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Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

DOJ, FTC Fought Mergers In 2022 And Judges Pushed Back

By **Bryan Koenig**

Law360 (December 21, 2022, 1:58 PM EST) -- During the first full calendar year of Senate-confirmed leadership for the Biden-appointed antitrust enforcers, the U.S. Department of Justice and the Federal Trade Commission tested their plans to rewrite merger enforcement, prompting a big push back from the courts.

While the FTC inked consent decrees to curtail the anti-competitive impacts of some transactions and pursued enforcement actions that drove the abandonment of others, 2022 was defined heavily by a series of stinging losses in litigated merger challenges, offset by a single win.

"The agencies' failed merger challenges demonstrate the tension between aggressive enforcement and the deployment of novel theories of harm, on the one hand, and checks and balances exerted by courts applying established jurisprudence, on the other," said Vishal Mehta, a partner with Morrison & Foerster LLP.

Writing A New Chapter With Penguin Win

For all their 2022 setbacks, enforcers did score an important win that could serve as a springboard for one of the Biden administration's highest priorities: using antitrust law to protect workers. That's because a D.C. federal judge held at the end of October that Penguin Random House LLC's planned purchase of Simon & Schuster risked giving the combined entity too much bargaining leverage over authors of anticipated bestsellers when negotiating publishing rights.

The ruling from U.S. Circuit Judge Florence Y. Pan, sitting by designation on a case she first took as a district judge before her elevation to the D.C. Circuit, came in a rare monopsony case challenging a deal based on how it will impact the purchase of a good or service, in this case buying publishing rights, instead of how it will affect sales to customers.

"That case is significant because obviously the theory of harm was a little different from other historical merger cases that alleged a downstream theory of harm," said Kevin Hahm, a partner with Hunton Andrews Kurth LLP and a former FTC official, referring to monopoly merger cases that usually focus on how deals will affect customers and especially end-consumers.

Despite the unique focus of the DOJ's case, Logan M. Breed, global co-head of the antitrust practice at Hogan Lovells, said "the logic of the [Clayton Act] Section 7 claim was a very traditional one."

"The evidence that was used was evidence that prior administrations would have relied on," he said. The DOJ "alleged a straightforward head-to-head reduction of competition" against a transaction that didn't have a proposed remedy that other administrations would have been likely to accept.

The publishing victory could bolster Biden administration efforts to expand its antitrust focus beyond how consumers are impacted by alleged anticompetitive deals, to how workers could be harmed.

"It's going to provide more fuel to the fire for the agencies to look at the impact on some or all members of the workforce," said Howard B. Iwrey, head of the antitrust practice at Dykema Gossett PLLC.

Hahm noted that the FTC's Democrats, before they had the votes to override GOP opposition, had already signaled a willingness to bring labor-impact claims in a February challenge of a planned but later abandoned merger between Rhode Island's two largest health care providers, one of several hospital transactions that were dropped in the face of enforcer lawsuits.

When challenging the Rhode Island deal, the FTC's Republicans said that while they support merger cases based on monopsony concerns, they didn't think the evidence there could support claims around reduced competition for health care workers, claims they argued would make the case more complex without providing any benefits.

Nearly a year later however, Hahm noted that the FTC's Democrats have firmly shored up their majority, giving them the votes to push labor market claims in other merger cases down the line.

Simon & Schuster parent company Paramount Global, the successor to ViacomCBS Inc., called off the planned sale in November, closing off Penguin's plans to appeal.

Judge Wary Of Health Deal's Vertical Harm Theories

In virtually every effort to push and test their most novel theories, including vertical concerns around data access in UnitedHealth's purchase of Change Healthcare, enforcers found courts pushing back.

"It doesn't seem like the courts are willing to go as far as the agencies want them to go on some of the more novel theories the agencies are trying to push," said Jon B. Dubrow, co-head of the mergers focus group at McDermott Will & Emery.

Jurists like U.S. District Judge Carl J. Nichols, who rejected the challenge to the Change purchase, demanded real-world evidence of how companies actually behave, rather than how economic analysis predicts they'll act. Experts' testimony, Dubrow said, "need to align with the real-world evidence."

Enforcers in 2022 often found judges skeptical that buyers would abuse vertical relationships by tapping competitively-sensitive data or otherwise harming competitors who also need access to the newly-integrated vertical service. Instead, jurists found that theory ran against business incentives, reputational caution and legal safeguards.

"When the courts faced that, they've discredited the expert testimony where it was disconnected from what they called the real-world evidence," Dubrow said.

In September, for instance, Judge Nichols rejected government assertions in D.C. federal court that pairing UnitedHealth with Change would incentivize UnitedHealthcare, the country's largest insurer to

abuse Change's access to rival insurers' data.

Following a two-week bench trial held at the same time as the Penguin-Simon & Schuster case was proceeding two floors below, Judge Nichols held that legal, contractual and practical data use limits prevented any abuse of Change's data clearinghouses connecting health care providers and insurers, and that the divestiture of Change's ClaimsXten unit completely resolved concerns that the combined company would otherwise control 94% of the market for so-called first-pass claims editing, which helps insurers process reimbursement claims.

One major stumbling block for enforcers in UnitedHealth and elsewhere was judges' wariness of "hot documents" allegedly demonstrating anti-competitive intent behind a transaction. Dubrow said finding such documents for "more esoteric theories" is harder.

Enforcers tried to show such documents, including in UnitedHealth discussions about the importance of acquiring Change's data, and contractor discussions about the meaning of Booz Allen Hamilton's purchase of EverWatch.

But the judges in those cases wrote off the material as taken out of context or not as telling as what enforcers asserted.

"The absence of hot documents makes it hard for the government to win its case," Dubrow said. "When they've tried to make things sound hot that really can be explained away pretty readily--the courts have swept those aside without much difficulty."

Change Divestiture Keeps PE In Enforcers' Sights

The UnitedHealth case, currently on appeal, also exemplified an increasing skepticism, or even distaste, for private equity firms by enforcers. In UnitedHealth, that translated to DOJ attacks on TPG Inc. as the proposed divestiture buyer, a role for which the department argued, unsuccessfully, that the private equity firm was not up to the task.

Elsewhere, the FTC's Democrats broadly put private equity on blast in announcing a settlement permitting a $1.1 billion merger of veterinary clinics. The agency's Democrats warned in June that enforcers need to watch for so-called roll-up strategies through which private equity firms scoop up sections of an industry one relatively small purchase at a time, often in individual transactions so small they don't trigger reporting requirements.

According to Michael Murray, a partner with Paul Hastings LLP and a former principal deputy assistant attorney general with the Antitrust Division, the FTC's PE consent decrees dovetail with stepped-up DOJ enforcement against so-called interlocking directorates, in which individuals sit on the boards of overlapping competitors in alleged violation of Section 8 of the Clayton Act, a law whose enforcement the agency says it has actively been trying to "reinvigorate."

Together, Murray said the enforcement presages increased focus on PE as either the buyer in a merger deal or the firm picking up divested assets, demonstrating "a general skepticism of the role of private equity firms of controlling the economics space."

"Some of that is still to come in terms of how the regulators will continue to play that out," Murray said.

DOJ Dinged On Markets, Regulatory Safeguards In Sugar Challenge

As much as enforcers were dinged in 2022 for pushing the envelope, they also suffered setbacks in a more traditional case contesting alleged horizontal overlap between direct competitors: U.S. Sugar's now-closed $315 million acquisition of Imperial Sugar.

In challenging the sugar deal in Delaware federal court, the DOJ had argued only two major suppliers of refined sugar would be left to supply wholesale customers in the southeastern U.S.

Following a four-day bench trial in April, U.S. District Judge Maryellen Noreika determined that, contrary to the DOJ's warning, customers are not limited to regional markets because sugar flows easily and cost-effectively across the country.

The department immediately gave notice that it would contest Judge Noreika's findings but was nevertheless denied an emergency block.

On appeal, the DOJ argues the judge wrongly held that the government failed to identify a relevant market and mistakenly assumed regulations could offset any anti-competitive impact.

U.S. Sugar has **continued** to defend the legality of the merger, accusing the DOJ in a November brief of using "gerrymandered" sugar markets to distort claims about the deal's competitive impact. According to the company, the geographic and product markets the DOJ presented during the trial were overly narrow and did not reflect the reality of the industry.

Antitrust observers say the case is particularly notable because Judge Noreika based her findings partly on the ability of the U.S. Department of Agriculture "to counteract" any upward pricing pressure through the department's control over domestic sugar sales and international imports into the country.

The Third Circuit appeal is already fully briefed and awaiting the scheduling of oral arguments.

An In-House Loss Over Illumina-Grail

The FTC's in-house challenge of Illumina's $8 billion reacquisition of Grail is shaping up as a multi-year ordeal.

First kicked off in March 2021, the case resulted in an administrative law judge's Sept. 1 rejection of allegations authorized by the commission. From there, staffers appealed to the same commission, which heard oral arguments in December. If the commissioners upend the ALJ's findings (which they historically always do when the ALJ finds against complaint counsel) the companies can then appeal to a federal circuit court. On top of all that, the companies are facing an order by European Union antitrust authorities to unwind the transaction.

The FTC's case contends the already-combined, vertically-integrated company pairing Illumina's DNA-sequencing technology with Grail's multi-cancer early detection tests would be able to hinder potential Grail rivals that are developing similar cancer tests because they also rely on Illumina's sequencing technology.

FTC Chief Administrative Law Judge D. Michael Chappell, however, found a lack of evidence that Grail has any actual rivals and that potential future rivals are far behind. The judge also acknowledged a long-

term supply agreement Illumina is offering to its sequencing customers that guarantees prices and access to its products.

The case is another demonstration of how difficult it can be to go after vertical transactions, which have historically been seen as less competitively harmful than horizontal tie-ups and potentially even beneficial.

"Now the government is 0-3 on litigating vertical merger cases in the last 5 years," said Jonathan M. Grossman, co-head of the antitrust practice at Cozen O'Connor.

Antitrust enforcers have however shown no sign of slowing down their litigated vertical merger enforcement, which are likely to get a major boost when new guidelines currently being overhauled are unveiled.

A four-decade hiatus in vertical merger challenges ended in 2017 with the failed challenge of AT&T's purchase of Time Warner. Most recently, the FTC challenged Microsoft Corp.'s planned $68.7 billion buyout of game developer Activision Blizzard over concerns about rivals to Microsoft's Xbox gaming console and related subscription and cloud services.

FTC complaint counsel are also seeking a commission reversal on their challenge to Altria Group Inc.'s $12.8 billion investment in Juul Labs Inc., alleging the purchase of a 35% stake itself as an anti-competitive merger and that the deal came with an agreement for Altria not to compete in the electronic cigarette market. Judge Chappell dismissed that case in February 2022 following a three-week in-house trial, finding good reasons for Altria to shutter its struggling electronic cigarette business around the same time it cut a deal to take a minority stake in Juul. The commission heard oral arguments in September.

FTC Goes Within The Metaverse

Much of the second half of 2022 was dominated for the FTC by its challenge to Meta Platform's proposed purchase of virtual reality app developer Within Unlimited. The FTC's case, launched in July, is all about potential: the potential of Facebook successor Meta to develop its own VR fitness apps and the potential of the merger to squash that possibility.

FTC complaint counsel had initially sought a preliminary injunction on the theories of both direct VR fitness app competition and prospective competition, only for the agency to drop the direct competition claim to move forward solely on concerns about potential competition in the future.

During evidentiary proceedings spaced out over several weeks in December in the U.S. District Court for the Northern District of California, the case is also a test of the potential of FTC Chair Lina Khan to dramatically reshape antitrust enforcement.

The Within case represents many of the Biden-era FTC's biggest priorities, especially reining in technology platforms in general and in trying to safeguard prospective competition.

"The FTC is putting its money where its mouth is," said Goodwin Procter LLP antitrust practice co-chair Andrew Lacy.

Enforcers contend that, without the purchase, Meta--separately battling a landmark FTC monopolization

case--could provide new competition in the VR fitness app market with its own dedicated app, particularly since it has owned Oculus, the leading VR headset manufacturer, since 2014.

Meta, which has made VR and the so-called metaverse a central pillar of its business model, has come out swinging against the allegations it derides as "regulatory central planning." It argues that enforcers are looking to block the deal over the agency's perception that it would be better if Meta built rather than bought resources to develop virtual reality fitness apps such as Within's Supernatural.

The preliminary injunction would pause the deal while the FTC's administrative process plays out, though companies frequently abandon transactions after courts enjoin them, while the commission normally drops cases after losing an injunction bid in federal court.

DOJ Pushes Envelope Against Deal Risk Language, Bidders For One Contract

The Biden-era DOJ Antitrust Division under Assistant Attorney General Jonathan Kanter also showed its aggressiveness in a number of ways in 2022, including through its challenge to Swedish locks giant Assa Abloy's $4.3 billion proposed purchase of Spectrum Brands' hardware and home improvement division and its challenge to Booz Allen Hamilton's $440 million purchase of EverWatch Corp.

The Assa Abloy case is expected to go to trial in April if the DOJ isn't satisfied by the company's plans to sell its door and cabinet hardware manufacturers to address concerns about dramatically reduced competition for premium mechanical door hardware and smart locks. Under Kanter, the division has largely shunned merger consent decrees, preferring to challenge potentially problematic transactions outright.

But even in the September complaint itself, the DOJ showed an increased interest in what is often thought of as boilerplate language baked into merger agreements in which companies try to allocate antitrust risk, such as through specific divestiture commitments and breakup fees.

The DOJ contends that in simply putting a contingency into the merger agreement for a potential divestiture to address antitrust concerns, "Assa Abloy and Spectrum effectively conceded that their proposed transaction would harm competition."

"The agencies seem to look at these [boilerplate provisions] as self-fulfilling prophecies, as an admission that there is an antitrust problem," said Iwrey of Dykema.

The EverWatch case in turn demonstrates an agency willingness to raise the narrowest possible market concerns: the DOJ sued because the companies were the only expected bidders for a single $140 million National Security Agency contract for signals intelligence modeling and simulation services, the latest version of a contract that Booz Allen has held for more than 20 years.

In refusing to grant a preliminary injunction in October, U.S. District Judge Catherine C. Blake of the District of Maryland found that there is no direct evidence suggesting the proposed deal has a detrimental effect on competition for the contract.

Instead, the government relies on "uncontextualized statements" from Booz Allen and EverWatch employees to show that the companies have a reduced incentive to compete for the contract, according to the opinion. But those comments, which came the same day the news broke of the deal, just show "excitement and uncertainty" among lower-level workers, the judge held.

The ultimate fate of the EverWatch case remains up in the air because of ongoing solicitation for the NSA contract.

The EverWatch case also stands out because the DOJ alleged, unsuccessfully, that the merger agreement itself violates Section 1 of the Sherman Act, which bars agreements that unreasonably restrain trade.

"Looking forward, advising clients on potential transactions, if DOJ is going to allege Section 1 violations more regularly, it could affect the way we counsel clients," said Breed of Hogan Lovells, who asserted that pre-closing actions could become "more risky."

--Additional reporting by Hailey Konnath, Matthew Perlman, Madeline Lyskawa, Jess Krochtengel, Dorothy Atkins, Kelly Lienhard, Piper Hudspeth Blackburn, Dave Simpson, Gina Kim, Lauren Berg and Daniel Wilson. Editing by Alex Hubbard.
