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HSR CLEARANCE: SECURITY BLANKET OR FALSE SENSE OF SECURITY FOR MERGING PARTIES?

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"The Division's decision not to challenge a particular transaction is not confirmation that the transaction is competitively neutral or procompetitive."[1]

Credit for the quotation above goes to the Antitrust Division of the U.S. Department of Justice ("DOJ") in its amicus brief filed in the United States Court of Appeals for the Fourth Circuit in *Steves and Sons, Inc. v. Jeld-Wen, Inc.* ("*Steves*"). The Division stated a truth that is often forgotten by merging parties in the glow of their transaction making its way out of the merger review process under the Hart-Scott-Rodino Improvements Act of 1976 ("HSR Act") without an agency challenge. But, as the Division made plain, HSR clearance does not immunize the transaction from later scrutiny from either the antitrust enforcement agencies or, in light of the Fourth Circuit's recent decision affirming the United States District Court for the Eastern District of Virginia's divestiture order in the *Steves* case, from challenges brought by private litigants.

The vast majority of transactions that go through the HSR review process are not challenged by the antitrust enforcement agencies. Agency challenges to consummated transactions that went through the HSR clearance process are exceedingly rare (less rare—but still unusual—are agency challenges to consummated transactions that did not go through HSR review). And, until the *Steves* case, the idea of a successful private challenge to a consummated transaction resulting in a divestiture order was, even if theoretically possible, a risk that could be largely dismissed as non-existent—it had never happened.

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That is why the *Steves* case warrants attention. The divestiture order in *Steves*—now affirmed by the Fourth Circuit, which also denied Jeld-Wen's request for re-hearing *en banc*—makes real the risk, however rare, that private merger enforcement can upend consummated transactions cleared through DOJ or FTC review.[2] In the *Steves* case, the result will be the effective unwinding of a transaction that was nearly nine years post-close. And even if *Steves* is an outlier, merging parties need to understand how it came to pass to avoid a similar fate.

This article begins with brief summaries of the *Steves* case and the HSR merger review process, including some of the factors that informed the antitrust agencies' decisions whether to challenge a transaction. We continue with an exploration of certain deal and industry characteristics that increase the risk of a private merger challenge but that also demonstrate the result in *Steves* is unlikely to be repeated often. The article concludes with some suggestions about how buyers can protect themselves from such a challenge, however rare they may be.

The *Steves* Litigation

In 2012, Jeld-Wen, a manufacturer of both doorskins (decorative coverings of interior molded doors) and molded doors, acquired Craftmaster International, a rival manufacturer of doorskins. The transaction would result in the number of doorskin manufacturers going from three to two. The parties made an HSR filing with the DOJ and the FTC. Following an investigation by the DOJ, it was cleared without challenge. Notably, just prior to the acquisition, Jeld-Wen entered into a long-term supply agreement for doorskins with its customer and competitor for molded doors, Steves & Sons ("S&S"), that included provisions governing the prices Jeld-Wen could charge S&S. The district court described this agreement as "part of [Jeld-Wen's] plan to secure merger approval."[3]

In 2014, Jeld-Wen requested a price increase from S&S that, according to S&S, was not permitted under the 2012 supply agreement, which S&S rejected. Jeld-Wen then gave notice that it would terminate the supply agreement effective September 2021 per the contract terms. In 2016,

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following another investigation by the DOJ prompted by a 2015 complaint from S&S that resulted in no action, S&S sued Jeld-Wen, alleging that the Craftmaster acquisition violated the Clayton Act. The jury delivered a verdict in S&S's favor, and S&S asked the court, among other things, to require Jeld-Wen to divest the facility S&S acquired with Craftmaster. The court granted S&S's request, marking the first time in which a court ordered a divestiture in a private challenge of a merger cleared under the HSR Act, which Congress passed in 1976. S&S appealed, and the Fourth Circuit affirmed the district court's divestiture order.

Factors Influencing HSR Merger Reviews

Prior to the passing of the HSR Act, merging parties were not required to notify the government prior to closing a merger. As a result, the vast majority of government merger challenges were (by default) post-close, creating an uphill battle for the government in court. The balance of hardships typically weighed in favor of the already combined company. This dynamic changed with the passing of the HSR Act, which requires parties to transactions that meet certain thresholds to obtain government clearance before closing.

The vast majority of reportable transactions obtain clearance without any substantive review. Some reportable deals are investigated during the initial 30 days after filing (the "initial waiting period"), or 60 days in the case of a pull-and-refile, and then cleared to close.[4] And only a small percentage of deals result in a formal investigation and issuance of a Second Request.[5] Following a formal investigation, the antitrust agencies have three options: (1) clear the transaction to close; (2) agree with the merging parties on a remedy that addresses competitive concerns about the transaction; or (3) challenge the transaction in court.

As the DOJ pointed out in its amicus brief in *Steves*, there are several factors that the antitrust agencies consider when deciding whether to challenge a transaction, including:

- **Enforcement Priorities.**[6] Enforcement priorities derive from agency and section heads, the presidential administration, Congress, public pressure, and current economic and antitrust scholarship. When deciding how to allocate limited resources, the agencies often give precedence to these priorities over other potential enforcement activities. The current focus on Big Tech and ensuing launch of the Technology Enforcement Division is an example of this factor at work.[7]

- **Potential to Create Unhelpful Precedent.**[8] When the agencies litigate merger challenges they risk creating unhelpful precedent that could hamstring a future enforcement action. Therefore, they consider not only the facts and likely arguments of a particular case, but also how the use of certain facts and structure of certain arguments could have unintended consequences for the agencies' enforcement activities in the future.

- **Litigation Risk.**[9] Finally, and related to the above, the agencies also consider the likelihood of winning in court. Over the years, the agencies' record in court has varied, but the agencies have recently had a strong track record in litigation, in part because of

careful case selection. This factor may deter some merging parties from litigating a government challenge, which may feel like an uphill fight.[10]

- **Agency Resources.**[11] From the outside, it may seem like the agencies have unlimited resources (especially when litigating). But like all aspects of government, they are constrained by annual budgets and attorney headcounts. Leadership at both the DOJ and the FTC have claimed that their budgets are too low and they need more staffing to handle their case volume. Thus, the agencies must constantly evaluate how best to allocate their resources to effectively enforce the antitrust laws.

These factors all relate to the institutional prerogatives of the enforcement agencies. They do not, however, inform whether a transaction violates the Clayton Act,[12] which is why the district court excluded evidence that the DOJ twice chose not to challenge Jeld-Wen's acquisition of Craftmaster.[13] As the Fourth Circuit noted, the evidence of the DOJ's decisions not to challenge the transaction could have misled the jury to infer that the DOJ determined the transaction was lawful. Thus merging parties can only take limited comfort in agency inaction.

While *Steves* reminds us that enforcement agency (in)action does not immunize a transaction from a challenge brought by a private litigant, it also teaches us that there are several, specific characteristics that increase the odds (and likelihood of success) of a private challenge to a transaction.

The Perfect Plaintiff

The institutional prerogatives that influence an enforcement agency's decision to challenge a transaction do not, however, govern or constrain private plaintiffs. There are different constraints on private plaintiffs to be sure—including, not insignificantly, litigation costs that may not be recouped where divestiture is the primary form of relief sought.[14] But existential risks to a plaintiff's business resulting from a consummated merger—risks that the enforcement agencies do not face—are a significant motive to litigate even when the costs to do so are high and the likelihood of recovery is uncertain.

The *Steves* case illustrates some industry and deal characteristics that may make it more likely that a private challenge will emerge post-close. While no single characteristic is determinative, each should be considered in a potential transaction when assessing current and future antitrust risk.

Concentrated Market. A more concentrated market means fewer options for customers after an acquisition of a rival firm. This, in turn, creates an incentive for customers to complain about the transaction to the agencies during a HSR merger review or as a private plaintiff.

The relevant market at issue in *Steves* was highly concentrated prior to the merger.[15] Jeld-Wen's acquisition of Craftmaster reduced the number of suppliers from three to two. As the Fourth Circuit noted, the increase in concentration well exceeded the HHI threshold for S&S to make a *prima facie* showing that the transaction substantially lessened competition. This alone may have given S&S reason to complain given the significant increase in relative concentration and S&S's shrinking supplier options. But soon after the transaction, the only other supplier

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exited the market, leaving S&S with nowhere to turn when Jeld-Wen attempted to raise prices and reduce non-price related services. S&S's inability to turn elsewhere for supply created the existential threat to its business that laid the groundwork for its showing of irreparable harm necessary for injunctive relief in the form of a divestiture order. It goes without saying that not every potential plaintiff will be able to make that same showing.

Customer/Competitor Relationship. Customers that are also competitors have extra incentive to complain (justified or not) about or to challenge a transaction. Normal competitive conduct, when viewed in the context of a customer/competitor relationship, may appear more sinister after an acquisition. In *Steves*, Jeld-Wen was vertically integrated, so it both supplied doorskins to and competed with S&S in the sale of molded doors. But after the acquisition, Jeld-Wen became the only remaining doorskin supplier for S&S while still remaining its competitor in molded doors—a dual role that heightened the conflict between the two.[16]

Failing to Abide by Long-Term Supply Agreements. When merging parties use long-term supply agreements with customers to facilitate HSR clearance, they need to be prepared to abide by those agreements post-closing. The failure (or perceived failure) to live up to those agreements later may turn customers into potential antitrust plaintiffs. In *Steves*, Jeld-Wen entered into a long-term supply agreement with S&S before notifying the DOJ about the transaction. The court believed Jeld-Wen entered into these long-term agreements to "allay concerns about the merger's potential anticompetitive effects."[17] Thus, after the transaction closed, when Jeld-Wen attempted to alter and then cancelled the long-term supply agreement with S&S, it spurned one of the parties it used to "buy" merger peace. Merging parties that use long-term supply agreements in an attempt to temper customer complaints during the HSR review process should be mindful that the risk of a customer complaint or a challenge to the transaction does not end at agency clearance.

Industry Is Not an Agency Focus. A private plaintiff may be more likely to bring a suit in an industry that is not a focus for the agencies, or where there are concerns about under-enforcement by the government. As noted above, several factors go into the agencies' decisions to investigate and potentially challenge a merger, including agency resources. In *Steves*, despite two investigations, the DOJ never pursued any meaningful enforcement action against Jeld-Wen.[18] S&S could either accept Jeld-Wen's terms or pursue its private antitrust claims against Jeld-Wen.

Private litigation is explicitly authorized by the Clayton Act, allowing plaintiffs to act as private enforcers of federal antitrust law.[19] As a result, the agencies' lack of enforcement activity in an industry incentives private litigants to fill the enforcement gap. Thus, while a lack of agency interest is often viewed as a blessing for aspiring merger partners, it does not necessarily foreclose private plaintiffs.

Post-Close Conduct. The facts that gave rise to S&S' complaint reveal the most significant lesson from the case. According to the Fourth Circuit's opinion, after the 2012 acquisition and after Jeld-Wen's successful efforts to obtain customer support for the transaction, Jeld-Wen

took actions inconsistent with its pre-transaction treatment of customers like S&S in violation of its long-term supply agreement with S&S. For example, Jeld-Wen provided notice of price increases unavailable under the supply agreement, lowered the quality of its products, and tightened its reimbursement policy for defective product. When Jeld-Wen gave notice it was terminating the long-term supply agreement in 2014, it effectively shut out S&S from the only available supply of a critical input—driving S&S to bring litigation. Each of these actions weighed against Jeld-Wen at trial where it fought to defend a transaction that, based on traditional HHI analysis, substantially increased concentration in the relevant market.

The record in the Fourth Circuit and district court opinions also highlight the litigation off-ramps that the parties did not take. That is, after S&S notified Jeld-Wen about its potential antitrust suit, Jeld-Wen appears to have done little to settle the dispute. Did the DOJ's multiple closed investigations or the historical lack of divestiture orders in private merger cases convince Jeld-Wen that it faced little or no risk of a court order unwinding the transaction? In hindsight, a benefit future buyers have, the risk was real and may have been avoidable.

Finally, though not a factor that makes a private challenge more likely, the structure of the challenged transaction can increase the likelihood of a divestiture order if a private litigant prevailed in its merger challenge. For several years, the antitrust agencies have been moving away from conduct remedies that govern the behavior of the combined company post-close for some period of time, favoring instead structural remedies such as divestitures. The Fourth Circuit's opinion in the *Steves* case provides support for this approach by calling out the difficulties enforcers face in managing behavioral remedies.[20] Post-close, however, it can be difficult to "unscramble the egg" once the buyer and seller have combined their operations. But, transactions that result in a wholly-owned subsidiary or the acquisition of standalone facilities are better candidates for a preferred post-closing structural remedy to address anticompetitive harm. In *Steves*, Jeld-Wen acquired a standalone production plant that operated (with capital improvements) fairly independent from the rest of Jeld-Wen. This transaction structure made it more palatable for the district court to order divestiture. While any divestiture will be messy, the court in *Steves* felt confident enough to cleave off the acquired plant to remedy the alleged anticompetitive conduct.[21]

How Do I Protect Myself?

Steves is a cautionary tale that buyers and their counsel can use as a reference for putting protections in place to minimize the still limited risk of a private challenge to a transaction that has cleared DOJ or FTC review. Though it is impossible to eliminate all risk of such a challenge, below are a few ways buyers can minimize the possibility of the *Steves* outcome.

Pre-Signing Risk Assessment. Where there is potential antitrust risk, merging parties often perform a pre-signing risk assessment. This assessment, however, generally focuses on the risk of a government challenge, not a private challenge. Post-*Steves*, merging parties should consider the likelihood of a private challenge post-close, using the characteristics described above as a starting point for this analysis. Sellers

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may be reluctant to perform this analysis since the risk of a post-close challenge will be borne solely by the buyer. But assessing the possibility of a private challenge is not overly burdensome and, likely, incremental to the assessment of the risk of a government challenge. For example, counsel and the parties should consider the expected reaction of customers and competitors to the deal, including the alternative sources of supply.

Merger Agreement. Where there is a risk of a government challenge to the transaction, merger agreements often include protections for both buyers and sellers—both of which can be harmed if the transaction does not obtain HSR clearance to close. Protections built into merger agreements related to post-close challenges are far less common, largely because the seller may not have any interest in the combined business. Sellers are not likely to agree to additional antitrust protections for the buyer in the merger agreement to cover this risk, *e.g.*, express indemnification for such a challenge, or to a reduction in purchase price that reflects the risk of such a challenge because private merger enforcement is rare, and likely will continue to be rare post-*Steves*. In addition, sellers will be wary of any obligation that arises from the buyer's post-transaction conduct (as in the *Steves* case). In other words, since the buyer is in control post-closing, it may have the ability to avoid or cause the litigation. Moreover, any additional antitrust protections in the merger agreement could risk the unintended consequence of piquing the interest of the reviewing antitrust agency.

Nevertheless, where the buyer determines the risk of a challenge is particularly high, the buyer could try to negotiate language in the seller's "Litigation" representation and warranty in the merger agreement that covers actions that threaten not just consummation of the transaction, but the transaction itself. If the buyer can show the seller had (or should have had) knowledge of a threat of private antitrust enforcement, it could rely on a breach of this representation and warranty as indemnification for defending the private merger challenge. Establishing the seller's actual or constructive knowledge of risk, however, is easier said than done. Though the seller's participation in a pre-signing risk assessment of a private challenge to the deal would be helpful evidence of such knowledge. And, of course, the buyer's ability to recover ultimately will depend on whether the seller still exists post-close in some form.

Post-Close Conduct. The most important—and perhaps easiest—thing a buyer can do to avoid a private challenge to the transaction post-close is to moderate post-close conduct. The lesson from the *Steves* case is that HSR clearance should not lull a buyer into thinking a transaction is immune from challenge down the line post-consummation. If the buyer or seller enters into a long-term supply agreement with a customer to assuage concerns about the transaction, it should not be just for "show." If down the road, the buyer needs to alter the agreement, it should confer with antitrust counsel before doing so, especially if market dynamics have changed since the signing of the long-term supply agreement. The company should conduct a careful evaluation of the increased antitrust risk from abandoning such an agreement and weigh that risk against the business objectives. Separately, it would not be surprising to see customers use *Steves* as leverage to get (and keep) better terms from merging parties in any negotiations around long-

term supply agreements leading up to a transaction or in discussions about renewing such agreements post-closing. Again, the buyer should confer with antitrust counsel should such demands be made.

Conclusion

The *Steves* case makes real the threat of litigants obtaining divestiture orders through private enforcement of the Clayton Act. That threat, though, is still limited and unlikely to affect the vast majority of transactions. Nonetheless, it cannot be ignored entirely. Buyers should not view an enforcement agency's decision not to challenge a transaction as a "free pass" to do what they like post-close. There may not be additional protections available (or agreeable) for the buyer to put in the merger agreement to limit its exposure to a post-close private merger challenge. But there is work the buyer and its counsel can do to assess the risk of private merger enforcement pre-signing, and moderate its conduct post-close to minimize that risk.

The views and opinions set forth herein are the personal views or opinions of the authors; they do not necessarily reflect views or opinions of the law firm with which they are associated.

ENDNOTES:

[1]Brief for the United States of America as Amicus Curiae in Support of Appellee Steves and Sons, Inc., at *15.

[2]Transactions that fall below HSR thresholds or are exempt under HSR rules are not reportable and in the vast majority of cases, are never reviewed by one of the antitrust agencies prior to close. These transactions also are vulnerable to challenge post-consummation by a private plaintiff or government entity.

[3]*Steves & Sons, Inc. v. JELD-WEN, Inc.*, 345 F. Supp. 3d 614, 630 (E.D. Va. 2018).

[4]In 2019, 74.2% of deals requested early termination and the FTC granted 73.5% of these requests, equating to approximately 54.5% of all deals receiving early termination. *Hart-Scott-Rodino Annual Report*, Federal Trade Commission Bureau of Competition & U.S. Department of Justice Antitrust Division (2019) at 6 (hereinafter "HSR Report"), *available at* https://www.ftc.gov/system/files/documents/reports/federal-trade-commission-bureau-competition-department-justice-antitrust-division-hart-scott-rodino/p110014hsrannualreportfy2019.pdf.

[5]In 2019, only 3% of reported transactions resulted in a Second Request. *Id.* at 6.

[6]*Prepared Statement of FTC Commission Acting Chairwoman Rebecca Kelly Slaughter Before the Subcommittee on Antitrust*, The Federal Trade Commission (Mar. 18, 2021) at 5-6 (hereinafter "Slaughter Speech"), *available at* https://www.ftc.gov/system/files/documents/public_statements/1588320/p180101_prepared_statement_of_ftc_acting_chairwoman_slaughter.pdf.

[7]*See FTC's Bureau of Competition Launches Task Force to Monitor Technology Markets*, The Federal Trade Commission (Feb. 26, 2019); *see also Intent to Nominate Lina Khan for Commissioner of the Federal Trade Commission*, The White House (Mar. 22, 2021); *Senator Klobuchar Introduces Sweeping Bill to Promote Competition and Improve Antitrust Enforcement*, Amy Klobuchar (Feb. 4, 2021).

[8]*See Rewriting History: Antitrust Not As We Know It . . . Yet*, Remarks of J. Thomas Rosch before the ABA Antitrust Spring Meeting (Apr. 23, 2010) at 14, *available at* https://www.ftc.gov/sites/default/files/documents/public_statements/rewriting-history-antitrust-not-we-know-it. . . yet/100423rewritinghistory.pdf.

[9]Slaughter Speech at 4.

[10]For example, in 2019, the FTC brought 21 merger enforcement challenges. Of the 21, 10 were the result of proposed consent decrees. Nine were abandoned. HSR Report at 9.

[11]*Steves and Sons, Inc. v. JELD-WEN, Inc.*,

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988 F.3d 690, 714, 2021-1 Trade Cas. (CCH) ¶ 81547 (4th Cir. 2021) (hereinafter "*Steves*"); *Antitrust Division Manual*, The United States Department of Justice (Fifth Ed.) at III-7, *available at* https://www.justice.gov/atr/file/761166/download.

[12]Section 18 of the Clayton Act (15 U.S.C.A. § 18) specifically prohibits "acquisition [whose effect] may be substantially to lessen competition, or to tend to create a monopoly."

[13]*Steves* at 713-15.

[14]The Clayton Act does, however, permit the recovery of "reasonable attorney's fee[s]" for a prevailing plaintiff. 15 U.S.C.A. § 4304.

[15]*Steves* at 699-701.

[16]*Id.*

[17]*Steves* at 700.

[18]*Id.* at 700, 702.

[19]15 U.S.C.A. § 18.

[20]*Steves* at 706, 720-21.

[21]*Steves* at 721.

DELAWARE COURT ENJOINS AN "EXTREME" STOCKHOLDER RIGHTS PLAN

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On February 26, 2021, Vice Chancellor Kathaleen S. McCormick of the Delaware Court of Chancery permanently enjoined a stockholder rights plan—or so-called "poison pill"—with a 5% trigger[1] that The Williams Companies, Inc. ("Williams" or the "Company") adopted at the beginning of the COVID-19 pandemic. In a lengthy post-trial opinion,[2] Vice Chancellor McCormick reviewed the rights plan under the *Unocal* standard and determined that the members of the Williams board of directors breached their fiduciary duties by adopting it, rendering it unenforceable.

The decision is a reminder that although rights plans remain an important tool, boards of directors should carefully consider and evaluate them before adoption based on a company's particular facts and circumstances.

Background

On March 19, 2020, the Williams board of directors adopted a one-year stockholder rights plan in response to the severe decline of Williams' stock price resulting from plummeting oil prices and the unprecedented COVID-19 pandemic, and concerns about opportunistic activist stockholders acquiring a substantial position in the Company.[3] In the press release announcing the adoption of the rights plan, Williams noted that the rights plan "is intended to enable all Williams stockholders to realize the full potential value of their investment in the company and to protect the interests of the company and its stockholders by reducing the likelihood that any person or group gains control of Williams through open market accumulation or other tactics (especially in recent volatile markets) without paying an appropriate control premium."

The Williams rights plan included two key features on which the court focused: (i) a 5% trigger and (ii) an expansive "acting in concert"[4] provision. Although Institutional Shareholder Services had relaxed its rights plan policy in light of the pandemic, it recommended that stockholders vote against the reelection of the chairman of the board at Williams' 2020 annual meeting of stockholders, opining that the low 5% trigger threshold was "problematic" and that the rights plan "was not a reaction to an actual threat—real or perceived—of an activist investor or hostile bidder."

Delaware Chancery Court Opinion

Williams stockholders sued to permanently enjoin the rights plan and for the court to declare it unenforceable. In her ruling, after first deciding that such claims were properly brought directly by stockholders against the Company and its board (not derivatively, on behalf of the Company), Vice Chancellor McCormick wrote that it is "settled law" that adoption of a rights plan must be analyzed under the so-called enhanced scrutiny *Unocal* standard. In applying the two-part *Unocal* framework, the court examined first whether directors could demonstrate that they acted in good faith "to serve a legitimate corporate objective by responding to a legitimate threat," and second whether the response by the board of directors was "reasonable in relation to the threat posed."

With respect to the first prong, the court reviewed three areas of focus the Williams board had identified: (i) deterring a general threat of stockholder activism at a time of uncertainty and a low stock price, (ii) insulating "the board from activists pursuing 'short-term' agendas and from distraction and disruption generally," and (iii) addressing a concern about a "lightning strike," where "a stockholder might stealthily and rapidly accumulate large amounts of stock" that would otherwise "go undetected under the federal disclosure regime." The court referred to each of these threats as "purely hypothetical," as the Williams board was not aware of any actual activist activity relating to the company. Following a lengthy analysis, Vice Chancellor McCormick concluded that abstract concerns about activism "untethered to any concrete event" were not cognizable threats under the first prong of the *Unocal* standard. However, without deciding the issue, the court assumed for purposes of analysis that detecting a lightning strike at a time when the stock price undervalues a corporation was a legitimate purpose.

Vice Chancellor McCormick then analyzed whether adopting this rights plan was within a range of reasonable responses to the threat posed and concluded that the plan's "combination of features created a response that was disproportionate to [the] stated hypothetical threat." The court emphasized the unusual nature of the 5% trigger, noting that of the precedent rights plans identified by Williams' banker, only 2% had triggers below 10%. The court further noted that the Williams rights plan was one of only nine rights plans to ever use a 5% trigger (outside the NOL context). The court also expressed concern for certain other features of the rights plan, including the definitions of "beneficial ownership" and "passive investor."

The court was particularly critical of the "acting in concert" provision as being overly broad and vague, with a potential "chilling effect" on stockholder communications. In addition, the

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court described a "daisy chain" concept included in the rights plan that would trigger the plan if "stockholders act in concert with one another by separately and independently 'Acting in Concert' with the same third party"—which "operates to aggregate stockholders even if members of the group have no idea that the other stockholders exist." The court did not specifically discuss the inclusion of derivative interests in the definition of beneficial ownership, a provision that has become quite common in recent rights plans. Ultimately, the court concluded that the rights plan did not fall within a range of reasonable responses to the purported threat and enjoined the rights plan.

Key Takeaways

Despite the court's ruling in *Williams*, rights plans remain an important and valuable tool when companies are faced with an unsolicited tender offer or an activist threat. Given the approach the *Williams* court took, a corporate board contemplating adoption of a rights plan should be prepared for the Delaware courts to scrutinize its decision under a heightened standard and to ascertain whether there is a legitimate, identified threat to the corporation to support the decision to adopt a rights plan. Accordingly, rights plans should be appropriately tailored to both the company's particular circumstances and threat posed.

In light of the *Williams* decision, companies should exercise extreme caution before adopting a rights plan with a 5% trigger threshold (outside of the NOL context) and review closely "acting in concert" provisions that could be viewed as having a chilling effect on stockholder communications, similar to the Williams rights plan.

It is also noteworthy that the court appeared critical of the board's process leading to the adoption of the rights plan. Proper board preparation and discussion to ensure that directors have a clear understanding of all the key terms of a rights plan and how such terms may differ from other rights plans, and proper documentation of the reasons for a board's determination to adopt a rights plan, are therefore critical.

In order to be able to move expeditiously when circumstances warrant, it remains prudent practice to have a rights plan "on the shelf" that is carefully reviewed and understood by the board of directors (including through advice from outside counsel and other advisers in advance), and which can be tailored to the relevant circumstances at the time of adoption.

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ENDNOTES:

[1]Practically speaking, the rights plan is triggered if a person or a group acquires beneficial ownership of at least 5% of the company's outstanding shares.

[2]*The Williams Companies Stockholder Litigation*, C.A. No. 2020-0707-KSJM (Del. Ch. Feb. 26, 2021).

[3]It should be noted that a number of companies adopted rights plans in 2020 in light of the COVID-19 pandemic and associated stock price declines. According to the research firm Deal Point Data, at least 74 other companies adopted a non-NOL (net operating loss carryforwards) stockholder rights plan in 2020.

[4]These provisions intend to prevent a group

of stockholders (often activist hedge funds) from sharing strategies and goals with respect to a campaign against the target company.

COMPETITION AGENCIES LAUNCH CROSS-BORDER PHARMACEUTICAL MERGER WORKING GROUP

By Andrew Finch, Charles "Rick" Rule, Aidan Synnott, and Krishna Veeraraghavan

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Competition authorities in the U.S., Canada, UK and the European Union have formed a pharmaceutical merger working group aimed at updating merger analysis in this industry. This initiative, with its focus on a particular industry, appears to be unique and serves a reminder that issues involving pharmaceuticals are at the forefront of many enforcers' agendas.

On March 16, the U.S. Federal Trade Commission ("FTC"), the Antitrust Division of the U.S. Department of Justice, certain state attorneys general, the Canadian Competition Bureau, the UK Competition and Markets Authority ("CMA"), and the European Commission Directorate General for Competition announced the launch of a multilateral working group to examine mergers in the pharmaceutical industry. According to the agencies,[1] the goal of the working group is "to identify concrete and actionable steps to review and update the analysis of pharmaceutical mergers."

The European Commission Directorate General for Competition said[2] that the initiative "will bring enhanced scrutiny and more detailed analysis of these kinds of mergers in the future, for the benefit of consumers." The head of the CMA said that "it is essential that competition authorities work together to protect consumers from any anti-competitive deals." The FTC, which is an impetus for the working group, said that the "project will ensure that FTC investigations include fresh approaches that fully analyze and address the varied competitive concerns that these mergers and acquisitions raise."[3]

The FTC listed several "questions to be considered":

- How can current theories of harm be expanded and refreshed?
- What is the full range of a pharmaceutical merger's effects on innovation?
- In merger review, how should we consider pharmaceutical conduct such as price fixing, reverse payments, and other regulatory abuses?
- What evidence would be needed to challenge a transaction based on any new or expanded theories of harm?
- What types of remedies would work in the cases to which those theories are applied?
- What have we learned about the scope of assets and characteristics of firms that make successful divestiture buyers?

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Acting FTC Chairwoman Rebecca Kelly Slaughter in particular has been critical of certain pharmaceutical mergers in the past. For example, in May 2020 she dissented from a Commission action accepting a consent order[4] relating to AbbVie's acquisition of Allergan. That order allowed the acquisition to proceed subject to divestiture of Allergan's assets and rights for certain drugs. In her dissent,[5] then-Commissioner Slaughter expressed general concern about the potential effects of pharmaceutical mergers on innovation. She wrote that "it is essential to scrutinize closely whether a merger is likely to diminish innovation competition by incentivizing the merged firm to curtail its innovative efforts, including investment in research and development, below the level that would prevail in the absence of the merger." To conduct such an analysis, she argued that the FTC should collect "past evidence of innovation in an industry" as well as "information about what parties and other stakeholders in the industry predict about future competition." She also expressed "concerns . . . about the proposed divestitures and the absence of meaningful benefits to consumers." She also made innovation-related arguments in her dissent[6] in the Bristol-Myers Squibb and Celgene matter. Acting Chairwoman Slaughter has also previously argued that the FTC "should carefully examine and aggressively employ new ways to utilize our enforcement tools that restore competition and eliminate unfair or deceptive acts or practices in the pharmaceutical industry."[7]

Significance

Many competition agencies around the world have investigated mergers and other matters in the pharmaceutical industry in recent years. And many of the agencies involved in the pharmaceutical merger working group often work together—bilaterally or multilaterally—on specific mergers and other competition investigations and on policy matters, including through organizations such as the International Competition Network or the Organisation for Economic Co-operation and Development ("OECD"). However, this initiative, with its focus on a particular industry, appears to be unique. While each jurisdiction will have its individual competition laws and outcomes, the formation of the working group is a reminder that issues involving pharmaceuticals are at the forefront of many enforcers' agendas.

ENDNOTES:

[1] https://ec.europa.eu/commission/presscorner/detail/en/ip_21_1203.

[2] https://ec.europa.eu/commission/presscorner/detail/en/ip_21_1203.

[3] https://www.ftc.gov/news-events/press-releases/2021/03/ftc-announces-multilateral-working-group-build-new-approach.

[4] https://www.ftc.gov/system/files/documents/cases/191_0169_c4713_abbvie_and_allergan_-_do_0.pdf.

[5] https://www.ftc.gov/public-statements/2020/05/dissenting-statement-commissioner-rebecca-kelly-slaughter-regarding.

[6] https://www.ftc.gov/system/files/documents/public_statements/1554283/17_-_final_rks_bms-celgene_statement.pdf.

[7] https://www.ftc.gov/system/files/documents/public_statements/1531606/p180101_section_5_report_dissenting_statement_by_chopra_and_slaughter_6-27-19.pdf.

2020 YEAR-END ACTIVISM UPDATE

By Barbara L. Becker, Richard J. Birns, Eduardo Gallardo, Saee Muzumdar and Daniel S. Alterbaum

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The following has been prepared for general informational purposes only and is not intended as legal advice.

This article provides an update on shareholder activism activity involving NYSE- and Nasdaq-listed companies with equity market capitalizations in excess of $1 billion and below $100 billion (as of the last date of trading in 2020) during the second half of 2020. (See our previous articles on activism in the June and the November-December 2020 issues of *The M&A Lawyer*.)

Announced shareholder activist activity increased relative to the second half of 2019. The number of public activist actions (35 vs. 24), activist investors taking actions (31 vs. 17) and companies targeted by such actions (33 vs. 23) each increased substantially. On a full-year basis, however, owing to the market disruption caused by the COVID-19 pandemic, 2020 represented a modest slowdown in activism versus 2019, as reflected in the number of public activist actions (63 vs. 75), activist investors taking actions (41 vs. 49) and companies targeted by such actions (55 vs. 64). During the period spanning July 1, 2020 to December 31, 2020, two of the 39 companies targeted by activists—CoreLogic, Inc. and Monmouth Real Estate Investment Corporation—were the subject of multiple campaigns. CoreLogic, Inc. was the subject of an activist campaign led by Cannae Holdings and Senator Investment Group; their efforts, in turn, ultimately drew the support of Pentwater Capital Management LP. In addition, certain activists launched multiple campaigns during the second half of 2020: Elliott Management, NorthStar Asset Management, and Starboard Value. These three activists represented 23% of the total public activist actions that began during the second half of 2020.

The rationales for activist campaigns during the second half of 2020 changed in certain respects relative to the first half of 2020. Over both periods, board composition and business strategy represented leading rationales animating shareholder activism campaigns, representing 55% of rationales in the first half of 2020 and 49% of rationales in the second half of 2020. M&A (which includes advocacy for or against spin-offs, acquisitions and sales) took on increased importance; the frequency with which M&A animated activist campaigns rose from 9% in the first half of 2020 to 19% in the second half of 2020. At the opposite end of the spectrum, management changes, return of capital and control remained the most infrequently cited rationale for activist campaigns. (Note that the above-referenced percentages total over 100%, as certain activist campaigns had multiple rationales.)

These themes are all broadly consistent with those observed in 2019. Proxy solicitation occurred in 14% of campaigns for the second half of 2020 and for 17% of campaigns in 2020

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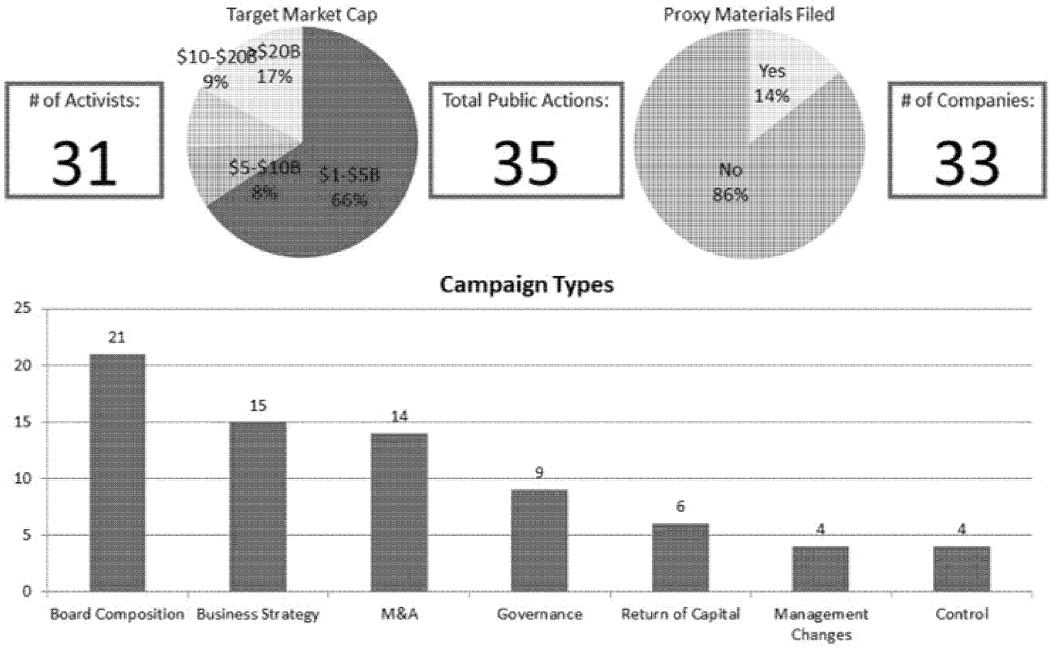
overall. These figures represent modest declines relative to 2019, in which proxy materials were filed in approximately 30% of activist campaigns for the entire year.

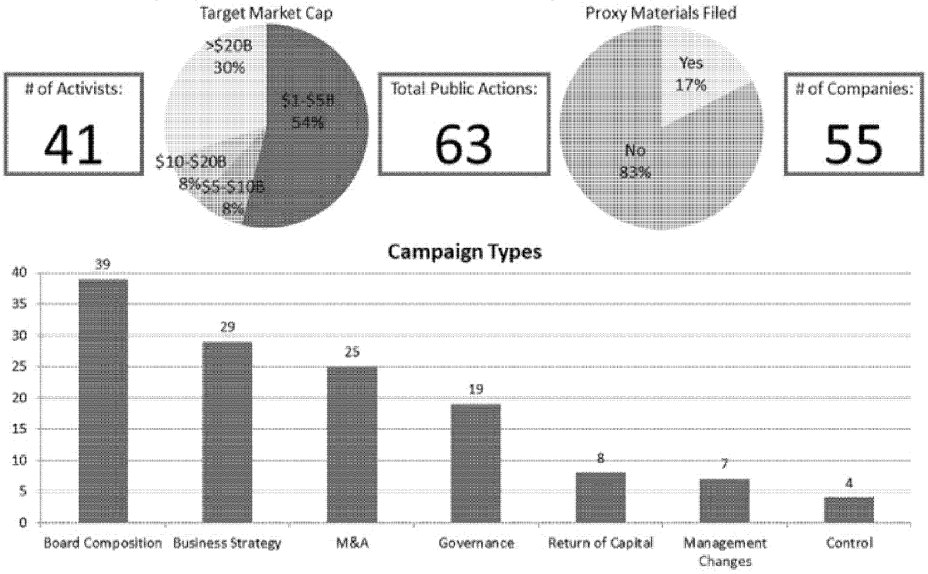
Eight settlement agreements pertaining to shareholder activism activity were filed during the second half of 2020 and only 17 were filed for the entire year, which continues a trend of diminution (relative to 22 agreements filed in 2019 and 30 agreements filed in 2018). Those settlement agreements that were filed had many of the same features noted in prior reviews, however, including voting agreements and standstill periods as well as non-disparagement covenants and minimum and/or maximum share ownership covenants. Expense reimbursement provisions were included in half of those agreements reviewed, which is consistent with historical trends.

By the Numbers—H2 2020 Public Activism Trends



*Study covers selected activist campaigns involving NYSE- and Nasdaq-traded companies with equity market capitalizations of greater than $1 billion as of December 31, 2020 (unless company is no longer listed).
**All data is derived from the data compiled from the campaigns studied for the 2020 Year-End Activism Update.

By the Numbers—2020 Full-Year Public Activism Trends



*Study covers selected activist campaigns involving NYSE- and Nasdaq-traded companies with equity market capitalizations of greater than $1 billion as of December 31, 2020 (unless company is no longer listed).
**All data is derived from the data compiled from the campaigns studied for the 2020 Year-End Activism Update.

By the Numbers—Trends in Settlement Agreements (2014–2020)

H2 2020 Board Representation Analysis

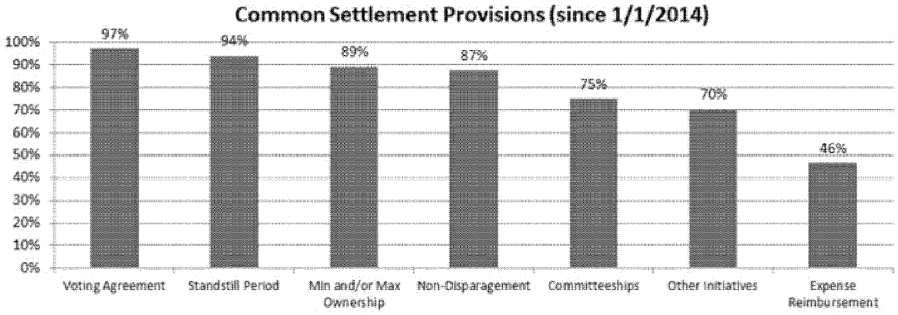
Category	Average
Board Seats Granted	2.2
Total Board Size*	10.9
Percent of Board*	20.4%

*Following settlement agreement

2014-H2 2020 Board Representation Analysis

Category	Average
Board Seats Granted	2.3
Total Board Size*	11.8
Percent of Board*	19.6%

*Following settlement agreement



*All data represented here is derived from the data compiled from the campaigns studied for Activism Update and include 12 agreements filed in 2014, 22 agreements filed in 2015, 30 agreements filed in 2016, 16 agreements filed in 2017, 30 agreements filed in 2018, 22 agreements filed in 2019 and 17 agreements filed in 2020.

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FROM *VON'S GROCERY* TO *WHOLE FOODS*: HOW NARROWING PRODUCT MARKETS HAVE QUIETLY CHANGED ANTITRUST

By Christine S. Wilson

Christine Wilson is a Commissioner in the U.S. Federal Trade Commission. This is adapted and edited from remarks that she gave on March 5, 2021 at the Seventh Annual Berkeley Spring Forum on M&A and Governance.

Some observers have attributed higher prices, poor customer service, and other ills to a modern antitrust policy that allowed mergers in airlines, social media, and other sectors. These critics characterize many industries in the U.S. as highly concentrated, and harken back to the 1960s as a more enlightened era of enforcement.[1] They advocate for a return to the 1968 Merger Guidelines issued by the U.S. Department of Justice Antitrust Division ("DOJ" or "Division"), which said the agency would ordinarily challenge mergers between firms with shares totaling as little as 8% to 10% of a relevant market. Two years earlier, in *Von's Grocery*, the Supreme Court had agreed with the DOJ that a merger of two supermarket chains with a total of 7.5% of the Los Angeles market for retail groceries violated Section 7 of the Clayton Act.[2]

Of course, the share of a market that a company holds necessarily depends on how the market is defined. Despite attempts to obviate it, market definition remains a critical part of most antitrust cases. The Supreme Court explained in 1992: "Because market power is often inferred from market share, market definition generally determines the result of the case."[3] Former Federal Trade Commission Chairman Bob Pitofsky likewise called it "the most important single issue in most enforcement actions."[4] Market definition continues to be a deciding factor in merger challenges brought under Section 7 of the Clayton Act today.[5]

The primacy of market definition in antitrust analysis—at least in the courts—reflects the large number of substantive legal rules that rely on it. For merger challenges, how the decision-maker defines the market determines both whether the merging firms are deemed competitors in the first place,[6] and whether their merger would substantially diminish competition.[7]

In a brief filed in 2015, the DOJ observed that "frequently, the government alleges narrow markets, the defendant describes broad markets, and the court must choose between the competing approaches."[8] Of course, narrower markets also can favor defendants that claim they are not competing in the same market. How a market is defined is often outcome-determinative, leading many to charge that market definition is "an essentially ex post choice"[9] designed "to achieve the desired results in calculating market shares."[10]

This gripe is long-standing. In the 1960s, commentators charged that "the Government has not been averse to shifting its market theories from case to case, seemingly with little justification other than making the relevant percentages more favorable to its cause."[11] But the tendency of antitrust enforcers to redefine product markets to suit their needs persists today. In February 2020, the Federal Trade Commission ("FTC") (collectively with the DOJ, "the Agencies") sued to block Edgewell's acquisition of Harry's, defin-

ing the market as "the manufacture and sale" of certain razors, thereby excluding from the market companies like upstart Billie that did not actually manufacture the razors themselves.[12] The FTC's complaint stated explicitly that "to be a significant competitor, a razor company must be able to manufacture and sell its own blades: in other words, the razor company must build or buy a factory."[13] But 10 months later, this defining characteristic of a "significant competitor" in the razor industry evaporated. In its suit to block Proctor & Gamble's acquisition of Billie, the FTC redefined the market as "the *production* and sale" of certain razors, thereby putting nonmanufacturer Billie into the same market as P&G.[14] For the record, I voted "yes" in the first case and "no" in the second, in part because I was concerned about shape-shifting market definitions.

Given this broad discretion, market definition can vary not just from one case or judge to the next, but also over time, as new tools and theories gain traction. These changes, in turn, may affect the way substantive antitrust rules are applied, even if those rules themselves have not changed. Many have argued that a particular policy change or analytical approach may theoretically broaden or narrow antitrust markets, and thereby affect substantive antitrust enforcement.

As far as I can tell, though, none have empirically tested the hypothesis. My former Attorney Advisor Keith Klovers and I have written an article that attempts to fill this gap, albeit crudely, for mergers.[15] It finds that, *in practice and on average*, product markets in Clayton Act cases have narrowed since the 1960s and 1970s. We do not characterize this narrowing as either desirable or undesirable—but the empirical evidence demonstrates this narrowing is real . . .

Narrowing Markets

Despite its importance, the rules that govern market definition have always been flexible enough to support a range of permissible choices. In the 1950s, the Supreme Court held both that product markets should be "drawn narrowly" and that it was not "proper" to define them so narrowly that only "fungible products" remained in the market.[16] The decision in *Brown Shoe* confused matters further by creating a list of factors capable of supporting a definition as broad or as narrow as the fact-finder desired.[17]

How courts exercise this discretion has varied substantially over time. During the first 25 years after the Celler-Kefauver Act of 1950, the Supreme Court and lower courts defined a mix of broad and narrow product markets. Examples of broad markets included "retail grocery" sales and "children's shoes"[18]; narrow ones included "accredited central station alarm services" and automotive finishes and fabrics.[19] Beginning in the 1980s, perhaps in response to the issuance of the 1982 Merger Guidelines, narrow markets became the rule. For example, the product market in grocery store mergers changed from "retail grocery" sales in the 1960s to "supermarkets" in the late 1980s and "premium natural and organic supermarkets" in the 2010s.

Today, the Agencies and courts routinely define product markets so narrowly that they require several adjectives. Consider "the sale of superpremium ice cream to the retail channel," "broadline foodservice distribution to national customers," and "branded seasoned salt products . . . (not including private or store label) sold at

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retail."[20] Some of these product market definitions call to mind Justice Abe Fortas' complaint in a 1966 monopolization case: "This Court now approves this strange red-haired, bearded, one-eyed man-with-a-limp classification."[21] Comparing the product markets used by the Supreme Court during the relatively "broad market" era to their modern equivalents suggests many product markets are narrower today.

Law

The basic legal rules for market definition were put in place decades ago. As a threshold matter, the Supreme Court recognized that the facts on the ground do not always lend themselves to a single, obvious result. It set out two principles that bestow substantial discretion on factfinders.

First, the Court explained that "a relevant market cannot meaningfully encompass [an] infinite range [of products]. The circle must be drawn narrowly to exclude any other product to which, within reasonable variations in price, only a limited number of buyers will turn."[22] This concept is known today as the "narrowest market" principle, which both courts and the Agencies routinely use.[23] Second, the Court cautioned against drawing the circle *too* narrowly, explaining that it is also improper "to require that products be fungible to be considered in the relevant market."[24] This tension—that markets should be narrow, but not too narrow—has haunted market definition exercises ever since. Indeed, both commandments appear, almost side-by-side, in the current Horizontal Merger Guidelines.[25]

Practice

Although the basic legal rules for defining relevant product markets have not changed since the mid-1960s, the product market in the average Clayton Act case has narrowed. Today, the Agencies typically allege—and courts routinely find—markets that are substantially narrower than their historical counterparts.

1. The Broad Market Era (1950-1975). Between approximately 1950 and 1975, the Supreme Court defined a mix of broad and narrow relevant product markets. In the 1962 *Brown Shoe* ruling, for example, the Supreme Court defined separate relevant product markets for all men's shoes, all women's shoes, and all children's shoes. The Supreme Court also endorsed a fairly broad product market the next year in *United States v. Philadelphia National Bank*. There the district court had rejected both the plaintiffs' and defendants' suggested narrower markets as attempts to "subdivide a commercial bank into certain selected services and functions."[26] The lower court said that this approach, if "carried to the logical extreme, would result in many additional so-called lines of commerce" but would serve "no useful purpose." The Supreme Court took the same view, holding that the relevant product market was "the cluster of products . . . and services . . . denoted by the term 'commercial banking.' "[27] The Court acknowledged that the competitive dynamics varied among the products and services included in this broad market. But it nonetheless concluded that "it is clear that commercial banking is a market sufficiently inclusive to be meaningful in terms of trade realities."[28] The Supreme Court applied the same "commercial banking" product market to six other bank mergers in the following 12 years, in the process rejecting both broader and narrower candidate markets.[29]

Even in this era, though, the Court did not always define broad markets. In the *DuPont* case, for example, the Court chose to define narrow product markets for "automotive finishes and fabrics."[30] The dissent argued that this market was drawn too narrowly because the very same finishes and fabrics were also used in many other industries. Lower courts also defined a mix of broader and narrower markets. In *United States v. General Dynamics Corp.*, for example, the district court defined an "energy market" based on evidence of significant competition from "oil, gas, and nuclear power."[31] Yet as Bob Pitofsky once wrote, there were also "many instances" during this era in which lower courts defined "excessively, and sometimes ludicrously, narrow market definitions."[32]

2. Subsequent Narrowing (1980 to the Present). Starting in the 1980s, courts and enforcers began to define product markets in a more standardized fashion, a dynamic that remains largely true today. Standardization typically meant rejecting broad markets in favor of somewhat narrower ones, often focused on a particular industrial or consumer good . . .

Most narrowing took place along two dimensions. First, markets narrowed to focus upon a product's next-closest substitutes, which often meant defining a market around a single price tier or product characteristic. For example, in the early 2000s the FTC alleged that "the sale of superpremium ice cream to the retail channel" was a relevant product market and that "refrigerated pickles" and "shelf-stable pickles" were in different product markets. And in *Whole Foods* the FTC alleged a market for "premium natural and organic supermarkets," which the district court rejected as too narrow but the court of appeals accepted.[33] In contrast, during the broad market era the Court rejected the defendant's attempt to define narrower shoe markets using "price/quality" and "age/sex" distinctions as "unrealistic." It found particularly laughable the suggestion that "men's shoes selling below $8.99 are in a different product market from those selling above $9.00."[34]

Second, enforcers more often defined narrow price-discrimination markets, even though those markets were hardly new. The DOJ had long defined markets around specific household appliances like dishwashers, washing machines, and ovens, both before and after the rise of price-discrimination markets. But in the 2015 case involving *Electrolux*, the DOJ alleged both individual markets for kitchen ranges, cooktops, and ovens *and* price-discrimination submarkets for "contract-channel" and "retail channel" purchasers of those appliances.[35] The "national broadline customers" market in the 2015 *Sysco/US Foods* case was also defined around the customers most vulnerable to price discrimination post-transaction.[36]

3. Systematic Comparison. These examples and other cases have led to a perception that enforcers allege narrow markets and that courts typically agree, particularly as the market definition exercise has become more standardized. What has been missing, at least so far, is substantial evidence that courts and the Agencies are defining product markets in a systematically narrower way than before . . .

Of the markets that have narrowed, how and when the definitional shift occurred varies significantly. Some markets, like retail groceries, have narrowed several times. In the 1966 *Von's*

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Grocery case, the relevant product market for a merger of two Los Angeles-area grocery stores was the market for "retail grocery" sales, including small corner stores.[37] In the 1990 case *California v. American Stores Co.*, the relevant market was "supermarkets," defined as grocery stores of at least 10,000 square feet. By 2008, in the *Whole Foods* case, the FTC alleged, and the D.C. Circuit found, an even narrower market for the "operation of premium natural and organic supermarkets."[38]

Other product markets like coal mining narrowed quickly and then stayed narrow. Take the early 1970s case *United States v. General Dynamics Corp.*,[39] which involved a merger of two coal mining companies. There, the district court concluded that the relevant market was "interfuel" competition among different energy sources—including coal, natural gas, and uranium—used to generate electricity. But in a merger of coal mines in the early 2000s, *Arch Coal*, the FTC alleged a market for "8800 BTU coal from the Southern Powder River Basin" in Wyoming and the district court found a market for all Southern Powder River Basin coal.[40] In 2020, the FTC alleged the same Southern Powder River Basin coal product market in a second transaction involving Arch Coal. The district court provisionally accepted this market definition when it granted a preliminary injunction. In this last case, the court emphasized that its finding was dictated primarily by "the 'narrowest market principle' " in *Brown Shoe*.[41]. . .

The banking industry provides a particularly useful case study on the evolution of product market definition because mergers are reviewed by both the DOJ and the Federal Reserve Board ("the FRB"). The DOJ has adopted ever-narrower markets during its antitrust review. In contrast, the FRB has retained the "broad market" approach of the 1960s, even broadening the geographic markets further to account for suburban sprawl. In at least two bank mergers, CoreStates/FirstUnion (1998) and BB&T/SunTrust (2020), the DOJ and the FRB explicitly acknowledged that this difference in methodology has led to different substantive results. (Ironically, CoreStates was a successor to Philadelphia National Bank.) By defining narrower markets, the DOJ has found significantly greater harm and fewer cognizable efficiencies than the Federal Reserve Board, and consequently has demanded larger divestitures. These bank mergers illustrate both how antitrust product markets have narrowed and how that narrowing affects the application of various legal rules. (Interestingly, Senator Elizabeth Warren has criticized the DOJ for not defining markets narrowly enough.) . . .

I believe there are at least four likely causes for the narrowing of product markets. First, the methodologies used to define markets have changed substantially over the years. As enforcers shifted their focus to differentiated products and unilateral effects, the models and tools used to define markets began to change. For example, the hypothetical monopolist test and diversion ratios have become commonplace. Second, as confidence in measures of demand side substitution improved, courts and enforcers began to de-emphasize supply-side substitution.

In fact, supply-side substitution has largely been excluded from the market definition exercise since the 1992 Horizontal Merger Guidelines. Third, the Guidelines have empha-

sized some concepts, like price-discrimination markets, that can result in narrower markets.

Fourth, the narrowing product markets may reflect—at least in some cases—real changes in the underlying economy, like greater product differentiation. For example, the "premium natural and organic supermarkets" at issue in *Whole Foods* did not exist when the Court decided *Von's Grocery* in 1966. But it is unlikely that greater differentiation can explain all, or even most, of the narrowing. Some products were already differentiated in the 1960s; there were many kinds of children's shoes, even though the Supreme Court consciously chose to lump them all together in its *Brown Shoe* decision. And the courts have narrowed many commodity product markets like coal and spices, even though the products' physical properties have not changed.

Substantive Changes Affected By Narrowing Markets

Narrowing markets affect the way several other substantive antitrust rules are applied in ways that, all else being equal, favor plaintiffs. Impacted rules include the exclusion of out-of-market efficiencies; the market share at which a transaction becomes presumptively unlawful; and the traditional emphasis on mergers involving "overlapping" horizontal competitors.

Narrowing product markets have altered the rules on cross-market balancing and structural presumptions in ways that favor plaintiffs. But narrowing product markets have impacted the traditional scrutiny of mergers involving overlapping competitors in ways that can favor either plaintiffs or defendants.

Efficiencies

The move toward narrower relevant product markets has affected the way courts assess efficiency claims in two ways.

1. Out-of-Market Efficiencies. First, narrow markets push more otherwise-cognizable efficiencies outside the relevant market. The Supreme Court held in *Philadelphia National Bank* that "anticompetitive effects in one market [cannot] be justified by procompetitive consequences in another."[42] The Agencies and courts have characterized this holding as precluding the "cross-market" or "multi-market" balancing of competitive effects and the consideration of out-of-market efficiencies.

But in *Philadelphia National Bank*, the relevant product market for banking mergers included everything "denoted by the term 'commercial banking,' " and the relevant geographic market was the four-county Philadelphia area.[43] The rule against out-of-market efficiencies should be understood within this context of a broad product and geographic market. Perhaps we should reconsider the propriety of applying the out-of-market rule verbatim when the market is defined very narrowly. A solution consistent with the Court's original formulation would aggregate harms and efficiencies into product markets akin in size to those in *Philadelphia National Bank* and assess the net effect within these broader markets.

2. Magnitude of Offsetting Efficiencies. Since *FTC v. H.J. Heinz Co.*, known to antitrust practitioners as "the Baby Foods case,"[44] narrower markets have also changed the magnitude of offsetting efficiencies a defendant must prove.

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Two dimensions of that case are relevant here. First, the D.C. Circuit adopted a sliding scale for assessing efficiency claims that becomes more exacting as markets narrow and market shares increase. In general, defendants must show only that the likely cognizable efficiencies exceed the likely anticompetitive effects, and therefore are unlikely "to substantially lessen competition." But when the market is highly concentrated, the court said the defendants must prove "extraordinary efficiencies." This statement appears to mean that the magnitude of those efficiencies that remain in the relevant market must substantially exceed the magnitude of harms. Although this rule started in the D.C. Circuit, it is now also binding circuit precedent in the Third and Ninth Circuits, and has been followed by trial courts in the Sixth and Seventh Circuits. Second, merging parties in highly concentrated markets face a heightened evidentiary burden when seeking—almost always in vain—to prove efficiencies. According to *Heinz*, "the court must undertake a rigorous analysis of the kinds of efficiencies being urged by the parties . . . to ensure that those 'efficiencies' represent more than mere speculation and promises about postmerger behavior."[45]

Combined, these two effects are greater than the sum of their parts. Because markets have narrowed, a defendant that previously could have carried its burden by showing efficiencies must now prove "*extraordinary* efficiencies" under a particularly "rigorous analysis." In other words, as markets narrow and market shares increase, defendants must produce stronger proof of much larger efficiencies. The obligation, if actually applied this way, likely forecloses an efficiencies defense in many narrow market cases.

Competitive Overlaps

The extent to which relevant product markets have narrowed also has implications for other aspects of merger analysis. Consider two that cut in opposite directions.

First, narrower markets can make it more likely that two firms competing in the same broad market—like "retail supermarkets" or "coal"—are not viewed as horizontal competitors. For example, one firm may fall out of the market entirely. This result may be particularly likely in dynamic markets. In these markets, competitors often seek to "leapfrog" each other by introducing products with new and different features. In the short run, an entrant's product may be differentiated from existing products sold by others. Yet incumbents may—and in these markets often do—quickly "catch up" by introducing similar features to their own products. Therefore, in some cases narrower markets may result in relatively *less* aggressive antitrust enforcement, at least in theory.

Second, while in some cases narrowing the product market will exclude one of the merging firms, in other cases it will exclude some of their competitors. If the merging parties are in the same relevant market, excluding rivals will increase the merging parties' combined market share. Because market shares are an input in many economic models used to measure anticompetitive effects, like diversion ratios, economic models may be more likely to find harm in narrow markets.

The Structural Presumption

Narrow markets may also be more likely to trigger a structural presumption of unlawfulness,

which has been characterized as "critical for effective horizontal antitrust enforcement."[46] The structural presumption, which is the total market share at which a transaction becomes presumptively unlawful, is embodied in both the caselaw and the Horizontal Merger Guidelines. When triggered, it shifts the burden from the plaintiff and requires the defendant to prove that the transaction is lawful. As the Supreme Court recognized in *Philadelphia National Bank*, the very case that established the presumption, the size of the relevant market can affect the market share calculations. When product markets shrink, the number of competitors declines and the market share of each remaining firm in the market increases. Because the structural presumption is triggered whenever certain market share thresholds are met, the presumption is more likely to apply when markets are narrow. Perhaps ironically, the structural presumption is a product of the broad market era generally, and of a case in which the courts defined a broader market than either party sought.

The relationship between market breadth and the structural presumption was clearly explained in the recent *Peabody* case, another FTC merger challenge involving Arch Coal. There, the district court explained that its "task is to identify the narrowest market within which the defendant companies compete that qualifies as a relevant product market . . . because potential harms to competition will likely be less apparent in a broader, less concentrated market than in a narrower included market."[47] The court then defined both a broad energy fuel market that included coal, natural gas, and renewable resources, and a narrower, overlapping market for Southern Powder River Basin coal. The narrower market triggered a structural presumption of illegality.

Narrowing markets also increase the probability of triggering a corollary to the structural presumption: "the acquisition of the second largest firm in the market by the largest firm in the market will tend to harm competition in that market."[48] If narrowing markets means that there are fewer other firms in the market, it becomes more likely, all else equal, that a given merger will combine the first- and second-largest firms in the relevant market. The *Whole Foods* case illustrates both of these dynamics. The FTC argued a narrow product market for premium, natural, and organic supermarkets and the defendant urged a broader market that included conventional supermarkets. As both the district court and the court of appeals noted, the "case hinged—almost entirely—on the proper definition of the relevant market."[49] If the market was narrow, then concentration was high, the structural presumption applied, and the transaction was likely unlawful. If the market was broad, then concentration was low and the structural presumption did not apply. Moreover, the FTC rested its entire case on the structural presumption and its corollary, and these were the controlling considerations in the final judgment of the D.C. Circuit.

Conclusion

Depending on your perspective, narrowing markets may be cause for either celebration or worry. Compared to their 1960s counterparts, market definitions today are the product of more coherent economic thinking, which makes the analysis more consistent and predictable. Yet that consistency also means litigants are left to debate whether markets are narrow or very narrow. And narrowing markets, in turn, have significantly altered the way in which courts apply bedrock

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merger rules like the structural presumption and efficiencies analysis.

The realization that markets have narrowed, and substantive antitrust rules have changed as a result, may also inform antitrust policy. First, proposals to return to earlier merger rules should be consistent. If enforcers should return to 1960s-era concentration thresholds, presumably they should also return to 1960s-era product markets. Second, because markets have narrowed substantially, we may need to reconsider the way we think about overlaps and efficiencies. For example, courts applying the Philadelphia National Bank rule against out-of-market efficiencies have failed to recognize that the Supreme Court in that case rejected precisely the kind of narrow product markets that are now routine. In other words, the Supreme Court envisioned an efficiencies analysis fundamentally different than what the courts apply today.

ENDNOTES:

[1]*See, e.g.,* Open Markets Institute and American Economic Liberties Project, "The Federal Trade Commission and the Department of Justice Should Abandon the Proposed Vertical Merger Guidelines and Embrace the Framework of the 1968 Guidelines" (Feb. 2020) https://www.ftc.gov/system/files/attachments/798-draft-vertical-mergerguidelines/comment_to_ftc-doj_re_vertical_merger_guidelines.pdf; American Economic Liberties Project, The Courage to Learn: A Retrospective on Antitrust and Competition Policy during the Obama Administration and Framework for a New, Structuralist Approach at 38 and 142 (Jan. 2021), https://www.economicliberties.us/wpcontent/uploads/2021/01/Courage-to-Learn_12.12.pdf.

[2]*U.S. v. Von's Grocery Co.*, 384 U.S. 270, 272, 86 S. Ct. 1478, 16 L. Ed. 2d 555 (1966).

[3]*Eastman Kodak Co. v. Image Technical Services, Inc.*, 504 U.S. 451, 469 n.15, 112 S. Ct. 2072, 119 L. Ed. 2d 265, 1992-1 Trade Cas. (CCH) ¶ 69839 (1992).

[4]Robert Pitofsky, New Definitions of Relevant Market and the Assault on Antitrust, 90 COLUM. L. REV. 1805, 1807 (1990).

[5]*See, e.g., FTC v. Peabody Energy Co.*, No. 4:20-cv-00317 (E.D. Mo. Sept. 28, 2020); *United States v. Sabre Corp.*, No. 1:19-cv-01548-LPS (D. Del. Apr. 8, 2020) (holding a one-sided firm could not compete in a two-sided market as a matter of law), vacated, *United States v. Sabre Corporation*, 2020-2 Trade Cas. (CCH) ¶ 81294, 2020 WL 4915824 (3d Cir. 2020) (per curiam); *Federal Trade Commission v. RAG-Stiftung*, 436 F. Supp. 3d 278, 2020-1 Trade Cas. (CCH) ¶ 81075 (D.D.C. 2020).

[6]*See, e.g., Sabre*, No. 1:19-cv-01548-LPS (holding a one-sided firm could not compete in a two-sided market as a matter of law).

[7]*See, e.g., U.S. v. E. I. du Pont de Nemours & Co.*, 353 U.S. 586, 593, 77 S. Ct. 872, 1 L. Ed. 2d 1057 (1957) ("Determination of the relevant market is a necessary predicate to a finding of a violation of the Clayton Act because the threatened monopoly must be one which will substantially lessen competition within the area of effective competition." (internal quotation marks omitted)).

[8]United States' Pretrial Mem. at 15-16, *United States v. AB Electrolux*, No. 1:15-cv-01039 (D.D.C. filed Dec. 18, 2015), available at https://www.justice.gov/atr/file/801726/download [hereinafter Electrolux Pretrial Brief].

[9]Louis Kaplow, Market Definition and the Merger Guidelines, 39 REV. INDUS. ORG. 107, 124 (2011).

[10]G.E. Hale & Rosemary D. Hale, A Line of Commerce: Market Definition in Anti-Merger Cases, 52 IOWA L. REV. 406, 426 (1966).

[11]Thomas M. Lewyn & Stephen Mann, Some Thoughts on Policy and Enforcement of Section 7 of the Clayton Act, 50 A.B.A.J. 154, 156 (1964); see Milton Handler & Stanley D. Robinson, A Decade of Administration of the Cellar-

Kefauver Antimerger Act, 61 COLUM. L. REV. 629, 649-50 (1961) (arguing enforcers expanded and contracted markets at will "to find a market that will magnify the acquisition and thus facilitate its condemnation").

[12]*In the Matter of Edgewell Personal Care Company and Harry's, Inc.*, Docket No. 9390, Compl. ¶ 21 (Feb. 2, 2020) ("The relevant market in which to evaluate the effects of the Proposed Acquisition is no broader than the manufacture and sale of wet shave system razors and disposable razors ('wet shave razors') sold in the United States.").

[13]Id. at ¶ 74.

[14]*In the Matter of The Procter & Gamble Company and Billie, Inc.*, Docket No. 9400, Compl. ¶ 15 ("A relevant market in which to evaluate the effects of the Proposed Acquisition is no broader than production and sale of wet shave system razors and disposable razors ('wet shave razors') sold in the United States.").

[15]Christine S. Wilson and Keith Klovers, Same Rule, Different Result: How the Narrowing of Product Markets Has Altered Substantive Antitrust Rules (Mar. 3, 2021), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3797089.

[16]*See Times-Picayune Pub. Co. v. U.S.*, 345 U.S. 594, 612 n.31, 73 S. Ct. 872, 97 L. Ed. 1277 (1953) ("drawn narrowly"); *U.S. v. E. I. du Pont de Nemours & Co.*, 351 U.S. 377, 394, 76 S. Ct. 994, 100 L. Ed. 1264 (1956) ("Nor is it a proper interpretation of the Sherman Act to require that products be fungible to be considered in the relevant market.").

[17]*Brown Shoe Co. v. U.S.*, 370 U.S. 294, 325, 82 S. Ct. 1502, 8 L. Ed. 2d 510 (1962).

[18]*U. S. v. Von's Grocery Co.*, 384 U.S. 270, 272, 86 S. Ct. 1478, 16 L. Ed. 2d 555 (1966); *Brown Shoe*, 370 U.S. at 326 (defining three markets in all: "men's, women's, and children's shoes").

[19]*U.S. v. Grinnell Corp.*, 384 U.S. 563, 571-74, 86 S. Ct. 1698, 16 L. Ed. 2d 778 (1966) (defining a product market for "the accredited central station service business"); *U.S. v. E. I. du Pont de Nemours & Co.*, 353 U.S. 586, 594-95, 77 S. Ct. 872, 1 L. Ed. 2d 1057 (1957).

[20]Complaint ¶ 11, Nestle Holdings, Inc., Dkt. No. C-4082, available at https://www.ftc.gov/sites/default/files/documents/cases/2003/06/dreyercomplaint.htm; *Federal Trade Commission v. Sysco Corporation*, 113 F. Supp. 3d 1, 48, 2015-1 Trade Cas. (CCH) ¶ 79221 (D.D.C. 2015) (defining overlapping product markets for (i) "broadline foodservice distribution" and (ii) "broadline foodservice distribution to national customers"); Compl. ¶ 8, McCormick & Co., Inc., No. C-4225 (F.T.C. filed July 30, 2008).

[21]*U.S. v. Grinnell Corp.*, 384 U.S. 563, 591, 86 S. Ct. 1698, 16 L. Ed. 2d 778 (1966) (Fortas, J. dissenting).

[22]*Times-Picayune*, 345 U.S. at 612 n.31.

[23]*See, e.g., FTC v. Peabody Energy Co.*, No. 4:20-cv-00317 (E.D. Mo. Sept. 28, 2020) ("Crucial to the Court's conclusion is the 'narrowest market principle.' "); *Federal Trade Commission v. Sysco Corporation*, 113 F. Supp. 3d 1, 26, 2015-1 Trade Cas. (CCH) ¶ 79221 (D.D.C. 2015) (quoting and applying the Times-Picayune rule).

[24]*DuPont*, 351 U.S. at 394.

[25]HORIZONTAL MERGER GUIDELINES, supra note 7, § 4.1.1 ("Because the relative competitive significance of more distant substitutes is apt to be overstated by their share of sales, when the Agencies rely on market shares and concentration, they usually do so in the smallest relevant market satisfying the hypothetical monopolist test."); Id. § 4, at 8 ("However, a group of products is too narrow to constitute a relevant market if competition from products outside that group is so ample that even the complete elimination of competition within the group would not significantly harm either direct customers or downstream consumers. The hypothetical monopolist test (see Section 4.1.1) is designed to ensure that candidate markets are not overly narrow in this respect.").

[26]*United States v. Philadelphia Nat'l Bank*, 201 F. Supp. 348, 363 (E.D. Pa. 1962).

[27]*Philadelphia Nat'l Bank*, 374 U.S. at 356

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(internal parentheticals omitted).

[28]*Philadelphia Nat'l Bank* at 357.

[29]*U. S. v. First Nat. Bank & Trust Co. of Lexington*, 376 U.S. 665, 667, 84 S. Ct. 1033, 12 L. Ed. 2d 1 (1964); *U.S. v. Third Nat. Bank in Nashville*, 390 U.S. 171, 181-82 n.15, 88 S. Ct. 882, 19 L. Ed. 2d 1015 (1968) (affirming "commercial banking" product market); *U. S. v. Phillipsburg Nat. Bank & Trust Co.*, 399 U.S. 350, 360-61, 90 S. Ct. 2035, 26 L. Ed. 2d 658, 1970 Trade Cas. (CCH) ¶ 73245 (1970) (holding the district court erred when it defined narrower product markets with a broader range of participants because "the cluster of products and services termed commercial banking has economic significance well beyond the various products and services involved"); *U.S. v. Marine Bancorporation, Inc.*, 418 U.S. 602, 618-619, 94 S. Ct. 2856, 41 L. Ed. 2d 978, 1974-1 Trade Cas. (CCH) ¶ 75125 (1974) (noting that the district court's definition of a "commercial banking" product market "is in full accord with our precedents"); *U.S. v. Connecticut Nat. Bank*, 418 U.S. 656, 666, 94 S. Ct. 2788, 41 L. Ed. 2d 1016, 1974-1 Trade Cas. (CCH) ¶ 75124 (1974) (reversing a district court finding that the relevant market included both savings banks and commercial banks, and remanding the case with instructions that "the District Court should treat commercial banking as the relevant product market"); *U. S. v. Citizens and Southern Nat. Bank*, 422 U.S. 86, 120-21, 95 S. Ct. 2099, 45 L. Ed. 2d 41, 1975-1 Trade Cas. (CCH) ¶ 60360 (1975) (affirming "commercial banking" product market). The Court did not reach the question in a seventh case. *See U.S. v. First City Nat. Bank of Houston*, 386 U.S. 361, 369 n.1, 87 S. Ct. 1088, 18 L. Ed. 2d 151 (1967).

[30]*U.S. v. E. I. du Pont de Nemours & Co.*, 353 U.S. 586, 594-95, 77 S. Ct. 872, 1 L. Ed. 2d 1057 (1957) ("Thus, the bounds of the relevant market for the purposes of this case are not coextensive with the total market for finishes and fabrics, but are coextensive with the automobile industry, the relevant market for automotive finishes and fabrics.").

[31]*U.S. v. General Dynamics Corp.*, 341 F. Supp. 534, 1972 Trade Cas. (CCH) ¶ 73927 (N.D. Ill. 1972), judgment aff'd, 415 U.S. 486, 94 S. Ct. 1186, 39 L. Ed. 2d 530, 1974-1 Trade Cas. (CCH) ¶ 74967 (1974), at 545.

[32]Pitofsky, supra note 5, at 1808.

[33]*FTC v. Whole Foods Market, Inc.*, 502 F.Supp.2d 1, 34-36 (D.D.C. 2007), rev'd, 548 F.3d 1028, 1041 (D.C. Cir. 2008) (Brown, J.).

[34]*Brown Shoe*, 370 U.S. at 326; *see also United States v. Philadelphia Nat'l Bank*, 201 F. Supp. 348, 363 (E.D. Pa. 1962) (rejecting both plaintiffs' and defendants' attempts to "subdivide a commercial bank into certain selected services and functions" as misguided because these smaller markets "would result in many additional so-called lines of commerce" but serve "no useful purpose"), aff'd, 374 U.S. 321 (1963).

[35]*See* Compl. ¶¶ 20-26, *United States v. AB Electrolux*, No. 1:15-cv-01039 (D.D.C. filed July 1, 2015) (defining separate markets for different distribution channels of the same product).

[36]*Federal Trade Commission v. Sysco Corporation*, 113 F. Supp. 3d 1, 48, 2015-1 Trade Cas. (CCH) ¶ 79221 (D.D.C. 2015).

[37]*U. S. v. Von's Grocery Co.*, 384 U.S. 270, 272, 86 S. Ct. 1478, 16 L. Ed. 2d 555 (1966).

[38]*F.T.C. v. Whole Foods Market, Inc.*, 548 F.3d 1028 (D.C. Cir. 2008).

[39]*U.S. v. General Dynamics Corp.*, 341 F. Supp. 534, 1972 Trade Cas. (CCH) ¶ 73927 (N.D. Ill. 1972), judgment aff'd, 415 U.S. 486, 510-11, 94 S. Ct. 1186, 39 L. Ed. 2d 530, 1974-1 Trade Cas. (CCH) ¶ 74967 (1974) (without reaching the relevant product market).

[40]*FTC v. Arch Coal, Inc.*, 328 F. Supp. 2d 109, 121 (D.D.C. 2004) (recounting plaintiff's argument before the court).

[41]*FTC v. Peabody Energy Co.*, No. 4:20-cv-00317 (E.D. Mo. Sept. 28, 2020); at *22. This conclusion is odd for two reasons. First, the district court defined overlapping broad and narrow product markets, while the narrowest market principle requires the definition of only one product market. *See, e.g.*, Werden, supra note 19, at 196 ("The Guidelines' Smallest Market Prin-

ciple states that the one and only relevant market for the antitrust market subsequence and the corresponding candidate market sequence 'generally' is the smallest element in the antitrust market subsequence, that is, the only one contained in each of the others."). Second, the district court cited Brown Shoe for this point, even though the Court there defined relatively broad markets and pointedly rejected the defendants' attempt to make narrower distinctions, such as price tiers. *See Peabody*, No. 4:20-cv-00317, at *23 (quoting *Times-Picayune Pub. Co. v. U.S.*, 345 U.S. 594, 612 n.31, 73 S. Ct. 872, 97 L. Ed. 1277 (1953)).

[42]*U.S. v. Philadelphia Nat. Bank*, 374 U.S. 321, 370, 83 S. Ct. 1715, 10 L. Ed. 2d 915 (1963).

[43]*Philadelphia Nat'l Bank*, 374 U.S. at 356 ("We have no difficulty in determining the 'line of commerce' (relevant product or services market) and 'section of the country' (relevant geographical market) in which to appraise the probable competitive effects of appellees' proposed merger. We agree with the District Court that the cluster of products (various kinds of credit) and services (such as checking accounts and trust administration) denoted by the term 'commercial banking,' composes a distinct line of commerce."); Id. at 359 (finding "the four-county area in which appellees' offices are located would seem to be the relevant geographical market").

[44]*F.T.C. v. H.J. Heinz Co.*, 246 F.3d 708, 2001-1 Trade Cas. (CCH) ¶ 73243 (D.C. Cir. 2001).

[45]*H.J. Heinz*, 246 F.3d at 721.

[46]Herbert Hovenkamp & Carl Shapiro, Horizontal Mergers, Market Structure, and Burdens of Proof, 127 YALE L.J. 1996, 1997 (2018).

[47]*FTC v. Peabody Energy Co.*, No. 4:20-cv-00317, at *23 (E.D. Mo. Sept. 28, 2020).

[48]*F.T.C. v. Whole Foods Market, Inc.*, 548 F.3d 1028, 1043 (D.C. Cir. 2008) (Tatel, J.) (quoting *F.T.C. v. Whole Foods Market, Inc.*, 502 F. Supp. 2d 1, 8, 2007-2 Trade Cas. (CCH) ¶ 75831 (D.D.C. 2007), rev'd, 533 F.3d 869, 2008-1 Trade Cas. (CCH) ¶ 76233 (D.C. Cir. 2008), opinion amended and superseded, 548 F.3d 1028 (D.C. Cir. 2008) and rev'd, 548 F.3d 1028 (D.C. Cir. 2008)); *Federal Trade Commission v. Sysco Corporation*, 113 F. Supp. 3d 1, 88, 2015-1 Trade Cas. (CCH) ¶ 79221 (D.D.C. 2015) (quoting *Whole Foods*, 548 F.3d at 1043); *Federal Trade Commission v. Staples, Inc.*, 190 F. Supp. 3d 100, 138, 2016-1 Trade Cas. (CCH) ¶ 79627 (D.D.C. 2016) (quoting *Sysco*, 113 F. Supp. 3d at 138 (quoting *Whole Foods*, 548 F.3d at 1043)); *see also Federal Trade Commission v. Wilh. Wilhelmsen Holding ASA*, 341 F. Supp. 3d 27, 59, 2018-2 Trade Cas. (CCH) ¶ 80509 (D.D.C. 2018) (quoting *Whole Foods*, 548 F.3d at 1043, in a parenthetical); Peabody, 4:20-cv-00317, at *74 (likewise quoting *Whole Foods*, 548 F.3d at 1043, in a parenthetical).

[49]*Whole Foods*, 548 F.3d at 1043 (Tatel, J., concurring) (internal citations and quotation marks omitted).

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FROM THE EDITOR

A New Vertical Merger Challenge Begins

At the end of March, the Federal Trade Commission moved to block Illumina's $7.1 billion takeover of Grail, saying the deal would harm competition in the U.S. market for life-saving multi-cancer early detection tests (MCED tests). Illumina said it planned to oppose the FTC's action, arguing that the two companies were not competitors in any way.

Illumina and Grail are a classic vertical merger, as the companies work in different sectors. Grail develops blood-based MCED tests while Illumina provides sequencing machines that, among other things, run MCED tests. The FTC claims that Illumina's dominance of the sequencing market could make it a potentially oppressive force for competitors, should it acquire Grail.

The FTC charged that as the "only viable supplier of a critical input, Illumina can raise prices charged to Grail competitors for NGS instruments and consumables; impede Grail competitors' research and development efforts; or refuse or delay executing license agreements that all MCED test developers need to distribute their tests to third-party laboratories." For MCEDs, the great majority of developers would have no choice but to use Illumina NGS instruments and consumables, the FTC said. FTC Acting Chairwoman Rebecca Kelly Slaughter said in a statement that "the MCED test is a game changer for cancer patients and their loved ones. If this acquisition is consummated, it would likely reduce innovation in this critical area of healthcare, diminish the quality of MCED tests, and make them more expensive."

The FTC complaint alleges that even if a competitive alternative to Illumina's NGS platform emerged, it would take years for MCED test developers to switch to it, as they would have to reconfigure their tests to be compatible with the new platform and run new clinical trials.

It's not the first time the FTC and Illumina have tangled. In December 2019, the FTC challenged Illumina's proposed acquisition of Pacific Biosciences of California and the deal was scuttled a few months afterward. This new case, should it proceed, would be the second litigated challenge to a vertical merger in over 40 years, following the DOJ's 2017 case against AT&T/Time Warner, which the government lost. Market analysts said that Illumina does not appear to be in as strong a defensive position at AT&T/Time Warner were, however.

Along with the FTC joining a multilateral working group to review and examine mergers in the pharmaceutical industry (see the article by Paul, Weiss lawyers in this month's issue), the Illumina challenge shows that federal antitrust enforcers may well be more aggressive—particularly in healthcare—over the next few years.

Chris O'Leary

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