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What the FTC and DOJ's Reinvigorated Litigation Strategy Means for Merger Review

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I. INTRODUCTION

The Federal Trade Commission ("FTC") and Department of Justice Antitrust Division ("DOJ") are hot to trot about merger litigation these days—and with multiple major wins in recent years after a string of tough losses, their bullishness is not surprising. While many trial lawyers prefer to keep their trade secrets under wraps, both agencies are not only litigating more, but are also openly talking about their litigation strategies as well.[2] To antitrust merger lawyers, the refrains in these public statements have become familiar: We will use your documents against you, we will use the merging parties as our star witnesses at trial, and we litigate to win. While no one can doubt that the agencies have always litigated only if they thought they could prevail, their recent successes in *H&R Block*, *ProMedica/St. Luke's*, and other litigated cases demonstrate that the agencies have changed their litigation strategy. They are, in fact, litigating to win.

What does this revived and successful litigation focus mean, if anything, for the merger review process? When an agency issues a Second Request, it faces a simple set of choices: it can seek a remedy or it can close the investigation. If it decides a remedy is appropriate, it can sue or negotiate a consent. The fact that the agencies now think more about what evidence will (and won't) work at trial has practical consequences for the type of advocacy that is likely to be most effective when the agencies make these decisions. After summarizing the recent evolution in the agencies' trial strategies, I discuss some of those consequences here.

II. LITIGATING TO WIN: EVIDENCE FROM THE MERGING PARTIES MOVES TO CENTER STAGE

To a seasoned trial lawyer, the fact that the agencies are building narratives around hot documents and leading with hostile witnesses who are the key figures in their narrative may seem unremarkable. Stretching back ten years, however, this is not how the agencies have always approached litigation. Over the last decade, the evidence they view as the linchpin to their litigation strategy has, quite starkly, changed.

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[2] *See, e.g.*, J. Thomas Rosch, Comm'r Fed. Trade Comm'n, Changing the Way We Try Merger Cases, Remarks before the 14th Annual Sedona Conference on Antitrust Litigation (Oct. 25, 2012), http://www.ftc.gov/speeches/rosch/121025sedonamergertrial.pdf; Joseph F. Wayland, Acting Asst. Attorney Gen. Antitrust Division, U.S. Dep't of Justice, Litigation in the Antitrust Division, Remarks before the Georgetown Law 6th Annual Global Antitrust Enforcement Symposium (Sept. 19, 2010), http://www.justice.gov/atr/public/speeches/287117.pdf.

A. Customer Testimony in Arch Coal and Oracle

The year 2004 was arguably a watershed year in government-initiated merger litigation. In *Arch Coal* and *Oracle*, the FTC and DOJ respectively each suffered a significant loss.[3] Although the cases were tried by different agencies, were heard in different courts, and involved different industries, both decisions—decided within the span of one month—zeroed in on and discredited the agencies' focus on customer testimony. Although each case had several moving parts that affected their outcomes, I briefly focus on the agencies' emphasis on (and the federal courts' rejection of) customer testimony here.

In *Arch Coal* the FTC challenged Arch Coal's proposed acquisition of Triton Coal Company, L.L.C., alleging that the acquisition would substantially lessen competition in coal mined from the Southern Powder River Basin ("SPRB") and in 8800 British Thermal Unit ("Btu") SPRB coal. Judge John Bates denied the FTC's request for injunctive relief. In so holding, Judge Bates observed that the FTC substantially relied on customer testimony and that, in many contexts, "antitrust authorities do not accord great weight to the subjective views of customers in the market."[4] He then explained that "while the court does not doubt the sincerity of the . . . customers," the customers concern "is little more than a truism of economics: a decrease in the number of suppliers may lead to a decrease in the level of competition in the market." As Judge Bates later observed, the government's burden in an unconsummated merger case is to show, on a forward-looking basis, that a merger is substantially likely to result in a lessening of competition; the customer testimony, however, "was not forward-looking, and did not require any predictions or projections about the future."[5]

One month later, Judge Vaughn Walker made similar pronouncements when he rejected the DOJ's challenge to Oracle's proposed acquisition of PeopleSoft. The DOJ's theory was that the acquisition was likely to have anticompetitive effects in the market for "high function" financial management services and human resource management software because it would leave SAP as Oracle's only remaining competitor. As Judge Walker has since observed, the DOJ "relied almost exclusively on a series of customer witnesses,"[6] which he rejected. He found the customers' testimony was speculative on whether the merger was likely to result in a price increase and lacked the analytical rigor needed to carry the DOJ's burden.[7] Having rejected their

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[3] *United States v. Oracle Corp.*, 331 F. Supp. 2d 1098, 1175 (N.D. Cal. 2004); *Federal Trade Commission v. Arch Coal, Inc.*, 329 F. Supp. 2d 109 (D.D.C. 2004).

[4] *See Arch Coal*, 329 F.Supp. 2d at 145-146 ("Furthermore, while the court does not doubt the sincerity of the anxiety expressed by SPRB customers, the substance of the concern articulated by the customers is little more than a truism of economics: a decrease in the number of suppliers may lead to a decrease in the level of competition in the market. Customers do not, of course, have the expertise to state what will happen in the SPRB market, and none have attempted to do so.").

[5] John D. Bates, *Customer Testimony of Anticompetitive Effects in Merger Litigation*, 2005 COLUM. BUS. L. REV. 279 (2005).

[6] *See* Vaughn R. Walker, *Merger Trials: Looking for the Third Dimension ("Third Dimension")*, COMPETITION POL'Y INT'L, Spring 2009, at 45.

[7] *See Oracle Corp.*, 331 F. Supp. 2d at 1131 (noting that the customer witnesses' "speculation was not backed up by serious analysis that they had themselves performed or evidence they presented. There was little, if any, testimony by these witnesses about what they would or could do or not do to avoid a price increase from a post-merger Oracle."). In a subsequent article, Judge Walker observed that he believed the witnesses themselves were not credible

testimony, Judge Walker had little other evidence to rely on and "[t]he disconnect between the economic analysis the government sought to relate and the storytellers it brought to court" proved fatal to its case.[8]

B. The Agencies Regroup and Unveil the 2010 Merger Guidelines

Following *Arch Coal* and *Oracle*, the heads of both agencies initially asserted that they would continue to give serious weight to customer testimony in litigation.[9] Then, for a four-year period, the agencies backpedaled and tried considerably fewer cases. As one former senior FTC staffer recently noted "[b]oth agencies revisited what they could do in court after decisions in *Arch Coal* and *Oracle*" rejected government cases that depended greatly on customer testimony. "It took some time to find the right cases."[10]

Beginning in 2008, however, two developments emboldened the FTC's litigation efforts. First, after not winning a merger case in almost seven years, the FTC obtained favorable decisions in *Whole Foods* (2008) and *CCC Holdings* (2009).[11] Although debate continues over whether these decisions furthered an existing divide between the DOJ and the FTC's standards for obtaining a preliminary injunction, the FTC viewed both decisions as favorable insofar as the FTC could claim that they lowered its burden to obtain injunctive relief.

Second, in April 2009 the FTC revised the Part III rules that govern the FTC's administrative trial process to expedite the time for administrative review.[12] The FTC presumably

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because it was implausible that the sizeable customers that the DOJ called as its lead witnesses could not push back on a price increase. *See* Walker, *Third Dimension*, *supra* note 6, at 45 ("the most striking feature or image the [customer] testimony conveyed was that it was at odds with the basic premise of the government's case" because "the witnesses and their employers seem[ed] unlikely victims for oppression or abuse of a dominant position by a supplier in the market").

[8] *See* Walker, *Third Dimension*, *supra* note 6, at 46.

[9] Thomas O. Barnett, Deputy Asst. Attorney Gen. Antitrust Division, U.S. Dept't of Justice Enforcement Priorities: A Year in Review, Remarks before the Fall Forum of the Section of Antitrust Law, American Bar Association (November 19, 2004) (noting that "in a post-Oracle world" customer testimony will remain relevant because "customers remain the most objective marketplace participants . . . the decisions they make in the ordinary course of business frequently provide a better window onto how the market actually functions than an economist's model or the court's intuition."); Deborah Platt Majoras , Chairman, Federal Trade Comm'n, U.S. Antitrust Practice – how does it affect European Business? Remarks by Federal Trade Commission Chairman delivered to the Studienvereinigung Kartellrecht (April 7, 2005) ("[W]e should . . . continue to present customer testimony at trial. Customers are valuable sources of information about many mergers' competitive effects because they have the most to lose from an anticompetitive deal, and usually have little incentive to provide misleading information.").

[10] Bill McConnell, *FTC's Matt Reilly: The Life of Reilly*, The Deal Pipeline (June 15, 2012) http://www.thedeal.com/magazine/ID/047726/dealmakers/the-ftcs-matt-reilly.php#ixzz2Ee7p6zhY. *See also* J. Thomas Rosch, Comm'r, Federal Trade Comm'n, Litigating Merger Challenges: Lessons Learned, Remarks presented at the Bates White Fifth annual Antitrust Conference (June 2, 2008), http://www.ftc.gov/speeches/rosch/080602litigatingmerger.pdf (noting that recent losses have "led to some sober reflection both inside and outside of the agencies. Indeed, the Federal Trade Commission held a one day workshop on merger litigation . . . [and] the day was spent reflecting on the agencies' recent merger litigation experiences and debating whether the agencies should consider changes to its approach").

[11] *FTC v. Whole Foods Market, Inc.*, 548 F.3d 1028, 1035 (D.C. Cir. 2008); *FTC v. CCC Holdings, Inc.*, 605 F. Supp. 2d 26 (D.D.C. 2009).

[12] Federal Trade Commission Press Release, FTC Issues Final Rules Amending Parts 3 and 4 of the Agency's Rules of Practice (April 2009), http://www.ftc.gov/opa/2009/04/part3.shtm.

made these changes to emphasize to federal courts hearing the FTC's preliminary injunction challenges that they did not need to resolve the merits of the FTC's challenge and could trust the FTC to move quickly. The initial seeds of these efforts were borne out in the FTC's May 2008 challenge to Inova Health System's proposed acquisition of Prince William Health System, in which the FTC publicly committed to move through the administrative process quickly.[13] The FTC's commitment to take the case through administrative proceedings regardless of the outcome in the parallel federal court proceedings eventually caused the parties to abandon their transaction.[14] Collectively, these events and others breathed new life into the FTC's litigation efforts.

It was against this backdrop that the FTC and DOJ unveiled the 2010 Merger Guidelines. Among other things, the 2010 Guidelines included two significant changes that had the potential to shape how the agencies litigate every merger case. First, the 2010 Guidelines codified the FTC's evolving litigation strategy by including a new section on "sources of evidence," which described the types of evidence that the agencies find most persuasive, with a particular emphasis on evidence from the merging parties. Second, and more controversially, the 2010 Guidelines also suggested that the agencies need not always engage in upfront market definition and can back into the relevant market by first determining how a merger is likely to cause anticompetitive effects. Whether these changes would meaningfully affect the agencies' approach to merger litigation remained to be seen.

C. The Agencies Take Their Direct Evidence (and, Yes, Upfront Market Definition) To Court

The FTC and DOJ's litigation efforts thus far suggest that the 2010 Guidelines only partially predicted the agencies' litigation strategy. On the one hand, the agencies remain firmly committed to relying on ordinary course documents, testimony from the merging parties, and other direct evidence from the parties to prove their case. On the other hand, perhaps recognizing that courts continue to view market definition as a threshold issue,[15] the agencies generally have not argued that courts should back into market definition.

The 2011 *H&R Block/TaxACT* litigation is telling in this regard. There, the DOJ sought to enjoin H&R Block from acquiring 2SS Holdings, Inc., the maker of TaxAct products, on the ground that the acquisition "would combine the second- and third-largest providers in the U.S. Digital DIY Tax Preparation product market."[16] The DOJ's brief in support of its motion for

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[13] Federal Trade Commission Press Release, FTC and Virginia Attorney General Seek to Block Inova Health System Foundation's Acquisition of Prince William Health System (May 9, 2008) ("The issuance of the complaint is the first step in the administrative trial process. Inova and PWHS will be offered FTC's "Fast Track" administrative trial procedure. Chairman William E. Kovacic and Commissioners Pamela Jones Harbour and Jon Leibowitz are committed, subject to the bounds of reasonableness and fairness, to a just and expeditious resolution of any potential appeal that may be taken to the full Commission.").

[14] Press Release, Inova Health System, Statement from Inova Health System and Prince William Health System About the Proposed Merger (June 6, 2008), http://newsroom.inova.org/article_display.cfm?article_id=5135.

[15] *See, e.g.*, *City of New York v. Group Health Inc.*, 649 F.3d 151 (2d Cir. 2011) (rejecting efforts by plaintiff to prove anticompetitive effects based on Upward Pricing Pressure in lieu of defining a relevant market).

[16] Complaint ¶ 1, *United States v. H&R Block, Inc.*, Case No. 1:11-cv-00948 (D.D.C. May 22, 2011), http://www.justice.gov/atr/cases/f271500/271579.htm.

injunctive relief did not start with a competitive effects argument, but instead read like a traditional Section 7 brief and argued at the outset that "the relevant product market is Digital DIY Tax Preparation."[17] As to evidentiary support for that proposition, the DOJ leaned very hard on the parties' ordinary course documents, which the DOJ claimed painted a vivid portrait of aggressive head-to-head competition in the Digital DIY Tax Preparation market.

In an 86-page opinion, U.S. District Court Judge Beryle Howell sided with the DOJ.[18] In so holding, Judge Howell relied heavily on the defendants' ordinary course documents. Judge Howell concluded that internal TaxACT documents demonstrated that TaxACT viewed H&R Block's and TurboTax's Digital DIY products as its primary competitors and that TaxAct based its pricing and business strategy on those competitors. Judge Howell found that internal H&R Block documents also supported the DOJ's Digital DIY market definition. The documents, combined with the analysis prepared by the DOJ's economist, Dr. Warren-Boulton, led Judge Howell to agree with DOJ's proposed market definition and conclude that the deal would likely result in coordinated and unilateral effects. Following the decision, then Acting Assistant Attorney General Sharis Pozen reflected that practitioners "can be assured that market definition retains the key role it has always played in [DOJ] investigations and litigations."[19]

The FTC's litigation efforts and the Commission's subsequent decision in the *ProMedica Health System* litigation are similarly revealing. In *ProMedica*, the FTC challenged ProMedica's acquisition of St. Luke's Hospital. Like the DOJ in *H&R Block*, the FTC led off its brief with a focus on market definition and argued that the acquisition would threaten substantial harm in the markets for (1) "general acute-care inpatient hospital services sold to commercial health plans" and (2) inpatient obstetrical services in southwestern Lucas County, Ohio.[20] Although the district court that considered the preliminary injunction request did not conduct a hearing with live testimony, the FTC laced its complaint and pleadings with numerous colorful statements from the parties' documents.[21] In a 115-page opinion, Judge David Katz sided with the FTC and entered a preliminary injunction that blocked the transaction pending an administrative trial on the merits.[22]

Following an administrative trial at the FTC, the ALJ concluded that the acquisition would result in higher reimbursement rates and the Commission affirmed. Significantly, though

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[17] Plaintiff's Memorandum of Points and Authorities in Support of its Motion for a Preliminary Injunction at 19, *United States v. H&R Block, Inc.*, Case No. 1:11-cv-00948 (D.D.C. August 1, 2011), http://www.justice.gov/atr/cases/f273600/273683.pdf.

[18] *United States v. H&R Block, Inc.*, 833 F. Supp. 2d 36 (D.D.C. 2011).

[19] Sharis A. Pozen, Acting Asst. Attorney Gen. Antitrust Division, U.S. Dept't of Justice, Remarks before the Fall Forum of the Section of Antitrust Law, American Bar Association (November 17, 2011).

[20] Complaint ¶ 1, *Federal Trade Comm'n v. ProMedica Health System, Inc.*, Case No. 3:11-cv-0047 (N.D. Ohio Jan. 7, 2011).

[21] *See e.g., id.* ("The parties' own documents acknowledge the Acquisition's '*great[] potential for higher hospital rates'* and that it 'may not be the best thing for the community in the community in the long run' (emphasis added).)."); *id.*¶ 3 ("Indeed, St. Luke's internal strategic plans unambiguously reveal that the Acquisition could allow ProMedica to '*stick it to employers, that is, to continue forcing high rates on employers and insurance companies*' (emphasis added)."); *id.* ("Elsewhere, [St. Luke's] documents observe that an '*affiliation with ProMedica ha[d] the greatest potential for higher hospital rates*' and could '*increase prices/costs to the community*' (emphasis added).").

[22] *FTC v. ProMedica Health Sys., Inc.*, 2011 U.S. Dist. LEXIS 33434 (N.D. Ohio March 29, 2011).

the Commission's decision cites the 2010 Guidelines to support the view that upfront market definition "need not always be the first step because evidence of competitive effects can often inform market definition," the Commission goes on to state that "based on the evidence before us, it is appropriate to begin the analysis utilizing the traditional burden-shifting framework" and begins by identifying the relevant markets.[23]

H&R Block and *ProMedica* illustrate the agencies' current strategies of (1) embracing (rather than avoiding) upfront market definition, and (2) proving their case through the parties' documents and testimony. The DOJ's complaint in *AT&T/T-Mobile*, the FTC's complaint in *Omnicare, Inc.*, and other cases in which the agencies sued to enjoin various transactions are to the same effect. Speeches delivered this fall by FTC Commissioner Tom Rosch and then-Acting Assistant Attorney General Joe Wayland regarding the agencies' reinvigorated litigation efforts, although silent on market definition, underscore that practitioners should expect that ordinary course documents and testimony from the merging parties' senior leadership will continue to play a central role in the agencies' trial tactics going forward.

III. THE PRACTICAL CONSEQUENCES OF THE AGENCIES' LITIGATION STRATEGY FOR ADVOCACY DURING THE MERGER REVIEW PROCESS

The agencies' litigation strategy has spillover effects for the merger review process. Although Second Requests provide the agencies with an opportunity to conduct an objective investigation, if the agencies conclude that a deal is likely to substantially lessen competition, they switch, at least in part, into litigation mode and start building a case. Unlike a private party that has a variety of legal interests, the agencies have to live day in and out with whatever case law they create. They do not like to lose and generally will be less likely to litigate a weaker case. As discussed below, this dynamic has practical implications for counseling and advocacy during the merger review process.

Counseling clients not to create bad documents is a must. Now, more than ever, bad documents can kill a deal of any size because they demonstrably increase the likelihood that the agencies will sue to block the transaction. Counseling personnel not to create misleading and inflammatory documents, including e-mails, cannot come too soon or too often. In particular, while companies should enlist antitrust counseling once they begin to contemplate a transaction, the agencies' emphasis on ordinary course documents suggests that conducting such counseling on a regular basis (i.e., regardless of a company's M&A plans), is a wise idea. Such presentations may seem boring or mundane in the absence of a pending deal, but no employee wants his/her e-mail to be front and center in a federal complaint; reminding potential hot document authors of this risk can therefore be a useful attention getter.

Identifying and understanding seemingly bad documents as early as possible is critical. Most deals will have documents that superficially may seem problematic, but when placed in their proper context are ultimately innocuous and may even be helpful to the merging parties. Getting on top of these documents is important so as not to be caught flat-footed when an agency staff attorney calls wanting more context about a particular e-mail or event.

[23] Opinion of the Federal Trade Commission at 15, *In re ProMedica Health System, Inc.*, Docket No. 9346 (June 25, 2012).

In terms of pre-deal counseling, merging firms who believe that their deal is likely to receive a Second Request may want to consider doing more front-end work to begin identifying potentially problematic documents. Historically, antitrust risk analysis has principally focused on (1) 4(c) documents; (2) easily obtainable strategic, pricing, and deal-specific documents; and (3) facts that are relevant to the substantive analysis (market definition, coordinated and unilateral effects, and predicting reactions from customers and, to a lesser extent, competitors). During this risk assessment phase, a deeper dive into e-mails and other electronic files that would surface during a Second Request, although high on the wish list of most antitrust lawyers, has simply not been on the table.

Going forward, however, making some front end investment on a more substantial document analysis might make sense. This could involve collecting a snapshot of documents from 1 to 2 key custodians or a broader request for ordinary course documents that relate to competitive dynamics in the relevant industry. An antitrust lawyer that knows these documents exist (or has an increased confidence that they are not littering the e-mails of likely key custodians) will be able to provide a more fine-tuned risk assessment.

In terms of merger review, whereas the agencies previously may have been more receptive to arguments that a stray bad e-mail was simply puffery, the current document focus means that it is critical to identify those documents and put them into a larger competitively neutral or pro-competitive context as early as possible. To be sure, if the parties have concluded that they are heading to litigation, laying out a pro-competitive narrative for the agencies (i.e., previewing the trial strategy) may not make tactical sense. If, however, the parties remain focused on persuading the agencies not to sue, walking the agencies through why the supposed bad documents that form the backbone of their trial strategy really are not that "bad"—and, in fact, are completely consistent with the merging parties' trial narrative—might help diminish the likelihood of a suit. Either way, investing time not just in identifying, but also in understanding and contextualizing potentially problematic documents, is essential.

The absence of smoking gun documents can deter litigation. The agencies have made it clear that they prefer not to build cases principally based on customer testimony and economic experts. The corollary to this is that, for those deals where there are few (if any) real bad documents, the agencies likely will be more open to arguments that they will face an uphill battle in litigation. Alternatively, in these circumstances the agencies may be more willing to consider accepting a consent order if it presents a plausible alternative to suing. Put differently, the absence of economic evidence or customer complaints has long provided leverage during discussions with the agencies about whether they should sue. The absence of problematic documents provides similar leverage.

The absence of good witnesses can also deter litigation. We know that the agencies like to build their cases by using the CEOs and other key personnel from the merging firms as their star witnesses. In part this is because such executives provide an easy means to admit key documents into evidence, which is inevitable. Such senior executives, however, can also provide further fodder for the government's case if they come across as untrustworthy, dishonest, or otherwise fit the mold of the government's anticompetitive narrative. Obviously, this means that preparing these executives for depositions and investigational hearings is paramount. It also means, however, that investing time in ensuring that company representatives are prepared to

answer tough questions in a sincere and credible manner during meetings with the agency staffs and senior leadership can pay dividends. The agencies will be less likely to sue if they think that their preferred star witnesses will do more harm to their case than good.

Market definition still matters. Now that the dust has settled on the 2010 Merger Guidelines, the agencies' own recent practice demonstrates that the agencies will continue (at least in litigation) to hew to the traditional Section 7 path of defining a market at the threshold, notwithstanding any suggestion to the contrary contained in the 2010 Guidelines. The agencies' trial teams and senior leadership will therefore pay close attention to market definition arguments as they decide whether or not to sue. Firms should therefore continue to make market definition arguments a key component of their advocacy, particularly in negotiations related to possible litigation.

IV. CONCLUSION

When it comes to selecting mergers to challenge in court, the FTC and DOJ by all accounts are focused on one objective: winning. The 2010 Guidelines' heightened emphasis on evidence collected from the merging parties appears fully consistent with this objective. Other suggestions in the 2010 Guidelines, including the possibility that the agencies "need not start with market definition" and the much-debated Upward Pricing Pressure discussion, may or may not be. Whether courts will embrace these approaches remains unclear.

In the meantime, merging firms that find themselves in contentious negotiations over potential remedies should focus not simply on whether, as a matter of law, *the agencies have a case that justifies the remedy*, but should also consider *how the agencies would ultimately like to try their case to obtain that remedy* and work to debunk that evidence and strategy. The agencies' renewed litigation focus means that arguments that previously might have been less compelling related to the strength of the documents or the unpersuasive nature of the agency's trial narrative may be more powerful in the current, more litigious environment.