APRIL 2009, RELEASE TWO

THE ONLINE MAGAZINE FOR GLOBAL COMPETITION POLICY

The FTC's Stacked Deck under Section 13(b): Does *CCC Holdings* Herald a Return to the S-C-P Paradigm?

Thom Lambert
University of Missouri Law School

WWW.GLOBALCOMPETITIONPOLICY.ORG

Competition Policy International, Inc. © 2009. Copying, reprinting, or distributing this article is forbidden by anyone other than the publisher or author.

The FTC's Stacked Deck under Section 13(b): Does *CCC Holdings* Herald a Return to the S-C-P Paradigm?

Thom Lambert[1]

I. INTRODUCTION

CCC Information Services, Inc. ("CCC") and Mitchell International, Inc. ("Mitchell") are two of the largest data systems providers that automobile body shops and insurance companies use to estimate repair costs and replacement values. A year ago, the two companies announced plans to merge. After a seven-month investigation, the Federal Trade Commission ("FTC" or "the Commission") issued an administrative complaint challenging the proposed merger. At the same time, the Commission filed a complaint in federal court under Section 13(b) of the FTC Act.[2] That complaint sought a temporary restraining order and a preliminary injunction barring the merger pending administrative adjudication. On March 18, 2009, the district court granted the FTC's motion for preliminary injunction,[3] whereupon CCC and Mitchell, unable to maintain financing during the pendency of an administrative action and appeal, announced that they would abandon the $1.4 billion merger.

The outcome of the district court's decision is not surprising, and an injunction against the CCC/Mitchell merger may well have been warranted. The reasoning the court employed, however, causes concern. By stacking the deck so heavily in favor of the FTC—a move dictated by the D.C. Circuit's lax standard for granting preliminary injunctions under Section 13(b)—the court ended up relying almost entirely on market share percentages. Its reasoning thus hearkens back to the overly simplistic Structure-Conduct-Performance ("S-C-P") paradigm, under which a market's structure is deemed to determine the participants' conduct, dictating market performance.[4] A less deferential standard for granting injunctive relief, such as that applicable to injunction requests by the U.S. Department of Justice ("DOJ"),[5] would ensure that important non-structural

---

[1] Associate Dean for Faculty Research and Development and Associate Professor, University of Missouri Law School.

[2] 15 U.S.C. § 53(b).

[3] Federal Tr. Comm'n v. CCC Holdings et al., No. 08-2043 (D.D.C. March 9, 2009).

[4] *See generally* HERBERT HOVENKAMP, FEDERAL ANTITRUST POLICY: THE LAW OF COMPETITION AND ITS PRACTICE 42-47 (3d ed. 2005) (describing S-C-P paradigm and its limitations).

[5] *See* ANTITRUST MODERNIZATION COMMISSION, REPORT AND RECOMMENDATIONS (hereinafter "AMC Report") 142 (2007) (explaining difference between standards applicable to FTC requests for merger injunctions under Section 13(b), 15 U.S.C. § 53(b), and those applicable to DOJ requests under Section 15 of the Clayton Act, 15 U.S.C. § 25).

Competition Policy International, Inc. © 2009. Copying, reprinting, or distributing this article is forbidden by anyone other than the publisher or author.

factors receive due attention and would thereby enhance the quality of pre-merger review.

II. THE DISTRICT COURT'S OPINION

Section 7 of the Clayton Act forbids mergers or acquisitions "the effect of [which] may be substantially to lessen competition, or to tend to create a monopoly."[6] As the Supreme Court has explained, use of the word "may" implies that Section 7 "deals in probabilities, not certainties,"[7] meaning that liability is established on showing that a lessening of competition is probable. Under the burden of proof normally applicable in civil cases, a Section 7 violation would be established upon a showing that it is more likely than not (i.e., there is a preponderance of the evidence) that there is a greater than 50 percent likelihood that a merger will substantially lessen competition. That is the showing DOJ must make to attain injunctive relief under Section 15 of the Clayton Act. Given that it requires showing only a probability of a probability, it is not exactly stringent.

Nonetheless, the *CCC Holdings* court held that the FTC's proof burden is even lighter. According to the court, the Commission is not required to establish a likelihood that the proposed merger would likely lessen competition. Instead, it may prevail as long as it "raise[s] questions going to the merits so serious, substantial, difficult and doubtful as to make them fair ground for thorough investigation, study, deliberation and determination by the FTC in the first instance and ultimately by the Court of Appeals."[8] (This lower standard of proof results from the fact that Section 13(b), unlike Section 15, calls for an injunction to be granted "[u]pon a proper showing that, weighing the equities and considering the Commission's likelihood of ultimate success, such action would be in the public interest."[9] That language has been interpreted to lower the standard from the traditional equity test, which applies to DOJ's requests for injunctions.[10])

Having set forth the applicable standard of proof, the district court turned to the parties' evidence. It began, as is typical, by defining the relevant markets affected by the proposed merger and assessing the pre- and post-merger concentration of those markets.[11] The FTC proposed product markets consisting of "Estimatics" (systems for valuing partial losses) and "TLV systems" (systems for valuing totaled vehicles). The former market definition was undisputed, but the defendants argued that the latter

[6] 15 U.S.C. § 18.

[7] United States v. Gen. Dynamics Corp., 415 U.S. 486, 505 (1974).

[8] CCC Holdings, *supra* note 3, at 12 (quoting Fed. Tr. Comm'n v. H.J. Heinz Co., 246 F.3d 708, 714-15 (D.C. Cir. 2001)).

[9] Compare 15 U.S.C. § 53(b) (FTC) with 15 U.S.C. § 25 (DOJ).

[10] *See* AMC Report, *supra* note 5, at 142.

[11] CCC Holdings, supra note 3, at 15-26.

Competition Policy International, Inc. © 2009. Copying, reprinting, or distributing this article is forbidden by anyone other than the publisher or author.

should be expanded to include "Book" providers (e.g., the Kelley Blue Book) that provide market values for vehicles. Relying on a number of "practical indicia," the court concluded that TLV systems represented a relevant market (though it noted that the FTC "is not 'required to settle on a market definition at this preliminary stage'").[12] Within the Estimatics and TLV markets, the combined CCC/Mitchell entity would have market shares of 70 percent and 65 percent, respectively, and would face competition from only one other significant competitor, "Audatex."[13] Given these high market shares, the high concentration of the post-merger market, and the degree to which the proposed merger would increase the Herfindahl-Hirschman Index ("HHI"), the court concluded that the Commission had "established a strong *prima facie* case that a merger between CCC and Mitchell would violate Section 7 of the Clayton Act."[14]

The court then considered and rejected defendants' argument that the lack of significant entry barriers in the Estimatics and TLV would constrain supra-competitive pricing following the merger.[15] The court first observed that there has historically been little entry into either market.[16] It then considered what it termed "technical" barriers to entry, such as the need to build parts and labor databases and to develop software, and concluded that they were significant.[17] Finally, it addressed the defendants' argument that a new and quickly growing competitor could expand in response to supra-competitive pricing.[18] While acknowledging the fringe competitor's innovativeness and advantages (e.g., it had its own innovative software system and had contracted to license Mitchell's parts and labor database), the court concluded that its expansion could not be counted on to counter anticompetitive effect, because it would remain "an ant to an elephant, compared to a post-merger CCC/Mitchell."[19]

The court's reasons for discounting entry seem weak. First, its observations concerning historical entry are inapposite. The pertinent question is not whether there has been significant entry into these competitive markets but whether there *would be* entry in response to post-merger supra-competitive pricing. With respect to so-called "technical" barriers to entry, the court adopted a broad "Bainian" (as opposed to "Stiglerian") definition[20] that would seem to deem all start-up costs as entry barriers; if

[12] *Id*. at 24-25.

[13] *Id*. at 26-30.

[14] *Id*. at 30.

[15] *Id*. at 31-55.

[16] *Id*. at 33-35.

[17] *Id*. at 38-48.

[18] *Id*. at 49-54.

[19] *Id*. at 52.

[20] Compare J. BAIN, BARRIERS TO NEW COMPETITION: THEIR CHARACTER AND CONSEQUENCES IN MANUFACTURING INDUSTRIES (1962) with G. J. STIGLER, THE ORGANIZATION OF INDUSTRY 67 (1968). On the dispute over how to define entry barriers, *see generally* Hovenkamp, *supra* note 4, at 39-42.

Competition Policy International, Inc. © 2009. Copying, reprinting, or distributing this article is forbidden by anyone other than the publisher or author.

the costs of developing (or licensing) a database and developing software are legitimate entry barriers in these markets, then virtually every market is subject to significant entry barriers, for the vast majority of new entrants have to spend money and develop things in order to get started. Finally, the fact that the existing fringe competitor will likely remain relatively small under current projections does not imply that it could not expand quickly in response to supra-competitive pricing following the proposed merger. This is, after all, an industry with very low variable costs, so expansion should be easy.

After considering entry barriers, the third step of the pre-merger analysis prescribed by the DOJ/FTC horizontal merger guidelines,[21] the court returned to the guidelines' second step.[22] It considered whether the defendants had shown that, despite the high post-merger market concentration, the merger would not be likely to produce adverse coordinated or unilateral effects in the relevant markets. With respect to the likelihood of coordinated anticompetitive effects, the court concluded that the evidence was unclear.[23] On the one hand, the defendants pointed to seven factors that would tend to prevent collusion or tacit coordination:

1. product heterogeneity;
2. lack of price transparency;
3. complexity and lack of standardization with respect to pricing and products;
4. firm heterogeneity;
5. large, infrequent contracts;
6. high fixed costs relative to variable costs; and
7. highly sophisticated buyers.[24]

These factors, the court conceded, would make it difficult to establish and/or police any sort of express or tacit competition-limiting agreement and therefore implied that the risk of adverse coordinated effects is lower than the high HHIs would suggest.[25] On the other hand, the court concluded that other factors identified by the FTC "tend to confirm the HHI's predictions regarding likelihood of coordination."[26] Specifically, the court pointed to the "stability" of the relevant markets (i.e., the fact that the participants know who buys what from whom, so that coordination is policeable) and their "maturity" (i.e., the fact that participants have little opportunity for sales growth apart from usurping business from rivals).[27] These factors, the court concluded, suggested that the likelihood

[21] U.S. DEPARTMENT OF JUSTICE AND THE FEDERAL TRADE COMMISSION, HORIZONTAL MERGER GUIDELINES § 3 ("Entry Analysis").

[22] *Id*. § 2 ("The Adverse Competitive Effects of Mergers").

[23] CCC Holdings, *supra* note 3, at 67.

[24] *Id*. at 56.

[25] *Id*. at 63.

[26] *Id*.

[27] *Id*. at 63-64.

Competition Policy International, Inc. © 2009. Copying, reprinting, or distributing this article is forbidden by anyone other than the publisher or author.

of adverse coordinated effects was uncertain and should thus be resolved by the FTC in the first instance.[28] With respect to adverse unilateral effects, the court concluded that the evidentiary record would not support a conclusion that such effects were likely.[29]

The court next turned to consider whether the proposed merger would occasion efficiencies that would offset its anticompetitive effects.[30] While the defendants had projected cost savings that "would indeed be substantial" and that "were fundamental to the parties' decision to merge,"[31] the court concluded that the projected efficiencies could not salvage the proposed merger. First, the efficiencies could take years to materialize.[32] Moreover, the efficiencies may not benefit consumers as a whole because (1) many customers would incur switching costs if efficiency-enhancing consolidation of operations occurred, and (2) the merged firm could simply pocket its cost savings rather than passing them on to consumers.[33]

Having concluded on the basis of the foregoing analysis that the FTC had raised serious questions warranting further study and thus was likely to succeed on the merits, the court turned to a weighing of equities.[34] Repeating points it had made in its analysis of the merger's potential efficiencies, the court concluded that "timing and free choice undercut Defendants' predictions of the public value of the potential merger."[35] Because projected efficiencies would take some time to achieve and might not be passed along to consumers, the equities favored granting the preliminary injunction the FTC requested.

III. IMPLICATIONS OF *CCC HOLDINGS*' LAX STANDARD OF PROOF AND ALLOCATION OF PROOF BURDENS

Numerous commentators, including most notably a majority of the members of the Antitrust Modernization Commission, have bemoaned the lax standard of proof applicable to FTC—but not DOJ—requests for preliminary injunctive relief.[36] As this case exemplifies, the FTC's theoretically "preliminary" injunctions often turn out to be permanent in fact, for the parties to a merger agreement usually cannot hold their agreement together for the duration of an administrative proceeding (whose adverse outcome is a foregone conclusion) and an appeal.[37] An overly lax standard for

[28] *Id*. at 67-68.

[29] *Id*. at 72-76.

[30] *Id*. at 76-82.

[31] *Id*. at 78.

[32] *Id*. at 78-79.

[33] *Id*. at 80.

[34] *Id*. at 82-84.

[35] *Id*. at 84.

[36] See AMC Report, *supra* note 5, at 129-47.

[37] As a former policy director of the FTC's Bureau of Competition observed,

Competition Policy International, Inc. © 2009. Copying, reprinting, or distributing this article is forbidden by anyone other than the publisher or author.

preliminary injunctions therefore permits mergers to be thwarted prior to a thorough examination of competitive concerns. Moreover, given that the deck is stacked so heavily in favor of the FTC, initiation or threat of a Section 13(b) action gives the Commission an undue degree of leverage (more than that possessed by the DOJ) in negotiating consent decrees with merging parties.[38] This discrepancy between regulatory bodies "undermines the public's trust that the antitrust agencies will review transactions efficiently and fairly" and "creates the impression that the ultimate decision as to whether a merger may proceed depends in substantial part on which agency reviews the transaction."[39]

In addition to these concerns, the lax preliminary injunction standard the D.C. Circuit has endorsed may push merger analysis into a purely structuralist direction that effectively endorses the Cournot-inspired S-C-P paradigm and deemphasizes important Chicago School insights concerning entry, scale economies, and the difficulty of establishing and maintaining cartels.[40] To see how this may occur, consider the reasoning espoused in *CCC Holdings*.

Following D.C. Circuit precedent, the court first set forth a low standard for granting the FTC an officially preliminary, but in actuality permanent, injunction. Because the requested injunction was merely preliminary (at least in theory), the FTC was required only to "raise[] questions going to the merits so serious, substantial, difficult and doubtful as to make them fair ground for thorough investigation, study, deliberation and determination by the FTC in the first instance and ultimately by the Court of Appeals."[41] (Never mind that the merger would be canceled and the FTC would never reach these serious, substantial, and difficult questions if the preliminary injunction were granted.) The court then permitted the FTC to discharge its burden to "raise questions" by demonstrating that the post-merger markets would be highly concentrated and that the merger would increase HHIs substantially.

This showing, the court held, shifted the burden to defendants to prove either that entry would preclude supra-competitive pricing in the relevant markets, that adverse competitive effects (coordinated or unilateral) were unlikely, or that substantial

> The reality is that no firm has ever continued to litigate a merger against the FTC after losing the preliminary injunction motion. The costs and difficulty of keeping a merger agreement together are simply too great. As Justice Fortas observed, in *FTC v. Dean Foods*, "'Preliminary' here usually means final."

David Balto, *Should there be a difference between the FTC and DOJ?*, in FTC: WATCH (May 22, 2002) (available at http://www.antitrustinstitute.org/Archives/187.ashx).

[38] AMC Report, *supra* note 5, at 139.

[39] *Id*. at 138-39.

[40] See generally Hovenkamp, *supra* note 4, at 42-47.

[41] CCC Holdings, *supra* note 3, at 12 (quoting Heinz, 246 F.3d at 714-15).

Competition Policy International, Inc. © 2009. Copying, reprinting, or distributing this article is forbidden by anyone other than the publisher or author.

efficiencies would offset any dangers occasioned by increased concentration.[42] On each of these affirmative defenses, the deck was stacked heavily in favor of the FTC:

- With respect to entry, the court recognized "barriers" (e.g., a need to develop products, earn customer loyalty, etc.) that will virtually always exist.
- In analyzing whether anticompetitive effects were likely, the court found no basis for worrying about adverse unilateral effects and conceded that the defendants had articulated a number of compelling reasons for concluding that the markets at issue were not susceptible to collusion. Nonetheless, the court sided with the FTC because the Commission had articulated a couple of broadly applicable theories as to why collusion might occur in the relevant markets (i.e., stability, maturity). Because the FTC had said **something** in response to the defendants' far more persuasive showing, the court concluded that it was obliged, under the lax Section 13(b) standard, to leave the matter to the FTC to resolve in administrative adjudication.[43] (Again, never mind that granting the preliminary injunction would foreclose the administrative adjudication altogether.)
- The court refused to credit the defendants' proffered efficiencies because (1) they might take a few years to materialize and (2) there was no guarantee that they would be passed on to consumers. Given that one or both of these factors will be present in the vast majority of cases in which efficiencies are asserted, one wonders whether the parties to a challenged merger could ever prevail on an efficiencies defense in a Section 13(b) action.

Throughout its analysis, the district court adhered closely to the DOJ/FTC horizontal merger guidelines, which aim to move pre-merger analysis beyond the overly simplistic S-C-P paradigm. As prescribed by the guidelines (which, incidentally, are

[42] *Id*. at 31 (following showing of high concentration and HHIs, "the burden shifts to Defendants to show that traditional economic theories of the competitive effects of market concentration are not an accurate indicator of the merger's probable effect on competition in these markets or that the pro-competitive effects of the merger are likely to outweigh any anticompetitive effects").

[43] The court explained:

> Whether the Defendants' argument that the unique combination of factors in these markets negates the probability that the merger may tend to lessen competition substantially, or whether the FTC is correct that the market dynamics confirm the presumptions that follow its prima facie case, is ultimately not for this Court to decide. As Judge Tatel confirmed in Whole Foods, "[c]ritically, the district court's task is not 'to determine whether the antitrust laws have been or are about to be violated. That adjudicatory function is vested in the FTC in the first instance.'" 548 F.3d at 1042 (Tatel, J., concurring) (quoting Heinz, 246 F.3d at 714-15). The Defendants' arguments may ultimately win the day when a more robust collection of economic data is lain before the FTC. On this preliminary record, however, the Court must conclude that the FTC has raised questions that are so "serious, substantial, difficult and doubtful" that they are "fair ground for thorough investigation, study, deliberation and determination by the FTC." Heinz, 246 F.3d at 714-15.

CCC Holdings, *supra* note 3, at 67-68.

Competition Policy International, Inc. © 2009. Copying, reprinting, or distributing this article is forbidden by anyone other than the publisher or author.

designed to guide the agencies' enforcement discretion, not adjudication),[44] the court officially ventured beyond pure structural matters (concentration, HHIs, etc.) to consider likely competitive effects, entry, and efficiency gains. Yet, examination of these non-structural matters was largely superficial because the court (1) was required to follow the D.C. Circuit's toothless standard of proof for Section 13(b) preliminary injunctions, and (2) allocated the burden of proof on all non-structural matters to the merging parties. Notably, the merger guidelines expressly decline to allocate proof burdens,[45] and it would seem that at least one of the non-structural matters, the likelihood of adverse coordinated or unilateral effects, should be part of the government's prima facie case. The district court, however, sided with the FTC on that matter, despite the fact that the Commission's evidence was substantially less compelling than that presented by the defendants.

None of this is to say that the ultimate outcome of the district court's decision (i.e., the enjoining of this merger) was improper. Rather, the point is that the D.C. Circuit's lax standard of proof in Section 13(b) cases, coupled with the district court's allocation of proof burdens on non-structural matters, will effectively prevent an in-depth consideration of such matters in merger challenges. Once high market concentrations and HHIs are shown, it is difficult to imagine how parties to a merger agreement could ever justify the merger.

Given the Bainian definition of entry barriers espoused by the district court, such barriers will always be present. Because the FTC can usually parrot some theories about market stability or maturity or something similar, there will always be some conflict in the evidence on adverse competitive effects; under the district court's reasoning, such conflict alone is a sufficient ground for siding with the Commission on the likelihood of coordinated or unilateral effects, even if the Commission's theory is less compelling than that of the defendants. When it comes to efficiencies occasioned by the merger, the FTC will almost always be able to articulate one of the arguments asserted in this case—i.e., that the efficiencies would take some time to achieve or that the cost-savings might not be passed on to consumers.

All this suggests that once the FTC establishes high concentrations and HHIs, its preliminary injunction will be virtually guaranteed. And, given that the issuance of a preliminary injunction usually thwarts a proposed merger, an in-depth consideration of competitive effects, entry barriers, and efficiencies—a consideration that is supposed to

[44] See Horizontal Merger Gu*id*elines, *supra* note 21, at § 0.1 ("Purpose and Underlying Policy Assumption of the Gu*id*elines").

[45] *Id*.

Competition Policy International, Inc. © 2009. Copying, reprinting, or distributing this article is forbidden by anyone other than the publisher or author.

be "vested in the FTC in the first instance"[46]—will never actually occur. Merger analysis will effectively turn on structural considerations exclusively.

IV. CONCLUSION

The merger at issue in *CCC Holdings* may well have been anticompetitive. Unfortunately, however, there was little opportunity to delve into the non-structural matters that could have acquitted the merger. By employing the D.C. Circuit's lax standard of proof for preliminary injunctions under Section 13(b) of the FTC Act and allocating to the defendants the burden of proving all non-structural considerations, the *CCC Holdings* court effectively ensured that structural matters alone would determine whether the CCC/Mitchell merger would proceed. If Congress desires a more nuanced pre-merger analysis that includes meaningful consideration of non-structural matters (entry barriers, the likelihood of adverse coordinated and unilateral effects, potential efficiencies), it should follow the Antitrust Modernization Commission's recommendations and align the FTC's right to injunctions with that of the DOJ.[47]

[46] CCC Holdings, *supra* note 3, at 68 (quoting Federal Tr. Comm'n v. Whole Foods Mkt., Inc., 548 F.3d 1028, 1042 (Tatel, J., concurring)).

[47] See AMC Report, *supra* note 5, at 129-43.

Competition Policy International, Inc. © 2009. Copying, reprinting, or distributing this article is forbidden by anyone other than the publisher or author.