitive analysis, if not a standalone defense, the Guidelines employ the doctrine restrictively.

The traditional judicial formulation of the failing company defense is straightforward: (1) the acquired firm must be failing or its failure must be imminent; and (2) there must be no alternate purchasers whose acquisition of the acquired firm would be less anticompetitive than the one proposed.[56] Some courts have added a third requirement: a reorganization of the acquired firm

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[52] *Id*. at 300-03; *see* United States v. General Dynamics Corp., 415 U.S. 486, 506-08 (1974); Citizen Publ'g Co. v. United States, 394 U.S. 131, 137-38 (1969).

[53] S. REP. NO. 1775, 81st Cong., 2d Sess. 7 (1950); H.R. REP. NO. 1191, 81st Cong., 1st Sess. 6 (1949).

[54] United States v. General Dynamics Corp., 415 U.S. 486, 507 (1974).

[55] The successful cases include International Shoe Co. v. FTC, 280 U.S. 291 (1930); Union Leader Corp. v. Newspapers of New England, Inc., 284 F.2d 582 (1st Cir. 1960); Reilly v. Hearst Corp., 107 F. Supp. 2d 1192, 120305 (N.D. Cal. 2000); FTC v. Great Lakes Chem. Corp., 528 F. Supp. 84, 96-98 (N.D. Ill. 1981); United States v. M. P. M., Inc., 397 F. Supp. 78 (D. Colo. 1975). *See* Granader v. Public Bank, 417 F.2d 75 (6th Cir. 1969) (summary dismissal of Section 7 complaint affirmed after state court receivership proceedings had found Public Bank insolvent and acquirer only prospective purchaser). For cases in which the defense was unsuccessful, see, for example, United States v. Greater Buffalo Press, Inc., 402 U.S. 549 (1971); Citizen Publ'g Co. v. United States, 394 U.S. 131 (1969); United States v. Third Nat'l Bank in Nashville, 390 U.S. 171 (1968); United States v. Von's Grocery Co., 384 U.S. 270 (1966); United States v. El Paso Natural Gas Co., 376 U.S. 651 (1964); United States v. Philadelphia Nat'l Bank, 374 U.S. 321, 372 n.46 (1963); United States v. Diebold, Inc., 369 U.S. 654 (1962); Michigan Citizens for an Independent Press v. Thornburgh, 868 F.2d 1285, 128788, (D.C. Cir. 1989) (Newspaper Preservation Act); United States v. Energy Sols., Inc., 265 F. Supp. 3d 415, 444-45 (D. Del. 2017); FTC v. ProMedica Health Sys., Inc., 2011 WL 1219281, at *57 (N.D. Ohio 2011); FTC v. Harbour Group Invs., L.P., Civ. No. 90–2525, 1990 WL 198819 (D.D.C. Nov. 19, 1990); FTC v. Bass Bros. Enters., Inc., 1984 WL 355 (N.D. Ohio 1984). The failing-firm defense has never succeeded in a Section 13(b) proceeding. *See* FTC v. ProMedica Health Sys., Inc., 2011 WL 1219281, at *57 (N.D. Ohio 2011).

[56] *See* Citizen Publ'g Co. v. United States, 394 U.S. 131, 136-39 (1969); International Shoe Co. v. FTC, 280 U.S. 291, 302 (1930); FTC v. University Health, Inc., 938 F.2d 1206, 1220 n.28 (11th Cir. 1991); Michigan Citizens for an Independent Press v. Thornburgh, 868 F.2d 1285, 1287-88 (D.C. Cir. 1989); California v. Sutter Health Sys., 130 F. Supp. 2d 1109, 1133 (N.D. Cal. 2001); Reilly v. Hearst Corp., 107 F. Supp. 2d 1192, 1203 (N.D. Cal. 2000); FTC v. Harbour Group Invs., L.P., Civ. No. 90–2525, 1990 WL 198819 (D.D.C. Nov. 19, 1990).

into a viable economic enterprise is not realistic.[57] Courts have narrowly construed the defense, and the company invoking it has the burden of establishing each element of the defense.[58]

Under the Supreme Court's *Citizen Publishing* decision, a failing company within the meaning of the defense is one whose "resources are so depleted and the prospects of rehabilitation so remote that it faces grave probability of business failure."[59] The failure requirement is established by analyzing the allegedly failing company's financial condition before and at the time of acquisition and examining the company's future business prospects, its relationships with banks and other potential creditors, and its available working capital. The objective facts must support the conclusion that the company is failing or that its failure is imminent; the company's good faith intention to go out of business because its return is subjectively insufficient will not establish the failure requirement.

The alternative purchaser requirement is usually the reason that the defense fails.[60] The difficulties in establishing this element may be illustrated by contrasting United States v. M.P.M., Inc.,[61] with FTC v. Harbour Group Investments, L.P.[62]

In MPM, the district court found that the parties had discharged their burden because immediately after Mobile's bank had informed the company that it had to raise $200,000 in new capital before further credit would be extended, the company embarked on exploring "virtually every potential source of funding."[63] Mobile's president contacted numerous firms, government agencies, and other possible funding sources. One of the major shareholders devoted virtually all of his time to finding new funding in order to maintain the company as a viable enterprise. The court found that the contacts were numerous and that each person approached was a credible potential source of new capital. Only Pre-Mix, whose combination with Mobile was the subject of the Section 7 challenge, was willing to become involved with the company; the others declined because they considered Mobile an unacceptable business risk. Moreover, Pre-Mix had emerged as a candidate months after many of the other contacts had been made.[64]

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[57] *See, e.g.*, Dr. Pepper/Seven-Up Cos., v. FTC, 991 F.2d 859, 86465 (D.C. Cir. 1993); U.S. Steel Corp. v. FTC, 426 F.2d 592, 608-09 (6th Cir. 1970); *In re* The Pillsbury Co., 93 F.T.C. 966, 1031-33, 1979 WL 44683 (1979); *In re* Reichhold Chems., Inc., 91 F.T.C. 246, 289-91, 1978 WL 206094 (1978). The requirement appears to have been suggested, but not formalized, in Citizen Publ'g Co. v. United States, 394 U.S. 131, 138 (1969). Two courts have suggested that the *Citizen Publishing* language did not add a new element to the failing company defense. *See* United States v. Black & Decker Mfg. Co., 430 F. Supp. 729, 778 (D. Md. 1976); United States v. M. P. M., Inc., 397 F. Supp. 78, 96 (D. Colo. 1975).

[58] *See, e.g.*, FTC v. Harbour Group Invs., L.P., Civ. No. 90-2525, 1990 WL 198819 (D.D.C. Nov. 19, 1990); United States v. G. Heileman Brewing Co., 345 F. Supp. 117, 123 (E.D. Mich. 1972).

[59] Citizen Publ'g Co. v. United States, 394 U.S. 131, 137 (1969).

[60] *See, e.g.*, Dr. Pepper/Seven-Up Cos., Inc. v. FTC, 991 F.2d 859, 862 (D.C. Cir. 1993) (rejecting failing company defense because it "had no adequate basis to determine whether Honickman [was] the sole plausible acquirer") (citation omitted).

[61] United States v. M.P.M., Inc., 397 F. Supp. 78 (D. Colo. 1975).

[62] FTC v. Harbour Group Invs., L.P., Civ. No. 90–2525, 1990 WL 198819 (D.D.C. Nov. 19, 1990).

[63] United States v. M.P.M., Inc., 397 F. Supp. 78, 101 (D. Colo. 1975).

[64] *See* California v. Sutter Health Sys., 130 F. Supp. 2d 1109, 1136-37 (N.D. Cal. 2001) (finding an adequate search was undertaken and that no reasonable alternative purchaser existed). Where one party to a joint venture is failing and the other joint venture partner wishes to acquire it, the failing venturer does not have to be marketed with

By contrast, in *Harbour Group,* the search for alternative acquirers did not begin until after an agreement had been struck on the challenged acquisition. Moreover, although an investment bank was retained to perform the search, it was contacted by the acquiring company, not the acquired company, and was given only a few weeks to conduct the search despite the fact that the original purchase agreement took months to negotiate. Nor did the investment bank's efforts comport with its usual manner of searching for potential acquirers. The investment bank team handling the search was not experienced in selling small companies, the investment bank distributed only minimal offering materials, and the search consisted of a few exploratory telephone calls with little or no follow-up. The *Harbour Group* court concluded that the merging parties did not fulfill their burden of proving that no alternative purchaser existed.

The requirement added by some courts that the acquired firm must not be able to reorganize under the bankruptcy laws into a viable economic enterprise has two significant implications for the failing company defense.

First, it may almost be impossible for the merging companies to discharge their burden of proof under this requirement. Reorganization proceedings can be extremely complicated. In many situations, reorganization plans have been confirmed after lengthy negotiations, despite expectations at the beginning of the process that the plan would fail and the company would be liquidated. Indeed, perhaps the only good way to prove this requirement is to show that the company's going concern value is less than the company's liquidation value.

Second, when coupled with the first two requirements, the inability to reorganize implies that the acquired firm's assets will quickly exit the market absent the challenged transaction or an alternative buyer. This effectively converts the failing company defense from an affirmative defense to a negative defense. An affirmative defense provides a justification for a transaction that threatens competition, but as to which the public interest in permitting the transaction outweighs the public interest in preventing any anticompetitive effects. A negative defense negates an essential element of the plaintiff's case, in this instance the requirement that the transaction will threaten competition in the future. If a failing company merges with a competitor, the immediate economic effect will be to make the market marginally less competitive than it was before the transaction. However, if the transaction is disallowed, the failing company will exit the market, thereby making the market even less competitive through the loss of its productive capacity. From a forward-looking perspective, the market is more competitive with the transaction than it would be without the transaction.

The courts have held that the failing company defense applies equally whether the failing firm is the buyer or the seller.[65] The courts are split as to whether the failing company defense may be invoked with respect to the acquisition of the failing part of a profitable company.[66]

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the venture intact if the terms of the joint venture agreement permit the successful joint venture partner to terminate the venture if the failing firm is sold to someone else. Reilly v. Hearst Corp., 107 F. Supp. 2d 1192, 1205 (N.D. Cal. 2000).

[65] *See* United States v. M.P.M., Inc., 397 F. Supp. 78, (D. Colo. 1975).

[66] For cases finding the defense applicable to failing divisions, see FTC v. Great Lakes Chem. Corp., 528 F. Supp. 84, 96 (N.D. Ill. 1981); United States v. Reed Roller Bit Co., 274 F. Supp. 573, 584 (W.D. Okla. 1967); United States v. Lever Bros. Co., 216 F. Supp. 887, 898-99 (S.D.N.Y. 1963). For cases finding the defense

The DOJ and FTC always have been antagonistic to the failing company doctrine, but in deference to its long judicial acceptance, the 2010 DOJ/FTC Horizontal Merger Guidelines, as have the earlier guidelines, include a section on failing companies.[67] Like the more demanding courts, the Guidelines recognize the defense only when: (1) the firm is failing in the sense that it is unable to meet its financial obligations in the near future; (2) the firm is unable to reorganize successfully under Chapter 11 of the Bankruptcy Act; and (3) the firm has made unsuccessful good-faith efforts to elicit reasonable alternative offers that would keep its tangible and intangible assets in the relevant market and pose a less severe danger to competition than does the proposed merger.[68]

There have been very few invocations of the failing company defense that have been successful before either the DOJ or the FTC. As before the courts, although it is relatively easy to show that the company or division is failing, historically it has been difficult to convince the agencies that the requisite effort has been made to find a less anticompetitive purchaser. Success means that the challenged transaction cannot go forward, and the agencies almost conclusively presume that the failure to find a less anticompetitive purchaser results from a failure of effort, not a real absence of alternative purchasers. This skepticism is compounded by the agencies' view, expressed in a footnote in the Guidelines, that any offer to purchase the failing firm's assets or division at a price above liquidation value is a reasonable alternative offer that vitiates the defense.

The Guidelines, like many courts, extend the defense to failing divisions of otherwise healthy companies, although they emphasize that great care must be exercised in analyzing the division's cash flow to ensure that it is negative in an economically meaningful sense and not just an artifact of financial accounting. In analyzing divisional cash flow, as well as in determining whether the division's assets will leave the market if the acquisition is unable to proceed, the agencies will require evidence beyond business plans or financial statements prepared by management.

Read Section 11 of the Horizontal Merger Guidelines (p. 156) and the class notes (slides 91-94) on the efficiencies defense. Then read the excerpt from *FTC v. Wilh. Wilhelmsen Holding ASA*[69] for a judicial application (pp. 157-59). The two posts from the FTC blog speak to how the agencies view the failing company defense and are quick and easy reads (pp. 160-63). Also, take a look at the paragraph in *Sanford Health* on the "weakened competitor" or "ailing firm" defense (p. 63).

Finally, if you have the time and the interest, take a look at what happened in the wake of the Eighth Circuit's decision: the parties abandoned the deal and the FTC dismissed the complaint as moot (pp. 64-75).

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inapplicable to failing divisions, see United States v. Blue Bell, Inc., 395 F. Supp. 538, 550 (M.D. Tenn. 1975); United States v. Phillips Petroleum Co., 367 F. Supp. 1226, 1260 (C.D. Cal. 1973).

[67] 2010 DOJ/FTC Horizontal Merger Guidelines § 11.

[68] *See* 2010 DOJ/FTC Horizontal Merger Guidelines § 11. The 1992 Guidelines included a fourth requirement: absent the acquisition under investigation, the assets of the failing firm would exit the relevant market. 1992 DOJ/FTC Horizontal Merger Guidelines § 5.1. The four-part 1992 Guidelines test has been adopted by some courts. *See* FTC v. Arch Coal, Inc., 329 F. Supp. 2d 109, 154 (D.D.C. 2004).

[69] 341 F. Supp. 3d 27, 70-71 (D.D.C. 2018).

Enjoy the reading! Email me if you have any questions.