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## **Antitrust Defeats May Spur Concentrated-Market Deals: Judicial defeats in Oracle and Arch Coal weaken regulatory dicta on competitor reduction and pricing power**

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Three federal court rejections of government merger challenges during 2004 may present new opportunities for companies to pursue mergers and acquisitions of competitors in concentrated markets. While each case is fact-specific, the series of decisions may demonstrate a shift in antitrust enforcement, with courts permitting transactions that were challenged under the Horizontal Merger Guidelines used by the FTC and Department of Justice (DOJ) in evaluating deals.

Among other effects, the court decisions - including Oracle Corp.'s attempted acquisition of PeopleSoft Inc. and Arch Coal Inc.'s purchase of Triton Coal Co. - dealt blows to regulatory theories turning on reduction of competitors in a market and pricing power based on market share or firm size. The result could be an easier road ahead for market-leading firms trying to bulk up in concentrated sectors.

Following is a short synopsis of these cases and their lessons, which may be applied in other industries.

### **FTC v. Arch Coal/Triton**

The FTC challenged Arch Coal's acquisition of competitor Triton's two coal mines in Wyoming. Arch initially intended to purchase both of Triton's mines, which would have resulted in a doubling of Arch's market share and an extremely concentrated market. In the face of the potential FTC challenge, Arch found a buyer, Kiewit Mining Acquisition Co., to purchase one of the two mines Arch had intended to buy. The FTC wanted the transaction evaluated, for purposes of a preliminary injunction, as Arch's acquisition of both mines, but the U.S. District Court for the District of Columbia evaluated the acquisition as Arch's acquisition of a single mine, with Kiewit acquiring the second mine.

Viewed as a one-mine acquisition, the concentration levels barely exceeded the Merger Guidelines concentration thresholds of concern. In light of a weak concentration-based presumption of harm, the court held the FTC to a high burden of showing a theory of competitive harm, rather than relying on the presumption from the Merger Guidelines.

Here, in light of the sale of one mine to Kiewit, Arch showed that its acquisition of the other mine would not reduce the number of competitors in the market as a result of the deal.

The court denied the FTC's request for a preliminary injunction on August 13, 2004, after a two-week trial.

#### DOJ v. Oracle/PeopleSoft

The DOJ challenged Oracle's hostile acquisition bid for PeopleSoft, a competing developer of enterprise software. On Sept. 10, 2004, the U.S. District Court for the Northern District of California denied the government's request for a preliminary injunction, rejecting numerous aspects of the DOJ's case.

The court found that the government's claimed narrow market of high-end enterprise resource planning (ERP) software providers was not sustainable. The government's claimed market included only Oracle, PeopleSoft, and SAP AG, so the government viewed the transaction as three competitors being reduced to two. Oracle successfully demonstrated the existence of numerous other firms providing ERP solutions, and demonstrated that no clear distinction existed between high-end ERP and other ERP software providers that served primarily smaller customers. Therefore, the court found the claimed "high-end" ERP solutions and the other ERP providers competed in the same relevant product market.

The court was dismissive of the DOJ's primary evidence - customer complaints - as anecdotal and not supported by rigorous analysis. The court wanted more statistical, econometric evidence, which the government did not offer. In addition, the court rejected the government's geographic market definition and found that ERP software providers competed in a world market. Because the government lost in its market definition, the case failed.

Importantly, the court indicated that even in the alleged market, the government **did** not have a viable theory of harm. First, the court held that a coordinated effects theory did not apply because the products involved were highly differentiated products, i.e., software. Second, the court rejected the Merger Guidelines' presumption regarding unilateral effects, which presumes a transaction combining two close competitors with a 35% combined market share is anticompetitive. The court found that unilateral effects are unlikely when, as in this case, there is a combination of two closely related firms with combined shares exceeding 35% as long as a third, similarly situated and competitive firm exists.

#### DOJ v. Dairy Farmers of America/Southern Belle

The DOJ also lost a post-closing challenge to a partial equity interest acquisition. Dairy Farmers of America (DFA) had acquired 50% interests in two dairies in Kentucky, which were major competitors of each other. The DOJ challenged the acquisition of the interest in the second dairy under Section 7 of the Clayton Act, asserting that DFA's holding of major stakes in two competing dairies owned by Southern Belle Dairy Co. would increase the likelihood of anticompetitive milk pricing, either by facilitating coordination between the dairies or changing their incentives to compete aggressively.

While the case was pending, the organizational documents of the dairies were changed to make clear that DFA had no role in operating either dairy, and no access to competitively sensitive information from either dairy. Because DFA's interest was entirely passive in both dairies, the

U.S. District Court for the Eastern District of Kentucky granted summary judgment to DFA. This was a unique case given the nature of DFA's interests in the competing dairies.

### Lessons May Apply in Other Sectors

These cases establish some principles that may allow parties to succeed in completing transactions with competitors.

### Coordinated effects cases may require specific evidence of coordination

One of the main theories that the government uses in challenging mergers is to argue that the reduction in the number of competitors will make it easier for the remaining competitors to coordinate on price or capacity. Most previous decisions had found that if the government were able to establish that the market in question was concentrated, the court would presume that coordinated effects were likely.

However, in the Arch case, the judge did not give the FTC its usual favorable presumption based on the high concentration levels. Instead, the judge stated that even though concentration levels were high, the burden of proof was still fully on the FTC to show that the acquisition would result in coordinated effects. Therefore, in the future, courts may require the agencies to demonstrate past coordination or factors indicating coordination is likely, rather than relying on a market share concentration presumption.

Similarly, the Oracle decision also makes it more difficult for the government to establish coordinated effects in markets where the products are not homogenous. The judge in Oracle stated that coordination in differentiated product markets is not a viable theory. As a result, in the future, it will be difficult for the government to challenge mergers under a coordinated effects theory in industries such as software, where the competitors typically customize the product for each customer.

### Unilateral effects theory was viewed narrowly

The second theory that the government uses to challenge horizontal mergers is the unilateral effects theory, in which it alleges that the new merged company will be able to raise prices unilaterally because of its large market share. The Merger Guidelines, which the government uses as a guide in analyzing mergers, presume unilateral anticompetitive effects in a market where a participant has 35% post-merger share and the merging firms are each other's closest competitors.

The judge in the Oracle case suggested that the government must show that the combined company would have a "monopoly or dominant position" before it could prevail in a unilateral effects case. Because there were three strong competitors - Oracle, PeopleSoft, and SAP - even in the market the government alleged, the court rejected the government's unilateral effects argument because SAP was a close competitor - if not the "closest" competitor." Following the Oracle decision, parties may argue more vigorously, if there is another close competitor, that unilateral effects are unlikely even if the Guidelines' thresholds are met.

### Statistical evidence can be more important than anecdotal evidence

Strong opposition from customers to a proposed merger and "bad documents," once a possible death sentence for a deal, will not necessarily stop a transaction. Courts will look beyond mere

"opposition" by customers and "bad documents" to see whether they are supported by underlying data. The judge in the Oracle case discounted customer testimony because the customers did not support their concerns with any "serious analysis." The judge said that the key is not what the customer would like or prefer, but what alternatives the customer has in the event of an anticompetitive price increase by Oracle.

The court in the Arch case discounted the significance of anecdotal customer complaints. In addition, the court ignored the Oracle "bad documents" on product market definition and gave much more weight to the economic evidence.

Parties can "fix" a deal to resolve competitive concerns

Arch found a buyer for one of the two mines it was acquiring, and the court analyzed Arch's acquisition in light of that self-help divestiture, while the FTC wanted to ignore it for purposes of the preliminary injunction. Therefore, even if the government does not view a proposed remedy as being a viable "fix," the court may require the government to prove why the proposed remedy does not resolve the competitive issues of the transaction.

Fringe competitors and entry are important

Even in highly concentrated markets, entry by other competitors is a critical defense that merging parties can utilize. "Fringe competitors" with the ability to expand can have importance far in excess of their current market share.

In the Arch case, the judge gave great weight to smaller competitors, far beyond their current production and small market shares. Similarly, in Oracle, the judge found that potential entry by other competitors, such as Microsoft Corp., would prevent Oracle from being able to raise prices.

The Oracle decision is particularly important for companies in high-tech industries because entry by "fringe competitors" or the emergence of new technologies can be a very successful defense.

Narrow markets are

difficult to prove

Courts are skeptical of results-oriented carving of markets. In the future, the government may have a more difficult time defining narrow markets based on the size of the customer or based on quality and price differentials.

In Arch, the judge did not accept the FTC's narrow market definition for premium coal, despite strong customer statements and generally accepted industry practice that premium coal was different from other types of coal. In Oracle, the judge rejected the government's claimed high-end ERP market.

In high-tech industries, it may be particularly difficult for the government to establish narrow product markets because of the dynamic and evolving nature of these products. Moreover, high market shares in the U.S. for software competitors may be a less significant antitrust issue in the future because of the court's rejection of the DOJ's attempt to define the geographic market as the U.S.

Economists are very important

Effective use of an economist is critical in defining the relevant market and explaining competitive effects. In both cases, the court gave substantial weight to the economists' testimony and was critical of the government's economic witnesses.

In Oracle, the judge was critical of the reliance by the government's economists on qualitative data and the failure to have performed econometric studies. Both cases demonstrate the importance of retaining top economists when contemplating a transaction that raises antitrust issues.

Efficiencies are unlikely

to save deals

Unless they are large and well supported by meaningful studies and analysis, efficiencies are unlikely to save a problematic deal. The courts in both Arch and Oracle found that the claimed efficiencies would not save the transaction if the government had been able to meet its burden of showing a likelihood of a substantial lessening of competition. Even so, having an efficiencies story is still very helpful in convincing the regulators that a transaction has pro-competitive purpose.

Judicial skepticism of non-mainstream theories

DFA shows that courts may be skeptical of cases brought under novel theories of anticompetitive harm.

In this case, the theory involved alleged changes to competitive incentives of competing entities based on common ownership by a third party. The passive nature of the ownership interest in both dairies resulted in the dismissal of the case. It is not clear whether this decision will restrain the FTC and DOJ from investigating or challenging partial equity interest situations where a firm directly takes a passive minority interest in its competitor.

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