FMERGER ANTITRUST LAW

LAWJ/G-1469-05
Georgetown University Law Center
Fall 2024

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READING GUIDANCE

Class 2 (August 29): Predicting Merger Antitrust Outcomes (Unit 2)

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

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

Moreover, with the new appointments during the Trump administration, the Supreme Court has developed a renewed interest in substantive antitrust law. A clear majority of justices today appear committed to interpreting the law under the consumer welfare standard that has animated antitrust law for over 40 years and is likely to be hostile to any new approaches advocated by the Biden antitrust enforcement officials that deviate from that standard. So, although the DOJ and FTC have significantly increased the burdens of doing deals by making investigations more intrusive and imposing increased investigation and litigation costs on the merging parties, when the courts adjudicate the cases, the traditional judicial standards almost certainly will apply unless Congress amends the antitrust statutes. Indeed, despite all of the talk by the Biden administration, there have been only two cases brought to date by the Biden administration where the DOJ or FTC has advanced a theory that would not be cognizable under modern precedent.[1]

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[1] *See* Complaint for a Temporary Restraining Order and Preliminary Injunction Pursuant to Section 13(b) of the Federal Trade Commission Act, FTC v. Meta Platforms, Inc., No. 3:22-cv-04325-EJD (N.D. Cal. filed July 27, 2022) (alleging that Meta's acquisition of Within would violate Section 7 because, if the acquisition was blocked,

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

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

Meta would develop its own dedicated fitness app but without alleging that Meta has any plans to do so), *motion for preliminary injunction denied*, 2023 WL 2346238 (N.D. Cal. Feb. 3, 2023); Complaint for Temporary Restraining Order and Preliminary Injunction Pursuant to Section 13(b) of the Federal Trade Commission Act, FTC v. Amgen Inc., No. 1:23-cv-03053 (N.D. Cal. filed May 16, 2023) (alleging that Amgen's acquisition of Horizon Therapeutics would violate Section 7 by enabling Amgen to use rebates on its existing blockbuster drugs to pressure insurance companies and pharmacy benefit managers (PBMs) into favoring Horizon's two monopoly products—Tepezza, used to treat thyroid eye disease, and Krystexxa, used to treat chronic refractory gout).

The FTC's challenge to Meta/Within was a major extension of the actual potential competition theory, which under existing case law requires a showing that the acquiring party would enter the relevant market on its own within two or three years in the absence of the acquisition. The FTC's challenge to Amgen/Horizon is an invocation of the "entrenchment theory," which was introduced in the 1960s, never gained any meaningful judicial traction, and was moribund by the mid-1970s. We will examine the elimination of potential competition and entrenchment as theories of anticompetitive harm, and the Trump and Biden administrations' efforts to invoke them, in Classes 21 and 26, respectively.

[2] Historically, where the investigating agency concluded that a horizontal merger presented an antitrust problem in a relevant market, the common solution was for the merging parties to enter into a consent decree requiring the divestiture of one or the other party's assets and business in that market to a buyer that would "step into the shoes" of the divesting firm and operate the business with the same competitive force the divestiture seller had premerger. The upshot would be that the structure of the problematic market did not change postmerger although the identity of one of the participating firms changed from the divestiture seller to the divestiture buyer and the problematic merger would be allowed to close without further interference by the agency.

The Biden antitrust agencies have been very reluctant to accept consent decrees to settle merger antitrust investigations. While the Biden FTC has accepted some divestiture consent decrees and rejected others, the Antitrust Division under AAG Jonathan Kanter has steadfastly refused to accept consent decrees with one exception that was forced on it by the court during the course of litigation. When the investigating agency refuses to accept a consent decree to remedy an alleged antitrust problem, the merging parties are left with the choice of either litigating the merits or voluntarily terminating their transaction. We will discuss consent settlements in Class 5. In an increasing number of cases, when the agency refuses to settle, the merging parties will put the "fix" into place voluntarily by entering into a definitive sale agreement with a divestiture buyer and litigate the adequacy of the divestiture in court. We will discuss "litigating the fix" in Class 6.

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

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

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

The class notes provide a way to think systematically about antitrust risk (slides 3-9). I find, by far, the best way to think about antitrust risk is in three nested buckets: (1) inquiry risk, (2) substantive risk, and (3) remedies risk. This three-bucket approach is a very natural way for business people to think about antitrust risk. While I will address these risks in the context of a merger, they apply to any situation where antitrust risk—or indeed any type of legal risk—is present.

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

the businesses or assets of the merging parties to a third party.[3] As we have already discussed, the idea of a "fix" is to enable an independent third party to "step into the shoes" of the divesting firm, preserve the premerger level of competition and so negate the agency's antitrust concern. Assessing remedies risk requires an evaluation of the minimally reasonable fix (and likely a range of other more onerous fixes), the likelihood of the acceptance of a particular fix by the relevant decision-maker (the investigating agency or the court), and the associated costs of the fix to the merged firm.[4] The evaluation of the remedies risk must also take into account the possibility that there is no fix acceptable to the enforcement agency to cure the antitrust problem, so the available outcomes are only to litigate the merits or terminate the transaction.[5]

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

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

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

[5] We will discuss this more in Class 5, but the acceptance of a precomplaint fix is purely within the discretion of the investigating agency. The agency may refuse to accept a consent decree for any reason, including an arbitrary one. Agency decisions to refuse to accept a consent decree are not subject to review under the Administrative Procedure Act. Only "final" agency actions are reviewable under the APA, 5 U.S.C. § 704, unless otherwise provided by statute. A decision to refuse to settle an investigation with a consent decree is not a "final agency action" because it is interlocutory, does not impose an obligation, deny a right, or fix a legal relationship, and no statute provides for its interlocutory review. *See* Bennett v. Spear, 520 U.S. 154, 177 (1997) (holding that agency action is "final" within the meaning of the APA only if (1) action marks the "consummation" of the agency's decision-making process, and (2) second, the action must be one by which "rights or obligations have been determined," or from which "legal consequences will flow"). Moreover, it is likely that a decision to refuse to settle is "committed to agency discretion by law" and so exempt from APA review under 5 U.S.C. § 701(a)(2).

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

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

1. Substantive risk can be defined in one of two ways: (a) the risk that the DOJ or FTC will challenge a deal at the end of a merger review, or (b) the risk that at the end of litigation, the transaction will be found to violate Section 7 of the Clayton Act. For reasons we will discuss, almost all challenged transactions historically have either settled with a consent decree or been voluntarily terminated. Conversely, until the Biden administration, very few challenged mergers have proceeded to litigation on the merits.[7] Since many clients are reluctant to litigate, our initial focus will be on the risk that the investigating agency challenges the transaction and not on litigation outcomes.
2. We will draw several important distinctions in this course. As noted above, the first one is between the reason the agency *decides* to challenge a transaction and the reason the agency puts forth to *explain* why a challenged transaction is illegal. The reason a particular decision was made and the explanation justifying the decision can be quite different. In evaluating antitrust risk, we need to focus primarily on the facts that influence the agency's decision to challenge the transaction and much less on how the agency explains this decision after the fact.

In this class, we will examine a model that predicts agency prosecutorial decision-making outcomes. The class notes first provide more detail on Section 7 of the Clayton Act (slides 10-19) and then describe the predictive model for downstream markets.[8] Concentrate on the general principles (slides 20-52). You may skim the special cases (slides 45-53), but be sure to get a general idea of what they are. We will examine these special cases in detail later in the course. I also have included a slide on novel theories—at least in the modern era—that the FTC and DOJ say they will apply (see slide 54). Whether the agencies will actually find, much less bring cases, on any of these novel theories remains to be seen. It is even more questionable whether the courts will accept these theories as establishing a cognizable anticompetitive harm under the antitrust laws.

Before moving on, I should point out that a merger may involve multiple products and therefore a number of horizontal, vertical, and (perhaps) conglomerate theories of anticompetitive harm could apply to some deals.

You may find our discussion provides a somewhat different perspective of merger antitrust analysis than you saw if you have taken an antitrust survey course. Most of what you see in

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7 Merging parties have exhibited somewhat more willingness to litigate their transactions in actions brought by the Biden administration than by past administrations. As noted above, the Biden administration has lost a number of antitrust cases in court. The more an agency loses in court, the more likely opposing parties will put the agency to its proof in court.

8 Almost all challenges to horizontal mergers located the anticompetitive effect in the downstream market (that is, where sellers merge and any harm is to customers). As explained in the class notes, the Biden administration believes that mergers are often anticompetitive in upstream markets (where buyers merge and any harm is to suppliers, especially labor), although with one exception the Biden agencies appear unable to find mergers to challenge in upstream markets. In any event, there are too few challenges in upstream markets to develop a reliable predictive theory, although the notes speculate a bit on when the Biden agencies may challenge upstream mergers (see slides 18-19).

antitrust courses is how judges and occasionally enforcement officials *explain* the antitrust decisions they reached; my model *predicts* the agency's enforcement decisions. It turns out that there is a big difference. You may also find it curious that my predictive model makes no reference to market definition, HHIs, diversion ratios, upward pricing pressure, or the 2023 DOJ/FTC Merger Guidelines—staples in the explanation of merger antitrust enforcement decisions.[9] Later, when we study litigated merger antitrust cases, we will examine these and other more formal concepts as we examine the agencies' arguments to the court that the challenged transaction is illegal.

2010 Merger Guidelines. Having examined the 2023 Merger Guidelines for Class 1, we now turn to the 2010 DOJ/FTC Horizontal Merger Guidelines. Although technically superseded, the 2010 Guidelines remain significant. While the 2023 Guidelines reflect the Biden administration's antitrust perspectives and are crucial for understanding the scope and focus of current merger antitrust investigations, the 2010 Guidelines (along with their 1992 predecessors) align more closely with judicial decision-making and precedent over the past 30 years. This makes the 2010 Guidelines valuable in predicting judicial merger antitrust outcomes.[10]

The DOJ press release (pp. 4-6) gives a good introduction. Study the table of contents (pp. 8-9) to understand the Guidelines' basic organizational structure. Read Section 1 (Overview), Section 2 (Evidence on Adverse Competitive Effects), and Section 3 (Targeted Customers and Price Discrimination)—with some care (pp. 10-16). You can skim the rest of the Guidelines (pp. 16-43) or even just look at the headings to get a rough sense of what else the Guidelines address. You will have the opportunity to read Sections 4-16 in more detail as they arise in the case studies later in the course. The statements of then-FTC Chairman Jon Leibowitz (p. 44) and then-Commissioner Tom Rosch (pp. 45-48) will give you an idea of what two important commissioners at the time thought of the Guidelines. My personal take on the 2010 Guidelines, which includes a somewhat unconventional view on why the agencies revised the Guidelines after 18 years, is memorialized in the S&S note to clients (pp. 49-54), which you can just skim or skip altogether.[11]

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[9] If you do not know some of these terms, don't worry about it. You will by the end of the semester.

[10] There is a good chance that the Biden administration's antitrust views will not endure. It is likely that the next administration—even if Democrat but almost certainly if Republican—will revert to an enforcement approach more consistent with the 2010 horizontal merger guidelines and the 2020 vertical merger guidelines than the 2023 guidelines.

[11] As outlined briefly in the Class 1 class notes, the first set of merger guidelines were issued in 1968 by the Department of Justice. *See* U.S. Dep't of Justice, Merger Guidelines (May 30, 1968). The guidelines were revised by AAG William F. Baxter in 1982 and covered both horizontal and nonhorizontal transactions. *See* U.S. Dep't of Justice, Merger Guidelines (June 14, 1982) (published at 47 Fed. Reg. 28,493). The FTC refused to join the 1982 guidelines and instead issued their own separate statement of how the Commission would assess mergers and acquisitions. *See* Fed. Trade Comm'n, Statement Concerning Horizontal Merger Guidelines (June 14, 1982). After a minor revision in 1984, the guidelines were significantly revised in 1992. *See* U.S. Dep't of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines (Apr. 2, 1992). Although the 1992 guidelines reflected the same conception of the goals of merger antitrust law as the 1982 guidelines, the 1992 guidelines were limited to horizontal transactions. The 1992 guidelines significantly enhanced the economic techniques to analyze horizontal mergers. Notably, the FTC joined in issuing the 1992 guidelines. The guidelines were again revised in 2010. *See* U.S. Dep't of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines (rev. Aug. 19, 2010). The 2010 revision loosened some of the requirements (especially in market definition and coordinated effects) to reduce the burden on the agencies to find a violation and were written to reduce predictability in merger outcomes. *See* Shearman & Sterling

Synergies and efficiencies. The next section of the class notes introduces synergies and efficiencies (slides 56-62). Synergies are the private benefits the merged company obtains through the merger. There are two major types of procompetitive synergies:

(1) *Customer value-enhancing synergies* enable the merged firm to create new products or to make existing products better, cheaper, or faster for the direct benefit of customers, which in turn increases the demand for the merged firm's products.[12]

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

In antitrust law, synergies that benefit customers under the consumer welfare standard are called *efficiencies* and can be used in defending a transaction. Think of efficiencies as procompetitive synergies. On the other hand, benefits to the merged firm that harm customers (say, higher profits due to the higher prices the merger enables the combined company to charge) are anticompetitive synergies and hence not recognized as efficiencies by the courts or the antitrust enforcement agencies.[13]

Putting things together. Finally, the remaining slides in the deck attempt to put everything in this unit together (slides 63-69) into a coherent defense of a transaction and some key questions to keep in mind when approaching a transaction. This is a quick read.

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

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

LLP, The 2010 DOJ and FTC Horizontal Merger Guidelines: Increasing Realism While Reducing Predictability (August 2010).

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

[13] No doubt being able to charge higher prices because the transaction created more market power in the combined firm is a benefit to the firm. You sometimes see this reflected in the firm's documents as a "revenue synergy." While the transaction can increase revenues to the combined for reasons other than market power, when the DOJ and FTC read "revenue synergy" in a company's documents, they assume that this is from the exercise of market power. Companies should be advised on how the antitrust agencies are likely to read the term and cautioned to be explicit as to its meaning if and when they use the term in their documents or emails.