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Why Courts Are Rejecting Agencies' Merger Challenges

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The U.S. Department of Justice's and the Federal Trade Commission's losses in three merger challenges in September and a fourth in October demonstrate that merging parties can close difficult transactions if willing to fight the agencies in court.

Federal courts and an FTC administrative law judge rejected the government's challenges in the following cases:

- In re: Illumina Inc. and Grail Inc., before FTC Administrative Law Judge Michael Chappell;
- U.S. and Plaintiff States v. UnitedHealth Group Inc. and Change Healthcare Inc., before the U.S. District Court for the District of Columbia;
- U.S. v. United States Sugar Corp., Imperial Sugar Co., Louis Dreyfus Co. LLC and United Sugars Corp., before the U.S. District Court for the District of Delaware; and
- U.S. v. Booz Allen Hamilton Holding Corp., Booz Allen Hamilton Inc., Everwatch Corp., EC Defense Holdings LLC and Analysis, Computing & Engineering Solutions Inc., before the U.S. District Court for the District of Maryland.

These cases show how difficult it is for the DOJ and FTC to challenge transactions without strong customer opposition and smoking gun documents supporting their theories. The judges in these cases generally placed more weight on the merging parties' executive testimony and less weight on the government's economic experts, and found that the structural and behavioral remedies proposed by the parties addressed the alleged theories of harm.

The cases illustrate that if the government does not get a presumption of anti-competitive effects based on market shares and concentration, winning a rule of reason case is very challenging for the government.

September began with Illumina and Grail, wherein FTC Administrative Law Judge Chappell rejected the FTC's incentive theory in a vertical merger challenge. Then, in U.S. Sugar and Imperial Sugar, Judge Maryellen Noreika rejected the DOJ's proposed relevant product and geographic markets, and was persuaded by evidence showing that the U.S. Department of Agriculture could adjust sugar supply to defeat an attempted price increase leading to a DOJ loss on a horizontal challenge.

Finally, in UnitedHealth and Change Healthcare, the DOJ alleged both horizontal and vertical theories. However, Judge Carl Nichols held that the horizontal issue was remedied by a proposed divestiture and the vertical theory was countered by the evidence at trial showing that UnitedHealth would not have the incentive to misuse customer data, contrary to the DOJ expert's theory.

October has not started better for the agencies. In Booz Allen and EverWatch, the DOJ alleged that entering into the merger agreement lessened competition for Optimal Decision, a contract with the National Security Agency for which Booz Allen and EverWatch were the only remaining competitors.

The DOJ thus asserted the merger agreement itself, even before closing, violated the Sherman Act, Section 1. In terms of the legal standard, Judge Catherine Blake rejected the DOJ's position that a quick look review was appropriate and instead applied a full rule of reason assessment.

The court found three fatal flaws in the DOJ's argument.

First, there was no direct evidence of harm presented, such as an expressed intent to reduce output, increase prices or decrease quality. The DOJ relied on documents created when Booz Allen employees first learned of the deal in which they made statements about standing down their competitive efforts on Optimal Decision.

Those employees, however, were quickly told by management that while the deal was pending it would be business as usual and the parties would continue to compete, and the testimony showed they continued to compete aggressively. The court rejected the DOJ's contention that these statements from lower-level employees, which the court referred to as "excited utterances," represented the company's views or the reality.

Second, the DOJ's theory was based on the merger providing some reduced incentives to compete. The DOJ's expert opined that Booz Allen has less incentive to compete when it would win Optimal Decision either way, if the merger completed. The court found this economic argument to be too simplistic and found many counterincentives pushed Booz Allen and EverWatch to compete, including:

- Booz Allen's desire to maintain a strong reputation and demonstrate strong past performance on Optimal Decision to allow Booz Allen to win future and larger bids; and

- Individual employees were motivated to win because they would achieve bonuses if their team won, they would keep their jobs, and they also had a strong competitive spirit.

In addition, Booz Allen pointed to prior situations where it did not increase the price on sole source extensions on the predecessor contract to Optimal Decision to argue that these counterincentives prevented it from taking a price increase in other situations where, under the government theory, Booz Allen should have done so. Past facts were inconsistent with the DOJ's theory.

Third, Judge Blake disagreed with the DOJ's proposed single-customer or single-contract market

definition of signals intelligence modeling and simulation services under the Optimal Decision contract, calling it "analytically incomplete."[1] The court held the market is the type of service — modeling and simulation, which is a generic capability with many applications — and is not limited by the application to a specific customer or contract, or the domain knowledge associated with serving that specific customer.

The court found that domain knowledge of how to perform this service in the NSA environment can be transferred readily to another contractor. The court distinguished other single-customer government contract markets by noting those were for items of hardware, such as a specific fighter aircraft or type of tank ammunition, with unique uses and usefulness only for one customer.

Here, the court found that the federal government bought the service — modeling and simulation — for many applications and under many contracts other than the NSA's Optimal Decision effort.

While the DOJ has appealed the U.S. Sugar decision and indicated it might appeal the Booz Allen decision, clear trends are emerging from recent cases. Below are a few takeaways showing how courts have reacted as the antitrust agencies have pursued aggressive new theories and expansions of existing law in both horizontal and vertical transactions.

Courts are more receptive to divestitures and behavioral remedies than the agencies.

Part of the antitrust agencies' aggressive posture has been their stated approach to seek full-stop injunctions rather than accept remedies to settle cases. However, the courts are far more receptive to remedies.

For vertical transactions, behavioral promises like firewalls and nondiscriminatory supply may be acceptable to courts, especially if the parties can show a similar vertical relationship already exists, is protected by firewalls and those firewalls have worked.

For example, in Illumina, the administrative law judge found that an open offer by Illumina to supply its gene sequencing product to all oncology test developers with defined terms and prices prevented Illumina from withholding its product or raising its prices.[2]

UnitedHealth relied on its existing firewalls and Judge Nichols found them effective in countering the DOJ's theory. UnitedHealth also shows that if the parties propose to resolve a horizontal issue through a divestiture and line up a solid buyer with a robust asset package, courts are a more receptive audience than the DOJ and the FTC.[3]

Courts are less receptive to economic incentive theories than the agencies.

Vertical merger challenges focus on whether a transaction will create an incentive to take action that will harm competition and whether the party will have the ability to act on that incentive.

The FTC and the DOJ have relied on experts who apply economic theory to demonstrate how a transaction creates incentives to withhold or condition the supply of a product to a competitor or misuse data obtained from customers, who are also downstream competitors. Parties have relied on executive testimony and their existing policies and actions to counter these theories.

Courts are willing to credit executive testimony if their testimony that they would not engage in vertical

foreclosure or data misuse is credible and supported by business imperatives, especially if the testimony is consistent with past practices. Economic incentive-based theories are legally viable, but if the real world facts don't fit the theory, then the theory isn't worth much.

The government might focus on experts who perform vertical math or rely on other theoretical incentives to argue there will be harmful competition. Those theoretical arguments alone are not enough when witnesses testify to the strong business counterincentives to engaging in the government's feared conduct.[4]

These themes played out in UnitedHealth where executives testified that using competitor data would violate an existing firewall and risk grave harm to its business, which is premised on serving customers who trust that firewall.

While not a vertical case, similar economic incentive theories underpinned the DOJ's case in Booz Allen, but the court rejected the DOJ expert's theory that the company would compete less aggressively for the Optimal Decision contract in light of contrary fact and economic expert witness testimony laying out the counterincentives.

Courts apply more stringent legal standards than the agencies would like.

The government has advocated for legal standards that would lower its burden of proof in merger cases, but the courts have not been receptive.

- Regulators have suggested any merger that may lessen competition is unlawful under the Clayton Act.[5] Courts demand reasonable likelihood that a proposed transaction will substantially harm competition.

- The court rejected the government's proposed quick look standard in Booz Allen.

- In terms of litigating the fix, the law is not clear whether it needs to be assessed as part of the prima facie case or it is a rebuttal to that case once made. Judge Nichols in UnitedHealth found that, regardless of the standard, the ultimate question is whether the transaction, including the fix, is likely to substantially lessen competition.[6] Replicating 100% of the pre-merger competition is not required, contrary to the government's position.

Courts focus on hot documents and strong customer complaints.

Courts want real-world evidence,[7] and that often comes through party documents and testimony from affected customers or competitors.

Hot documents that support the government's theory are essential. But when the government strains to make a document hot by stretching its meaning, courts have not been persuaded. This was the case in Booz Allen where the DOJ attempted to make documents seem hot when they were readily explainable.

If there are no strong complainants and the supposedly harmed customers or competitors are not worried about a deal, the government struggles to make its case. In UnitedHealth, for example, the court rejected expert-based theory where credible industry witnesses offered factual testimony that undercut that economic theory.

Market definition remains critical even though the government wants to downplay it in some cases.

The government would like to refocus merger analysis away from market definition in some cases, suggesting that showing anti-competitive harm at some level should be sufficient without precisely defining the market.[8] But in Booz Allen, Judge Blake demanded the government prove the market as part of its prima facie case and found that "the government has not sufficiently defined the relevant economic market at this stage."[9]

Likewise, in U.S. Sugar, Judge Noreika rejected both the DOJ's proposed product market limited to sugar producers for failing to include distributors and failing to distinguish between different types of customers,[10] and its proposed southeastern U.S. geographic market because the evidence showed that sugar flows throughout the U.S..[11] The failure of the narrow alleged market doomed the DOJ's case.

What does this mean?

The agencies continue to emphasize they intend to keep bringing difficult cases.[12] But the results of these recent litigations show parties can prevail before impartial judges appointed by Republicans or Democrats.

To posture difficult matters to succeed, parties should leave enough time to litigate in their merger agreements, and they should strongly consider robust and early fixes to undermine the government's ability to obtain a structural presumption of anti-competitive harm.

Having a good divestiture buyer and a good asset package is essential. Parties who nickel and dime this give the government ammunition to attack the fix as being inadequate. When the government gets that structural presumption, it wins. When it does not have that shortcut and has to try a full rule of reason case, it has a difficult time in court.

We expect the FTC and the DOJ will use their forthcoming merger guidelines to try to migrate the standards for merger review to be more restrictive than the current guidelines are. The guidelines do not have the force of law and courts may reject the forthcoming guidelines in the same way they have rejected the recent challenges if they try to move the government's assessment and policies beyond the case law.

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[1] Memorandum Opinion, U.S. v. Booz Allen Hamilton Inc., No. 1:22-cv-01603, Dkt. 227 at 9 (Oct. 17, 2022).

[2] Initial Decision, In the Matter of Illumina, Inc. and GRAIL, Inc., No. 9401, at 178 (Sept. 9, 2022).

[3] See, e.g., Memorandum Opinion, U.S. v. UnitedHealth Group Inc., No. 1:22-cv-0481, Dkt. 138 (Sept. 21, 2022).

[4] See, e.g., Booz Allen, at 14 ("The Government's theory of human behavior is far too reductive. It is hard to believe the defendants' employees were vigorously competing earlier this year, but stopped competing once the Proposed Acquisition was announced, only to continue competing once the Government brought this litigation, and will again stop competing if the court denies the Government's motion.").

[5] See, Respecting the Antitrust Laws and Reflecting Market Realities, prepared remarks from Assistant Attorney General Jonathan Kanter, Keynote Speech at Georgetown Antitrust Law Symposium, available at https://www.justice.gov/opa/speech/assistant-attorney-general-jonathan-kanter-delivers-keynote-speech-georgetown-antitrust.

[6] See, UnitedHealth, at 13-14.

[7] Id., at 33.

[8] See, Respecting the Antitrust Laws and Reflecting Market Realities ("We obsess in all cases about market definition, when in many situations direct evidence can help us assess the potential for harm.").

[9] See, Booz Allen, at 18.

[10] Memorandum Opinion, U.S. v. U.S. Sugar Corporation, No. 1:21-cv-01644, Dkt. 242, at 27 (Sept. 23, 2022).

[11] Id., at 32.

[12] See, Assistant Attorney General Jonathan Kanter of the Antitrust Division's Testimony Before the Senate Judiciary Committee Hearing on Competition Policy, Antitrust, and Consumer Rights, September 20, 2022, available at https://www.justice.gov/opa/speech/assistant-attorney-general-jonathan-kanter-antitrust-division-testifies-senate-judiciary.