Push It To The Limit: The US Merger Agencies Before the Courts in 2022

2022 has been a busy year for the US antitrust agencies, with a number of litigated cases bringing their heightened enforcement policies into sharp relief. These developments in the Biden Administration's second year give parties and practitioners much to consider for their current and future deals.

The DOJ and FTC had filed nine complaints through October 2022 (excluding settlements filed on the same day). Yet most of their litigated actions have proven to be out of line with courts that continue to apply the established precedents of merger control law. This article synthesizes some takeaways from the agencies' recent enforcement actions.

Aside from the DOJ's one win to block Penguin Random House's deal, the agencies have not prevailed in four merger cases—US Sugar, UnitedHealth, Illumina, and Booz Allen. However, the statements of Chairwoman Lina Khan and Assistant Attorney General Jonathan Kanter suggest that these results may not bring any changes in enforcement strategy in the short term.

Indeed, the US agencies' efforts have proven effective at causing some parties to abandon their transactions, rather than withstand the time, cost, and unpredictable outcomes of litigation. For example, Nvidia abandoned its purchase of Arm in February 2022 after the FTC sued to block that transaction. A string of proposed hospital mergers were abandoned in the first half of 2022 in the face of opposition from the FTC. And in late 2021, Great Outdoors Group and Sportsman's Warehouse called off their merger in the face of FTC scrutiny. These, of course, omit the deals that parties were deterred from attempting in the first place based on the agencies' public statements and aggressive investigations.

Despite such activism from antitrust regulators, deals can still be done, as companies adapt to the new environment.

How Have Companies Adapted?

First, we are seeing parties to transactions prepare rigorously, both in their initial risk assessments and anticipating probes based on innovative and ambitious theories of harm, for example to counter alleged market definitions that are inconsistent with how the industries operate in practice and with verifiable facts. Second, we are increasingly seeing parties contemplate "fix-it-first" or "litigate the fix" strategies, whereby parties attempt to remedy potential anticompetitive effects on their own—sometimes before filing for merger clearance when "fixing it first," or after an investigation in the case of "litigating the fix." Third, we observe parties planning for longer timelines in deal documents, with long stop dates that extend for up to 24 months to account for in-depth investigations in both the US and globally, and for litigation. And finally, on the topic of litigation, we see companies not only accept the possibility of merger litigation but also account for it as part of their clearance strategy.

With litigation as one approach to getting deals done in today's environment, recent court decisions offer lessons for parties considering future transactions.

What Recent Court Decisions Tell Us

- *US Sugar/Imperial Sugar: DOJ Asserting Market Definitions That Are Found To Ignore Economic Realities*

The DOJ's September 2022 failed attempt to block US Sugar's $315 million acquisition of Imperial Sugar is evidence that identifying a proper relevant market still matters to judges—even if the agencies are questioning the need to do so. The DOJ alleged a relevant product market that the court characterized as ignoring economic realities, writing that the DOJ asked the court to "figure out which market allows the [DOJ] to prevail and then to use that market."

The complaint claimed the acquisition would leave roughly 75% of refined sugar sales in the Southeast US in the hands of two producers, defining the relevant product market as the production and sale of refined sugar to wholesale customers. The "commercial realities" of the industry, however, demonstrated a broader relevant market that included refined sugar sold by distributors (not just direct sales to wholesale customers) and covered a greater geographic area. A failure to properly define the relevant market proved fatal.

On relevant product market, the court wrote, "Given that distributors already do compete with the various other suppliers for business, it is not difficult for the Court to conclude that customers would turn to distributors for refined sugar if producers and cooperatives were to increase their price for refined sugar." Likewise, the court disagreed with the DOJ's alleged relevant geographic market, which DOJ defined as either the US "Southeast" or "Georgia Plus." Again, the court found that this geographic market definition ignored the commercial reality that "sugar flows freely and over long distances in response to market forces. The evidence establishes that customers already look beyond the Government's proposed markets for competitive alternatives."

The court also emphasized that its competitive effects analysis needed to consider the transaction in the context of industry realities. The court found the existence of a US Department of Agriculture program that regulates the supply (and price) of sugar would act as a safeguard against potential anticompetitive effects of the proposed acquisition.

- *UnitedHealth Group/Change Healthcare: Judge Accepts a Structural and Behavioral Remedy Previously Rejected*

The decision in the DOJ's challenge to UnitedHealth Group's $13 billion acquisition of Change Healthcare illustrates that judges are not as skeptical about remedies as those in leadership at the US agencies. The case also highlights a practice point: "litigating the fix" is an important strategic tool to consider.

The agencies' leadership has expressed deep skepticism that remedies resolve mergers' anticompetitive harms. Rather than allow merging parties to divest overlapping assets in a settlement or remedy a vertical deal with a behavioral commitment, the DOJ has at times sued to block mergers entirely, leading parties to "litigate the fix" that they had offered. In January 2022, AAG Kanter said, "Complex settlements, whether behavioral or structural, suffer from significant deficiencies…. [W]hen the division concludes that a merger is likely to lessen competition, in most situations we should seek a simple

injunction to block the transaction." This position was contrary to decades of practice in which agency settlements enabled parties to realize the benefits of a transaction while eliminating the potential competitive harms.

The courts in UnitedHealth/Change Healthcare and in Illumina/Grail (discussed below) rejected the agencies' negative view of settlements, finding instead that the companies' proposed remedies have in fact adequately addressed competitive concerns.

In UnitedHealth/Change Healthcare, DOJ's complaint alleged the transaction would combine the two largest providers of first-pass claims editing technology, providing UnitedHealth with over 90% of that market. Additionally, DOJ argued that UnitedHealth's structural remedy to divest Change Healthcare's claims editing technology (*ClaimsXten*) was insufficient to address DOJ's horizontal competition concerns. The complaint also alleged a vertical competition concern involving UnitedHealth's commercial health insurance business and Change's electronic data interchanges clearinghouse services. DOJ claimed UnitedHealth would be able to use its rival insurer's competitively sensitive information (CSI) that passed through Change's clearinghouse for its own benefit, lessening competition in commercial health insurance. DOJ charged that UnitedHealth's behavioral remedies, a firewall policy and customer commitments, were inadequate to address these concerns.

In finding for the parties, Judge Nichols found that both the structural and behavioral elements of the proposed remedy would effectively address any potential anticompetitive harms. Starting with the structural element, the court agreed with the parties that the proposed divestiture of *ClaimsXten* to TPG, a sophisticated private equity buyer, would "restore the competitive intensity lost because of the acquisition," directly contradicting DOJ's theory that Change's proposed divestiture of *ClaimsXten* would not prevent the anticompetitive effects of the merger because of the nature of the buyer.

The court also found that the parties' proposal to implement firewalls between Change and UnitedHealth and customer commitments also would prevent potential competitive harm. The court pointed to United's history of effectively implementing and maintaining firewalls in its existing lines of business that touch other insurers' information. Furthermore, the court cited the reputational and financial damage that UnitedHealth would incur for breaching its obligations—"evidence at trial established, and the Court finds, that UnitedHealth will have strong legal, reputational, and financial incentives to protect rival payers' CSI after the proposed merger"—something the parties had asserted in discussions with the DOJ, but that DOJ had deemed inadequate.

- *<u>Illumina/Grail</u> and <u>Booz Allen/EverWatch</u>: Behavioral Remedies Previously Rejected Helped To Persuade Courts*

Other decisions in the fall of 2022 further underscore that judges may be open to resolving alleged competition concerns with behavioral remedies, which US agencies have – even prior to the Biden Administration – decried as ineffective and unenforceable. Beyond UnitedHealth/Change Healthcare, judges in Illumina/Grail and Booz Allen/EverWatch have accepted the parties' proposed behavioral remedies to assuage competition concerns.

In a trial before the FTC's in-house Administrative Law Judge (ALJ), Illumina and Grail successfully defeated the FTC's suit to block the vertical transaction, largely because the ALJ believed the parties' proposed behavioral remedy would mitigate any potential foreclosure concerns with respect to Grail's

rivals. The ALJ also found the transaction would not harm competition with Grail's rivals in the near term, rejecting the FTC's innovation and potential competition arguments.

Illumina provides a DNA sequencing technology platform that is used in blood-based multi-cancer early detection (MCED) tests in the US. The FTC alleged that Illumina's acquisition of Grail, which makes an MCED test that is more advanced than its closest potential rivals, would incentivize Illumina to deprive Grail's future rivals of this necessary input (i.e., the testing platform for MCED tests).

Prior to the FTC's challenge, Illumina made an "Open Offer"—a unilateral behavioral commitment—to provide supply and price protections, equivalent to what Grail would receive, for a period of 12 years to all existing and future DNA sequencing customers (i.e., Grail's future competitors). Coupled with these terms, the parties proposed stringent monitoring and enforcement provisions.

The FTC rejected the parties' proposed Open Offer remedy as being a "made-for-litigation" fix, finding it was an inadequate contractual protection against competitive harms that would do nothing to change Illumina's incentives to favor Grail. In addition, the FTC believed the Open Offer failed to resolve customer concerns and could not be adequately monitored or enforced. The ALJ disagreed with the FTC, noting that the Open Offer pre-dated the FTC's challenge of the deal and found the proposed remedy "effectively constrains Illumina from acting on its asserted ability and incentive to harm Grail's alleged rivals."

In October 2022, a Maryland federal judge similarly rejected the DOJ's attempt to block Booz Allen's acquisition of EverWatch in part due to behavioral commitments by the parties. Booz Allen and EverWatch were the only competitors for a National Security Agency (NSA) signals intelligence and simulation contract – *Optimal Decision*. The NSA was the only customer, and this was the only contract bidding opportunity for which the parties were competing.

Prior to the challenge, the parties had committed "to submit separate bids, stick with those bids, implement various firewalls between the two bidding teams, and create financial incentives for the winning team." In addition, Booz Allen unilaterally modified a clause in the initial merger agreement that provided veto power over EverWatch's bids before closing.

Like the ALJ in Illumina/Grail, the district court judge held that no imminent competitive harm was likely for reasons beyond the parties' commitments. First, the court found that the facts did not suggest any anticompetitive intent in relation to bids for the Optimal Decision: "Little evidence suggests the companies, or their capture-team employees, intend to give the NSA anything less than their best proposal." Second, the court held that tight government controls over NSA contracting meant that "Even if Booz Allen artificially increased the cost or decreased the quality of its work, the NSA still has significant control over Booz Allen's profit on Optimal Decision." Finally, the court declined to accept the DOJ's relevant market definition, a single contract with a single customer, the NSA. Echoing the *US Sugar* opinion, the court determined that the DOJ's definition of the relevant market was overly narrow, describing that the DOJ "attempt[ed] to 'gerrymander its way to victory without due regard to market realities.'"

It is uncertain whether the judges in Illumina/Grail and Booz Allen/EverWatch would have ruled for the parties in the absence of the remedy offers, as both judges found the transactions were not likely to

harm competition. Nevertheless, these decisions illustrate that judges may accept behavioral remedies to resolve competitive concerns under the right factual circumstances, even if the agencies may not.

- *Penguin Random House/Simon & Schuster: Alleged Monopsony and Labor Market Harms Are of Interest*

Scrutiny of labor markets in conduct investigations is not new with the Biden Administration. In 2016, the FTC and DOJ issued joint guidance that warned employers of criminal enforcement of wage fixing and no-poach agreements, and complaints filed under that policy continue to make headlines.

What is somewhat new is the appearance of labor issues in merger enforcement and the emergence of a focus on monopsony in labor markets. In his 2021 Executive Order on Promoting Competition in the American Economy, President Biden specifically identified the need for enforcers to address labor market harms, stating the goal of competition enforcement must be to "combat the excessive concentration of industry, the abuses of market power, and the harmful effects of monopoly and monopsony—especially as these issues arise in labor markets."

The DOJ's suit to block Penguin Random House's (PRH's) proposed acquisition of Simon & Schuster (S&S) highlights the seriousness of this Administration's focus on labor theories of harm. The deal, announced in 2020, was enjoined by a federal court at the end of October 2022. The DOJ's complaint alleged a monopsony theory of harm in a labor market. After a three-week trial in August 2022, Judge Pan found that the DOJ had properly defined a relevant market for "publishing rights for anticipated top-selling books," meaning books for which publishers pay authors an advance of $250,000 or more (i.e., authors like Stephen King and other best-selling authors), and the "post-merger concentration […] would be concerningly high," with the parties' combined share of 49%, the top two competitors post-transaction holding 74%, and the top four controlling 91%.

The court found that the DOJ "presented a compelling case that predicts substantial harm to competition," resulting, as the DOJ contended, "in lower advances for the authors of such books and less favorable contract terms." The parties had asserted that merger efficiencies (i.e., cost savings) would result in *increased* advances to authors of anticipated top selling books. However, Judge Pan "precluded the defendants' evidence of efficiencies, after determining that the defendants had failed to verify the evidence, as required by law," so they played no role in her analysis.

Takeaways

From this array of enforcement activity in 2022, businesses can draw a few takeaways when thinking about their current and future transactions:

- Parties to transactions are benefitting more than ever from performing rigorous initial antitrust risk assessments to avoid being caught flat-footed by an inquiry during the first 30 days.
- Where there is scope for a potentially deep and wide-ranging review by the antitrust agencies, parties should prepare thoroughly to advance a robust and strategic defense, including consideration of any potential fixes to address anticipated competition concerns of the agencies.
- Parties are increasingly planning for longer timelines to allow for in-depth investigations and to be able to contest any complaints from the agencies in court.

- Judges are not compromising on the need for alleged competition harms to be convincingly substantiated by the agencies.
- Courts are upholding established merger control precedents in response to innovative theories advanced by the Biden-era agencies.
- Certain sectors are clear enforcement priorities but no sector has been untouched.