Antitrust Alert

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Lessons from Three Antitrust Agency Losses in Three Merger Trials

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Key Takeaways

- The antitrust agencies have lost three litigated merger challenges in less than one month. The DOJ Antitrust Division lost challenges to *UnitedHealth/Change* and *U.S. Sugar/Imperial Sugar* while the FTC lost its challenge to *Illumina/Grail*, although the antitrust agencies are appealing the latter two cases.
- In each of these cases, the merging parties held the antitrust agencies' feet to the fire by litigating merger challenges in court. In a world where antitrust agency leaders have promised aggressive enforcement and have advanced new legal theories of harm, litigating in front of an impartial judge may be the best way for merging parties to get their deal approved. The varying political backgrounds of the three judges underscores this point: one is a Republican Trump appointee, one is a Democrat Trump appointee, and the third is not aligned with a political party but was appointed during the Clinton administration.
- As was the case in *U.S. Sugar/Imperial Sugar*, the merging parties took the traditional route of defending their horizontal merger—a merger in which both parties compete—by attacking the government's alleged market definition and theory of competitive effects.
- The other two cases involved vertical mergers, or mergers involving firms participating in different levels of the supply chain. In *UnitedHealth/Change* and *Illumina/Grail*, the merging parties in each case offered up robust remedies, enabling them to "litigate-the-fix"—in other words, defend the transaction as modified by its proposed remedies—and attack the government's theories of competitive harm.
- Vertical merger challenges have proven hard for the government to win. With losses in *UnitedHealth/Change* and *Illumina/Grail*, the government has now lost all three of its vertical merger challenges in the modern era (the third being *AT&T/Time Warner*).

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Three Merger Trials, Three Losses

September 2022 was unkind to the antitrust agencies, which lost three litigated merger challenges in the month. On September 1, 2022, the Federal Trade Commission (FTC) administrative law judge found that the FTC failed to demonstrate that the vertical merger between Illumina, Inc. and Grail, Inc. (*Illumina/Grail*) would harm competition in the market for available and developmental multi-cancer early detection (MCED) tests. Then, on September 19, 2022, a district court judge ruled against the Department of Justice (DOJ) and allowed the proposed merger between UnitedHealth Group Inc. and Change Healthcare, Inc. to proceed (*UnitedHealth/Change*). Most recently, on September 23, 2022, the DOJ again failed to demonstrate that the proposed merger between United States Sugar Corp. and Imperial Sugar Co. (*U.S. Sugar/Imperial Sugar*) would harm competition in the alleged refined sugar market.

***Illumina/Grail* (FTC Administrative Court) (Vertical Theory) (FTC)**.[1] In *Illumina/Grail*, the FTC litigated the merger in its own administrative court, alleging that Illumina's proposed acquisition of Grail—a company it formerly owned and in which it retained a minority interest—would allow Illumina to harm competition in the development and sale of MCED tests by either raising the costs of a critical input or by foreclosing access to it altogether. Although the FTC has challenged mergers on potential harm to innovation, the FTC's theory was somewhat unusual because only Grail had a product available in the marketplace while its rivals were still many years away from commercializing a product. According to Judge Chappell, the FTC administrative law judge, the FTC failed to prove that the transaction would change Illumina's ability and incentive to harm competition. In applying the FTC's own reasoning, because Illumina held a 12 percent interest in Grail at the time of its proposed acquisition, Illumina *already* had the incentivize to favor Grail over Grail's rivals. In this way, the transaction did not change Illumina's incentives. Even so, Judge Chappell agreed with the defense that any MCED tests developed by competitors likely would be different from Grail's, diminishing diversion from rival tests to Grail, and thereby reducing Illumina's incentives to raise rivals' costs (because then any lost sales to Grail's competitors resulting from higher prices would be unlikely to be recaptured by increased sales of Grail's tests). Perhaps most significantly, Judge Chappell credited Illumina's robust, open offer to make its offerings available to all of Grail's rivals and found that it effectively constrained the company from acting anti-competitively. The FTC is appealing the administrative law judge's decision to the FTC Commissioners.

***UnitedHealth/Change* (D.C. District Court) (Horizontal and Vertical Theories) (DOJ)**.[2] In this case, DOJ alleged that health insurer UnitedHealth's proposed acquisition of Change would combine the two most significant suppliers of first-pass claims editing solutions, leaving UnitedHealth with a 90 percent market share. At the time of the lawsuit, however, the merging parties had agreed to divest Change's entire first-pass claims editing business, ClaimsXten, to private equity firm TPG Capital, which, according to the district court, fully resolved any horizontal competitive concerns. DOJ also challenged the vertical aspects of the transaction and argued that, by gaining control over Change's electronic data interchange (EDI) clearinghouse, UnitedHealth would have the ability and incentive to misuse rival health insurer's competitively sensitive information for its own advantage. According to the court, however, the record evidence showed that UnitedHealth's incentives to protect the confidentiality of external customer data outweighed any incentives to misuse it and, in

any event, UnitedHealth's firewalls and customer contracts effectively constrained the potential for misuse. In sum, the court found that the DOJ's arguments rested on speculation and were not supported by the real-world evidence presented at trial.

***U.S. Sugar/Imperial Sugar* (Delaware District Court) (Horizontal Theory) (DOJ)**.[3] Here, DOJ alleged that the proposed merger between competing sugar producers would concentrate about 75 percent of sugar sales in the southeastern United States in two producers and harm competition in the production and sale of refined sugar to wholesale customers. The judge refused to block the merger for three primary reasons: first, the judge found that the government's alleged product market failed because it excluded distributors, which served as meaningful competitive constraints, and because DOJ failed to explain why it lumped all wholesale customers in the same market as opposed to defining markets around subsets of wholesale customers such as industrial customers and supermarkets. Second, DOJ failed to prove its narrow geographic markets—consisting of two variations of collections of southeastern U.S. states—because the evidence showed that customers located within the southeast U.S. bought material amounts of sugar from producers located outside the southeast. Third, the evidence showed that the government—through the U.S. Department of Agriculture (USDA)—can protect against attempted price increase by adjusting sugar supply. The USDA's Federal Sugar Program controls supply of refined sugar and thus can ensure "that prices do not get too high (due to undersupply) or too low (due to oversupply)."[4] The 3rd Circuit subsequently denied DOJ's emergency motion to enjoin the merger pending DOJ's appeal of the district court decision.

It remains to be seen whether this recent streak in merger challenges will continue. DOJ is awaiting court decisions in two merger cases: *Penguin Random House/Simon & Schuster*, which is a merger between book publishers, and *Booz Allen/EverWatch*, a merger that the DOJ alleged harms competition for services to the National Security Agency (NSA). DOJ also recently filed suit against the *Assa Abloy/Spectrum Brands* merger, a merger between makers of residential door hardware, and is litigating another collaboration, the *American Airlines/JetBlue* Northeast Alliance. The FTC, for its part, is litigating *Meta/Within*, a transaction that the FTC claims will harm competition in fitness and dedicated-fitness virtual reality applications.

Lessons for Merging Parties

Here are a few takeaways for companies considering strategic deals:

- **Litigation continues to be a viable option for merging parties.** Although the path to closing becomes longer, these three victories underscore the viability of litigating before an impartial judge. Notably, only the judge in *UnitedHealth/Change* is a Republican Trump appointee; the judge in *U.S. Sugar/Imperial Sugar* is a Democrat Trump appointee, and the judge in *Illumina/Grail* is not aligned with a political party but was appointed during the Clinton administration. The results are consistent with outcomes in past merger litigations in which Republican-affiliated judges have blocked deals while Democrat-affiliated judges have rejected agency challenges (e.g., *Sabre/Farelogix*). These three cases also highlight judicial disapproval with recent changes in agency enforcement philosophy. For example, DOJ leadership has publicly disfavored merger remedies, including even structural remedies like divestitures. But courts have not shown the same hostility towards remedies. The court in *UnitedHealth/Change* approved a divestiture to an experienced private equity firm, a category of buyers that has drawn skepticism

from both antitrust agencies. Perhaps more significantly, the same court credited UnitedHealth's behavioral commitments to protect the confidentiality of customer data by implementing information firewalls. Likewise, Illumina's robust commitments to keep its products open to rivals were key factors in the judge's ruling for the defense. These cases demonstrate the viability of defending deals through litigation and, accordingly, merging parties may want to consider planning for litigation from the get-go.

- **Horizontal merger cases continue to turn on market definition, although courts have considered unique elements of a marketplace in evaluating prospects for harm.** *U.S. Sugar/Imperial Sugar*, a horizontal merger, is an example of a traditional defense to a merger. The defense convinced the judge that DOJ failed to properly define the product and geographic markets because DOJ's alleged market was both underinclusive and overinclusive. This failure alone was fatal to the DOJ's case. But the judge also was persuaded by the defense's use of an industry expert—an experienced USDA economist—who explained why unique features of the marketplace prevent the potential for competitive harm. Specifically, the parties showed that the USDA's ability to control the supply of sugar enabled it to check any attempt by the merging parties to increase sugar prices.
- **Litigating-the-fix can be an important tool for merging parties.** The decisions in the other two cases relied heavily on the "fixes" proposed by the merging parties. In some respects, both *UnitedHealth/Change* and *Illumina/Grail* highlight one advantage that the parties may have in court, which is the ability to marshal evidence to support the post-merger impact of proposed remedies. In *UnitedHealth/Change*, the parties offered testimony from an experienced executive of the divestiture buyer, who explained how it would expand the budget for the divested ClaimsXten business, improving the business's ability to compete with UnitedHealth post-divestiture. The judge also reconfirmed the viability of information firewalls, which are common behavioral solutions to vertical concerns about the potential for the misuse of competitively sensitive information. But the FTC administrative law judge went even further. Judge Chappell embraced the adequacy of novel but robust behavioral solutions in *Illumina/Grail*. The merging parties devoted considerable resources to develop a robust, elaborate set of private contractual commitments, including by updating its offer with continuous input from competitors of Grail. To support its solution, the defense offered testimony from at least two experts, including an antitrust economist and a CPA, the latter of whom explained the enforceability of the behavioral commitments. The extensive commitments aimed to resolve each of the competitive concerns articulated by the FTC.
- **Merging parties appear to have an edge in vertical merger litigation.** The antitrust agencies have now litigated three vertical merger cases in the modern era and lost all three. DOJ lost AT&T/Time Warner in 2018 and the agencies' vertical merger enforcement efforts have been dealt another blow after *UnitedHealth/Change* and *Illumina/Grail*. These cases highlight three major hurdles for the agencies. First, unlike horizontal merger challenges, the government cannot establish that a vertical merger is presumptively unlawful by presenting market share statistics because vertical mergers produce no immediate change in market shares. Without a market-share presumption, the agencies must make a fact-specific prediction about the proposed merger's likely competitive effects, which has proven difficult. Second, unlike horizontal merger cases where the government can

present ordinary-course evidence of past head-to-head competition to show why the deal lessens competition, vertical merger challenges instead rely heavily on predictions about the parties' future incentives. Absent clear evidence of anticompetitive intent from "bad" documents, this evidence has proven difficult to marshal in a convincing way. Third, the parties can litigate-the-fix by offering behavioral remedies that undercut or contradict the government's theory and may even neutralize the venom of "bad" documents. As described above, in *UnitedHealth/Change*, UnitedHealth implemented a firewall, a measure commonly used in its industry (which even witnesses offered by DOJ confirmed), to prevent the misuse of competitively sensitive information that DOJ was concerned about. Likewise, in *Illumina/Grail*, Illumina offered its key input on economic terms that were no less favorable than those Illumina provided Grail, all in highly transparent fashion. These commitments directly rebutted the FTC's theory that Illumina would not have an incentive to make the critical input available economically to Grail's competitors.

[1] Initial Decision, *In the Matter of Illumina, Inc.,* FTC No. 9401 (Sept. 9, 2022).

[2] Memorandum Opinion, *U.S. v. UnitedHealth Group Inc.,* No. 1:22-cv-0481, Dkt. 138 (Sept. 21, 2022).

[3] Memorandum Opinion, *U.S. v. United States Sugar Corp.,* No. 1:21-cv-01644, Dkt. 256 (Sept. 28, 2022).

[4] *Id.* at 17.