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MESSAGES FROM THE U.S. ANTITRUST ENFORCERS AT THE ABA ANTITRUST SPRING MEETING

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In late March in Washington, D.C., the American Bar Association Section of Antitrust Law held its annual Spring Meeting. Antitrust lawyers from around the world—including top antitrust and competition law enforcement officials from the U.S. and abroad—convened to ruminate on all things antitrust. Enforcer comments during Spring Meeting panels and roundtables provide useful insights to the private bar and their clients about enforcers' priorities and concerns.

All three current Federal Trade Commission ("FTC") commissioners, including FTC Chair Lina Khan, and several FTC attorneys participated on panels during this year's Spring Meeting. Additionally, Joseph Kanter, Assistant Attorney General for the U.S. Department of Justice Antitrust Division ("DOJ"), and several DOJ attorneys also spoke on panels. The antitrust chiefs of the New York, Washington, and Washington, D.C. state attorneys general also contributed to Spring Meeting programming. These federal and state enforcers spoke on a number of topics over the course of the meeting, many of which touch on M&A.

1. Aggressive Enforcement is Here to Stay

Neither the DOJ nor the FTC participants revealed any radical changes to the agencies' aggressive enforcement strategy. Leaders from the agencies reiterated claims that there has been systematic underenforcement of the antitrust laws in the U.S. over the past several decades, resulting in industry consolidation and anticompetitive conduct, ultimately harming the public. One Deputy Assistant Attorney General ("DAAG") from the DOJ even disputed that the DOJ's enforcement is "aggressive," instead describing it as "just enforcement." That same DAAG went on to discount the risks of overenforcement, claiming that the adversarial process during investigations and enforcement actions serve as a "check" to ensure overenforcement does not curb growth and innovation.

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That "check" has resulted in a number of recent losses for the DOJ and the FTC. Undeterred, however, the enforcer panelists attempted to reframe those losses as wins. They credited their aggressive merger enforcement strategy with successfully deterring numerous anticompetitive mergers; according to AAG Kanter, "many more" deals have been silently abandoned by parties in light of the enforcers' aggressive posture. Per one DAAG, "If you only bring cases you are sure of winning, you will underenforce, and you will under-deter." They similarly hailed their court losses for establishing or reinvigorating particular legal theories. Chair Khan and Commissioner Rebecca Slaughter characterized their failed attempt to block Meta's acquisition of Within Unlimited, for example, as "an important programmatic win," claiming the judge's opinion provided a "roadmap" for future enforcement by recognizing that the legal theory of harm to prospective future competition is "alive and well."

DOJ and FTC participants at the Spring Meeting also provided some hints regarding the likely contents of the long-awaited revised merger guidelines, all reflecting their aggressive merger enforcement strategy. DOJ and FTC participants signaled that the new merger guidelines will touch on divisive antitrust topics such as nonhorizontal mergers (*i.e.*, M&A in the vertical supply chain, conglomerate mergers, and complementary mergers), potential competition, nascent markets, serial acquisitions, private equity ("PE") acquisitions, and monopsony (buy-side monopolization), including in labor markets. DOJ participants in particular noted that the enforcers' work on the guidelines has focused on impacts to certain stakeholders, including workers and small businesses. AAG Kanter's comments also showed a preference for direct evidence of anticompetitive conduct over indirect evidence of market power, suggesting the new merger guidelines will diminish the significance of market-based economic tests and models.

2. Process Matters

Spring Meeting participants from both the DOJ and the FTC indicated that their agencies are dedicating further resources to investigating compliance with the Hart-Scott-Rodino Antitrust Improvements Act of 1976 ("HSR Act"). They announced that there are several open (non-public) investigations into HSR Act violations, ranging from failing to file at all, omitting required Item 4 documents from the

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filing, and "gun jumping" (allegations that the companies took steps to integrate their operations before the transaction closed).

During one session, the FTC Bureau of Competition Director highlighted the possible consequences of violating the HSR Act, noting that the FTC could reject filings, issue a Second Request, or require that the parties make a corrective filing.[1] The HSR Act also permits the enforcers to seek significant penalties for violations of the HSR Act—at the moment, up to $50,120 per day in violation, which can add up quickly.

Commissioner Slaughter also signaled that the enforcers' "temporary suspension" of "early termination" of the HSR waiting period for non-problematic transactions may be indefinite.[2] Despite public comment by the FTC (of which Commissioner Slaughter was then Acting Chairwoman) in February 2021 that it expected "this temporary suspension will be brief," Commissioner Slaughter relayed to 2023 Spring Meeting attendees, "It isn't our job to be a service agency for merger attorneys, as much as I love all of you. It is our job to protect competition in markets and the American people we serve."

Finally, DOJ participants revealed that they are working with the FTC to ensure that the enforcers' investigations are not harmed by the use of increasingly popular third-party ephemeral messaging platforms like WhatsApp, Signal, and Telegram. Both the DOJ and FTC participants cautioned that failing to preserve records relevant to enforcers' investigations from these platforms could prompt spoliation penalties.

3. To Remedy (with a Catch) or Not to Remedy

Under AAG Kanter's leadership, the DOJ has not entered into any formal merger settlements allowing parties to "fix" arguably problematic transactions through divestiture or behavioral remedies. However, one DAAG was quick to emphasize that such consent decrees are not "off limits" at the DOJ. Instead, he claimed the bar is just "extremely high"—citing past alleged examples of failed divestitures that have made DOJ doubtful of such settlements' efficacy, despite plenty of evidence, including an FTC report, that such remedies are typically successful. Because the Clayton Act bars transactions that *may* harm competition, any remedies must "eliminate the possibility" of harm, not just probable harms. Choosing his words carefully, that DAAG also denied rumors that the DOJ is pushing companies to fix anticompetitive issues before filing HSR to avoid publicly endorsing settlements that allow otherwise problematic transactions to close, despite earlier comments in 2022 by DOJ officials that merging parties bear the responsibility for formulating solutions to competitive problems rather than asking the government to "work with us to figure out how to fix this." By contrast, AAG Kanter refused to address these "shadow" settlements without specific examples.

The FTC under Chair Khan has taken a different approach. Unlike the DOJ, the FTC has continued to routinely reach consent decrees in merger cases—however, these consents come with strings attached. FTC representatives at the Spring Meeting highlighted the agency's now-routine use of "prior notice" and "prior approval" requirements in its consent decrees. These provisions effectively provide the FTC veto power over any future transactions in the relevant market(s) for a minimum of 10 years. Additionally, the FTC's consent orders now typically require divestiture buyers to obtain prior approval from the FTC for any sale of the divestiture assets for a three-year period—seven if the later acquiror is a competitor.

4. Private Equity Gets a Warning Flag

Private equity was a trending topic at this year's Spring Meeting, and DOJ and FTC participants aired a number of concerns about transactions involving PE buyers. While one FTC panelist clarified that the enforcers' concerns are focused on certain *practices* used by PE buyers, not PE itself, he also decried the "debt-fueled, strip-and-flip" business model of certain PE firms. He claimed that this business model, which prioritizes short-term returns, undermines the long-term health of acquired companies and impacts their ability to compete.[3]

His attitude was echoed by representatives from the DOJ. One DOJ panelist commented that PE's business model means portfolio companies are unlikely to be "mavericks" that upset the status quo with respect to pricing, service levels, quality, and/or innovation, but provided no evidence for that assertion. That DOJ participant also suggested that PE firms that follow a "strip-and-flip" business model are not adequate divestiture buyers because they cannot replicate the competition that would be lost as a result of a transaction.[4]

"Serial acquisitions" by private equity firms, in which they make a number of acquisitions in the same industry, were also of particular concern to DOJ and FTC participants. Speaking in the context of health care, one FTC participant noted that "serial acquisitions" are often not reportable under the HSR Act, but claimed there is evidence that they have resulted in higher prices, lower wages, and lower quality of services. AAG Kanter revealed that the DOJ plans to use the Clayton Act's prohibition on transactions that "tend to create a monopoly" (which Kanter characterized as often ignored) to challenge such serial acquisitions.

Finally, DOJ participants noted that private equity is a focus of the agency's reinvigoration of Section 8 of the Clayton Act, which prohibits "interlocking directorates." The DOJ has taken the position, which is not settled by the courts, that Section 8 bars a PE firm from appointing agents or representatives to the boards of competing companies, even where those appointees are different people. AAG Kanter noted that approximately 15 directors have stepped down from boards in response to DOJ inquiries, and the DOJ has approximately 20 open investigations into additional violations.[5] Some of these alleged violations of Section 8 involve PE firms.

5. Federalism at Work

The state enforcer participants at the Spring Meeting issued a warning not to forget that the states also have merger enforcement goals. The Washington state antitrust chief noted that some states already have premerger notification laws that apply to certain industries (*e.g.*, health care) and parties (*e.g.*, utility companies), and a growing number of states, including Washington, Nevada, Massachusetts, Oregon, and California, have passed additional so-called "mini-HSR" state pre-merger notification filings to fill perceived gaps in the HSR Act.[6]

New York's antitrust chief also noted that like the federal enforcers, state enforcers are not limited to pre-merger challenges. She pointed to a recent case against a ski operator that purchased a competitor and shut down the competing ski hill. The state heard about the transaction through consumer complaints and news coverage post-closing.

Ultimately, the advice from the state enforcer participants was to "come early and often" when interacting with state enforcers in a merger investigation. They expect to receive the same facts, evidence, and advocacy at the same time that they are presented to their federal counterparts—while still expecting parties to address issues that may be of more concern to a state enforcer than a federal one (historically, *e.g.*, hospitals, physicians).

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Finally, the state enforcer participants addressed their ability to remedy concerns with a proposed merger. First, they offered a reminder that states have the ability to seek remedies even if a deal is cleared by the DOJ or FTC, or to seek remedies on top of any remedies agreed to by the DOJ or FTC. Second, unlike the federal enforcers, who have resisted behavioral remedies for the past few years, state enforcers may be more willing to agree to behavioral remedies, *e.g.*, rate protection or price caps. Washington's antitrust chief pointed out that the burden is lower on the states to monitor compliance with these types of remedies because certain industries are already subject to state regulatory oversight.

Key Takeaways

- Antitrust enforcers know that what they say at the Spring Meeting will be analyzed by the private bar and their clients. It is no surprise, therefore, that federal and state enforcer participants' carefully crafted statements did not reveal any major shifts in their enforcement strategies. Still, what they chose to share about their enforcement strategies is useful for merging parties trying to predict how antitrust enforcers might evaluate their transaction.

- Do not expect the DOJ's and the FTC's recent losses to have any chilling effect on their merger enforcement strategy. Over the course of the Spring Meeting, DOJ and FTC participants touted their aggressive approach to enforcement and listed a number of enforcement goals, many of which relate to M&A. And they attempted to recast those losses as creating "good law" for their future enforcement. In practice, however, resources are limited, and the DOJ and the FTC will have to prioritize these goals. With respect to merger enforcement, you can bet PE transactions will be a focus, as well as mergers involving potential competition, monopsony, nascent competition, and serial acquisition theories of harm.

- Both DOJ and FTC participants highlighted the importance of HSR filings. Merging parties should make sure to consult HSR counsel early, especially if there are questions about whether a transaction is reportable. A thorough sweep for 4(c) and (d) documents also should be conducted. Discovery of a 4(c) or (d) document that was not included in the filing in, *e.g.*, a Second Request response, could have a dramatic effect on timing, especially if the document raises new concerns.

- If merging parties issue a legal hold in response to a merger investigation, make sure that it covers any ephemeral messaging platforms, and do not be surprised if DOJ and FTC attorneys ask about the use of such platforms, especially if none are included in documentary productions.

- It is more difficult than ever to predict which agency will review a merger. However, if the DOJ receives clearance to review, merging parties may want to consider remedying potential concerns upfront because the DOJ has said that post-investigation settlements will be harder to obtain, except in limited circumstances. If the FTC gets clearance, a post-investigation remedy may be more workable, but merging parties should think about how "prior notice" and "prior approval" provisions could affect their long-term M&A strategies.

- If one of the merging parties is a PE firm, expect the DOJ or the FTC to ask questions regarding the business' other acquisitions in

the space and/or if the space is already consolidated. Additionally, PE firms should be prepared to discuss their investment strategy for the acquiring fund and their plans for the acquired company, in addition to the usual inquiries of a significant merger investigation.

- Finally, if a transaction involves local markets, do not be surprised if state enforcers express interest in investigating the transaction. You should work with your antitrust counsel to develop a strategy for responding to the state enforcers' requests and addressing their specific concerns. However, unlike the DOJ and the FTC, the state enforcers may be amenable to a behavioral remedy.

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

ENDNOTES:

[1]True to its word, the FTC filed a complaint against New Orleans-area hospitals for failing to comply with the HSR Act on April 20, 2023. Complaint, *FTC v. La. Children's Med. Ctr.*, No. 1:23-cv-01103 (D.D.C. Apr. 20, 2023).

[2]*See* Jones Day Alert, *Antitrust Agencies Suspend Early Termination of HSR Waiting Period* (Feb. 2021), https://www.jonesday.com/en/insights/2021/02/antitrust-agencies-suspend-early-termination-of-hsr-waiting-period.

[3]*See generally* Michael A. Gleason, Aimee E. DeFilippo, Jeremy P. Morrison & Ryan C. Thomas, *U.S. Antitrust Agencies Take Aim at Private Equity*, The M&A Lawyer, July-Aug. 2022, at 1.

[4]The DOJ raised concerns with UnitedHealth Group Inc.'s proposed PE divestiture buyer in its challenge to UnitedHealth Group's acquisition of Change Healthcare Inc., which a federal judge rejected in September of last year. *See United States v. UnitedHealth Group Incorporated*, 2022 WL 4365867 (D.D.C. 2022), dismissed, 2023 WL 2717667 (D.C. Cir. 2023). Additionally, it was revealed in opening arguments on April 24, 2023 in the DOJ's challenge to Assa Abloy's acquisition of Spectrum Brands' hardware and home improvement business that the DOJ gave Assa Abloy three requirements for a divestiture, one of which was that the buyer not be a PE firm. *See* Bryan Koenig, *DOJ Told Assa Abloy: No Private Equity Buyers*, Law360 (Apr. 24, 2023), https://www.law360.com/articles/1600512/doj-told-assa-abloy-no-private-equity-buyers.

[5]*See, e.g.*, Press Release, U.S. Dep't of Just., Justice Department's Ongoing Section 8 Enforcement Prevents More Potentially Illegal Interlocking Directorates (Mar. 9, 2023), https://www.justice.gov/opa/pr/justice-department-s-ongoing-section-8-enforcement-prevents-more-potentially-illegal; Press Release, U.S. Dep't of Just., Directors Resign from the Boards of Five Companies in Response to Justice Department Concerns about Potentially Illegal Interlocking Directorates (Oct. 19, 2022), https://www.justice.gov/opa/pr/directors-resign-boards-five-companies-response-justice-department-concerns-about-potentially.

[6]*See generally* Michael A. Gleason & Charlie Stewart, *Proposed Legislation in New York Would Enact the First General, State-Level Premerger Reporting Regime*, The M&A Lawyer, Mar. 2022, at 1. The Washington antitrust chief also highlighted the Oregon state premerger notification law applicable to the healthcare industry, which requires state healthcare regulators to conduct a public interest *and* competition review for all healthcare transactions and permits the regulators to set and enforce cost growth targets. *See* ORS § 415.500-501 (2023). That law does not require merging parties to notify state antitrust enforcers, and per the Washington antitrust chief, this has resulted in delayed or omitted notifications to state enforcers.

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TRIO OF DELAWARE CASES SIGNAL STRICTER REVIEW OF SALE-OF-BUSINESS NON-COMPETES

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On March 16, 2023, the Delaware Chancery Court in *Intertek Testing Services NA, Inc. v. Eastman* found a sale-of-business non-compete was overbroad, given its worldwide geographic scope, and refused to modify it to make it enforceable. *Intertek* marks the third time in less than six months that a Delaware state court has refused to enforce or modify a non-compete under the more lenient sale-of-business standard. These cases signal a potential trend of Delaware state courts more closely scrutinizing non-competes under the sale-of-business standard to determine if they go beyond the legitimate business interests of the party seeking enforcement. Where overbreadth is found, these courts appear increasingly hesitant to modify or blue pencil the restrictions to make them enforceable. Companies should be mindful of these cases when drafting and enforcing sale-of-business non-competes governed by Delaware law.

Background on Delaware Sale-of-Business Non-competes

With its well-developed corporate law and precedent, Delaware is generally viewed as a favorable jurisdiction for businesses. Because of this, many companies choose Delaware law to govern documents related to their corporate formation, transactions, and general business operations, including non-competition agreements. Under Delaware law, a restrictive covenant, such as a non-compete, generally is enforceable if it: (1) meets general contract law requirements; (2) is reasonable in scope and duration; (3) advances a legitimate economic interest of the party enforcing the covenant; and (4) survives a balance of the equities. Historically, Delaware courts have applied a "less-searching" inquiry to sale-of-business non-competes than non-competes in the employment context. This less-searching inquiry tends to favor enforcement, since the restricted individuals are selling their business, including their businesses' confidential information, trade secrets, and goodwill, usually in exchange for monetary and other consideration. Delaware courts also have the discretion to blue pencil or modify non-competes they determine to be overbroad. As noted in *Kodiak Building Partners, LLC v. Adams*,[1] however, courts applying Delaware law have generally not had to blue pencil or modify sale-of-business non-competes since they have found most sale-of-business non-competes enforceable.

The *Kodiak* and *Ainslie* Cases

Leading up to *Intertek*, two recent Delaware state court decisions authored by Vice Chancellor Zurn called into question the more lenient standard for reviewing sale-of-business non-competes under Delaware law.

In *Kodiak*, the Delaware Chancery Court struck down a sale-of-business non-compete and refused to blue pencil it because the non-compete sought to prohibit the seller from competing against the buyer's existing affiliated businesses outside the seller's business and competing in territories in which the seller had not operated.[2]

- **Facts**: The case involved Kodiak purchasing several companies from four stockholders,

including a general manager, Adams, who received around $1 million in the transaction. As part of the transaction, Adams agreed to a 30-month non-compete covering "Idaho, Washington, and 100 mile radius of any other location outside those states in which [seller] or any member of the Company Group have sold products or provided services within the 12 months prior to Closing."

- **Geography and Company Group Overbroad**: In its analysis, the court explained that it does "not mechanically enforce" non-competes, but rather non-competes "must be closely scrutinized as restrictive of trade." Despite there being no dispute that Adams breached the non-compete by joining a competitor operating in the same industry as the sold business, the court reasoned that the buyer could not show a legitimate interest to bar Adams from competing against each of the businesses in the "Company Group," even though many of those entities were in the same industry as the business that was sold. The court noted that acquirers in the sale-of-business context have a legitimate interest in protecting "only the purchased asset's goodwill and competitive space that its employees developed or maintained"—not in "restricting the target's employees from competing in other industries in which the acquirer also happened to invest." Accordingly, the court found the geographic term overbroad because it restricted Adams from competing in the 100 mile radius around each of the buyer's subsidiaries, which went beyond the territories in which the sold business operated.

- **Refused to Blue Pencil**: Although the court recognized long-standing Delaware precedent giving it discretion to modify the non-compete to make the non-compete enforceable, it refused to exercise that discretion and, instead, struck the non-compete entirely.

Then, on January 4, 2023, the Delaware Chancery Court in *Ainslie v. Cantor Fitzgerald, L.P.*,[3] found a forfeiture-for-competition provision in a limited-partnership agreement unenforceable under the less-searching sale-of-business standard.

- **Facts**: *Ainslie* involved former partners who had a partnership agreement allowing them to receive capital distributions over four years after their withdrawal from the partnership. The partnership agreement, however, required the partners to forfeit those distributions if they competed during that four-year payout period, effectively extending the restricted period to four years.

- **Duration and Affiliated Entities Overbroad**: In determining the enforceability of the forfeiture-for-competition provision, the court considered what standard of review to apply.[4] The court considered three options: (1) the employee choice doctrine, which provides that courts should not review forfeiture-for-competition provisions for reasonableness so long as the employee voluntarily terminates his or her employment; (2) the searching reasonableness standard reserved for restrictive covenants in employment agreements; or (3) the "more lenient" or (in the court's words) "employer friendly" standard for sale-of-business non-competes. The court opted to apply the sale-of-business standard to the restriction. Yet, it found the forfeiture provision unreasonable under that standard because the four-year duration and the scope of "competitive activities" prohibited other actions related to entities affiliated to the company. The court reasoned that the legitimate interest "in years one and two is stale by years three and

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four." The court also found prohibiting competition with other "unspecified affiliates" overbroad because, among other things, there was no evidence that the partner had access "to any kind of information—proprietary or otherwise—that would warrant the restriction," and the partnership had discretion to determine whether the partner had breached the restriction (as opposed to proving an actual breach).

- **No Blue Pencil**: The court also declined to blue pencil the restriction, citing *Kodiak*'s holding that "Delaware courts are hesitant to 'blue pencil' [non-competes] to make them reasonable," even where the agreement allows modification.

The *Intertek* Case

In the latest case, *Intertek Testing Services NA, Inc. v. Eastman*,[5] a different Chancellor, Vice Chancellor Will, found that a non-compete with a global scope was overbroad and refused to exercise her discretion to blue pencil the restrictions.

- **Facts**: Intertek purchased Alchemy Investment Holdings ("Alchemy"), a business that provided workforce trainings and consulting services to clients in the food and cannabis industries. Eastman was the co-founder, CEO, and major stockholder of Alchemy and received $10 million in exchange for his ownership in the business. As part of the purchase agreement, Eastman agreed to the following non-compete: "[F]rom the Closing until the five-year anniversary of the Closing, each Restricted Seller shall not, and shall cause each of its Affiliates not to, anywhere in the world, own, manage, control, undertake, participate in or carry on or be engaged in, or in any other manner advise or knowingly assist any other Person in connection with the operation of, any business or Person competitive to any portion of the business of [Alchemy] or [Alchemy's subsidiaries] as conducted as of the Closing Date." After the sale, Eastman worked for Alchemy for five months and then resigned. Two years later, Eastman's son started a competitive business, Rootwurks, serving clients nationwide in workforce training and compliance for the cannabis industry. Rootwurks' website even advertised that its learning platform had been "crafted from the 'ground up using the know-how and experience of the founders of Alchemy Systems.' " Eastman became an investor and board member of Rootwurks.

- **Global Territory Overbroad**: Intertek filed a suit, seeking, among other things, to enforce the non-compete. Eastman filed a motion to dismiss, arguing that the non-compete was unenforceable because its geographic scope was overbroad. The court agreed. Relying, in part, on *Kodiak*, the court found that the restriction that prohibited Eastman from working "anywhere in the world" went beyond the buyer's legitimate interest. The court noted that the buyer did not even allege it provided services globally and, at best, it only conducted business nationwide.

- **Refusing to Blue Pencil**: The court also refused to blue pencil the non-compete, reasoning that "revising the non-compete to save Intertek—a sophisticated party—from its overreach would be inequitable."

Practical Takeaways

These cases signal a potential trend for Delaware courts: (1) to more closely scrutinize the temporal, geographic, and functional scope of non-competes even under the more lenient sale-of-business standard; and (2) to be hesitant to blue pencil or modify

those restrictions if the courts deem them overbroad. Indeed, in each of the three cases, the courts closely reviewed the restrictions to ensure they had a close connection to the business' legitimate protectable interest, which they found was measured only by "the goodwill and competitive space" purchased from the seller and in the market the seller served. For example, these courts found the geographic and functional scope of the non-competes to be overbroad where they went beyond territories or businesses that the restricted seller had served. These courts also found that including affiliated entities in the scope of the non-compete was unenforceable where there was no showing that the restricted individual had obtained any confidential information of those entities or worked for them. As the *Kodiak* court noted, "[t]he acquirer's valid concerns about monetizing its purchase do not support restricting the target's employees from competing in other industries in which the acquirer also happened to invest."

Although some Delaware courts have been reluctant to blue pencil restrictive covenants in the employment context, courts applying Delaware law have generally not had to consider whether to exercise their discretion for sale-of-business non-competes since those have typically been enforced. Indeed, the plaintiff in *Kodiak* noted that the restricted individual could not point to a single case where Delaware had struck down a sale-of-business non-compete.

With this recent string of cases, however, Delaware courts appear increasingly more reluctant to blue pencil sale-of-business non-competes, even where it seemingly would be easy to modify the non-compete to make it enforceable, such as narrowing the geographic term. We also observe that the *Kodiak* and *Intertek* courts relied on cases in the *employment* context to justify their decisions not to modify the sale-of-business non-competes. This potential blurring of the line between sale-of-business and employment non-competes by drawing on the equities of non-competes in the employment context to justify their refusal to blue pencil sale-of-business non-competes, makes this area even more challenging for practitioners and companies alike to navigate.

Although it is unclear whether other Delaware courts will follow these decisions, companies should be mindful of these cases when drafting or trying to enforce non-competes governed by Delaware law. Several points to keep in mind are as follows:

- Non-competes should be drafted in a manner that can support the legitimate business interests for those restrictions, including the jurisdictions and related corporate entities that are covered.

- If the non-compete will cover a buyer's existing businesses, consider whether the existing businesses are in the same industry as what the buyer is acquiring and whether the company could show a legitimate business interest in covering those related entities if it tried to enforce the restriction.

- If the seller will continue as an employee with the buyer post-acquisition, the buyer may also want to consider having the seller enter into a separate employment non-compete in addition to having a non-compete related to the sale of business.

- Avoid relying on a court to blue pencil or modify the restriction as a guaranteed fail-safe. The three recent cases show that courts appear hesitant to modify non-competes to make them enforceable.

- Consult with counsel to consider whether there is another jurisdiction or forum with a

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sufficient connection to the contracting parties that may be more favorable for enforcement than Delaware.

These cases also follow the growing trend of jurisdictions across the country, including Colorado, Illinois, the District of Columbia, and Washington, passing laws limiting the use of non-competes with employees.[6] The trend of states regulating employee non-competes is expected to continue. Although many of these laws expressly carve-out non-competes entered into in connection with the sale of a business, companies should be mindful of the potential for their sale-of-business non-competes to be subject to these state laws or the more rigorous employment standards of review if those sale-of-business non-competes include employment concepts and terms. Some courts, for example, have applied more stringent employment standards to sale-of-business non-competes where the duration of the non-compete ran from the end of employment and not just the closing of the corporate transaction.

ENDNOTES:

[1] *Kodiak Building Partners, LLC v. Adams*, 2022 WL 5240507 (Del. Ch. 2022).

[2] *See* https://elc.mofo.com/topics/delaware-court-refuses-to-enforce-or-blue-pencil-sale-of-business-non-compete.

[3] *Ainslie v. Cantor Fitzgerald, L.P.*, 2023 WL 106924 (Del. Ch. 2023).

[4] Delaware law treats partnership agreements differently when it comes to penalties. As the court acknowledged, Delaware statute "departs from the common law in that it 'authorizes LLC agreements to provide for remedies that would be unavailable in a standard commercial contract, most notably penalties and forfeitures.' " *Ainslie v. Cantor Fitzgerald, L.P.*, 2023 WL 106924, at *12 (Del. Ch. 2023).

[5] *Intertek Testing Services NA, Inc. v. Eastman*, 2023 WL 2544236 (Del. Ch. 2023).

[6] *See* https://www.mofo.com/resources/insights/220517-colorados-new-limits-on-employee-non-competes *and* https://www.mofo.com/resources/insights/210630-illinois-ushers-new-restrictions *and* https://elc.mofo.com/topics/dc-joins-jurisdictions-banning-non-competes.html *and* https://www.mofo.com/resources/insights/190730-tightening-restrictions-noncompetes.

FTC ORDERS DIVESTITURE IN VERTICAL MERGER CASE, SETTING UP FEDERAL COURT APPEAL

By Andrew C. Finch, Mark R. Laramie, Joshua H. Soven, Aidan Synnott and Brette Tannenbaum

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- The Federal Trade Commission recently reversed its administrative law judge and found that Illumina's acquisition of GRAIL was illegal under Section 7 of the Clayton Act. The commission ordered that Illumina divest GRAIL.
- The commission's opinion is notable for its discussion of how the FTC analyzes vertical mergers and proposed deal "fixes," both of which are increasingly coming under scrutiny by the U.S. antitrust agencies.
- Illumina has appealed, presenting an opportunity for a federal court of appeals to weigh in on vertical merger analysis.

In a lengthy opinion made public in early April,

the FTC, by a vote of 4-0, determined that Illumina's acquisition of GRAIL may substantially lessen competition in a market for the "research, development, and commercialization of MCED [multi-cancer early detection] tests" and ordered Illumina to divest GRAIL. In doing so, the commission overruled its administrative law judge ("ALJ"), who had earlier found that FTC complaint counsel failed to prove a prima facie case. Illumina has appealed the FTC's decision to the U.S. Court of Appeals for the Fifth Circuit, arguing that the decision "suffers from many flaws—including that it is unconstitutional, misconstrues the antitrust laws and cherry picks from the administrative record."

Background

In March 2021, the FTC filed an administrative complaint seeking to block Illumina's vertical acquisition of GRAIL. At the time, Illumina owned 14.5% of GRAIL's voting shares and proposed to acquire the remainder. GRAIL has developed an MCED test which relies on "next-generation" DNA sequencing ("NGS") platforms sold by Illumina. In its complaint, the FTC alleged that Illumina is "a dominant provider of NGS platforms," GRAIL and its competitors "have no substitutes for Illumina's NGS platforms" and the acquisition would harm competition in the market for MCED tests, which had not yet been commercialized. Specifically, the FTC alleged that "Illumina will gain the incentive to foreclose or disadvantage firms that pose a significant competitive threat to GRAIL and to limit the competitiveness of any MCED product" and, as a result, "Illumina will control the fate of every potential rival to GRAIL for the foreseeable future." The theory of harm is one found in the DOJ-FTC vertical merger guidelines, which were rescinded by the FTC in September 2021.[1]

In an attempt to address the FTC's challenge, after the litigation was commenced, Illumina announced that it was "irrevocably offering" a 12-year supply contract, which it said includes terms for "guaranteed access to the latest sequencing products," "no price increases for the sequencing products covered by the agreement," and "guaranteed lower pricing for the sequencing products by 2025." Citing this "open offer," among other things, the FTC ALJ concluded in September 2022[2] that FTC complaint counsel "failed to prove its asserted prima facie case that Illumina's post-Acquisition ability and incentive to advantage GRAIL to the disadvantage of GRAIL's alleged rivals is likely to result in a substantial lessening of competition in the relevant market for the research, development, and commercialization of MCED tests."

The procedural journey of the FTC's litigation is notable. When it commenced its administrative proceeding in March 2021, the FTC also sued Illumina in federal court, seeking a preliminary injunction against the acquisition. (This dual-track approach is common for FTC merger challenges because without an injunction or some impediment in another jurisdiction, the parties would be free to merge despite the pendency of an administrative action.) However, in June 2021, the federal court dismissed the complaint at the FTC's request. This allowed the FTC to proceed solely in its "home court." At the time, the FTC asserted that because the European Commission "announced that it has accepted requests from member states to assess Defendants' proposed transaction," the parties could not close the transaction and a preliminary injunction was not necessary to preserve the status quo. But in August 2021, Illumina stated that it "believes that the European Commission does not have jurisdiction to review the merger as the EU merger thresholds are not met, nor are they met in any EU member state" and closed the transaction. The European Commission later prohibited[3] the deal in a decision announced in September 2022, shortly

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after the FTC ALJ's decision to the contrary. Illumina challenged this, and legal proceedings are ongoing in the EU.

The FTC's Decision

The FTC complaint counsel appealed the decision of the ALJ to the commissioners, who conducted a de novo review of the initial decision's findings of fact and conclusions of law. The commission, in an opinion authored by Chair Lina M. Khan, reversed the initial decision.

Prima Facie Finding of Competitive Harm

The commission began by examining whether complaint counsel had established a prima facie case that the acquisition would likely harm competition.

Relevant market. First, the commission agreed with the ALJ that the relevant product market in which to analyze the acquisition's effect was "the research, development, and commercialization of MCED tests." Here, the commission used a common method to define the market—*i.e.*, it looked for "practical indica" that a market existed. These practical indica, which derive from the Supreme Court's 1962 *Brown Shoe* opinion, include: "industry or public recognition of the [market] as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors." Notably, in response to the claim that "GRAIL's rivals are 'years away' from launching an MCED test," the commission wrote that this "may have relevance for defining a relevant market for existing MCED tests," but "miss[es] the mark for a market defined around the research, development, and commercialization of such tests," which is the market posited by the FTC. According to the opinion, the applicable question is "whether MCED tests will be sufficiently interchangeable in the future such that the merged firm has an incentive to disadvantage GRAIL's rivals as they pursue research, development, and commercialization." The commission found that the "balance of evidence shows that they will." The commission also found that several companies were engaged in "current competition in the research and development of MCED tests."

Related product. The commission then determined that Illumina's NGS platforms were a "critical input" for developers of MCED tests. It also found that "Illumina is the only viable supplier of the critical NGS inputs on which MCED developers depend," after finding, in line with the ALJ's decision, that other companies' NGS platforms were "insufficient, either because they lack characteristics essential for MCED test development, or because they will not become available to MCED test developers in the United States within a reasonable time frame, or both." Notably, the commission's opinion stated that it was not necessary for complaint counsel to "demonstrate that NGS is a relevant product market," only to show that "Illumina's NGS platform is a critical input for MCED developers."

Competitive effects analysis. After the threshold relevant market and critical input determinations, the commission turned to analyze the potential competitive effects of the transaction using "two different but overlapping standards for evaluating the likely effect of a vertical transaction." Here, the commission first looked at competitive effects using the framework from the 1962 *Brown Shoe* case, which involves an examination of "the share of the market foreclosed" and other factors. (According to *Brown Shoe*, "the diminution of the vigor of competition which may stem from a vertical arrangement results primarily from a foreclosure of a share of the market otherwise open to competitors," but that in many cases where foreclosure is not "of monopoly . . . proportions . . . it becomes necessary to

undertake an examination of various economic and historical factors.")

The commission acknowledged, however, that "[m]ore recently, courts and enforcers have focused on whether a transaction is likely to increase the ability and/or incentive of the merged firm to foreclose rivals from sources of supply or from distribution outlets." Commissioner Wilson, who has since resigned, did not join the part of the commission opinion that analyzed competitive effects under *Brown Shoe*, writing that "there is no '*Brown Shoe* standard' in modern antitrust analysis." She nevertheless joined with the other commissioners in finding that a prima facie case was established using "the ability and incentive approach to analyzing foreclosure."

Using *Brown Shoe*, the commission found "that at least four of the factors" from that case "support a finding of a violation here." These are: "likely foreclosure, the nature and purpose of the transaction, the degree of market power possessed by the merged firm, and entry barriers." With respect to likely foreclosure, the commission found that "Illumina is currently, and for the reasonably near future will remain, the only viable supplier of a critical input: NGS platforms necessary for MCED tests." The commission also found that Illumina's "dominance is sustainable" given the lack of adequate alternative NGS platforms; and that "MCED developers' dependence on Illumina's NGS platforms renders them susceptible to foreclosure," which Illumina could do by raising their NGS-related costs or withholding access to supplies, service or "new or improved NGS products," among other things. "Consequently," the commission wrote, "the share of the market that may be foreclosed is very substantial." The commission went on to find, in a heavily redacted part of the opinion, that the "nature and purpose of the transaction," the merged firm's market power, and entry barriers also supported the prima facie case. The opinion noted that "the nature of the transaction is a sole-source supplier taking full ownership of a downstream customer."

The commission also analyzed the transaction under the "different but overlapping standard" of vertical merger harm: whether Illumina would have the ability and incentive to harm GRAIL's rivals. According to the commission, "[t]o harm competition, a merger need only create or augment either the combined firm's ability or its incentive to harm competition. It need not do both." In this case, the commission found that Illumina had the ability to harm MCED test developers given its position as "the dominant provider of NGS," and the acquisition increased its incentive to do so. Among other things, after the merger, "Illumina will directly benefit from tilting the innovation race in favor of GRAIL, the MCED provider that it now 100% owns" because it will now earn margin on the sale of GRAIL tests.

Rebuttal Case

After finding that FTC complaint counsel had established a prima facie case that the transaction would likely harm competition, the commission weighed the parties' arguments that the anticompetitive effects established by complaint counsel would be overcome by Illumina's "open offer" to supply NGS, market entry by other firms, deal-related efficiencies, and procompetitive benefits. The commission determined that Illumina failed to rebut the prima facie case.

According to the commission, "[t]o serve as a plausibly effective remedy, the Open Offer would need to foresee and foreclose all possible ways Illumina could harm GRAIL's competitors." The commission, however, found fault with several aspects of the open offer, ultimately concluding that it "would not restore the pre-Acquisition level of competition" because "it does not eliminate Il-

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lumina's ability to favor GRAIL and harm GRAIL's rivals, . . . does not fundamentally alter Illumina's incentives to do so, . . . does not replicate the cooperation Illumina would have been incentivized to provide to third-party MCED test developers absent the Acquisition, and it would not replace the competitive intensity that existed before the Acquisition."

The commission also concluded that "claims of efficiencies"—including R&D efficiencies and acceleration of the time to bring MCED tests to market—"are inadequate" because, among other things, they are unverified, are "not merger-specific" and "not likely to benefit the public.

Significance

Return to *Brown Shoe* for vertical mergers? Here, the FTC's reliance on *Brown Shoe* did not impact the ultimate outcome of the case. The commission concluded that the merger was likely to harm competition using either *Brown Shoe* or incentive/ability analysis. However, if *Brown Shoe* were to be used in future vertical merger analysis, for example by being incorporated into the forthcoming revision of the DOJ-FTC merger guidelines, it could have consequences for merger enforcement. In general, *Brown Shoe* was more skeptical of vertical mergers than most current economic theory is. Ultimately, of course, it is up to courts or Congress to determine how vertical mergers are to be judged.

Consideration of "fix." In this case, the commission declined to consider the open offer "fix" at the prima facie case stage, where the burden would have been on the FTC complaint counsel to establish that the transaction, including the open offer, may lessen competition. Instead, the commission considered the open offer at the rebuttal stage, where the burden is on the deal parties to overcome the likely anticompetitive effects established at the prima facie stage.

The treatment of "fixes" is very much a live issue in merger enforcement. In particular, agencies and deal parties have recently differed over whether courts should analyze proposed deal fixes in the prima facie case, in rebuttal or as a remedy after finding of liability. In the recent UnitedHealth-Change Healthcare case,[4] the judge suggested, contrary to the DOJ's position, that the parties' proposed fix (a divestiture) should be analyzed at the prima facie stage. And the judge in the DOJ's pending challenge to the Assa Abloy-Spectrum Brands deal is weighing how she should evaluate a proposed divestiture fix. The DOJ argues that it should be considered at the remedy stage.

There are significant practical implications for how fixes are considered. If a proposed fix is considered only after a prima facie case has been made, the government may initially have an easier time satisfying its initial burden to show likely anticompetitive effects, and deal parties would have to show that the fix would overcome the likely anticompetitive effects. In such a situation, deal parties may find it strategically beneficial to "fix it first"—that is, structure their deal with divestitures already in place.

Issues that may be dealt with on appeal. Illumina's decision to appeal the commission's action is notable for several reasons. First, it will provide a federal court of appeals the opportunity to weigh in on vertical merger analysis. Appeals in merger cases are rare, and vertical merger cases are rarer still—though they are coming under increased scrutiny by U.S. antitrust enforcement agencies, with mixed results. In recent years, the Department of Justice lost two vertical merger challenges in the courts (AT&T-Time Warner and UnitedHealth-Change Healthcare). However, several other vertical deals were abandoned by the parties in the face of government challenges, but those challenges were not litigated to judgment in court.

Additionally, depending on the arguments put forward in the appeal, the court may have occasion to address several constitutional questions: in the administrative proceeding, Illumina raised defenses based on the FTC's structure, as well as due process and equal protection concerns.

ENDNOTES:

[1] https://www.paulweiss.com/practices/litigation/antitrust/publications/ftc-rescinds-vertical-guidelines-introducing-opacity-into-merger-review?id=40984.

[2] https://www.ftc.gov/system/files/ftc_gov/pdf/D09401InitialDecisionPublic.pdf.

[3] https://ec.europa.eu/commission/presscorner/detail/en/ip_22_5364. *See also* Jay Modrall, "Illumina/Grail and the M&A Implications of Expanded EU Merger Regulation Jurisdiction," *The M&A Lawyer*, Vol. 26, No. 9, October 2022.

[4] https://www.paulweiss.com/practices/litigation/antitrust/publications/takeaways-from-the-doj-s-unitedhealth-change-healthcare-merger-loss?id=44360.

DOES A DIFFERENT MAE ANALYSIS APPLY TO A "FINANCIAL" BUYER?

By Grant McGlaughlin, Caitlin Rose, Gesta Abols and Paul Blyschak

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"Financial" buyers are amongst the most active participants in M&A. Alleged material adverse effects ("MAE") are amongst the most complex disputes in M&A.

What happens when the two meet? Numerous Delaware decisions have indicated that a different MAE analysis might apply where the M&A transaction features a "financial" buyer (as opposed to a "strategic" buyer). Moreover, the scant Canadian caselaw that has considered the issue arguably points in the same direction.

Given that Canada is consistently the largest foreign destination for U.S. outbound M&A by deal volume,[1] we explore this issue for the benefit of M&A lawyers on both sides of the border.

"Financial" Buyers vs "Strategic" Buyers

Private equity ("PE") has become an increasingly important force in M&A, largely due to the classic PE model whereby a PE fund acquires an underperforming business to improve such performance before selling the business for a profit.

This "flipping" of businesses by PE (often called "financial" buyers) is in contrast to the typical goals of a "strategic" buyer. Being an established industry player, a "strategic" buyer usually acquires the business not for short-term improvement but for comprehensive and long-term integration into its operations and growth plans and for potential synergistic and operational savings.

Material Adverse Effect Disputes

A detailed dive into the MAE clause is beyond the scope of this article.[2]

What is important for the current discussion is that, first, MAE clauses allow the *buyer* to avoid closing the transaction where the target has experienced a "material adverse effect," and second, in deciding whether a "material adverse effect" has occurred, courts consider the anticipated *duration* of the adverse impact on the target. Simply put, an adverse development of only momentary conse-

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quence is unlikely to be considered "material" as intended by an MAE clause.

When a "Financial" Buyer Meets an MAE

What is the consequence of the convergence of an M&A transaction with a "financial" buyer and an alleged MAE on the target such that the "financial" buyer argues it is entitled to walk away from the deal?

The answer is that several courts have indicated—although none to the knowledge of the authors definitively—that the *required duration* of the adverse impact experienced by the target may be *briefer* where the buyer is a "financial" with a short-term investment horizon. Stated differently, these courts have shown an appreciation of the distinction in acquisition motivations and intentions between "strategics" and "financials" and have implied that such differences may in part drive their MAE analysis.

Delaware Caselaw

Indeed, such indications are relatively longstanding, at least in Delaware.

In *IBP* the Court of Chancery noted the MAE clause "must be read in the *larger context* in which the parties were transacting" before distinguishing between "a short-term speculator" and a "strategic buyer." For the former, the failure of the target "to meet analysts' projected earnings for a quarter could be highly material." For the latter it would be "odd" to "view a short-term blip in earnings to be material . . ."

Both *Hexion* and *Bardy* stated that, in the absence of evidence otherwise, "a *corporate acquirer* may be assumed to be purchasing the target as part of a *long-term strategy*." *Level 4 Yoga* remarked that "durational significance is particularly important here because [the buyer] was seeking to acquire [the target] as part of a *long-term strategy*."[3]

Another recent example is *Snow Phipps*, which involved the sale of a cake decorations company by a mid-market PE firm to a larger PE group. The Court of Chancery summarized:

> [The buyer] argues that, in a debt-financed acquisition, the timeframe for evaluating durational significance should align with the timing of post-closing covenant compliance testing. [The buyer's] argument effectively invites the court to *view private equity transactions dissimilarly from strategic acquisitions when interpreting an MAE*, an idea that is the subject of a wealth of scholarly commentary that the parties neither cited nor discussed. This decision flags the issue without engaging in it . . . (emphasis added)

This "wealth of scholarly commentary" was also noted in *Akorn*, where the Court of Chancery recognized that "[c]ommentators have suggested that 'the requirement of durational significance may not apply when the buyer is a financial investor with an eye to short term gain.' "

Canadian Caselaw

Noteworthy for U.S. "financial" buyers eyeing a Canadian target is that these themes recurrent in Delaware MAE caselaw were recently echoed by the Ontario Superior Court of Justice (the Court) in *Fairstone*.[4]

First, the Court endorsed the statement in *IBP* that, "[f]or a short-term speculator, the durational requirement may be relatively short to constitute a MAE."[5] The Court also acknowledged that, in other instances, U.S. courts have required adverse changes that "persist significantly into the future," including adverse changes "consequential to the [target's] long-term earnings power . . ."[6]

The result for *Fairstone* was that "[t]he length of the durational requirement *depends on the context*."[7]

This led the Court to base its required adverse duration of "approximately two years" in reference to the buyer's expected "synergies," "scale," and "diversification."[8] Furthermore, there are other instances of *Fairstone* emphasizing the importance of context, including when, in considering the MAE's carve-outs, the Court explained that "[o]ne of the factors that Canadian and American courts have identified as relevant to interpreting MAE clauses is the *identity of the parties*."[9]

Practical Takeaways for U.S. Private Equity Considering a Canadian Acquisition

Canadian and Delaware law generally align on many key M&A issues, but on certain others they do not.[10] One difference pertinent to the intersection of "financial" buyers and MAE clauses is that between the "factual matrix" and the "four corners."

In Canada, per the Supreme Court of Canada's decision in *Sattva*, the "factual matrix" surrounding a contract's execution is considered in *every case* and can impact the court's interpretation of the contract's terms. By contrast, in Delaware, courts adhere to the "four corners" principle whereby they generally strive to resolve contractual interpretation disputes, where possible, without looking beyond the document.[11]

Among other things, this difference in basic principles of contract interpretation could facilitate an argument by a "financial" buyer that its nature as such reduces the required duration of an adverse impact on the target in an MAE dispute governed by Canadian law.[12] Also notable towards this end is *Fairstone*'s repeated statement that MAE clauses should be "interpreted from the perspective" of the buyer.[13]

Overall, the practical takeaways for PE buyers are clear. First, should an MAE arguably occur, a PE buyer's nature as such *may* function to *reduce* the *duration* of adverse impact on the target a Delaware court would require as part of an MAE analysis. Second, given that, at a high level, Canadian law gives more consideration to the "factual context" in deciding contractual interpretation disputes than does Delaware law (*i.e.*, given Delaware's "four corners" principle), this argument *may* be more open to a PE buyer where the M&A agreement is governed by Canadian law (*i.e.*, where the target is a Canadian company).

ENDNOTES:

[1]*See* Paul Weiss' "M&A at a Glance Year-End Roundups" for each of 2022, 2021, 2020, 2019, and 2018.

[2]For further discussion, *see* P. Blyschak, "Material Adverse Effect (MAE) Clauses in Canada: What U.S. Counsel Needs to Know" (2022) 16(2) *Virginia Law & Business Review* 327.

[3]*See also Frontier Oil v. Holly*, which cautioned that the "notion of [an MAE] is imprecise and varies both with the *context of the transaction* and *its parties* . . ." (emphasis added).

[4]*Fairstone Financial Holdings Inc. v. Duo Bank of Canada*, 2020 ONSC 7397 (CanLII) ["*Fairstone*"].

[5]*Fairstone* at para. 78.

[6]*Fairstone* at paras. 78 and 79, citing *IBP*, *Hexion*, *Frontier Oil,* and *Akorn*.

[7]*Fairstone* at para. 78 (emphasis added).

[8]*Fairstone* at paras. 81, 84, and 85.

[9]*Fairstone* at para. 93 (emphasis added).

[10]*See*, for example, P. Blyschak, "Material Adverse Effect (MAE) Clauses in Canada: What U.S. Counsel Needs to Know" (2022) 16(2) *Virginia Law & Business Review* 327.

[11]*See* E. Norman Veasey & Jane M. Simon, "The Conundrum of When Delaware Contract Law Will Allow Evidence Outside the Contract's 'Four Corners' in Construing an Unambiguous Contractual Provision" (2017) 72 *The Business Lawyer* 893.

[12]Note, however, that as a decision of the On-

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tario Superior Court of Justice, *Fairstone* would not be binding in Canada's other provinces and territories. That said, it could be considered persuasive in such other jurisdictions. The authors are unaware of any Canadian caselaw other than *Fairstone* discussing this issue in any meaningful detail.

[13] *See Fairstone* at paras. 25-26, 72, and 86. *See also* paras. 162 and 166.

DELAWARE COURT OF CHANCERY DISMISSES BREACH OF CONTRACT CLAIMS AGAINST BUYER, FINDING SELLER RETAINED POST-CLOSING LIABILITY RELATED TO CERTAIN PRODUCT-LIABILITY LITIGATIONS

By K. Mallory Brennan, Alan S. Goudiss, Jeffrey D. Hoschander and Carter Gantt

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On April 3, 2023, in *Merck & Co., Inc. v. Bayer AG*,[1] Vice Chancellor Nathan A. Cook of the Delaware Court of Chancery dismissed the breach of contract claims by one pharmaceutical company ("Seller") against another ("Buyer") in connection with Buyer's acquisition of Seller's consumer product lines in 2014 pursuant to a Stock and Asset Purchase Agreement (the "Agreement").

After closing, product liability claims relating to talcum powder used in one of the product lines were filed against both companies. Seven years after the closing, Seller informed Buyer that as of the seventh anniversary, it would no longer pay for defense and liability stemming from the claims and, after Buyer refused to assume the liability, sued Buyer for breach of the Agreement. The Court found that the Agreement—which was negotiated by sophisticated parties—unambiguously established that Seller was indefinitely liable for the products liability claims for products sold before closing.

In the "Assumption of Liabilities" provision of the Agreement, Buyer assumed liability for all purchased assets, except for "Retained Liabilities" that remained with Seller. Seller "absolutely and irrevocably" retained "all obligations and liabilities" for the Retained Liabilities, which included products liability claims relating to products purchased prior to the closing date. Seller asserted that if the parties had intended Seller to retain the liability indefinitely, the Agreement would have used words like "perpetual" or "forever." The Court disagreed, explaining that the words "absolutely" and "irrevocably" established that Seller retained the liability into perpetuity.

Seller also argued that the "Expiration of Representations and Warranties" clause (the "Expiration Provision") imposed a seven-year limitation on its obligations to defend product liability claims, asserting that "the general language" describing the Retained Liabilities was "qualified by the specific language" of the Expiration Provision. The Court, however, found that (i) the Expiration Provision imposed limits only on claims that the parties might bring against each other, not tort claims by third parties, and (ii) the sections of the Agreement were neither in conflict nor ambiguous.

The Court noted that Seller's reading would have unwound the carefully assigned liabilities explicitly established in the Agreement, which also contained

no mechanism for any assumption by Buyer of the liabilities. The Court further observed that Seller's interpretation was commercially unreasonable and thus could not possibly be correct. Carried to its logical conclusion, the Court reasoned that Seller's construction of the Agreement would allow Seller to purposefully stall litigation so that after the seven-year period had passed, Buyer would be liable for all pending claims. Finally, the Court reviewed the purchase price for the assets and found it did not contemplate liabilities for litigation.

ENDNOTES:

[1]No. 2021-0838-NAC (Del. Ch. Apr. 3, 2023).

RETHINKING ANTITRUST

By Elizabeth Wilkins

Elizabeth Wilkins is the Chief of Staff to the Chair and Director of the Office of Policy and Planning at the Federal Trade Commission. The following is edited from remarks that she gave at a conference by The Schwartz Center for Economic Policy Analysis and the Communications Workers of America, "Antitrust Policy and Workers," on March 30, 2023.

One of the contributing factors to declining worker power is labor market concentration. Workers are facing extremely concentrated markets for their labor. Nationally, labor market concentration has increased since the 1980s, and local labor markets remain stubbornly concentrated, spelling trouble for workers.[1] Limited options for employment mean that employers don't have to compete for workers on wages and benefits, reducing the pay and quality of the jobs available to workers. And mergers that significantly increase labor market concentration have been shown to lead to lower wages and slower wage growth . . .[2]

Over the course of this decline, antitrust agencies have been absent, or worse. For 40 years, the antitrust agencies didn't just ignore labor markets. The policymakers at the agencies, laser focused on efficiency, actively endorsed the benefits of 'cost cutting' and other efficiencies that squeezed workers. They ignored harms in labor markets in favor of perceived benefits in products and service markets, to the detriment of workers and worker power. And of course in cases like *FTC v. Superior Court Trial Association* and the Seattle Uber drivers matter, agency policymakers chose to use antitrust law to undermine organizing efforts by groups of workers looking to push back against their employer.

Now, with that backdrop, Chair Khan has made it a key priority to ensure that the FTC is doing our part to create a more inclusive economy with greater worker power. In her first vision and strategy memo to the agency, Chair Khan said that a priority of hers was to examine places where power asymmetries can enable illegal practices, and made it a point to single out "extractive business models that centralize control and profits while outsourcing risks, liabilities, and costs."[3] These principles have animated the agency's approach to labor market issues . . .

I want to take some time to walk through some of the major lines of work we have on both mergers and on conduct cases—both competition and consumer protection—to talk about how we're currently thinking about labor market regulation. And I want to emphasize that this is a start. We're looking to expand on this work as we move forward.

First, I want to talk a bit about how we think about mergers. This is a huge part of our work across the board. Concentration has increased dramatically across the economy. Evidence suggests that decades of mergers have been a key driver of consolidation across industries,[4] and our merger review program is the first line of defense against this trend.

We're thinking about this both as we revise the

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Merger Guidelines and in real time as we assess and challenge the mergers coming through our doors. In terms of revising the Merger Guidelines, we've made clear that we're incorporating labor market effects analysis into merger review.[5] We've brought on experts like Eric Posner, Ioanna Marinescu and Hiba Hafiz to help us with this understanding. And we've asked for public comment, and will do so again, to ensure that we're getting the best thinking on how to review mergers for labor market harms even as we're still in learning mode.[6]

Labor markets have unique characteristics that product markets lack, and the new Guidelines will need to be sensitive to that. The Guidelines will also need to clarify, with no ambiguity, that assessing the labor market effects of mergers are a core component of the agencies' merger review process, and those effects will not be ignored just because a merger might generate benefits in other markets. In revising the Guidelines, worker mobility and worker power will be at the forefront of merger policy.

While we're revising the merger guidelines, we're also reviewing mergers in real time in line with these goals, including being willing to challenge mergers that reduce labor market competition.

On merger review, take for example the Lifespan/Care New England merger in New Jersey this past year, which implicated a labor market.[7] Our staff did a diligent job of understanding the labor market impacts for ourselves—again, something that's different from the product or service market analysis that we're more steeped in. The Commission split on whether to challenge the merger on labor market grounds. The Chair and Commissioner Slaughter made clear they were prepared to go forward with a challenge on the grounds of harm to labor market competition.[8] But potentially equally notable, all four commissioners confirmed the notion that a merger that threatens competition for labor is a cognizable basis for Section 7 liability.[9] Going forward, I would expect labor questions to feature in more FTC merger investigations.

We are also taking a critical eye toward how we think about merger remedies. Let me say first off that we are taking a fresh, skeptical eye toward merger remedies generally because the evidence shows they don't always work out as planned, and it's the public that bears the risk that an illegal deal is imperfectly remedied in a way that still leads to higher prices, lower wages, and the like. That said, as we do consider remedies, we have for a while now been, and are doubling down on, scrutinizing mergers for provisions like non-competes that impede talent mobility. For example:

- In November 2021, as part of the FTC's divestiture remedy to 7-Eleven, Inc.'s acquisition of Marathon's Speedway subsidiary, the FTC prohibited 7-Eleven from enforcing noncompete provisions for franchisees or employees working at or doing business with the divested assets.[10]

- In January 2022, the Commission approved a final order imposing strict limits on future mergers by DaVita, a dialysis service provider with a history of fueling consolidation in life-saving health industries. As part of the order, DaVita was prohibited from entering into or enforcing noncompete agreements and other employee restrictions.[11]

We are also beginning a dialogue on the ways in which divestitures and other remedial practices might have consequences for worker power, and how we can take that into account in our thinking. Last, let me say that across these activities—revising the guidelines, merger review, and merger remedies—we view unions as key stakeholders to engage in understanding the full scope of the market dynam-

ics and consequences at play . . . As folks here surely know, the FTC has signed an MOU with the National Labor Relations Board (NLRB), and Department of Justice has done so with both NLRB and the Department of Labor. People often ask me what this means.

First, perhaps not terribly sexy but definitely terribly important: we're learning from each other through training and technical assistance. Second, we are providing key technical assistance to each other both in case matters and in policy matters like statements and rulemakings . . .

Last, though the focus has been on collaboration across the federal government, I would be remiss if I didn't mention our close collaboration with state counterparts. They're also often keenly interested in how mergers affect their constituents. Given that a lot of labor effects are local, state AGs can have a deep interest in those effects and can be important partners in investigating them.

So, that's a lot. Chair Khan has challenged us to think not in terms of competition or consumer protection, but in terms of the market structures that directly affect peoples' lives and the tools we have to address them. With its dual mandates, the FTC is uniquely placed to establish and clarify fair rules of labor market governance.

ENDNOTES:

[1]U.S. Dep't of Treasury, The State of Labor Market Competition, at 25 (2022), https://home.treasury.gov/system/files/136/State-of-Labor-Market-Competition-2022.pdf.

[2]*See, e.g.*, José A. Azar et al., Concentration in US Labor Markets 13 (Nat'l Bureau of Econ. Res., Working Paper No. 24395, 2018); Simcha Barkai, Declining Labor and Capital Shares, 75 J. Fin. 2421, 2422 -45, 48 (2020); *see, e.g.*, Elena Prager & Matt Schmitt, Employer Consolidation and Wages: Evidence from Hospitals, 111 Am. Econ. Rev. 397, 423-24; *see also* Remarks of Chair Lina M. Khan Regarding the Request for Information on Merger Enforcement, Docket No. 2022-0003, at 2 (Jan. 18, 2022), https://www.ftc.gov/legal-library/browse/casesproceedings/public-statements/statement-chair-lina-m-khan-regarding-request-information-merger-enforcement (noting that "evidence suggests that many Americans historically have lost out, with diminished opportunity, higher prices, lower wages, and lagging innovation").

[3]Memorandum from Chair Lina M. Khan to Commission Staff and Commissioners Regarding Vision and Priorities for the FTC, at 4 (Sept. 22, 2021), https://www.ftc.gov/legal-library/browse/cases-proceedings/publicstatements/memo-chair-lina-m-khan-commission-staff-commissioners-regarding-vision-priorities-ftc.

[4]*See, e.g.*, Simcha Barkai, Declining Labor and Capital Shares, 75 J. Fin. 2421, 2422 -45, 48 (2020); Jan De Loecker et al., The Rise of Market Power and the Macroeconomic Implications, 135 Q.J. Econ. 561, 644 (2020); Germán Gutiérrez & Thomas Philippon, Investmentless Growth: An Empirical Investigation, Brookings Paper on Econ. Activity, 89, 95-97 (2017); *See generally* JOHN KWOKA, MERGERS, MERGER CONTROL, AND REMEDIES: A RETROSPECTIVE ANALYSIS OF U.S. POL'Y (2014); *see also* Remarks of Chair Lina M. Khan Regarding the Request for Information on Merger Enforcement, Comm'n File No. FTC-2022-0003, 1-2 (Jan. 18, 2022), https://www.ftc.gov/legal-library/browse/cases-proceedings/public-statements/statement-chair-lina-m-khanregarding-request-information-merger-enforcement.

[5]U.S. Dep't of Just. & Fed. Trade Comm'n, Request for Information on Merger Enforcement, Docket No. 20220003, at 2, 5-7 (Jan. 18, 2022), https://www.regulations.gov/docket/FTC-2022-0003.

[6]*Id.; see also* Press Release, Fed. Trade Comm'n, Federal Trade Commission and Justice Department Seek to Strengthen Enforcement Against Illegal Mergers (Jan. 18, 2022), https://www.ftc.gov/news-events/news/pressreleases/2022/01/federal-trade-commission-justice-department-seek-strengthen-enforcement-against-illegal-mergers.

[7]In the Matter of Lifespan Corp., Comm'n File No. 2110031 (2022).

[8]*See generally* Concurring Statement of Com-

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missioner Slaughter and Chair Khan regarding FTC and State of Rhode Island v. Lifespan Corporation and Care New England Health System, Comm'n File No. 2110031 (Feb. 17, 2022), https://www.ftc.gov/legal-library/browse/cases-proceedings/public-statements/concurring-statementcommissioner-slaughter-chair-khan-regarding-ftc-state-rhode-island-v-lifespan.

[9]*Id.; see also* Concurring Statement of Commissioners Noah Joshua Phillips and Christine S. Wilson Regarding Lifespan Corporation and Care New England Health System, Comm'n File No. 2110031, at 1 (Feb. 17, 2022), https://www.ftc.gov/legal-library/browse/cases-proceedings/public-statements/concurring-statement-commissionersnoah-joshua-phillips-christine-s-wilson-regarding-lifespan.

[10]Press Release, Fed. Trade Comm'n, FTC Orders the Divestiture of Hundreds of Retail Stores Following 7-Eleven, Inc.'s Anticompetitive $21 Billion Acquisition of the Speedway Retail Fuel Chain (June 25, 2021), https://www.ftc.gov/news-events/news/press-releases/2021/06/ftc-orders-divestiture-hundreds-retail-storesfollowing-7-eleven-incs-anticompetitive-21-billion.

[11]Press Release, Fed. Trade Comm'n, FTC Imposes Strict Limits on DaVita, Inc.'s Future Mergers Following Proposed Acquisition of Utah Dialysis Clinics (Oct. 25, 2021), https://www.ftc.gov/news-events/news/pressreleases/2021/10/ftc-imposes-strict-limits-davita-incs-future-mergers-following-proposed-acquisition-utah-dialysis.

FROM THE EDITOR

Activision as a Bellwether

In what's been the most turbulent year for M&A in a decade, further instability came in late April when the UK's antitrust authority said it would block Microsoft's $69 billion acquisition of Activision Blizzard Inc.

Britain's Competition and Markets Authority said it blocked the deal in part due to concerns that the merged company would hinder competition in the cloud gaming sector. Microsoft said it would appeal to the UK's Competition Appeal Tribunal, which will examine and rule upon the CMA's decision-making process. Microsoft won't be able to offer new remedies at this stage.

At the same time, Microsoft faces more challenges—European regulators will rule on the Activision deal by May 22, while the Federal Trade Commission last December filed a complaint to block it. Analysts predict that the deal stands a good chance of collapsing should the EU regulators go against it. Despite having to pay Activision a $3 billion break fee, Microsoft may calculate the odds of prevailing against UK and U.S. regulators won't be worth the court fights.

The CMA's move against Activision is part of a growing cross-Atlantic trend in which regulators are taking action against mergers they perceive could have a chilling effect on future competition in their respective markets. See the FTC's ongoing battle with Illumina Inc., seeking to block Illumina's $7 billion acquisition of cancer-testing startup GRAIL (a detailed piece by lawyers from Paul, Weiss, Rifkind, Wharton & Garrison is elsewhere in this issue).

So while facing the lowest M&A deal volumes since 2013, dealmakers must also contend with an increasingly heavy regulatory hand on some potential mergers. FTC Commissioner Rebecca Slaughter recently told a room full of M&A lawyers (see our cover article), "it isn't our job to be a service agency for merger attorneys, as much as I love all of you. It is our job to protect competition in markets." Or as the FTC's Elizabeth Wilkins has said, the FTC's revisions of its Merger Guidelines will likely take into greater account labor concerns, that "assessing the labor market effects of mergers are a core component of the agencies' merger review process, and those effects will not be ignored just because a merger might generate benefits in other markets. In revising the Guidelines, worker mobility and worker power will be at the forefront of merger policy."

Chris O'Leary

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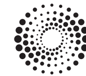

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