MERGER ANTITRUST LAW

Unit 12: The Ice Cream Merger

“Loose Ends”

Class 19

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U.S. Department of Justice

and the

Federal Trade Commission

Issued: August 19, 2010

Buyer characteristics and the nature of the procurement process can affect coordination. For example, sellers may have the incentive to bid aggressively for a large contract even if they expect strong responses by rivals. This is especially the case for sellers with small market shares, if they can realistically win such large contracts. In some cases, a large buyer may be able to strategically undermine coordinated conduct, at least as it pertains to that buyer's needs, by choosing to put up for bid a few large contracts rather than many smaller ones, and by making its procurement decisions opaque to suppliers.

8. Powerful Buyers

Powerful buyers are often able to negotiate favorable terms with their suppliers. Such terms may reflect the lower costs of serving these buyers, but they also can reflect price discrimination in their favor.

The Agencies consider the possibility that powerful buyers may constrain the ability of the merging parties to raise prices. This can occur, for example, if powerful buyers have the ability and incentive to vertically integrate upstream or sponsor entry, or if the conduct or presence of large buyers undermines coordinated effects. However, the Agencies do not presume that the presence of powerful buyers alone forestalls adverse competitive effects flowing from the merger. Even buyers that can negotiate favorable terms may be harmed by an increase in market power. The Agencies examine the choices available to powerful buyers and how those choices likely would change due to the merger. Normally, a merger that eliminates a supplier whose presence contributed significantly to a buyer's negotiating leverage will harm that buyer.

> *Example 22:* Customer C has been able to negotiate lower pre-merger prices than other customers by threatening to shift its large volume of purchases from one merging firm to the other. No other suppliers are as well placed to meet Customer C's needs for volume and reliability. The merger is likely to harm Customer C. In this situation, the Agencies could identify a price discrimination market consisting of Customer C and similarly placed customers. The merger threatens to end previous price discrimination in their favor.

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

> *Example 23:* In Example 22, if Customer C instead obtained the lower pre-merger prices based on a credible threat to supply its own needs, or to sponsor new entry, Customer C might not be harmed. However, even in this case, other customers may still be harmed.

9. Entry

The analysis of competitive effects in Sections 6 and 7 focuses on current participants in the relevant market. That analysis may also include some forms of entry. Firms that would rapidly and easily enter the market in response to a SSNIP are market participants and may be assigned market shares. See Sections 5.1 and 5.2. Firms that have, prior to the merger, committed to entering the market also will normally be treated as market participants. See Section 5.1. This section concerns entry or adjustments to pre-existing entry plans that are induced by the merger.

FTC v. WILH. WILHELMSEN HOLDING ASA
341 F. SUPP. 3D 27, 70-71 (D.D.C. 2018)
(excerpt[1])

TANYA S. CHUTKAN, District Judge

The Federal Trade Commission ("FTC") has moved for a preliminary injunction to block a proposed merger between defendants Wilhelmsen Maritime Services AS ("WMS"), Wilhelmsen Ship Services ("WSS") (collectively "Wilhelmsen"), and The Resolute Fund II, L.P., Drew Marine Intermediate II B.V., and Drew Marine Group, Inc. (collectively "Drew"), two large providers of marine water treatment chemicals and related services. The FTC objects to the merger on the grounds that Defendants are each other's closest and only realistic competition for supplying these chemicals and services on a global scale, and the merger threatens to reduce or eliminate tangible consumer benefits resulting from market competition. Having considered the evidence presented through live testimony, as well as extensive pleadings, exhibits, and other submissions, the court hereby GRANTS the motion for preliminary injunction.

[The court found, for the purpose of deciding whether to enter a preliminary injunction, that the supply of marine water treatment (MWT) products and services, including boiler water treatment (BWT) chemicals, cooling water treatment (CWT) chemicals, and associated products and services, to global fleets, constituted a relevant antitrust market and that, within this market, the FTC had established a prima facie case of anticompetitive effect. In response, the merging parties advanced entry, power buyer, and efficiencies defenses.]

. . .

b. *Power Buyers*

1. LEGAL STANDARD

Courts have also noted that the existence of power buyers—sophisticated customers who retain strategies post-merger that "may constrain the ability of the merging parties to raise prices," Merger Guidelines § 8—is a factor that can serve to "rebut a prima facie case of anti-competitiveness." *Cardinal Health*, 12 F.Supp.2d at 59. However, "[t]he ability of large buyers to keep prices down ... depends on the alternatives these large buyers have available to them." *Sysco*, 113 F.Supp.3d at 48. Where mergers reduce alternatives—i.e., prevent the use of certain competitive strategies—"the power buyers' ability to constrain price and avoid price discrimination can be correspondingly diminished." *Id*. (citing Merger Guidelines § 8). Thus, the mere presence of power buyers "does not necessarily mean that a merger will not result in anti-competitive effects." *Cardinal Health*, 12 F.Supp.2d at 59. In assessing a power

1. Record citations omitted

buyer argument, the court should "examine the choices available to powerful buyers and how those choices likely would change due to the merger," keeping in mind that "[n]ormally, a merger that eliminates a supplier whose presence contributed significantly to a buyer's negotiating leverage will harm that buyer." Merger Guidelines § 8. Finally, although the consideration of non-entry factors—including the existence of power buyers—is "relevant, and can even be dispositive, in a section 7 rebuttal analysis," *Baker Hughes*, 908 F.2d at 987, courts have not typically held "that power buyers alone enable a defendant to overcome the government's presumption of anticompetitiveness." *Cardinal Health,* 12 F.Supp.2d at 58; *Chicago Bridge & Iron Co. N.V. v. FTC*, 534 F.3d 410, 440 (5th Cir. 2008) ("[C]ourts have not considered the 'sophisticated customer' defense as itself independently adequate to rebut a prima facie case.").

2. ANALYSIS

Defendants argue that the FTC's Global Fleets construct focuses on the largest shipping companies—those most likely to have the power to constrain the merger's anticompetitive effects. In support of this contention, Defendants point out that customers tend to purchase other goods from suppliers, which permits them to discipline attempted BWT [boiler water treatment chemicals] and CWT [cooling water treatment chemicals] price increases by switching or credibly threatening to switch purchases of these other products to other suppliers or by negotiating price decreases on other products. Defendants further argue that customers could adapt purchases to another supplier's distribution network or shift part of their fleet to another competitor, since many vessels in Global Fleets do not avail themselves of all of Defendants' networks—instead visiting a subset of available ports and picking up MWT from an even smaller subset. Defendants also contend that Global Fleets could stockpile larger quantities of MWT products in order to shift purchases to major ports with lower costs, and that customers can partner with suppliers to sponsor entry or expansion to new ports.

The court is unpersuaded by Defendants' power buyer argument. The evidence is mixed—at best—regarding the effectiveness of each of the Defendants' suggested strategies. Although at least one witness suggested that customers could shift purchases of other products in more competitive markets to other suppliers, there is, as Dr. [Avid] Nevo [the FTC's expert economist] noted, little empirical basis for the notion that this strategy—already available to large customers—would yield any additional benefits beyond those customers currently enjoy. Similarly, while testimony suggested that customers may be able to stockpile product and concentrate purchases in ports where products are cheaper, that same testimony suggests that storage space is often limited and that customers already do so. Defendants have not identified any new strategy or alternative likely to emerge post-merger—instead, they have focused on strategies that are already part of the competitive landscape and which show no promise of becoming more effective. On the other hand, the FTC has shown that the merger will result in the loss of a proven strategy—the ability to leverage one large, global supplier against another—that appears to be the most effective price constraint

in the consolidated MWT market. In other words, the FTC has established a reasonable probability that as a result of the merger, sophisticated buyers will have one less alternative strategy through which they can exercise power, and Defendants have not identified any equally or more effective buyer options to counteract that loss. Thus, the reduction of buyer alternatives means that "power buyers' ability to constrain price and avoid price discrimination can be correspondingly diminished," *Sysco*, 113 F.Supp.3d at 48, and evidence of buyer power is insufficient to rebut the FTC's prima facie case.

A NOTE ON THE POWER BUYERS DEFENSE

In some markets, large buyers may exist that, because of their bargaining power, are able to 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 or 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.[1] 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.[2]

Simply because a buyer is powerful does not mean that it is able to discipline the collective or unilateral exercise of market power by suppliers postmerger to protect itself.[3] The question here is two-fold: 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?[4] Moreover, even a particular buyer can protect itself from the exercise of market power, its action may not protect other, less powerful buyers and only result in a regime of price discrimination where some buyers get hurt and

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1. *See* Chicago Bridge & Iron Co. N.V. v. FTC, 534 F.3d 410, 440 (5th Cir. 2008); FTC v. Wilh. Wilhelmsen Holding ASA, 341 F. Supp. 3d 27, 70 (D.D.C. 2018); FTC v. Cardinal Health, Inc., 12 F. Supp. 2d 34, 58 (D.D.C. 1998); U.S. Dep't of Justice & Fed. Trade Comm'n, DOJ/FTC Horizontal Merger Guidelines § 8 (rev. 2010).

2. *See, e.g.*, United States v. Baker Hughes, 908 F.2d 981 (D.C.Cir.1990) (finding the existence of power buyers along with the ease of entry was sufficient to rebut a prima facie case of anticompetitive effect); United States v. Country Lake Foods, Inc., 754 F. Supp. 669, 675, 679 (D. Minn. 1990) (finding the lack of entry barriers, the potential entry by distant dairies, the power of the fluid milk buyers in the area, the possibility of vertical integration, and efficiencies rebutted a prima facie case of anticompetitive effect).

3. *See, e.g.*, *Wilhelmsen*, 341 F. Supp. 3d at 70; FTC v. Cardinal Health, Inc., 12 F. Supp. 2d 34, 58 (D.D.C. 1998).

4. *See Wilhelmsen*, 341 F. Supp. 3d at 70.

others do not.[5] The 2010 Merger Guidelines recognize the defense and these limiting principles:

> The Agencies consider the possibility that powerful buyers may constrain the ability of the merging parties to raise prices . . . . However, the Agencies do not presume that the presence of powerful buyers alone forestalls adverse competitive effects flowing from the merger. Even buyers that can negotiate favorable terms may be harmed by an increase in market power. The Agencies examine the choices available to powerful buyers and how those choices likely would change due to the merger. Normally, a merger that eliminates a supplier whose presence contributed significantly to a buyer's negotiating leverage will harm that buyer.... Furthermore, even if some powerful buyers could protect themselves, the Agencies also consider whether market power can be exercised against other buyers.[6]

It is important in raising a power buyer defense to present both an explanation and evidence of the mechanics of how the power buyer will constrain the exercise of market power postmerger against itself and how other customers, if any, in the market will be protected.

Self-protection. The first requirement for a power buyer defense is that the putative power buyer be able to protect itself from any anticompetitive effect resulting from the merger. In the absence of a clear mechanism—and the incentive to use it—courts and the enforcement agencies will reject a power buyer defense.[7]

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5. *See* FTC Cardinal Health, Inc., 12 F. Supp. 2d 34, 61 (D.D.C. 1998) (rejecting power buyer defense in a two mergers of mergers of wholesale prescription drug distributors where, although large pharmacy chains had significant bargaining power and likely could protect themselves, the market also contained independent pharmacies and the smaller hospitals that could not protect themselves); United States v. United Tote, 768 F. Supp. 1064, 1085 (D. Del.1991) ("Even if the Court were to accept United Tote's argument that the owners of these large, sophisticated facilities would be able to protect themselves from any anti-competitive price increase, this would still leave at least one hundred nine facilities unprotected in the small market segment alone.").

6. U.S. Dep't of Justice & Fed. Trade Comm'n, DOJ/FTC Horizontal Merger Guidelines § 8 (rev. 2010). For cases recognizing the existence of the defense and applying Section 8 of the guidelines, see FTC v. RAG-Stiftung, 436 F. Supp. 3d 278, 315 (D.D.C. 2020); FTC v. v. Wilh. Wilhelmsen Holding ASA, 341 F. Supp. 3d 27, 70 (D.D.C. 2018); FTC v. Sanford Health, Sanford Bismarck, No. 1:17-CV-133, 2017 WL 10810016, at *16 (D.N.D. Dec. 15, 2017), *aff'd*, 926 F.3d 959 (8th Cir. 2019); 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).

7. *See* Chicago Bridge & Iron Co. v. FTC, 534 F.3d 410, 439-40 (5th Cir. 2008) (discussing types of power buyer defense mechanisms); AlliedSignal, Inc. v. B.F. Goodrich Co., 183 F.3d 568, 575 (7th Cir. 1999); FTC v. Cardinal Health, Inc., 12 F. Supp. 2d 34, 58 (D.D.C. 1998); but cf. FTC v. RAG-Stiftung, 436 F. Supp. 3d 278, 315, 317 (D.D.C. 2020) (denying a preliminary injunction where, among other factors, "the hydrogen peroxide industry is marked by sophisticated and powerful customers that are well equipped to defeat coordination" and "there is no reason to suspect that suppliers will not continue to participate in a blind bidding system for long-term and large contracts to win the business of sophisticated buyers" but not further explaining the mechanism).

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:

1. *Share shifting*. When buyers are large relative to the overall market, upstream firms have substantial excess capacity to service new business, marginal costs are low relative to fixed costs, and the costs to the buyers of switching from one supplier to another are low, then price competition for the patronage of these buyers usually is intensive even when the market is highly concentrated. In these circumstances, the upstream firms already have covered their fixed costs, so that—in light of the relatively low marginal costs—the revenues earned on incremental business are almost all profit. Conversely, the loss of one of these buyers to another firm will cost the original supplier heavily, since almost all of the lost revenue is lost profit. As a result, under this theory changes in concentration short of a merger to monopoly are unlikely to disturb price competition in such markets, at least in the absence of explicit collusion.[8] Courts can be skeptical, however, and find that the bargaining power of the putative power buyers declines as the number of the firms with the excess capacity are few in number and become fewer as a result of the merger.[9]

2. *Sponsoring entry*. In markets in which the primary impediment to entry is the risk of not being able to secure enough business to load a minimum efficient scale plant, buyers (who may at collectively though a buying group) that are large relative to the market can protect themselves, at least in the long-run, by inducing entry by third parties by agreeing to purchase enough output to load the new plant. When the time to enter is short and the sunk costs are low, the threat of inducing entry is likely to be a credible one and the threat alone may be sufficient to dissuade the merged firm to raising prices to these buyers. In

8. For cases recognizing a share-shifting argument, see, for example, FTC v. Tenet Health Care Corp., 186 F.3d 1045, 1055 (8th Cir. 1999); *Wilhelmsen*, 341 F. Supp. 3d at 70-71; and presumably FTC v. RAG-Stiftung, 436 F. Supp. 3d 278, 317 (D.D.C. 2020).

9. *See* United States v. Anthem, Inc., 236 F. Supp. 3d 171, 221 (D.D.C. 2017) (rejecting defense where, notwithstanding the substantial sophisticated of large national companies, the "loss of one competitor from the four major carriers alters the RFP and negotiating dynamic, even with strong advocates on the other side" and "[t]his loss of leverage undermines the defense contention that customers will be able to wield their seasoned human resource managers and consultants to counteract the anticompetitive effects of the merger"); *see also* Chicago Bridge & Iron Co. v. FTC, 534 F.3d 410, 440 (5th Cir. 2008) (rejecting share-shifting as defense where the market has had only two dominant players, PDM and CB&I [the merging companies], so buyers cannot now swing back and forth between competitors to lower bids post-acquisition); FTC v. Sysco Corp., 113 F. Supp. 3d 1, 48 (D.D.C. 2015) (finding that large customers premerger have been able "to keep prices down by leveraging the defendant companies against one another," the merger will eliminate that ability); U.S. Dep't of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines § 8 (rev. 2010) ("Normally, a merger that eliminates a supplier whose presence contributed significantly to a buyer's negotiating leverage will harm that buyer.")

such situations, markets are likely to remain competitive even with significant increases in concentration in upstream markets caused by mergers.[10]

3. *Vertical integration*. Vertical integration is a special case of inducing entry. Here, rather than inducing a third party to enter the upstream market, the downstream buyers (who again may act collectively) may vertically integrate into the upstream market of the merged firm. Essentially the same conditions apply for the defense as for inducing entry.[11]

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.[12] This was the situation in *Sanford Heath*, where (1) a representative from blue Cross (the putative power buyer) testified that 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 a near-monopolist in another part of North Dakota.

Protection of others. Whenever a power buyer defense is employed, the parties should pay careful attention to the possibility that, although the large firms in the market may be able to protect themselves, the smaller ones may not. The enforcement agencies and the courts will examine closely the possibility that the upstream firms can isolate the smaller firms and discriminate against them while acting competitively toward the larger firms. If some buyers are able to protect themselves from the

10. *See* Chicago Bridge & Iron Co. v. FTC, 534 F.3d 410, 440 (5th Cir. 2008) (rejecting sponsored entry where "[n]o buyer can assure that a new entrant has 'adequate volume and returns' for meaningful entry into the market); FTC v. Cardinal Health, Inc., 12 F. Supp. 2d 34, 59 (D.D.C. 1998) (finding large pharmacy chains have ability to sponsor entry into drug wholesale distribution to protect themselves but rejecting power buyer defense because of unprotected smaller pharmacies and hospitals); United States v. Baker Hughes Inc., 731 F. Supp. 3, 11 (D.D.C.) (finding the "sophistication" of large customers significant in being able to deter price increases, presumably although not explicitly because they could induce entry by Canadian suppliers) , *aff'd*, 908 F.2d 981, 986 (D.C. Cir. 1990); *see also* FTC v. Sanford Health, Sanford Bismarck, No. 1:17-CV-133, 2017 WL 10810016, at *29 (D.N.D. Dec. 15, 2017) (recognizing mechanism but finding it unsupported by the record), *aff'd*, 926 F.3d 959 (8th Cir. 2019).

11. *See* United States v. Country Lake Foods, Inc., 754 F. Supp. 669, 674, 675, 679 (D. Minn. 1990) (finding capability to vertically integrate); *see also* Sanford Health, 2017 WL 10810016, at *29 (recognizing mechanism but finding it unsupported by the record); United States v. Energy Sols., Inc., 265 F. Supp. 3d 415, 442 (D. Del. 2017) (same).

12. *See Chicago Bridge*, 534 F.3d at 440 (rejecting defense where premerger "[i]nstances of CB&I pressuring customers to offer sole-source contracts by withdrawing its bid and CB&I's success at obtaining sole-source contracts undermine any argument that buyers have the ability to pressure CB&I in contract negotiations").

otherwise anticompetitive effects of a merger but others are not, the defense will fail.[13] This was the case, for example, in *Sanford Health*, where although Blue Cross was a very large firm with a statewide share of the commercial health insurance market of between 55% and 65%, that still left between 35% and 45% of the commercial insurers unprotected from the merger.[14]

Acceptance by courts. To date, courts have been very reluctant to find existence of "power buyers" sufficient by itself to rebut a *prima facie* case of anticompetitive effect,[15] but several courts have noted "power buyers" as one of several factors in a successful rebuttal.[16] The DOJ and FTC are probably more willing to accept the defense, but they will be demanding both in the articulation of precisely why the defense should apply in the case, in the evidence from the customers who are said to be able to exercise this power, and in the ability of all firms in the market to protect themselves.

13. *See* FTC v. Cardinal Health, Inc., 12 F. Supp. 2d 34, 59 (D.D.C. 1998); FTC v. Tenet Healthcare Corp., 17 F. Supp. 2d 937, 941 (E.D. Mo. 1998), *rev'd on other grounds*, 186 F.3d 1045 (8th Cir. 1999); United States v. United Tote, Inc., 768 F. Supp. 1064, 1085 (D. Del. 1991).

14. FTC v. Sanford Health, Sanford Bismarck, No. 1:17-CV-133, 2017 WL 10810016, at *16 (D.N.D. Dec. 15, 2017), *aff'd*, 926 F.3d 959 (8th Cir. 2019).

15. A counterexample may be United States v. Country Lake Foods, Inc., 754 F. Supp. 669, 679 (D. Minn. 1990), where the court denied the government's motion for a preliminary injunction where 90 percent of the market consisted of large customers able to protect themselves individually and that smaller customer could unite through a buying group to protect themselves.

16. *See, e.g.*, United States v. Baker Hughes Inc., 908 F.2d 981, 98687 (D.C. Cir. 1990); United States v. Archer-Daniels-Midland Co., 781 F. Supp. 1400, 1422 (S.D. Iowa 1991) (accepting a power buyers defense where the market for high fructose corn syrup "is populated by very large and sophisticated purchasers and there is a continuing trend toward increasing concentration on the buying side, as large bottlers purchase formerly independent bottling franchises or bring them under their sweetener purchasing wings, and as smaller concerns band together in buying cooperatives to increase their purchasing leverage"). For a case in which the defense was rejected as insufficient on the merits, see FTC v. Cardinal Health, Inc., 12 F. Supp. 2d 34, 5861 (D.D.C. 1998).

Failing Firm Defense

Horizontal Merger Guidelines

U.S. Department of Justice

and the

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11. Failure and Exiting Assets

Notwithstanding the analysis above, a merger is not likely to enhance market power if imminent failure, as defined below, of one of the merging firms would cause the assets of that firm to exit the relevant market. This is an extreme instance of the more general circumstance in which the competitive significance of one of the merging firms is declining: the projected market share and significance of the exiting firm is zero. If the relevant assets would otherwise exit the market, customers are not worse off after the merger than they would have been had the merger been enjoined.

The Agencies do not normally credit claims that the assets of the failing firm would exit the relevant market unless all of the following circumstances are met: (1) the allegedly failing firm would be unable to meet its financial obligations in the near future; (2) it would not be able to reorganize successfully under Chapter 11 of the Bankruptcy Act; and (3) it has made unsuccessful good-faith efforts to elicit reasonable alternative offers that would keep its tangible and intangible assets in the relevant market and pose a less severe danger to competition than does the proposed merger.[16]

Similarly, a merger is unlikely to cause competitive harm if the risks to competition arise from the acquisition of a failing division. The Agencies do not normally credit claims that the assets of a division would exit the relevant market in the near future unless both of the following conditions are met: (1) applying cost allocation rules that reflect true economic costs, the division has a persistently negative cash flow on an operating basis, and such negative cash flow is not economically justified for the firm by benefits such as added sales in complementary markets or enhanced customer goodwill;[17] and (2) the owner of the failing division 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 acquisition.

12. Mergers of Competing Buyers

Mergers of competing buyers can enhance market power on the buying side of the market, just as mergers of competing sellers can enhance market power on the selling side of the market. Buyer market power is sometimes called "monopsony power."

To evaluate whether a merger is likely to enhance market power on the buying side of the market, the Agencies employ essentially the framework described above for evaluating whether a merger is likely to enhance market power on the selling side of the market. In defining relevant markets, the Agencies

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[16] Any offer to purchase the assets of the failing firm for a price above the liquidation value of those assets will be regarded as a reasonable alternative offer. Liquidation value is the highest value the assets could command for use outside the relevant market.

[17] Because the parent firm can allocate costs, revenues, and intra-company transactions among itself and its subsidiaries and divisions, the Agencies require evidence on these two points that is not solely based on management plans that could have been prepared for the purpose of demonstrating negative cash flow or the prospect of exit from the relevant market.

Merger Guidelines

U.S. Department of Justice and the Federal Trade Commission

I. Overview

These Merger Guidelines explain how the Department of Justice and the Federal Trade Commission (the "Agencies") identify potentially illegal mergers. They are designed to help the public, business community, practitioners, and courts understand the factors and frameworks the Agencies consider when investigating mergers.

The Agencies enforce the federal antitrust laws, specifically Sections 1 and 2 of the Sherman Act, 15 U.S.C. §§ 1, 2; Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45; and Sections 3, 7, and 8 of the Clayton Act[1], 15 U.S.C. §§ 14, 18, 19. Congress has charged the Agencies with administering these statutes as part of a national policy to promote open and fair competition, including by preventing mergers and acquisitions that would violate these laws.

Section 7 of the Clayton Act is the antitrust law that most directly addresses mergers and acquisitions.[2] Section 7 prohibits mergers and acquisitions where "in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly."[3] Section 7 is a preventative statute that reflects the "mandate of Congress that tendencies toward concentration

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[1] As amended under the Celler-Kefauver Antimerger Act of 1950, Public Law 81-899, 64 Stat. 1125, and the Hart-Scott-Rodino Antitrust Improvements Act of 1976, 15 U.S.C. § 18a.
[2] Mergers may also violate, *inter alia*, Sections 1 and 2 of the Sherman Act or Section 5 of the FTC Act.
[3] 15 U.S.C. § 18.

IV. Rebuttal Evidence Showing that No Substantial Lessening of Competition is Threatened by the Merger.

The Agencies may assess whether a merger may substantially lessen competition or tend to create a monopoly based on a fact-specific analysis under any one or more of the Guidelines discussed above.[92] Supreme Court precedent also examines whether "other pertinent factors" presented by the merging parties nonetheless "mandate[] a conclusion that no substantial lessening of competition [is] threatened by the acquisition."[93]

Several types of rebuttal and defense evidence are subject to legal tests established by the courts. The Agencies apply those tests consistent with prevailing law, as described below.

1. Failing Firms

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

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

A. "[T]he evidence show[s] that the [failing firm] face[s] the grave probability of a business failure."[94] The Agencies typically look for evidence in support of this element that the allegedly failing firm would be unable to meet its financial obligations in the near future. Declining sales and/or net losses, standing alone, are insufficient to show this requirement.

B. "The prospects of reorganization of [the failing firm are] dim or nonexistent."[95] The Agencies typically look for evidence suggesting that the failing firm would be unable to reorganize successfully under Chapter 11 of the Bankruptcy Act, taking into account that "companies reorganized through receivership, or through [the Bankruptcy Act] often emerge[] as strong competitive companies."[96] Evidence of the firm's actual attempts to resolve its debt with creditors is important.

C. "[T]he company that acquires the failing [firm] or brings it under dominion is the only available purchaser."[97] The Agencies typically look for evidence that a company

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[92] *See United States v. AT&T, Inc.*, 916 F.3d 1029, 1032 (D.C. Cir. 2019) (either "short cut" market-concentration presumption or "fact-specific showing" sufficient to establish prima facie case of Section 7 violation).
[93] *See Gen. Dynamics*, 415 U.S. 486, 498 (1974); *United States v. Baker Hughes*, 908 F.2d 981, 990 (D.C. Cir. 1990) (quoting *General Dynamics* and describing its holding as permitting rebuttal based on a "finding that 'no substantial lessening of competition occurred or was threatened by the acquisition'").
[94] *Citizen Publ'g Co. v. United States*, 394 U.S. 131, 138 (1969).
[95] *Citizen Publ'g*, 394 U.S. at 138.
[96] *Id*.
[97] *Id.* at 136-39 (1969) (quoting *Int'l Shoe Co. v. FTC*, 280 U.S. 291, 302 (1930)).

has made unsuccessful good-faith efforts to elicit reasonable alternative offers that pose a less severe danger to competition than does the proposed merger.[98]

Although merging parties sometimes argue that a poor or weakening position should serve as a defense even when it does not meet these elements, the Supreme Court has "confine[d] the failing company doctrine to its present narrow scope."[99] The Agencies evaluate evidence of a failing firm consistent with this prevailing law.[100]

2. Entry and Repositioning

Merging parties sometimes raise a rebuttal claiming that a reduction in competition resulting from the merger would induce entry into the relevant market, preventing the merger from substantially lessening competition in the first place. This claim posits that a merger may, by substantially lessening competition, make the market more profitable for the merged firm and any remaining competitors, and that this increased profitability may induce new entry. To evaluate this rebuttal evidence, the Agencies assess whether entry induced by the merger would be "timely, likely, and sufficient in its magnitude, character, and scope to deter or counteract the competitive effects of concern."[101]

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

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

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[98] Any offer to purchase the assets of the failing firm for a price above the liquidation value of those assets will be regarded as a reasonable alternative offer. Parties must solicit reasonable alternative offers before claiming that the business is failing. Liquidation value is the highest value the assets could command outside the market. If a reasonable alternative offer was rejected, the parties cannot claim that the business is failing.

[99] *Citizen Publ'g Co. v. United States*, 394 U.S. at 139.

[100] The Agencies do not normally credit claims that the assets of a division would exit the relevant market in the near future unless: (1) applying cost allocation rules that reflect true economic costs, the division has a persistently negative cash flow on an operating basis, and such negative cash flow is not economically justified for the firm by benefits such as added sales in complementary markets or enhanced customer goodwill; and (2) the owner of the failing division has made unsuccessful good-faith efforts to elicit reasonable alternative offers that would keep its assets in the relevant market and pose a less severe danger to competition than does the proposed acquisition. Because firms can allocate costs, revenues, and intra-company transactions among their subsidiaries and divisions, the Agencies require evidence that is not solely based on management plans that could have been prepared for the purpose of demonstrating negative cash flow or the prospect of exit from the relevant market.

[101] *FTC v. Sanford Health*, 926 F.3d 959, 965 (8th Cir. 2019).

UNITED STATES V. ENERGY SOLUTIONS, INC.
265 F. Supp. 3d 415, 444 (D. Del. 2017)
(excerpt[1])

[SUE L.] ROBINSON, Senior District Judge

I. INTRODUCTION

The Department of Justice, Antitrust Division (the "government"), seeks to enjoin Rockwell Holdco, Inc. and its wholly owned subsidiary Energy Solutions, Inc. ("Energy Solutions") from acquiring Andrews County Holding, Inc. and its wholly owned subsidiary Waste Control Specialists LLC ("WCS," and collectively with the other defendants, the "defendants"). The government alleges that the acquisition would substantially lessen competition for disposal of low-level radioactive waste in violation of Section 7 of the Clayton Act, 15 U.S.C. § 18.

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II. FINDINGS OF FACT

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E. WCS Financial Situation

WCS has asserted a failing firm defense. The record shows that so far, WCS has not been a profitable enterprise. Because of regulatory requirements, WCS operates with high fixed costs. Meanwhile, the volume of LLRW generated over the past decade has declined. Lower disposal volumes means less coverage for WCS's fixed costs. As a result, WCS has never made an operating profit and consistently misses projections. Even US Ecology has suggested that the amount of Class B/C waste generated annually after the industry became "highly motivated to reduce volumes ... isn't enough to make WCS viable."

The government put forth several facts to rebut defendants' assertion that WCS is at risk of imminent failure. WCS funds its operations through an $85 million revolving credit facility with its parent Valhi. Valhi extended WCS's credit facility until March 31, 2018. As of the end of 2016, WCS had an outstanding balance on that credit facility of $41.7 million. Valhi projects that WCS will borrow an additional [redacted] between the beginning of 2017 and the end of the first quarter 2018, when the current credit facility expires, but the total amount borrowed will still be "below the maximum available."

The government further notes that WCS is a relatively new firm (opened in 2012) still trying to win customers who are under long-term LOP agreements with Energy Solutions. WCS has never defaulted on any debt. It is still current on its lease payments

1. Record citations and footnotes omitted.

and trust fund payments. It is meeting payroll and paying bonuses. And WCS recently executed several long-term disposal contracts. It has also invested in future growth opportunities, including teaming agreements with North Star for decommissioning projects and an application with the NRC seeking approval to construct and operate a consolidated interim storage facility ("CISF") for spent nuclear fuel. The decommissioning market is expected to grow substantially over the next twenty years, as aging nuclear power plants close, and could reach $53 billion or more. Approximately 10% of the cost of decommissioning goes towards LLRW disposal.

In the CISF application filed in April 2016, WCS represented that its "financial qualifications are adequate to carry out the activities for which the license is sought.") WCS has filed a number of updates to the application and never changed the representation regarding its financial qualifications. Also in March 2017, WCS's independent auditor did not issue a going concern qualification, meaning that the auditors believe WCS will be in business twelve months from the date of the report. Finally, WCS has not entered into preliminary discussions with its regulator, the Texas Commission on Environmental Quality ("TCEQ"), about closing the WCS facility, even though it cannot take the first step in that process–i.e., developing a contingency plan for closing–until it consults with the TCEQ.

WCS tries to rebut the government's picture of its financial health by pointing to several investments in growth opportunities that have not (yet?) proved profitable, including cask rentals, partnerships with processors to offer sorting and segregation, and teaming agreements for bids on decommissioning projects. Opening the exempt cell was a growth initiative but, according to WCS's chief financial officer, "[r]unning [the exempt cell] full out . . . could never generate enough income to make up the delta on the loss." WCS's CEO agrees that decommissioning projects are "good jobs," but says they are "not a silver bullet for the financial issues of WCS." WCS needs "near-term cash to survive" and the "decommissioning projects are too far out to save us." Several witnesses testified that it is difficult to accurately forecast when exactly disposal companies will start to see revenues from decommissioning projects, because those projects are famous for "sliding right on the schedule." In addition, WCS has "temporarily suspend[ed]" its CISF application "due to substantially increased" costs to have the application reviewed at a time when it "must focus its limited financial resources on those expenditures necessary to safely run and maintain its current facilities." Valhi has also suspended charges to WCS under their intercorporate services agreement, whereby WCS is supposed to pay for services Valhi employees provide to WCS, including accounting, human resources, legal, tax, risk management, and executive management.

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III. CONCLUSIONS OF LAW

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C. Rebuttal

Once the government establishes a prima facie case, the defendant must "show that the market-share statistics [give] an inaccurate account of the acquisitions' probable

effects on competition." *United States v. Citizens & S. Nat'l Bank*, 422 U.S. 86, 120 (1975). Before trial, defendants asserted that the following factors would rebut the government's prima facie case: (1) customers' ability to substitute defendants' services with self-help; (2) the existence of powerful buyers; (3) the existence of regulatory schemes that constrain anticompetitive effects; (4) efficiencies to be gained from the merger; (5) the weakened competitor doctrine; (6) the ease of entry and expansion into the market; and (7) the failing firm defense.

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2. Failing firm defense

The failing-firm doctrine applies a "choice of evils" approach where "the possible threat to competition resulting from an acquisition is deemed preferable to the adverse impact on competition and other losses if the company goes out of business." *Gen. Dynamics*, 415 U.S. at 507; *Mich. Citizens for an Independent Press v. Thornburgh*, 868 F.2d 1285, 1288 (D.C. Cir. 1989). To successfully assert the defense, defendants have the burden of showing "(1) that the resources of [WCS] were 'so depleted and the prospect of rehabilitation so remote that it faced the grave probability of a business failure,' and (2) that there was no other prospective purchaser for it." *United States v. Greater Buffalo Press, Inc*., 402 U.S. 549, 555 (1971). Because the doctrine is "narrow in scope," *Citizen Pub. Co. v. United States*, 394 U.S. 131, 139 (1969), it "rarely succeeds," Philip E. Areeda & Herbert Hovenkamp, Antitrust Law ¶ 951e (4th ed. 2016).

The parties contest whether WCS is in imminent failure. There is evidence to support both sides of the issue.20 Ultimately, however, the court need not decide that issue, because defendants have failed to demonstrate that Energy Solutions is the "only available purchaser." "The failing company doctrine plainly cannot be applied in a merger or in any other case unless it is established that the company that acquires the failing company or brings it under dominion is the only available purchaser." *Citizen Pub.*, 394 U.S. at 138. For Energy Solutions to be the only available purchaser, defendants must show that WCS made "good faith efforts to elicit reasonable alternative offers ... that would both keep it in the market and pose a less severe danger to competition." *Dr. Pepper/Seven–Up Co. v. Fed. Trade Comm'n*, 991 F.2d 859, 865 (D.C. Cir. 1993); *Joseph Ciccone & Sons, Inc. v. E. Indus., Inc*., 537 F. Supp. 623, 628 (E.D. Pa. 1982) ("Successful invocation of that doctrine requires proof that the defendant acquired the failing company . . . by way of a 'reasonable offer which effects the least anti-competitive result.'").

Defendants have not shown that WCS's parent, Valhi, made a good faith effort as part of its 2015 sale process to elicit reasonable alternative offers. Valhi engaged with one other potential bidder–[redacted]–and left it in the dark about the sale process before abruptly ending discussions without obtaining a bid. Thus, Valhi essentially engaged in a single bidder process and then agreed to several deal protection devices that have made it impossible to entertain other offers once it became known that Valhi was finally serious about selling all of WCS. Delaware courts have found that a no-talk provision without a fiduciary-out, as existed here, "is the legal equivalent of willful blindness" that may prevent a board from meeting its duty to "be informed of all

material information reasonably available," which would include reasonable alternative offers. *Phelps Dodge Corp. v. Cyprus Amax Minerals Co.*, 1999 WL 1054255, at *1–2 (Del. Ch. Sept. 27, 1999); *compare In re IXC Commc'ns, Inc. v. Cincinnati Bell, Inc.*, 1999 WL 1009174, at *6 (Del. Ch. Oct. 27, 1999) (finding that a board with a no-talk and no-shop provision adequately informed itself of reasonable alternatives by publicly announcing 6 months before the merger that it had retained an investment banker to consider possible merger or sale options and obtaining a fiduciary-out that allowed it to entertain superior proposals).

WCS argues that it has always had a "for sale" sign hanging out such that if there were another interested party, it would have appeared by now. But the facts suggest otherwise. It was well known in the industry that Energy Solutions made frequent overtures, or "annual calls," to buy WCS and had been repeatedly rebuffed. In addition, the deal on which Valhi focused in 2014 was for a minority equity investment, not a sale of the entire company. There was no clear "for sale" sign until WCS announced its transaction with Energy Solutions and, then, Valhi could neither respond nor share information that would allow another interested party to formulate a credible bid, let alone a bid that provides the "least anti-competitive result." *Joseph Ciccone & Sons*, 537 F. Supp. at 628. Considering the foregoing, the court does not give any weight to the fact that no other company but Energy Solutions has made a firm offer.

Finally, under the horizontal merger guidelines, a reasonable alternative offer is "[a]ny offer to purchase the assets of the failing firm for a price above the liquidation value of those assets." Horizontal Merger Guidelines (2010) § 11 n. 6. Valhi was clearly focused on obtaining what it perceived to be WCS's fair value, not an offer above the liquidation value, which is likely to be less. The court is sympathetic to the fact that if Valhi genuinely wants to exit the LLRW disposal market, there may be few (if any) potential buyers that would not raise some anti-trust concerns. The parties did not address whether the law gives Valhi the ability to sell WCS without it being a failing firm. Nevertheless, under the facts presented here, defendants have not shown that Valhi/WCS made good faith efforts to elicit reasonable alternative offers that would pose a less severe danger to competition.

A NOTE ON THE FAILING FIRM DEFENSE

In 1930, the Supreme Court in International Shoe Co. v. FTC[1] 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 firm, an acquisition by a competitor that otherwise might threaten competition would not violate the Clayton Act.[2] The legislative history of the 1950 amendments to the Clayton Act specifically

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

[2] *See* United States v. General Dynamics Corp., 415 U.S. 486 (1974); Citizen Publ'g Co. v. United States, 394 U.S. 131, 137-38 (1969).

recognized this "failing company" defense.[3] 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.[4]

The failing company defense is frequently invoked in transactions that are *prima facie* unlawful under the *Philadelphia National Bank* presumption. It has been invoked on numerous occasions in the courts, usually without success.[5] 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.

Judicial approach

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.[6] Some courts have added a third requirement: a reorganization of the acquired firm into a viable economic enterprise is

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

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

[5] 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).

[6] *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).

not realistic.[7] The defense has been narrowly construed, and the company invoking it has the burden of establishing each element of the defense.[8]

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."[9] The failure requirement is established through an analysis of the allegedly failing company's financial condition prior to and at the time of acquisition, together with an examination of its 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.[10] The difficulties in establishing this element may be illustrated by contrasting United States v. M.P.M., Inc.,[11] with FTC v. Harbour Group Investments, L.P.[12] 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." [13] 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 not only were the contacts numerous, but also that each person approached was a credible potential source of new capital. Only Pre-Mix, whose combination with Mobile was challenged, was willing to become involved with the company; the others declined because they

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[7] *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).

[8] *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).

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

[10] *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).

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

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

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

considered Mobile an unacceptable business risk. Moreover, Pre-Mix had emerged as a candidate months after many of the other contacts had been made.[14]

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 one 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 going concern value of the company 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 is one that 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 is one that 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.

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[14] *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 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).

The courts have held that the failing company defense applies equally whether the failing firm is the buyer or the seller.[15] 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.[16]

The DOJ/FTC Guidelines approach

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.[17] 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.[18]

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 is the result of 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 assets of the failing firm 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

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

[16] 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 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).

[17] 2010 DOJ/FTC Horizontal Merger Guidelines § 11.

[18] *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).

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.

Weak and competitively disadvantaged companies

In United States v. General Dynamics Corp.,[19] the DOJ challenged a merger between two coal companies that substantially increased market concentration. The Supreme Court held that the government's statistics on concentration did not accurately forecast competitive conditions in the relevant market. The focus of competition in the coal market was found to be the procurement of new long-term supply contracts. Because the acquired coal company's available reserves had already been committed to long-term supply contracts, the Court concluded that its probable future ability to compete had been exhausted and that its removal by merger would not adversely affect competition in the future. The Court supported its conclusion with the following observation:

> Evidence of past production does not, as a matter of logic, necessarily give a proper picture of a company's future ability to compete . . . Irrespective of the [acquired company's] . . . size when viewed as a producer, its weakness as a competitor . . . fully substantiated [the district court's] . . . conclusion that its acquisition . . . would not substantially . . . lessen competition.[20]

Since the *General Dynamics* decision, some courts have relied, at least in part, on evidence of a company's weak financial condition to permit a merger, notwithstanding a *prima facie* proof of anticompetitive effect based on the *Philadelphia National Bank* presumption using current market shares.[21] This is commonly known as the "flailing company" defense. The general idea is that the financial condition of the weak firm indicates that its market share and more generally its competitive significance in the marketplace would rapidly decline in the future absent the merger, so that on a forward-looking basis the merger today would have little likelihood of an anticompetitive effect.[22] Under this logic, the flailing company defense is not a defense per se, but rather a recognition that the financial condition of a company can be a factor in a rebuttal to the *Philadelphia National Bank* presumption.[23] Under this

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

[20] United States v. General Dynamics Corp., 415 U.S. 486, 501, 50304 (1974).

[21] *See, e.g.*, FTC v. Nat'l Tea Co., 603 F.2d 6 (8th Cir. 1979) (preliminary injunction denied because acquiring company was weak competitor and market was relatively competitive); United States v. Consolidated Foods Corp., 455 F. Supp. 108, 13537 (E.D. Pa. 1978) (declining sales and lack of technical ability of acquiring company); *see also* FTC v. Arch Coal, Inc., 329 F. Supp. 2d 109, 153 (D.D.C. 2004); FTC v. Tenet Healthcare Corp., 17 F. Supp. 2d 93 (E.D. Mo. 1998); United States v. Federal Co., 403 F. Supp. 161, 16669 (W.D. Tenn. 1975); United States v. M. P. M., Inc., 397 F. Supp. 78 (D. Colo. 1975).

[22] *See* FTC v. Arch Coal, Inc., 329 F. Supp. 2d 109, 157 (D.D.C. 2004); Dr. Pepper/Seven-Up Cos. v. FTC, 991 F.2d 859, 864-65 (D.C. Cir. 1993); Lektro-Vend Corp. v. Vendo Co., 660 F.2d 255, 276-77 (7th Cir. 1981); FTC v. Nat'l Tea Co., 603 F.2d 694, 699-700 (8th Cir. 1979).

[23] Kaiser Aluminum & Chem. Corp. v. FTC, 652 F.2d 1324, 1339 (7th Cir. 1981).

reading, to be successful the defendant must show that the weakness of the firm (together with any other relevant factors) not only results in the firm’s nominal market share overstating its future competitive significance but also that the firm’s expected future share absent the merger would be low enough so as not to trigger the *Philadelphia National Bank* presumption.[24]

The federal antitrust enforcement agencies and the courts have been very skeptical of arguments seeking to justify *prima facie* anticompetitive transactions on the grounds that one of the merging companies is financially weak or otherwise competitively disadvantaged.[25] Much of this skepticism appears to derive from the frequency with which somewhat less than believable claims of this sort historically have been advanced. Even when the claims of weakness or competitive disadvantage are believed, the agencies insist that the parties prove that the impediment cannot be overcome by some less anticompetitive means than the proposed acquisition. In effect, the agencies adopt a standard very similar to the standard they employ in the failing company defense.

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[24] FTC v. University Health, Inc., 938 F.2d 1206, 1221 (11th Cir. 1991) (articulating the failing firm defense as requiring the defendant to show that “the government’s market share statistics overstate the acquired firm’s ability to compete in the future and that, discounting the acquired firm’s market share to take this into account, the merger would not substantially lessen competition”); *accord* FTC v. ProMedica Health Sys., Inc., 2011 WL 1219281, at *58 (N.D. Ohio 2011).

[25] *See* FTC v. Warner Commc’ns Inc., 742 F.2d 1156, 1164-65 (9th Cir. 1984) (noting that other cases have provided “persuasive reasons for rejecting or attaching little weight to a defense of financial plight as a ground for justifying a merger”); FTC v. ProMedica Health Sys., Inc., 2011 WL 1219281, at *58 (N.D. Ohio 2011) (“Courts have viewed the defense with extreme skepticism, describing it as ‘probably the weakest ground of all for justifying a merger.’”) (citing Kaiser Aluminum & Chem. Corp. v. FTC, 652 F.2d 1324, 1338-41 (7th Cir. 1981)).

Efficiencies

1 UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA
2
3 THE UNITED STATES OF AMERICA, Civil Action
No. 21-02886
4 Plaintiff(s),
5 vs.
6 BERTELSMANN SE & CO. KGAA, Washington, D.C.
et al, August 17, 2022
7 9:30 a.m.
Defendant(s). **Morning Sessio**n
8 --
9 TRANSCRIPT OF BENCH TRIAL
BEFORE THE HONORABLE FLORENCE Y. PAN
10 UNITED STATES DISTRICT JUDGE
11 APPEARANCES:
12 FOR THE PLAINTIFF: John R. Read, Esquire
Ihan Kim, Esquire
13 Melvin A. Schwarz, I, Esquire
Ethan Stevenson, Esquire
14 United States Department of Justice
Antitrust Division
15 450 Fifth Street, Northwest
Washington, D.C. 20530
16
17 FOR THE DEFENDANTS Daniel M. Petrocelli, Esquire
BERTELSMANN and M. Randall Oppenheimer, Esquire
18 PENGUIN RANDOM HOUSE: Megan Smith, Esquire
O'Melveny & Myers, LLP
19 1999 Avenue of the Stars
Eighth Floor
20 Los Angeles, California 90067
21
22
23
24
25

1 THE COURT: I understand that. Thank you.
2 MR. FRACKMAN: Thank you.
3 THE COURT: Anything else from you, Mr. Schwarz?
4 MR. SCHWARZ: No, Your Honor. Just for the record I
5 would like to say that the Peabody Energy case, which he cited,
6 there was an expert in that case, and the court still rejected
7 most of the efficiencies in any event.
8 And I think the law is clear from the D.C. Circuit in
9 Anthem on the fact that these cannot be vague, speculative, or
10 otherwise cannot be verified by reasonable means. That's at
11 359. And I don't think this is reasonable at all.
12 THE COURT: Okay. Thank you.
13 The Court has heard the evidence on this issue and the
14 arguments of the parties and is prepared to rule.
15 Dr. Snyder is an expert witness for the defendants who
16 is offered to testify on merger-related efficiencies. His
17 expert opinion relies on a projection of synergies produced in
18 November of 2020 by Manuel Sansigre, a senior vice president at
19 Penguin Random House who's in charge of mergers and
20 acquisitions.
21 Mr. Sansigre produced his synergy projections to help
22 Random House evaluate whether it should acquire Simon &
23 Schuster.
24 Dr. Snyder's expert report offers three primary
25 conclusions about Mr. Sansigre's projections.

1 First, that the projected synergies are the type that
2 economists would recognize given the features of the publishing
3 industry.
4 Second, that the projected synergies are
5 merger-specific efficiencies.
6 Third, that the projected synergies would benefit
7 authors through higher income and consumers through greater
8 availability of books.
9 Significantly, however, Dr. Snyder concedes that he
10 did not, quote, independently verify specific dollar amounts,
11 unquote, and did not, quote, independently derive estimates,
12 unquote, of Mr. Sansigre's projected synergies. Thus, the
13 parties agree and stipulate that Dr. Snyder did not verify the
14 projections from the November 2020 model that form the basis of
15 his expert opinion on efficiencies.
16 The government filed a motion in limine to exclude
17 Dr. Snyder's testimony on efficiencies under Federal Rule of
18 Evidence 702. The government argued, among other things, that
19 Dr. Snyder's reliance on unverified projections rendered his
20 efficiencies testimony inadmissible under Rule 702, the
21 horizontal merger guidelines, and cases applying the horizontal
22 merger guidelines.
23 The Court essentially deferred ruling on the motion to
24 preclude the expert testimony on efficiencies determining that
25 it should hear the evidence about Mr. Sansigre's projections

1 before deciding whether the alleged efficiencies are verifiable
2 and verified as required by the horizontal merger guidelines
3 and persuasive case law.
4 The Court decided to hear the evidence during the
5 trial given that this is a bench trial but instructed the
6 parties to arrange the presentation of evidence so that the
7 verifiability of Mr. Sansigre's projected synergies could be
8 considered and argued and the Court could then rule on the
9 government's motion before hearing the totality of Dr. Snyder's
10 expert testimony on efficiencies.
11 The Court determined that it would be more efficient
12 to proceed in this fashion because if defendants were unable to
13 meet their burden to show that the efficiencies were
14 substantiated, verifiable, and verified under the horizontal
15 merger guidelines, then it would be unnecessary to consider any
16 of the other aspects of the efficiencies evidence.
17 The Court has now heard the evidence on the projected
18 efficiencies and arguments from the parties, and it will grant
19 the motion to preclude the efficiencies evidence because the
20 efficiencies projected by Penguin Random House are not
21 substantiated and verified.
22 Although many of the projections may be verifiable,
23 some are not verifiable. Moreover, the efficiencies have not,
24 in fact, been independently verified by anyone, and they,
25 therefore, are not cognizable under the horizontal merger

1 guidelines and are not reliable under Rule 702.
2 Finally, the Court concludes that the efficiencies
3 projections in the November 2020 model are unreliable because
4 they are out of date and include 2021 projections that have
5 been proved to be inaccurate.
6 The applicable legal standards are as follows:
7 Federal Rule of Evidence 702 concerning testimony by
8 expert witnesses provides, quote, a witness who is qualified as
9 an expert by knowledge, skill, experience, training, or
10 education may testify in the form of an opinion or otherwise
11 if, A, the expert's scientific, technical, or other specialized
12 knowledge will help the trier of fact to understand the
13 evidence or to determine a fact in issue; B, the testimony is
14 based on sufficient facts or data; C, the testimony is the
15 product of reliable principles and methods; and D, the expert
16 has reliably applied the principles and methods to the facts of
17 the case, unquote.
18 Rule 702 incorporates the Supreme Court's guidance in
19 Daubert versus Merrell Dow Pharmaceuticals, Inc. which called
20 upon trial judges to serve a gatekeeping role in ensuring that
21 an expert's testimony both rests on a reliable foundation and
22 is relevant to the task at hand.
23 Also in Kumho Tire Company, Limited versus Carmichael,
24 the Supreme Court clarified that the gatekeeper role extends to
25 all expert testimony.

1 And this is confirmed by Rule 702's advisory committee
2 note to the 2000 amendment.
3 The party seeking to introduce expert testimony must
4 demonstrate its admissibility by a preponderance of the
5 evidence. Courts take a flexible approach to deciding Rule 702
6 motions and have broad discretion in determining whether to
7 admit or exclude expert testimony.
8 Horizontal merger guideline section 10.
9 The horizontal merger guidelines outline the analysis
10 and enforcement practices of the Department of Justice and the
11 Federal Trade Commission with respect to horizontal mergers
12 under the federal antitrust laws including section 7 of the
13 Clayton Act. See horizontal merger guideline section 1.
14 Federal courts frequently use the guidelines to
15 develop legal standards in antitrust litigation. See, for
16 example, FTC versus H.J. Heinz Company, 246 F.3d 708. That's a
17 D.C. Circuit case from 2001.
18 Section 10 of the horizontal merger guidelines
19 discusses efficiencies. The guidelines observe that
20 efficiencies are difficult to verify and quantify in part
21 because much of the information relating to efficiencies is
22 uniquely in the possession of the merging firms. Moreover,
23 efficiencies projected reasonably and in good faith by the
24 merging firms may not be realized.
25 Therefore, the merger guidelines say, it is incumbent

1 upon the merging firms to substantiate efficiency claims so
2 that the agencies can verify by reasonable means the likelihood
3 and magnitude of each asserted efficiency.
4 Courts interpret this requirement of substantiation
5 and verification to encompass, quote, how and when each
6 efficiency would be achieved and any costs of doing so, how
7 each efficiency would enhance the merged firm's ability and
8 incentive to compete, and why each would be merger specific,
9 end quote. That's from United States versus H&R Block, 833
10 F.Supp.2d 36 at 89. That's a D.D.C. case from 2011, and it is
11 quoting the horizontal merger guidelines section 10.
12 Under the guidelines, projected efficiencies are
13 generally less credible when generated outside the usual
14 business planning process, and they are more credible when
15 substantiated by analogous past experience.
16 Ultimately, efficiencies must be cognizable to be
17 considered under the guidelines. Quote, cognizable
18 efficiencies are merger-specific efficiencies that have been
19 verified and do not arise from anticompetitive reductions in
20 output or service.
21 A cognizable efficiency claim must represent a type of
22 cost saving that could not be achieved without the merger, and
23 the estimate of the predicted saving must be reasonably
24 verifiable by an independent party. And that's quoting the
25 horizontal merger guidelines and also, I believe, H&R Block.

1 Case law provides that the Court must undertake a
2 rigorous analysis of the kinds of efficiencies being urged by
3 the parties in order to ensure that those efficiencies
4 represent more than mere speculation and promises about
5 post-merger waiver. That's H&R Block at 89.
6 So, thus, in sum, the foregoing legal standards and
7 precedents place the burden on defendants to establish that the
8 projected efficiency relied upon by Dr. Snyder are
9 substantiated, that they are reasonably verifiable by an
10 independent party, and that they are, in fact, verified.
11 Where efficiencies are not independently verifiable
12 and verified, no court in this jurisdiction has ever given any
13 weight to such efficiencies evidence. See H&R Block, 833
14 F.Supp.2d 36, D.D.C. 2011; United States versus Aetna, 240
15 F.Supp.3d, D.D.C. 2017; FTC versus Sysco Corporation, 113
16 F.Supp.3d, 1, D.D.C. 2015; FTC versus Wilhelmsen Holding, ASA,
17 341 F.Supp.3d 27, D.D.C. 2018; FTC versus Staples, 970 F.Supp
18 1066, D.D.C. 1997.
19 This is because it is the parties' interest to be
20 aggressive and optimistic in the projection of efficiencies to
21 justify their own merger. Because courts are not
22 well-positioned to verify such projections, independent
23 verification is critical in order to allow a court to determine
24 whether such projections are reliable.
25 Without verification, the efficiencies analysis could

1 swallow the analytical framework required by the Clayton Act.
2 See H&R Block at 91.
3 The Court's findings and conclusions are as follows:
4 Number one, many of the projected efficiencies in the
5 November 2020 model may be verifiable, but at least some are
6 not verifiable.
7 According to the testimony of Mr. Sansigre, he and his
8 team worked very hard to derive the efficiencies model. They
9 began in March 2020 by including detailed data about Penguin
10 Random House. When data became available from Simon & Schuster
11 in September 2020, he added that data to the model. When
12 additional data became available in October 2020, he included
13 that data as well. The data and assumptions in the model were
14 closely checked by executives in the Bertelsmann M&A group and
15 the ZI risk management group including Markus Dohle and Nihar
16 Malaviya.
17 Mr. Sansigre estimates that the model was revised a
18 hundred times before it became final. All of Mr. Sansigre's
19 judgments and assumptions were based on his broad experience in
20 M&A and in particular in M&A in the publishing industry.
21 And the Court has no doubt that Mr. Sansigre is very
22 competent, an expert in these matters.
23 Mr. Sansigre uses the term synergies and efficiencies
24 interchangeably. His model identified four categories of
25 synergies; real estate, operating expenses, variable costs, and

1 revenue.

2 The real estate efficiencies were largely based on
3 expected consolidation of Simon & Schuster's New York
4 headquarters with Penguin Random House's New York headquarters.
5 Mr. Sansigre consulted with managers within Penguin Random
6 House and determined that the personnel of Simon & Schuster
7 could be accommodated in Penguin Random House's New York office
8 space. He then examined Simon & Schuster's lease and consulted
9 with real estate experts who advised him that he could sublet
10 Simon & Schuster's office space for 50 percent of the rental
11 payments owed under the lease. He also examined other real
12 estate holdings and estimated some additional savings from
13 allowing other leases to expire. Based on those calculations,
14 he projected approximately $10 million in savings per year,
15 almost all of which are from consolidating the New York office
16 space.

17 The operating expense synergies reflect efficiencies
18 in headcount and non-headcount expenses, essentially personnel
19 costs.

20 Mr. Sansigre's November 2020 model projected
21 $[redacted] in annual operating expense synergies in 2025.

22 You know, I didn't think of this before, parties, but
23 I do have numbers in this. Is it okay for me to be reading
24 this publicly?

25 MR. FRACKMAN: As the Court knows, we actually made

1 quite an effort to keep the numbers confidential. And I think
2 both Simon & Schuster and Penguin Random House believe they are
3 confidential. They affect personnel issues and subsequent
4 events.
5 THE COURT: I am going to black out the numbers then,
6 and we will issue a blacked out -- I will just black out the
7 numbers and then read on the record. Thank you. I'm sorry
8 about that.
9 Okay. So Mr. Sansigre's November 2020 model projected
10 a certain amount in annual operating expense synergies in 2025.
11 Mr. Sansigre began by predicting a percentage decrease in
12 operating expenses. And this figure was based on prior
13 operating expense synergies in 26 prior acquisitions including
14 the 2013 Penguin Random House merger which had operating
15 expense synergies of a certain percentage as well as
16 consultation with Penguin Random House executives like
17 Mr. Malaviya and Mr. Dohle.
18 Then Mr. Sansigre looked at the data examining costs
19 department by department to identify where operating expense
20 synergies actually might be achieved.
21 In some departments such as sales, IT, and
22 administration, Mr. Sansigre looked at specific employee roles
23 and third party contracts to determine which kinds of positions
24 or contacts might be redundant to estimate headcount and
25 non-headcount savings.

1 In some other departments such as fulfillment,
2 Mr. Sansigre used his judgment to project a percentage of
3 savings based on considerations like Penguin Random House's
4 ability to scale its distribution to meet a portion of Simon &
5 Schuster's distribution demand.
6 After reviewing the department-by-department data,
7 Mr. Sansigre compared the cumulative projected synergies of
8 that analysis with the expected percentage of synergies that he
9 had used based on prior transactions and management judgment,
10 and the two projected synergies number matched.
11 Mr. Sansigre's November 2020 model projected a
12 certain amount of annual variable cost synergies in 2025. As
13 part of the variable costs, Mr. Sansigre considered return
14 rates. He found that Penguin Random House had lower return
15 rates than Simon & Schuster by certain percentage points
16 between 2017 and 2021. He reviewed records of improved rates
17 from the 2013 merger from Penguin and Random House, the
18 acquisition of smaller publishers like Little Tiger, and
19 experiences of Penguin Random House's third party distribution
20 clients. He also consulted Simon & Schuster and Penguin Random
21 House management.
22 Based on those considerations, Mr. Sansigre used his
23 judgment to predict a certain percentage of improvement in
24 Simon & Schuster's post-merger return rate by 2025. Penguin
25 Random House's investments in a supply chain were a significant

1 factor in those projections.
2 Mr. Sansigre's November 2020 model projected a certain
3 amount of annual revenue synergies in 2025. The most
4 significant projected revenue synergies came from gross
5 physical sales and audio. After accounting for certain rising
6 costs, most significantly royalties and advance write-offs, he
7 came up with a particular number that was a projected increase
8 in sales. And the sales projections are based on
9 Mr. Sansigre's judgment and experience.
10 Penguin Random House's large sales force was a
11 significant factor in Mr. Sansigre's gross physical sales
12 projections. He believed this large sales force would get
13 Simon & Schuster books into more stores and, thus, increase
14 sales, namely in independent books stores, specialty stores,
15 and international retailers.
16 Simon & Schuster relies on its top customers for a
17 greater proportion of its sales than Penguin Random House does.
18 Mr. Sansigre interpreted this to mean that Penguin Random House
19 could improve Simon & Schuster's sales among it's non-top
20 customers.
21 Considering past acquisitions, Mr. Sansigre noted that
22 Penguin Random House doubled the sales of Little Tiger's
23 imprints within two years after acquiring the smaller
24 publisher.
25 Notably, however, Mr. Sansigre's sales projections do

1 not align with the historical data from the 2013 merger of
2 Penguin and Random House which is more similar in scale to the
3 proposed merger of Penguin Random House and Simon & Schuster.
4 After the 2013 merger, sales declined. Mr. Sansigre
5 discounts the sales results of the 2013 merger because of
6 changed market conditions including the decline of commercial
7 fiction around 2013 in which Penguin was heavily invested at
8 the time.
9 In audio Mr. Sansigre predicted that Penguin Random
10 House's significant investments in in-house audio production
11 would let it improve Simon & Schuster's audio revenue because
12 Simon & Schuster relied on third parties for much of its audio
13 revenue.
14 Mr. Sansigre used his judgment to predict that Simon &
15 Schuster would have a certain percentage increase in audio
16 revenue post merger through essentially growing with the market
17 and benefiting from Penguin Random House's in-house
18 capabilities.
19 Mr. Sansigre discounted Simon & Schuster's
20 management's relatively high predictions for a Simon & Schuster
21 standalone future audio revenue because he wanted to
22 independently analyze the value of the merger.
23 So in sum, Mr. Sansigre's projected synergies are
24 based on educated management judgments mostly based on past
25 experience and applied to whatever detailed data about the

1 businesses of Penguin Random House and Simon & Schuster that
2 was available to him.
3 Many of the projections about cost savings are
4 arguably verifiable because theoretically an independent party
5 could look at all the underlying data about the costs of each
6 entity that Mr. Sansigre compiled and inputted into his
7 spreadsheets. They could get detailed explanations about the
8 assumptions that Mr. Sansigre made in coming up with his
9 percentage estimates of savings, and they could determine
10 whether those assumptions were reasonable and based on past
11 experience. Relying on past experience is favored by the
12 horizontal merger guidelines.
13 Some of the projections, however, most notably the
14 revenue projections, are not verifiable and are not based on
15 past experience.
16 The November 2020 model projects sales synergies after
17 the merger even though past experience does not support any
18 sales synergies because after Penguin and Random House merged
19 in 2013, they experienced a decrease in sales.
20 There were other merger experiences of Penguin Random
21 House that supported the idea of sales synergies, but
22 Mr. Sansigre picked and chose among the different precedents
23 and he justified his sales projections not relying on Penguin
24 and Random House merger based on his evaluation of changed
25 marketing conditions.

1 Therefore, the actual percentages that Mr. Sansigre
2 chose to apply to revenues as synergies are not verifiable.
3 Indeed, the defendants have conceded that revenue
4 synergies are the least easy to predict, and one of
5 Mr. Sansigre's own emails in the record acknowledges that the
6 sales efficiencies are difficult to predict.
7 Ultimately, however, the projected sales synergies are
8 derived from Mr. Sansigre's personal judgment, and they are not
9 consistent with the most prominent past experience and, thus,
10 the projected sales synergies in particular are not verifiable.
11 Number two, none of the efficiencies are independently
12 verified.
13 The parties agree and stipulate that, regardless of
14 whether the model was verifiable, it was not, in fact, verified
15 by anyone outside of Penguin Random House. Thus, there was no
16 independent verification as the horizontal merger guidelines
17 and prior case law contemplate.
18 Defendants argue that the Court may verify the
19 projections by hearing how they were derived and satisfying
20 itself that Mr. Sansigre put in a lot of work and made
21 reasonable assumptions, but the Court strongly disagrees that
22 this is what is contemplated by horizontal merger guidelines
23 and the case law.
24 The Court is not in a position to fact-check what
25 Mr. Sansigre says that he did or to determine whether his

1 assumptions were reasonable. Notably, none of the cases that
2 have considered this issue support the notion that the Court
3 should provide the independent verification necessary to
4 support efficiencies evidence proffered by defendants.
5 Defendants have said that there's no case that says an
6 expert is necessary. And I think that's true. Nobody has said
7 that explicitly. But the defendants have the burden to
8 establish that these efficiencies were independently verified,
9 and they assume a risk in litigation in arguing to a court that
10 a court should do that work that in many precedents was
11 performed by experts with much more knowledge about the
12 industry and expertise in dealing with financial models and
13 assumptions than a court could reasonably be expected to have.
14 This Court notes that in the Sysco case, that court
15 found that the expert had not verified whether efficiencies
16 predicted by a consulting company were merger specific and for
17 that reason among others declined to consider the efficiencies
18 evidence. That court did not attempt to verify the merger
19 specificity on its own. And this Court is not aware of any
20 other precedent where a court has undertaken the kind of
21 rigorous verification that is necessary in order to rely on
22 efficiencies in an antitrust case.
23 Number three, subsequent updates of the November 2020
24 model undermine its reliability.
25 After the November 2020 model was created,

1 Mr. Sansigre continued to update and refine the model. Most
2 notably, new iterations of the model were created in June 2021
3 and January 2022. The new iterations have some drastically
4 different projections with respect to efficiencies. The Court
5 focuses on the January 2022 model because defendants contend
6 that the June 2021 model was about a special circumstance, a
7 possible large infusion of cash to the business.
8 Looking at the January 2022 model, that model predicts
9 an increase in gross physical sales of [redacted] as
10 compared to [redacted] in the November 2022 model.
11 The January 2022 model predicts -- I'm sorry, I should
12 not have said those numbers.
13 The January '22 model predicts a certain number in
14 fulfilling savings as compared to a much larger number
15 predicted in November 2020, and savings on administration in
16 the 2022 model is far larger as compared to the number in the
17 November 2020 model. And I understand that that includes
18 editorial and art, but the additions of those lines does not
19 account for the magnitude of the change.
20 Furthermore, certain projections of the November 2020
21 model were proved inaccurate by the actual performance of
22 Simon & Schuster in 2021.
23 While the November 2020 model made certain predictions
24 of synergies for a merged company based on inputs regarding
25 Simon & Schuster's expected performance as a standalone

1 company, the actual standalone performance of Simon & Schuster
2 exceeded the predictions.
3 This indicates that the November 2020 model is both
4 out of date because it does not include actual updated
5 performance numbers and also that the November 2020 model
6 relied on proveably wrong projections and predictions.
7 Mr. Sansigre testified that the November 2020 model is
8 still the most reliable because it reflects pre-pandemic market
9 conditions. It appears to be his judgment that the future will
10 look more like the pre-pandemic world than the present world.
11 The Court rejects that testimony because Mr. Sansigre
12 cannot possibly know what the post-pandemic world will be like
13 and whether the book industry will revert to pre-pandemic
14 levels of sales and costs. Even with the benefit of industry
15 expertise, it is clear to this Court that we are in uncharted
16 waters.
17 Thus, the Court concludes that the November 2020 model
18 is unreliable because its inputs are not updated and its
19 projections are proveably inconsistent with actual numbers for
20 Simon & Schuster in 2021. The Court finds that Mr. Sansigre's
21 justifications for continuing to use the November 2020 model
22 are unpersuasive.
23 The Court, thus, finds that the November 2020
24 efficiencies model contains some projected efficiencies that
25 are not verifiable and that, in any event, none of the

1 efficiencies have been verified as required by the horizontal
2 merger guidelines and persuasive case law.
3 Moreover, the model is unreliable because it is not
4 updated and makes proveably inaccurate projections. As a
5 result, Dr. Snyder's expert report based on the November 2020
6 model is not based on sufficient facts and data under Rule 702
7 and must be excluded.
8 Five precedents in this jurisdiction unanimously
9 support this conclusion. Those precedents are H&R Block,
10 Wilhelmsen, Staples, Aetna, and Sysco.
11 In United States versus H&R Block, the court rejected
12 efficiencies evidence where the projected efficiencies, quote,
13 were largely premised on defendant's managers' experiential
14 judgment about likely costs rather than a detailed analysis of
15 historical data.
16 The court noted that, while reliance on the estimation
17 and judgment of experienced executives about costs may be
18 perfectly sensible as a business matter, the lack of a
19 verifiable method of factual analysis resulting in the cost
20 estimates renders them not cognizable by the court.
21 If this were not so, then the efficiencies defense
22 might well swallow the whole of section 7 of the Clayton Act
23 because management would be able to present large efficiencies
24 based on its own judgment and the court would be hard pressed
25 to find otherwise.

1 In this case, many of the efficiencies projections are
2 also premised on management expectations and judgment.
3 In FTC versus Wilhelmsen Holding ASA, the court
4 rejected efficiencies evidence where the projected efficiencies
5 were based on, quote, a series of significant assumptions,
6 percentage reductions in cost, percentage increases in
7 productivity, or assumed cost product equivalencies that were
8 doing all the work in calculation of the estimates.
9 There the critical issue was that because the bases
10 for the assumptions the expert identified and their role in the
11 efficiencies analysis were unclear, the reasonableness of the
12 assumptions along with the ultimate determinations could not be
13 verified with any degree of rigor.
14 Significantly, the court in that case noted that,
15 quote, references to the merging parties' past practices,
16 managerial expertise, and incentives or internal verification
17 processes, unquote, could not, quote, serve to substantiate any
18 efficiencies, unquote, because a court cannot substitute
19 defendants' assessments and projections for independent
20 verification.
21 So here, while Penguin Random House's internal process
22 was rigorous, that internal process cannot substitute for
23 independent verification.
24 In FTC versus Staples, the court rejected efficiencies
25 evidence where, quote, the defendants' projected base case

1 savings of $5 billion were in large part unverified or at least
2 the defendants failed to produce the necessary documentation
3 for verification, unquote.
4 Here the efficiencies also are unverified. And
5 although the defendants will say that they produced the
6 documentation for verification, as the Court has already
7 stated, the Court does not have the capability, the time, or
8 resources to perform the verification.
9 In United States versus Aetna, the court rejected
10 efficiencies evidence where the defendants' experts failed to
11 review the underlying provider contracts after the merging
12 parties approached -- after the merging parties projected
13 efficiencies based on the contracts, and that was criticized.
14 Instead, the expert noted simply that a third party
15 consultant had taken a large haircut to the total savings
16 estimated and without much analysis concluded that the savings
17 were verifiable.
18 The court deemed that insufficient. The court said,
19 without a more robust analysis which the companies have not
20 provided, the court cannot conclude that these network
21 efficiencies are verifiable and likely to be passed on to
22 consumers.
23 Here, like in that case, Dr. Snyder also failed to
24 look closely at the underlying data and did not do any robust
25 analysis to verify the efficiencies.

1 Finally, in FTC versus Sysco, the court rejected
2 efficiencies evidence where defendants' expert relied on
3 synergy projections made by McKinsey, the consulting firm which
4 was hired by Sysco to determine the prospective value of
5 acquiring U.S. Foods.
6 The court there did not question the rigor and scale
7 of the analysis conducted by McKinsey but noted that the expert
8 had not verified that the synergies were merger specific.
9 The court stated that it was not clear what
10 independent analysis the expert did to reduce McKinsey's
11 projected savings to merger-specific savings.
12 The court also noted that in one example, the expert
13 relied exclusively on documents created by either McKinsey or
14 defendants. He performed no independent analysis to verify
15 those numbers.
16 Again, similarly in this case, Dr. Snyder did not
17 perform any independent analysis to verify the numbers. And in
18 that case, the court did not undertake to do the verification
19 itself.
20 As a result, the Court will exclude Dr. Snyder's
21 testimony on efficiencies. No independent party could
22 reasonably verify the magnitude of at least some of the
23 asserted efficiencies in Mr. Sansigre's projected model,
24 especially the sales synergies, and Dr. Snyder made no attempt
25 to provide a quantitative verification of the synergies.

1 Because Dr. Snyder's testimony was not based on sufficient
2 facts and data, that testimony cannot help the trier of fact to
3 determine a fact at issue and, therefore, is not admissible
4 under Rule 702.
5 Although the Court's reasoning is firmly grounded in
6 precedents applying the horizontal merger guidelines, it bears
7 mentioning that the Court's analysis under Rule 702 is also
8 consistent with the application of that rule in other contexts.
9 It is well established that expert testimony may be excluded
10 under Rule 702 where the expert relies uncritically on
11 information provided to them by the party or parties for whom
12 they are working.
13 In the Title VII case, Campbell versus National
14 Railroad Passenger Corporation, the court excluded the
15 testimony of plaintiffs' expert who relied on a summary of
16 testimony prepared by plaintiffs' counsel to form his opinions
17 without independently reviewing or verifying that testimony.
18 That case is at 311 F.Supp.3d 281 from 299 to 300. That's
19 D.D.C. 2018.
20 The court reasoned, quote, such blind reliance on
21 facts provided by plaintiff's counsel combined with his failure
22 to review other sources of information renders his expert
23 report unreliable, unquote. That's at 300.
24 See also McReynolds versus Sodexho Marriott Services,
25 Inc., 349 F.Supp.2d 30 at 38, D.D.C. 2004, allowing in a

1 Title VII case testimony of plaintiffs' expert who relied on
2 data prepared by the opposing party instead of by the same
3 party who retained the expert.
4 And see also United States ex rel Morsell versus
5 NortonLifeLock, Inc. That's 568 F.Supp.3d 248 at 276, D.D.C.
6 2021, where expert and false claims case explicitly disclaimed
7 verification of assumptions, the expert was allowed to opine
8 only conditionally assuming the government succeeds in proving
9 the assumptions upon which the opinions rely.
10 All of these cases support the proposition that an
11 expert's opinion may be excluded as unreliable when the opinion
12 blindly rests on evidence provided by the party that retains
13 the expert. A party may not cloak unexamined assumptions in
14 the authority of expert analysis. See Ask Chemicals, LP versus
15 Computer Packages, Inc, 593 F.Appx. 506, 510, Sixth Circuit,
16 2014.
17 For all the foregoing reasons, the Court grants the
18 government's motion to exclude the defendants' efficiencies
19 evidence.
20 Does any party want any additional findings or
21 conclusions for the record?
22 MR. SCHWARZ: No, Your Honor.
23 MR. FRACKMAN: I think that covers it, Your Honor.
24 THE COURT: Okay. Thank you.
25 So we were in the midst of Dr. Snyder's testimony.