MERGER ANTITRUST LAW

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Tuesdays and Thursdays, 3:30-5:30 pm
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READING GUIDANCE

There is a lot of material in this unit. Read this guidance carefully. In order of priority, the class notes are the most important. Spend whatever time you need on them. Then turn to the 2010 Merger Guidelines, following the reading guidance on what to read carefully and what to skim. If you can get to more, follow the rest of the reading guidance. If not, don't worry about it.

Class 2 (September 1): Predicting Merger Antitrust Outcomes (Unit 2)

On Thursday, we will explore how to predict merger antitrust law enforcement outcomes with only limited information. More often than not, only limited information will be available at the beginning of a transaction, when the purchase price and terms of the deal are being negotiated and only a handful of senior executives know about the prospect of a transaction. Still, predictions need to be made about the deal's antitrust risk and the likelihood that divestitures or other changes will need to be made to enable the deal to close. The client—whether buyer or seller—needs a sense of the antitrust outcome in order to negotiate a sensible deal price and make informed judgments about tradeoffs in negotiating the antitrust risk-shifting provisions in the merger agreement (a topic we will cover in Class 8). A good sense of the antitrust risk and likely outcome of a merger investigation at the beginning of negotiations are among the most important things an antitrust deal lawyer can provide the client.

Accordingly, we need a way to predict antitrust outcomes when only limited information is available. No doubt, this has become more problematic as the leaders in the Biden DOJ and FTC bring a perspective to antitrust enforcement that differs dramatically from the approach the DOJ and FTC have pursued over the last 30 to 40 years in both Democratic and Republican administrations. But it is important to keep in mind that the courts—not the agencies—will have the final say on whether a transaction violates the antitrust laws. In the absence of Congress changing the law, courts will be guided not only by the language of the antitrust laws but also by the significant amount of precedent that has developed in applying these laws since the early 1980s.

Moreover, with the new appointments during the Trump administration, the Supreme Court has developed a new interest in substantive antitrust law. A clear majority of justices today appear committed to interpreting the law under the traditional consumer welfare standard and are likely to be hostile to any new approach advocated by the Biden antitrust enforcement officials that deviates from the consumer welfare standard. So, while the DOJ and FTC can and have increased the costs of doing deals by making investigations more burdensome and by imposing litigation costs on the merging parties, when the courts adjudicate the cases, the traditional judicial standards almost certainly will apply in the absence of new antitrust legislation. Indeed, despite all of the talk by the Biden administration, there has been only one case brought to date by the Biden administration where the DOJ or FTC has advanced a theory that would not be cognizable under the traditional standards.[1]

Therefore, the model we will develop—albeit with a few tweaks—still retains significant predictive power, at least in the courts. That said, no doubt the agencies will press aggressive applications of merger antitrust law in their merger reviews or perhaps refuse to accept a restructuring of the transaction in a consent decree (a so-called "fix") to eliminate the agency's concerns.[2]

When the investigating agency adopts any aggressive position, the merging firms may decide to voluntarily terminate their transactions at the end of an investigation rather than fight the agency in court. A critical aspect of merger antitrust counseling today is conveying to the client a realistic sense that in today's environment, the ability to close a deal may depend on the willingness of the parties to litigate the merits of the deal in court. If the merging parties evince a willingness to litigate—or indeed have a provision in the merger agreement requiring them to do so—the agencies have to decide whether they will prosecute an aggressive case in court notwithstanding the prevailing judicial standards. In these circumstances, the agencies may decide to take a consent decree "fix" rather than litigate and risk losing on the merits. In today's world, the merging parties' willingness to litigate can materially reduce the probability of litigation and improve the likelihood of a successful deal completion with a consent decree.

An important distinction. Before exploring the predictive model, we should first distinguish how decision-makers (such as the DOJ, the FTC, or the courts) make decisions and how they explain or justify their decisions after making them. A fundamental mistake all too many make is believing that how a decision is *explained* or *justified* (say in a court opinion or an agency press release) describes why the decision *was actually made*. The two often are not the same.

Accordingly, we will not be able to directly explore how the agencies or the courts make their merger antitrust decisions. What we can do, however, is develop a model that empirically aligns with the outcomes we observe in merger antitrust enforcement decisions.

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1 See Complaint for a Temporary Restraining Order and Preliminary Injunction Pursuant to Section 13(b) of the Federal Trade Commission Act, FTC v. Meta Platforms, Inc., No. 3:22-cv-04325 (N.D. Cal. filed July 27, 2022) (alleging that Meta's acquisition of Within would violate Section 7 because, if the acquisition was blocked, Meta would develop its own dedicated fitness app but without alleging that Meta has any plans to do so). This is a major extension of the actual potential competition theory, which under existing case law requires a showing that the acquiring party would enter the relevant market on its own within two or three years in the absnce of the acquisition. We will examine the elimination of potential competition as a theory of anticompetitive harm, and the Trump and Biden administrations' efforts to expand it, in Class 21.

2 Historically, where the investigating agency concluded that a horizontal merger presented an antitrust problem in a relevant market, the common solution was for the merging parties to enter into a consent decree requiring the divestiture of one or the other party's assests and business in that market to a buyer that would "step into the shoes" of the divesting firm and operate the business with the same competitive force the divestiture seller had premerger. The upshot would be that the structure of the problematic market did not change postmerger although the identity of one of the participating firms changed from the divestiture seller to the divestiture buyer. In some cases, the Biden antitrust agencies have been unwilling to accept these "divestiture consent decrees" as a remedy to the antitrust problem, leaving the merging parties with the choice of either litigating the merits or voluntarily terminating their transaction. We will discuss litigating these types of cases, including when the merging parties put the "fix" into place voluntarily ("litigating the fix"), in Class 6.

Antitrust risk. Before continuing to the model, we also need to examine the concept of *antitrust risk* in a transaction. Much of the first part of this course will focus on the knowledge and tools merger antitrust counsel need to anticipate and deal with the antitrust risk associated with a pending merger or acquisition. Lawyers give advice; clients make decisions. The goal of a lawyer at the beginning of a deal is to get the client into a position to make informed decisions about how to proceed (if at all) in light of the transaction's antitrust risk. A big problem for practitioners, and hence for clients, is how to develop and then convey a meaningful sense of this risk to the client. Overall, I find that antitrust lawyers do a terrible job on this.

The class notes provide a way to think systematically about antitrust risk (slides 3-7). I find by far the best way to think about antitrust risk is in three nested buckets: (1) inquiry risk, (2) substantive risk, and (3) remedies risk. This three-bucket approach is a very natural way for business people to think about antitrust risk. While I will address these risks in the context of a merger, they apply to any situation where antitrust risk—or indeed any type of legal risk—is present.

1. *Inquiry risk* is the risk that the transaction's merits will be seriously examined. Antitrust questions do not materialize out of thin air. Someone has to have both the *incentive* and the *institutional means* of raising the question and requiring the merging parties to defend their transaction. Inquiry risk can be easily analyzed by looking at the incentives and the institutional means of the various actors interested in the transaction (primarily the federal enforcement agencies, the state attorneys general, competitors, customers, and occasionally suppliers) to raise an antitrust question about the deal in a forum that requires an answer.
2. *Substantive risk* is the risk that the transaction violates the antitrust laws. Substantive risk arises if and only if there is an inquiry. The analysis of substantive risk requires an identification of the possible theories of antitrust liability and defenses that could apply to the transaction and then a dispassionate evaluation of those theories in light of the evidence to which the parties have access (including their own documents) or can develop (notably expert evidence), as well as a judgment about the evidence that the investigating agency may develop from third parties that is not available to the merging parties (at least absent discovery in the course of litigation).
3. *Remedies risk* reflects the consequences of a conclusion that the transaction violates the antitrust laws. Remedies risk is analyzed in terms of the types and probabilities of the possible relief that might result from a finding of a violation. This includes the range of possible "fixes," most particularly consent decrees requiring the divestiture of some of the businesses or assets of the merging parties to a third party that will then operate the divested businesses or assets in competition with the merged firm.[3] The idea of a "fix" is to enable an independent third party to "step into the shoes" of the divesting firm,

[3] A typical "fix" in a horizontal merger (that is, a combination of two competitors) is the divestiture of a product line or business in the problematic area from one of the two merger companies. For examples, if two supermarket chains are merging and there is an antitrust problem is the Chattanooga supermarket market, then the merging parties can "fix" the problem by agreeing to divest the all of the supermarket stores in Chattanooga owned or operated by one or the other of the other merging parties to an independent third party that will continue to operate them as supermarket stores with the same competitive force as the divestiture seller. These fixes are embodied in judicially enforceable consent decrees. We will cover "fixes" through consent decrees in some detail in Class 5.

preserve the premerger level of competition and so negate the agency's antitrust concern. Assessing remedies risk requires an evaluation of the minimally reasonable fix (and likely a range of other more onerous fixes), the likelihood of the acceptance of the fix by the relevant decision-maker (the investigating agency or the court), and the associated costs of the fix to the merged firm.[4] Evaluation of the remedies risk must also take into account the possibility that there is no fix acceptable to the enforcement agency to cure the antitrust problem.[5]

I should note that, for me at least, a lawyer cannot ethically assist a client in proceeding with a transaction or course of conduct where the inquiry risk is essentially zero but the substantive risk is near or at 100%. That is, a lawyer needs something more to advise a client than a high level of confidence that the client will not get caught. That something more is a *colorable argument* that the course of conduct is lawful. A colorable argument does not have to be a winning argument, nor does it have to comport with the judicial antitrust rules then in effect. Although definitions vary, my test in practice is that an argument—including an argument that the judicial rules applying the antitrust statutes should be changed —is colorable if I am comfortable making the argument to a judge I respect in open court and knowing that the argument will be reported through the various antitrust newsletters and blogs to the antitrust bar at large.[6]

Substantive antitrust risk. While inquiry risk is logically prior, you will better understand inquiry risk if we first examine substantive antitrust risk. When you read the slides on substantive risk, keep these two points in mind:

1. Substantive risk can be defined in one of two ways: (a) the risk that the DOJ or FTC will challenge a deal at the end of a merger review, or (b) the risk that at the end of a litigation the transaction will be found to violate Section 7 of the Clayton Act. For reasons we will discuss, almost all challenged transactions historically have either settled with a consent decree or voluntarily terminated.[7] Conversely, very few challenged

[4] These include the loss of synergies associated with the divested businesses, any discount from going-concern value that the divestiture seller likely will have to accept since merger divestitures are usually made in "fire sale" conditions, and the transactions costs associated with the divestiture sale.

[5] We will discuss this more in Class 5, but the acceptance of a precomplaint fix is purely within the discretion of the investigating agency. The agency may refuse to accept a consent decree for any reason, including an arbitrary reason. Agency decisions to refuse to accept a consent decree are not subject to review under the Administrative Procedure Act. Unless provided by statute, only "final" agency actions are reviewable under the APA, 5 U.S.C. § 704, and a decision to refuse to settle an investigation is not a "final agency action" because it is interlocutory and does not impose an obligation, deny a right, or fix a legal relationship. *See* Bennett v. Spear, 520 U.S. 154, 177 (1997) (holding that agency action is "final" within the meaning of the APA only if (1) action marks the "consummation" of the agency's decision-making process, and (2) second, the action must be one by which "rights or obligations have been determined," or from which "legal consequences will flow"). In addition, it is likely that a decision to refuse to settle is "committed to agency discretion by law" and so exempt from APA review under 5 U.S.C. § 701(a)(2).

[6] I should emphasize that this is a personal approach and not a view on what the formal rules of ethics governing lawyers necessarily require. Some attorneys to whom I have spoken who know more about the formal requirements of the ethics rules agree with me when the conduct in question is criminal, but say that my approach is more restrictive than necessary where the unlawful conduct would not be criminal. Others, however, are not so sanguine about the noncriminal scenario.

[7] Merging parties have exhibited somewhat more willingness to litigate their transactions in actions brought by the Biden administration than by past administrations. As noted above, the Biden administration has lost a number of

mergers have proceeded to litigation on the merits. Therefore, our initial focus will be on the risk that the investigating agency challenges the transaction and not on litigation outcomes.

2. As noted above, we will draw several important distinctions in the course. The first one is between the reasons the agency *decides* to challenge a transaction and the reasons the agency puts forth to *explain* why a challenged transaction is illegal. The reasons a particular decision was made and the explanation justifying the decision can be quite different. In evaluating antitrust risk, we need to focus primarily on the facts that influence the agency's decision to challenge the transaction and much less on how the agency explains this decision after the fact.

In this class, we will examine a model that predicts agency prosecutorial decision-making outcomes. The class notes first provide more detail on Section 7 of the Clayton Act (slides 10-16) and then describe the predictive model for downstream markets.[8] Concentrate on the general principles (slides 18-36). You may skim the special cases (slides 37-44), but be sure to get a general idea of what they are. We will examine these special cases in excruciating detail later in the course.

You may find our discussion provides a somewhat different perspective of merger antitrust analysis than you saw if you have taken an antitrust survey course. Most of what you see in antitrust courses is how judges and occasionally enforcement officials *explain* the antitrust decisions they reached; my model *predicts* what enforcement decisions the agency will make. It turns out that there is a big difference. You may also find it curious that my predictive model makes no reference to market definition, HHIs, diversion ratios, upward pricing pressure, or the 2010 DOJ/FTC Horizontal Merger Guidelines—staples in the explanation of merger antitrust enforcement decisions. Later, when we study litigated merger antitrust cases, we will examine these and other more formal concepts as we examine the agencies' arguments when trying to convince a court that the challenged transaction is illegal.

Merger Guidelines. Notwithstanding the lack of any reference to the 2010 DOJ/FTC Horizontal Merger Guidelines in the predictive model, I have included it in the reading. You will have to read merger guidelines sometime, and gaining some familiarity with them now will help you throughout the course. The DOJ press release (pp. 4-6) gives a good introduction. Study the table of contents (pp. 8-9) to understand the Guidelines' basic organizational structure. Review Section 1 (pp. 10-11), which you should have read for the first class. Read Sections 2 and 3—Evidence on Adverse Competitive Effects (pp. 11-15) and Targeted Customers and Price Discrimination (pp. 15-16)—with some care. You can skim the rest of the Guidelines (pp. 16-43) or even just look at the headings to get a rough sense of what else the Guidelines address. You will have the opportunity to read those sections in more detail as they arise in the case studies

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antitrust cases in court. The more an agency loses in court, the more likely opposing parties will put the agency to its proof in court.

[8] Almost all challenges to horizontal mergers located the anticompetitive effect in the downstream market (that is, where sellers merge and any harm is to customers). As explain in the class notes, the Biden administration believes that mergers are often anticompetitive in upstream markets (where buyers merge and any harm is to suppliers, especially labor). There are too few challenges in upstream markets to develop a reliable predictive theory, although the notes speculate a bit on when the Biden agencies may challenge upstream mergers (see slides 15-16).

later in the course. The statements of FTC Chairman Jon Leibowitz (p. 44) and Commissioner Tom Rosch (pp. 45-48) will give you an idea of what two important commissioners at the time thought of the Guidelines. My personal take on the 2010 Guidelines, which includes a somewhat unconventional view on why the agencies revised the Guidelines after 18 years, is memorialized in the S&S note to clients (pp. 49-54), which you can just skim or skip altogether.[9]

2022 Merger Guidelines review. On January 18, 2022, the Biden DOJ and FTC announced that they would review the existing merger guidelines with the view of "strengthening enforcement against illegal mergers."[10] (see pp. 56-58) Read the Request for Information on Merger Enforcement (pp. 59-68) to get an idea of where the Biden DOJ and FTC might like to take merger antitrust law. The supporting remarks by FTC Chair Khan (pp. 69-72) and the more skeptical views of the Republican-appointed commissioners (pp. 73-75) will give more color to the review.

Since the Biden antitrust agencies almost surely will revise, if not completely replace, the 2010 Horizontal Merger Guidelines, why, you might ask, should we spend any time on the 2010 guidelines? The answer is twofold. First, most of the modern merger antitrust judicial precedent was developed under the 1992 and 2010 Horizontal Merger Guidelines. When the 2010 guidelines replaced the 1992 guidelines, courts still followed the precedent they had developed under the 1992 guidelines. Merger guidelines ostensibly describe how the agencies will exercise their prosecutorial discretion; the guidelines have no legal force and are not binding on the courts. If the new guidelines depart materially from the existing guidelines, courts are unlikely to give them much credence. Second, there is a good chance that the Biden administration's antitrust views will not stick. The next administration—especially if it is a Republican administration—likely will revert to something like the current 2010 guidelines.

"Bad documents." If you are interested in the types of unhelpful things the merging companies can write, read the 1995 *Microsoft* DOJ complaint (especially 79-80, 87) and the 2007 *Whole Foods* FTC complaint (especially pp. 96-99, 101-02). I suggest leaving these materials until last and if you still have the time and interest, take a look. Otherwise, skip them. That said, they will open your eyes to some harmful statements executives make that can be used against the transaction.

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[9] The first set of merger guidelines were issued in 1968 by the Department of Justice. *See* U.S. Dep't of Justice, Merger Guidelines (May 30, 1968). The guidelines were revised by AAG William F. Baxter in 1982 and covered both horizontal and nonhorizontal transactions. *See* U.S. Dep't of Justice, Merger Guidelines (June 14, 1982) (published at 47 Fed. Reg. 28,493). The FTC refused to join the 1982 guidelines and instead issued their own separate statement of how the Commission would assess mergers and acquisitions. *See* Fed. Trade Comm'n, Statement Concerning Horizontal Merger Guidelines (June 14, 1982). After a minor revision in 1984, the guidelines were significantly revised in 1992. *See* U.S. Dep't of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines (Apr. 2, 1992). Although the 1992 guidelines reflected the same conception of the goals of merger antitrust law as the 1982 guidelines, the 1992 guidelines were limited to horizontal transactions. The 1992 guidelines significantly enhanced the economic techniques to analyze horizontal mergers. Notably, the FTC joined in issuing the 1992 guidelines. The guidelines were again revised in 2010. *See* U.S. Dep't of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines (rev. Aug. 19, 2010). The 2010 guidelines, which continue to be limited to horizontal transactions, remain in effect today, although there is an excellent chance that they will be revised by the Biden administration. We will discuss the evolution of the merger guidelines more in Class 3.

[10] Fed. Trade Comm'n & U.S. Dep't of Justice, Antitrust Div., Federal Trade Commission and Justice Department Seek to Strengthen Enforcement Against Illegal Mergers (Jan. 18, 2022).

Synergies and efficiencies. The next section of the class notes introduces synergies and efficiencies. Synergies are the private benefits the merged company obtains through the merger. Two major types of procompetitive synergies are:

(1) *customer value-enhancing synergies*, which enable the merged firm to create new products or to make existing products better, cheaper, or faster to the direct benefit of customers, which in turn increases the demand for the merged firm's products;[11] and

(2) *cost-saving synergies*, which reduce duplicative costs (e.g., by closing one of the two headquarters buildings) or increase the firm's productive efficiency of the combined operation (e.g., through best practices, transfer of more efficient production technology).

In antitrust law, synergies that benefit customers under the consumer welfare standard are called *efficiencies* and can be used in defending a transaction. That is, efficiencies are procompetitive synergies. On the other hand, benefits to the merged firm that harm customers (say, higher profits due to the higher prices the merger enables the combined company to charge) are anticompetitive synergies and hence not recognized as efficiencies by the courts or the antitrust enforcement agencies.[12]

A question in many transactions is whether the efficiencies of a transaction somehow outweigh or offset the anticompetitive tendencies of the transaction. In other words, even if the transaction is likely to have some anticompetitive effects (such as higher prices), can the procompetitive benefits of the transaction nonetheless make consumers better off with the transaction than without it and hence pass antitrust muster under the consumer welfare standard? This will be a recurring focus in many of our case studies. For now, we are just introducing the subject. Read the class notes for a quick practical introduction (slides 45-51) and Section 10 of the 2010 DJ/FTC Horizontal Merger Guidelines (pp. 38-40) for some sense of how the agencies treat efficiencies.

Note that the Guidelines (and now the courts) require that, to be considered in the antitrust analysis, efficiencies must be:

1. Merger-specific (i.e., could not be accomplished in the absence of the merger),
2. Verifiable by sufficient evidence,
3. Completely and immediately sufficient to offset any anticompetitive tendencies of the merger, and
4. Not the result of an anticompetitive effect of the transaction

The DOJ and FTC apply these criteria very restrictively. For example, the agencies have rejected evidence of merger specificity as insufficient where it was at least theoretically possible for the merging companies to achieve the synergies individually in the absence of the merger—for

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[11] As a general rule, when I say "products" and mean both products and services.

[12] No doubt being able to charge higher prices because the transaction created more market power in the combined firm is a benefit to the firm. You sometimes see this reflected in the firm's documents as a "revenue synergy." While the transaction can increase revenues to the combined for reasons other than market power, when the DOJ and FTC read "revenue synergy" in a company's documents, they assume that this is from the exercise of market power. Consequently, it is important for companies to be clear in their documents that any revenue synergy is from increasing, and not decreasing, the value proposition the firm offers its customers. Better yet, companies should be advised to avoid the use of the term altogether.

example, by the target through additional R&D investment—even when the evidence was undisputed that the companies had no plans to make the investment in the absence of the merger. Likewise, the agencies have rejected the testimony of responsible company employees to establish verifiability, even when the synergies estimates were relied upon by the acquiring firm's board of directors in approving the transaction, the resulting estimates reported in public announcements and SEC disclosure filings, and the buyer had achieved similar efficiencies in similar prior transactions. Finally, the agencies have rejected efficiencies as sufficient to eliminate any anticompetitive tendencies of the merger for failure of the parties to model the transaction's anticompetitive effects to the investigating agency's satisfaction.[13] As a result, by the latter years of the Obama administration, the DOJ and FTC in their merger investigations all but eliminated efficiencies from any serious consideration in determining whether a transaction presented a competitive problem. Much to the surprise of many observers, the Trump administration continued this policy, as has the Biden administration. I have included a critique of this approach by Commissioner Josh Wright in his dissent in the *Ardagh* case (pp. 109-16).

Putting things together. Finally, the remaining slides in the deck attempt to put everything in this unit together (slides 52-58) into a coherent defense of a transaction and some key questions to keep in mind when approaching a transaction. This is a quick read.

As you prepare for class, think about how you would use the concepts and tools in today's materials to advise a client who wants to know what antitrust risk may be presented by a possible deal. Assume, as is often the case, that at this early point in the transaction you know essentially nothing about the underlying facts. Suppose the CEO of the acquiring company has asked you for a short meeting to answer your questions about the facts and hear your preliminary advice. How would you structure the meeting?

If you have any questions or comments, send me an e-mail. See you in class.

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[13] As we will discuss in class and develop in more detail later in the course, in the usual neoclassical microeconomic models used in antitrust analysis a profit-maximizing firm will set its price so that its marginal revenue equals its marginal cost. This means that cost reduction synergies are cognizable only if the synergy reduces the combined firm's marginal cost of production and that fixed cost reductions (such as the elimination of duplicative facilities), while perhaps significant to the merging firm's expected future earnings, do not count in the antitrust analysis as a procompetitive offsetting factor.