Challenges to Consummated Mergers: Making the Game Worth the Candle

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The prior issue of the Mergers and Acquisitions Newsletter focused on antitrust agency investigations of and challenges to mergers after their consummation.[1] The antitrust agencies continue to bring these challenges and conduct these investigations. The FTC most recently challenged a consummated hospital merger. Evanston Northwestern Healthcare Corporation, FTC Docket No. 9315 (complaint Feb. 10, 2004). In a sharply divided decision, the FTC recently closed an investigation into the consummated Genzyme/Novazyme merger.[2] Meanwhile, the first—and in some respects most difficult—consummated merger challenge to be adjudicated, Chicago Bridge & Iron, is pending final decision by the full FTC.[3] Another consummated merger challenge, Aspen Technology, is about to go to trial before an FTC Administrative Law Judge.[4] And the Antitrust Division is litigating its challenge to a consummated merger in the dairy industry in federal court.[5]

Two particular comments prompt me to ask whether consummated merger challenges are worth the agencies' effort and the parties' expense. Chris Compton and Scott Sher suggest that merging parties restrain their post-closing market behavior (and indeed "defer or exercise great caution in raising prices, particularly in the first few quarters after closing") in order to avoid agency scrutiny of post-merger anticompetitive effects.[6] In other words, post-merger conduct might lead the agency to contend that the merger had anticompetitive effects; hence a prudent firm should avoid that conduct. Josh Gray suggests that post-closing merger challenges should be subject to different (and from the merging parties' perspective more lenient) enforcement standards than pre-merger enforcement.[7] In particular, he is concerned that enforcement against mergers in small markets might not be justifiable exercises of prosecutorial discretion, even as an exercise in deterrence, in light of the small

[1] Mergers and Acquisitions Newsletter, Fall 2003, included three articles on post-acquisition challenges: Chris Compton and Scott Sher's "If at First You Succeed … Counseling for the Close of a Merger Between Competitors" (hereafter "Compton & Sher"); Tefft Smith and Marimichael Skubel's "Litigating Mergers Against the Federal Trade Commission—Some Practical Tips" (hereafter "Smith & Skubel"); and Joshua Gray's "Should the Ordinary Standards of the Horizontal Merger Guidelines Apply to Non-Reportable Transactions?" (hereafter "Gray"). All are available on line at http://www.aba.org/antitrust/.

[2] FTC File No. 021-0026 (Jan. 13, 2004).

[3] FTC Docket No. 9300.

[4] FTC Docket No. 9310.

[5] U.S. v. Dairy Farmers of America, civil action No.:6:03-206 (E.D. Ky.) (complaint filed April 24, 2003).

[6] Compton & Sher, p. 4

[7] Gray, p. 19.

amounts of consumer welfare and the high costs of enforcement.

These post-closing merger challenges reflect two responses to the most significant trend in merger enforcement, pre- or post-closing: the agencies' conviction that concentration, "except at very high levels," is an unreliable barometer of competitive effects from mergers. One—not very satisfactory—agency response is to define markets smaller and smaller, in order to eliminate competitors and reach the "very high levels" of concentration—typically limiting the market to three competitors merging to two—at which point the agency is willing to infer adverse effects on competition. That response gives rise to the concern legitimately raised by Josh Gray that post-merger challenges in small markets may not be worth the expense to all parties. The other—better—agency response is to attempt to develop proof of actual anticompetitive effects.

Both of these responses are found in current merger enforcement in both pre-closing and post-closing investigations and challenges. The agencies' increasing demand for evidence of anticompetitive effects will lead to more post-closing challenges. In a pre-closing challenge, the agencies face the criticism that their prediction of likely anticompetitive effect is speculative; hence, why not look at consummated mergers for evidence of actual anticompetitive effect?

As the antitrust agencies become less confident of their ability to predict anticompetitive effects pre-closing, they will increasingly feel compelled to attempt to remedy mergers that result in demonstrable anticompetitive effects post-closing. The only alternative would be limiting enforcement to three-to-two mergers or mergers to monopoly in clearly defined markets (and indeed markets that are sufficiently large to make the transactions HSR reportable), something the agencies do not appear willing to do.

In my view, consummated merger challenges will be worthwhile if they help the agencies develop more reliable theories of anticompetitive effects from mergers, and thereby help them—and merging parties—better predict which mergers are and are not worth investigating and challenging before consummation. This article briefly describes the familiar trend in agency merger analysis and enforcement away from concentration and towards efforts to show anticompetitive effects (and three-to-two combinations), and then shows how the FTC's recent post-closing challenges fit within that trend.

Death of a Paradigm

It is well known to readers of this newsletter that the federal antitrust agencies are increasingly reluctant to bring cases based on market concentration, except at very high levels. This proposition was reaffirmed publicly by FTC Chairman Muris in February 2004, when he opened the joint FTC/DOJ conference on mergers by saying that "state-of-the-art merger analysis has moved well beyond a simplistic causality of high concentration leading to anti-competitive effects."[8] Thus, current merger enforcement (whether pre- or post-closing) often requires proof of likely anticompetitive effects, not just of concentration, and consummated mergers provide a good opportunity for the agency to attempt to meet that burden of proof. Even if the agencies rely on the concentration presumption in court, agency staffs typically must prove to their principals that the merger is indeed likely to have anticompetitive effects.

[8] Timothy Muris, Remarks, Workshop on Horizontal Merger Guidelines, Feb. 17, 2004, available at http://www.ftc.gov/speeches/muris/040217hmgwksp.htm.

Modern merger enforcement began with the Celler-Kefauver Amendment of 1950, when Congress fixed Section 7 of the Clayton Act to close a loophole in the 1914 law that put most mergers beyond statutory review. The Amendment put the government back in the merger control business, but required it to challenge consummated mergers, since there was no mechanism to detect mergers before they closed. The Antitrust Division challenged several consummated mergers and established the proposition that a merger could be presumed anticompetitive if it significantly increased concentration in a properly defined market,[9] leaving to defendants the obligation to come forward with evidence that their merger would not be anticompetitive, despite its effect on concentration.[10]

Fixing an anticompetitive merger was another matter. Merger litigation, including appeals, could take many years, during which the merged firms could exercise whatever market power they had amassed and only after which they would be required to undo the merger—which might or might not restore competition. Thus, despite the broad remedial powers enjoyed by the government and courts,[11] divestiture was seen as an ineffective and undesirable remedy.[12]

In the 1970s, Congress enacted two laws to address the inefficacy of post-closing merger enforcement. In 1973, Congress recognized the inadequacy of post-merger divestiture as a remedy,[13] and amended Section 13(b) of the FTC Act, 15 U.S.C. § 52(b), giving the FTC the power to seek preliminary injunctions in merger (and other) cases, rather than relying on cease-and-desist orders and supplemental relief years later. The D.C. Circuit, interpreting § 13(b), recognized the reasons for pre-closing enforcement: to preserve a meaningful remedy and prevent interim harm to competition.[14] And in 1976 Congress added the Hart-Scott-Rodino Act, 15 U.S.C. § 14a, requiring merging parties to report their plans to the antitrust agencies and provide an opportunity for investigation and challenge before closing.

While the agencies now had more power to remedy anticompetitive mergers, they had difficulty in some cases persuading judges that mergers were indeed anticompetitive. Baker Hughes allowed defendants to advance essentially any argument to rebut the government's reliance on the concentration presumption,[15] and Syufy ridiculed the government for relying on a snapshot of concentration.[16] Thus, in 1992, the agencies adopted the current Horizontal Merger Guidelines, emphasizing that concentration was only a threshold inquiry into a broader analysis of "anticompetitive effects."[17] By comparison, the 1982 and 1984 Guidelines had accepted the concentration pre-

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[9] U.S. v. Philadelphia Nat'l Bank, 374 U.S. 321 (1963); Brown Shoe Co. v. U.S., 370 U.S. 294 (1962).

[10] U.S. v. General Dynamics Corp., 415 U.S. 486 (1974); U.S. v. Baker Hughes Inc, 908 F.2d 981 (D.C. Cir. 1990).

[11] Ford Motor Co. v. U.S., 405 U.S. 562, 575 (1972).

[12] FTC v. Dean Foods Co., 384 U.S. 597, 606 n.5 (1966).

[13] See FTC v. H.J. Heinz Co., 246 F.3d 708, 726 (D.C. Cir. 2001), citing 119 Cong. Rec. 36612 (1973),

[14] FTC v. Weyerhaeuser Co., 665 F.2d 1072, 1085 (D.C. Cir. 1981).

[15] 908 F.2d 981, 982-83 (D.C. Cir. 1990).

[16] "Suspect that giant film distributors like Columbia, Paramount and Twentieth Century-Fox had fallen prey to Raymond Syufy, the canny operator of a chain of Las Vegas, Nevada, movie theatres, the United States Department of Justice brought this civil antitrust action . . . ." 903 F.3d 659, 661 (9th Cir. 1990).

[17] Horizontal Merger Guidelines § 0.2, available at http://www.ftc.gov/bc/docs/horizmer.htm.

sumption, but sought to make the market definition and entry analyses more rigorous.

The agencies made clear in the 1992 Guidelines that by "anticompetitive effects" they principally mean higher prices. They also made clear that any price effect—even if less than 5%—was a sufficient basis to condemn a merger. Merger Guidelines § 1.0 ("the 'small but significant and non-transitory' increase in price is employed solely as a methodological tool for the analysis of mergers: It is not a tolerance level for price increases"). Thus, merger analysis has become a hunt for higher prices, or the likelihood of higher prices, rather than a hunt for higher concentration. And while the 1992 Guidelines suggested some theories of anticompetitive effects, those theories have not been seen to provide reliable predictors of those effects.[18] Rather, they provide a starting point for an argument.

It has taken 10 years for the effect of this shift to "anticompetitive effects" to be seen. In 1992, it appeared that the Guidelines would require the agency staff to prove anticompetitive effects on a predictive basis, and some feared (or maybe hoped) that the Guidelines gave the staff an impossible task. Today there is no presumption that a six-to-five merger in a properly defined market is anticompetitive, even though the current (1992) Guidelines assert such a presumption.[19] Nor is there a presumption that coordination will occur if the conditions favoring either coordination or unilateral effects (Guidelines § 2) are present. Even though merger enforcement was intended by Congress to be based on "probabilities, not certainties,"[20] agency staffs were faced with a significant challenge: How do you prove to the satisfaction of a district judge (or to an agency head) that an effect is "likely" when there is no generally accepted theory that predicts an effect?

Two methods have emerged: First, the FTC drew the line at three-to-two, asserting that there would continue to be a strong presumption against mergers to duopoly, and persuaded the D.C. Circuit to adopt that view.[21] Second, in several key investigations, the FTC based its decision whether to challenge the merger on its determination whether anticompetitive effects were indeed likely.

In its investigation of the acquisition of ARCO by BP (then BP Amoco), for example, the FTC was persuaded that BP's acquisition of ARCO's Alaska crude oil production and reserves would allow BP to raise prices for that crude oil, even though it faced competition from other crudes used by West Coast refiner-

[18] For example, the antitrust agencies do not generally presume likely anticompetitive effects where a merger will give one firm 35% of a market, cf. Guidelines § 2.22.

[19] Merger Guidelines § 1.51 states that mergers resulting in HHIs greater than 1800 (more than five equal size firms) and increasing concentration by more than 100 HHI points are "presumed . . . likely to create or enhance market power or facilitate its exercise," but "the presumption may be overcome by a showing" that the merger is unlikely to be anticompetitive. Id. The agencies do not adhere to this statement of their enforcement policy, but instead look for additional evidence of anticompetitive effect in almost all mergers, in particular in mergers resulting in at least three firms in the market. See, e.g., AmeriSource Health Corp., FTC File No. 011-0122 (Commission closing statement).

[20] Brown Shoe, 370 U.S. at 323,

[21] Heinz, 246 F.3d at 716-17. The FTC had already won three "three-to-two" challenges: FTC v. Staples, Inc., 970 F. Supp. 1066 (D.D.C. 1997); FTC v. Cardinal Health, Inc., 12 F. Supp. 2d 34 (D.D.C. 1998); FTC v. Swedish Match North America Inc., 131 F. Supp. 2d 151 (D.D.C. 2000).

ies.[22] The (alleged) evidence: BP was already reducing the supply of crude oil to West Coast refineries in order to raise prices for ANS crude.[23] Thus, the agency concluded that the merger would likely result in a significant lessening of competition because the market was already behaving less than competitively. In FTC v. Libbey, the district court agreed that the FTC had proven that the merger was likely to have an anticompetitive effect, by raising the cost of goods of a formerly effective competitor.[24] By contrast, Genzyme/Novazyme (described below) is an example of the FTC declining to challenge a merger because of a lack of evidence of likely anticompetitive effect.

Proving likely anticompetitive effects is easier in a market that is already dysfunctional. The harder question, how to prove likely anticompetitive effects in a market that is currently competitive, was presented in Heinz and Cardinal, and the difficulty in proving that prediction may have led the court of appeals, in Heinz, to hold that the defendants' efficiencies evidence failed to rebut the government's prima facie case, rather than hold that the government had overcome defendants' showing.

Anticompetitive Effects in Consummated Mergers

Especially where there is no accepted theoretical construct of what facts predict likely anticompetitive effects, it is difficult to prove the likelihood of anticompetitive effects from a merger that has not yet occurred. Unless (as in BP/ARCO and UPM Kymmene[25]) the government already believes the market is dysfunctional, it is easier as a matter of proof to wait and see. This is particularly true where the issues are complex: Compton and Sher point to Synopsys/Avant! as an example. In that vertical merger—where innovation and product integration would be the source of both efficiency and possible anticompetitive effect—the FTC found the case insufficiently compelling for a pre-closing challenge, but promised to continue to monitor the market for anticompetitive effect.[26] In Genzyme, another innovation case, a majority of the FTC concluded that the merger had not had anticompetitive effects in the two-plus years since consummation, even though it was arguably a merger to monopoly in an innovation market. The majority, indeed, declared that "neither economic theory nor empirical research supports an inference regarding the merger's likely effect on innovation (and hence patient welfare) based simply on observing how the merger changed the number of independent R&D programs."[27]

[22] See Statement of Chairman Pitofsky and Commissioner Thompson, concurring and dissenting in part, BP Amoco plc, FTC Docket No. C-3938 (April 13, 2000).

[23] This allegation was disputed, and BP Amoco and the FTC settled the case on the eve of trial.

[24] 211 F. Supp. 2d 34, 47 (D.D.C. 2002). The case arose under the unusual procedural posture that defendants claimed that they had fixed the competitive problem presented by Libbey's proposed acquisition of Anchor Glass from Newell Rubbermaid by agreeing to have Newell retain the food service glassware business at issue, while transferring Anchor's glassware factories to Libbey. Thus, the court asserted that "the FTC has not presented a statistical analysis regarding the potential anticompetitive effects," i.e., an HHI analysis, but instead presented evidence of likely anticompetitive effects. Id.

[25] 2003-2 Trade Cas. ¶ 74,101 (N.D. Ill. 2003).

[26] FTC File No. 021-0049, see separate statements of Commissioners Anthony, Thompson and Leary (July 26, 2002).

[27] Muris statement at 5-6.

If the merger stands or falls on the existence of a price effect, or other anticompetitive effect, it might be easier to detect that effect after the fact, when the agency has the benefit of actual experience and price data. Several of the recent post-merger challenges illustrate why such challenges may appeal to antitrust enforcers looking to prove anticompetitive effects from mergers. In Evanston Northwestern, the most recent example, the FTC alleged in its administrative complaint that the merged hospital raised prices to various private payers by amounts ranging from 15-20% to 190%.[28] In Hearst Trust, as Compton and Sher note, after the merger "First DataBank 'drastically increased prices . . . in some instances more than doubled or tripled the total fees previously paid.'"[29] Likewise, in Monier Lifetile, the merged firm "increased prices significantly and the remaining, smaller competitors quickly followed suit."[30] In Chicago Bridge & Iron, FTC complaint counsel again contended that the merged firm had raised prices after the merger, although the ALJ found that "Complaint Counsel's evidence did not prove that CB&I has implemented price increases."[31] In Dairy Farmers, the Antitrust Division alleges that the merging firms themselves had previously fixed prices (for more than ten years).[32]

While Hearst Trust and Chicago Bridge (as well as Aspen Technology and Dairy Farmers) were alleged to be mergers to monopoly, the others were not: In Monier, there were other, smaller competitors in the market. The same was true in some pre-closing challenges, including UPM Kymenne, Cardinal Health and Libbey. The complaint in Evanston Northwestern alleges that "the merger resulted in a post-merger HHI increase in excess of 500 points to a level exceeding 3000 points"—clearly not a merger to monopoly or duopoly.

The FTC's hospital retrospective likewise shows that the agency is attempting to find evidence of actual anticompetitive effects from mergers in an industry where it has been singularly unsuccessful in proving a likelihood of anticompetitive effects from mergers. The government routinely loses hospital merger challenges, typically on geographic market. In a pre-closing challenge, the government often attempts to prove that patients will not travel across metropolitan areas for medical care, even in densely populated metropolitan areas such as New York and San Francisco.[33] But if two hospitals can raise price—by 190%—in "northeast Cook County and southeast Lake County, Illinois," without being constrained by other hospitals in Chicago, that (alleged) actual anticompetitive effect bolsters (if not obvi-

[28] Administrative Complaint ¶ 31.

[29] FTC v. Hearst Trust, D.D.C. Civ. No. 1:01CV00734 (complaint filed April 4, 2001), ¶ 37, available at http://www.ftc.gov/opa/2001/04/hearst.htm.

[30] Compton & Sher, p. 4.

[31] Chicago Bridge & Iron, FTC Docket No. 9300, Initial Decision at 109. The ALJ nonetheless found a violation, essentially on the ground that the FTC had made out a case based on concentration: "Complaint counsel has established its prima facie case by showing that CB&I's acquisition of PDM's EC and Water Divisions produces a firm controlling an undue percentage share in each of the four relevant markets," a presumption that the ALJ later found to be unrebutted. Id. at 88, 109. FTC complaint counsel are pressing on appeal their claim that CB&I increased prices following the merger—notwithstanding the pendency of the FTC's investigation and administrative adjudication. Complaint counsel's Reply Brief at 28-34 (Oct. 24, 2003).

[32] Complaint ¶ 18. The government also alleged that DFA's acquisition of a controlling interest in Southern Belle would constitute a merger to monopoly or duopoly in the alleged geographic markets. Id. ¶ 3.

[33] U.S. v. Long Island Jewish Medical Ctr., 983 F. Supp. 121 (E.D.N.Y. 1997); California v. Sutter Health Syst., 130 F. Supp. 2d 1109 (N.D. Cal. 2001) (amended opinion), aff'd, 217 F.3d 846 (9th Cir. 2000).

ates) the market definition exercise and the reliance on concentration.[34]

The Costs (and Benefits) of Post-Merger Enforcement

Josh Gray is certainly correct in noting that post-merger enforcement can be costly to the merged firm and to the government. These costs should be taken into account when considering whether the anticompetitive effects of a merger justify the commitment of agency resources. Moreover, the agency should consider whether an effective remedy would be available. There is little point in pursuing a violation where the agency cannot restore competition at the end of the day. On the other hand, the agency understandably believes that it is important to preserve the integrity of its process. In Chicago Bridge & Iron, the merged firm appears determined to frustrate the possibility of an effective remedy.[35] If the FTC finds a violation, it will then be called on to decide how to unscramble the eggs and restore competition, quite possibly without any constructive input from the respondent.

Josh Gray also notes that "one might seek to justify selective enforcement against a few non-reportable transactions by its deterrent effect on other small transactions," but questions the value of that deterrence in small mergers where the effects are unclear. There are two types of deterrence that are relevant: deterring clearly anticompetitive mergers, even if not reportable, and deterring HSR violations, as in Hearst Trust, where the FTC alleged that the merging companies had failed to provide Item 4(c) documents. The latter is clearly appropriate. As to deterring non-reportable yet anticompetitive mergers, I agree that Section 7's "requirements are difficult to discern in most close cases," especially if, as discussed below, the test for legality is likely future anticompetitive effects, rather than the merger's (somewhat) more ascertainable effect on concentration. Deterrence should be accompanied by clearer statements of the conduct that is to be deterred.

The agency is clearly more likely to obtain effective relief if it examines and, if necessary, challenges a merger before consummation rather than after. It will obtain more complete relief and prevent the interim harm to competition—the Weyerhaeuser factors that warrant preliminary injunctions under the FTC Act. But so long as it is unwilling to rely on a presumption from concentration, the agencies' ability to obtain pre-closing relief will require them to prove a likely anticompetitive effect. At the moment, the agencies do not appear to be ready to generalize from their experience and say what constitutes such evidence, at least in situations where the market is not already performing in a noncompetitive fashion. I hope that the current challenges to consummated mergers will help the agencies articulate theories that identify what facts are needed to prove (or disprove) that anticompetitive effects are likely in mergers beyond mergers to monopoly or duopoly.

[34] This proposition, recognized by the Supreme Court to apply in conduct cases in FTC v. Indiana Fed'n of Dentists, 476 U.S. 447 (1986), was argued by the FTC to apply in merger cases as well, in BP/ARCO and Libbey, and accepted (more or less) by the court in Libbey. 211 F. Supp. 2d at 48-49.

[35] According to Complaint Counsel's allegations, after the case was argued and submitted to the FTC, CB&I announced that it would shut down the fabrication facility it had acquired from PDM and had been required by the ALJ's order to divest. Emergency Motion, Dec. 5, 2003. CB&I then entered into a consent order requiring it to preserve the assets it had acquired from PDM. Complaint Counsel noted in its emergency motion that CB&I had earlier closed its merger with PDM, without notice to the FTC, while the FTC was investigating the proposed merger.

The agencies' affection for challenges in "small markets"—which Josh Gray notes—is likewise consistent with pre-closing agency enforcement and with the agencies' reluctance to rely on concentration as a predictor of anticompetitive effects. If the agency is unwilling to challenge five-to-four mergers absent extraordinarily strong evidence of likely anticompetitive effect, that philosophy leads the staff to define smaller and smaller markets in order to identify mergers that would fit the three-to-two variety. The Merger Guidelines' "smallest market" principle reinforces this tendency, as does the reliance on a 5-10% price increase test. The result — challenges to mergers involving hobby telescopes or high-priced fountain pens[36]— risks trivializing the entire enterprise. But until the agencies develop theories that allow them to predict anticompetitive effects in mergers beyond three-to-two, merger challenges (whether before or after closing) are likely to strike small markets—and small firms.

Early experience and economic theory led the agencies, the courts and Congress to believe that concentration was a good predictor of anticompetitive effects from mergers. For 25 or more years doubt has been cast on that prediction, to the point where the Chairman of the FTC states that it is unreliable and generally will not be relied on. If post-closing investigations and challenges allow the agencies and courts to develop new understandings of what (if anything) can make mergers anticompetitive, they may be able to move beyond three-to-two preliminary injunction challenges and develop more robust theories for merger control. They might then be able to use those theories in pre-closing investigations and challenges, which (as my fellow commenters agree) are more efficient for all concerned—even if it does not seem that way in the midst of the second request process. If not, and these challenges are merely outliers or efforts at deterrence, then the agencies' efforts to investigate and challenge mergers after consummation will be far less valuable.

[36] U.S. v. Gillette Co., 828 F. Supp. 78 (D.D.C. 1993); FTC press release, Meade/Tasco, http://www.ftc.gov/opa/2002/05/meadecelestron.htm.