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WHAT A DIFFERENCE A YEAR MAKES: FTC WITHDRAWS VERTICAL MERGER GUIDELINES

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In September 2021, the five-member Federal Trade Commission voted 3-2 along party lines to withdraw its support for the Vertical Merger Guidelines[1] ("Guidelines") and related FTC commentary on vertical merger enforcement.[2] At the same time—indeed, only hours later on the same day—the acting head of the Antitrust Division of the Department of Justice issued a statement indicating that the Guidelines "remain in place" at the DOJ while the agency conducts a "careful review" of its process for making enforcement decisions.[3]

What a difference a year makes. The Guidelines had been jointly adopted by the FTC and the DOJ in mid-2020, marking the first revision in more than 35 years and following the DOJ's failed attempt to block AT&T's acquisition of Time Warner.[4] At that time, Republican leadership at both agencies lauded the new Guidelines. The head of the DOJ's Antitrust Division said the new Guidelines would "give greater predictability and clarity to the business community, the bar, and enforcers." The FTC Chair echoed this sentiment, explaining that the "new guidelines reflect our current enforcement approach and, through increased transparency, will help businesses and practitioners understand how we evaluate vertical transactions."

As the saying goes, elections have consequences. The last two administration changes resulted in repeals of antitrust guidance. The Obama Administration repealed the Bush Administration's monopolization guidance, and the Trump Administration repealed the Obama Administration's guidance on merger remedies. The Biden FTC's repeal of the Vertical Merger Guidelines continues that pattern and builds on a number of personnel announcements and policy decisions

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by President Biden squarely directed at increasing enforcement of U.S. antitrust laws. Since taking office in January 2021, President Biden has named pro-enforcement leadership to key positions in the White House and at both federal antitrust agencies; he also issued a sweeping executive order instructing federal agencies to promote competition in the American economy.

Within the world of merger enforcement, U.S. enforcement actions historically have been focused most on horizontal transactions—combinations involving direct current or future competitors. The prevailing view had been that these deals were more likely than vertical transactions to raise significant competitive concerns due to the agencies' conclusion that transactions involving parties operating at different levels in the same supply chain often resulted in efficiencies that benefit competition and consumers.

The sands, however, are shifting. The drafting and adoption of the Guidelines, including their recognition that vertical deals often result in efficiencies that are pro-competitive, generated significant controversy with some in the antitrust bar and within the agencies themselves. The current FTC majority believes the Guidelines rely on "unsound economic theories that are unsupported by the law or market realities." Some of the FTC majority's objections have been criticized as inconsistent with accepted economic principles.[5] Other aspects of the majority's critique simply reflect a more pro-enforcement policy position.

We describe below the creation of the 2020 Vertical Merger Guidelines, the FTC's decision to withdraw the Guidelines, and what merging parties should expect going forward.

New Guidelines Emerge After Extensive Public Input

The DOJ issued its first Non-Horizontal Merger Guidelines in 1984. These original Guidelines remained officially on the books for almost 40 years but were widely understood to no longer reflect actual agency practice by the time the DOJ and FTC jointly revisited them in 2020.

While there was nearly unanimous consensus that the Guidelines required updating, there was little agreement on what the new version should

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say. The DOJ and FTC issued draft guidelines and invited public comment. During a contentious six-month public comment period, the agencies received more than 70 comments from the private bar, economists, state enforcers, and academia. Depending on your perspective, the draft document was either too anti- or pro-enforcement. The agencies made several changes to the draft Guidelines to address criticism received, including removing a non-binding "safe harbor" for vertical mergers where the parties' combined share was less than 20% in either the upstream or downstream market. Although the proposed market share screen was a flashpoint among commenters, the agencies rarely have challenged vertical mergers in practice unless the parties' upstream and downstream market shares were substantial, often above 50%.[6]

The Guidelines that emerged in June 2020 highlighted four primary theories of harm potentially caused by vertical transactions:

1. The merger incentivizes the merged company not to sell inputs or outputs to its rivals ("foreclosure").

2. The merger incentivizes the merged company to raise rivals' costs by charging them higher price(s) or decreasing the quality of products or services sold to them.

3. The merged company gains access to competitively sensitive information about its upstream or downstream competitors.

4. The merger increases the likelihood of industry coordination.

The Guidelines directly addressed one controversial topic by acknowledging that, because vertical mergers combine complementary functions and eliminate middle-man mark-ups, they "often" produce efficiencies. These include: streamlining production, inventory management, and distribution; facilitating the creation of new products; and cost savings, such as eliminating "double marginalization." A vertical merger can lower the merged company's costs if it self-supplies the input, eliminating the margin that the formerly independent supplier charged before the deal. Defendants have regularly pointed to such efficiencies in past DOJ/FTC vertical merger reviews.

Contentious from the Start

From the new Guidelines' inception, the fault lines over their content extended within the agencies themselves. The final adoption of the Guidelines was achieved over the vigorous dissent of the FTC's then-two Democratic Commissioners Slaughter and Chopra. Both abstained from the vote advancing the draft Vertical Merger Guidelines. Even after significant revisions to address their objections—including the removal of the safe harbor discussed above—the minority Commissioners strongly objected to the Guidelines' adoption.[7] Chopra lamented that the new Guidelines did "not directly address the many ways that vertical transactions may suppress new entry or otherwise present barriers to entry," and characterized the economic theories underpinning the assumption that such deals could yield pro-competitive benefits as "speculative" and "often inaccurate." Commissioner Slaughter went further, arguing that the Guidelines should have "disavow[ed] the false assertion that vertical mergers are almost always procompetitive." She pushed for the agency to "accept[] more litigation risk" by following not only the theories of harm laid out in the Guidelines, but also "additional theories of harm as economic learning and investigatory experience evolves."

The Commission attempted to address some of the comments expressed after the Guidelines' adoption by issuing a further independent "Commentary on Vertical Merger Enforcement" in December 2020. In addition to citing specific case examples of the potential issues created by vertical transactions, the Commentary further discussed the "procompetitive effects that are often associated with vertical mergers." Commissioners Slaughter and Chopra again dissented.[8] In recognition of the potential for shifting enforcement priorities under a new administration, they "strongly caution[ed] the market against relying on the Vertical Merger Guidelines . . . as an indication of how the FTC will act upon past, present, and future transactions." They "look[ed] forward to turning the page on the era of lax oversight and to beginning to investigate, analyze, and enforce the antitrust laws against vertical mergers with vigor." Following the confirmation of new FTC Chair Lina Khan and the new Democratic FTC majority, practitioners widely predicted that the Guidelines likely would be withdrawn in whole or in part.[9]

Differing Agency Responses to Guidelines

While the Guidelines' demise seemed to be a matter of when, not whether, the FTC's decision to withdraw its approval of the Guidelines without the DOJ's backing is surprising and unfortunate. Independent of whether one believes the policy statements require revisions, we are now confronted with different policy standards at two federal agencies that have overlapping jurisdiction. While we expect the DOJ will follow suit after the anticipated confirmation of the President's nominee to lead the Antitrust Division, the differing agency responses creates uncertainty in the interim, as we discuss below.[10]

In withdrawing the Guidelines, the FTC released two statements by the Commissioners—one issued by the Democratic majority and another by the two dissenting Republicans—which illuminate the deep divisions within the FTC on this and other aspects of antitrust enforcement. In echoes of Commissioners Slaughter's and Chopra's earlier dissents, the FTC majority statement criticizes the Guidelines for "flawed provisions," particularly those that discuss the "purported procompetitive benefits of vertical mergers, especially . . . the elimination of double marginalization."[11] According to the majority, the Guidelines recognized an efficiencies defense that is inconsistent with the statutory text of the Clayton Act, which in the majority's view "does not provide for a balancing test where an 'efficient' merger is allowed even if it may lessen competition." The majority also criticized the use of behavioral remedies to fix vertical mergers. Overall, these criticisms are in keeping with their views that merger enforcement has been too permissive and has allowed rampant industry consolidation.

The dissenting statement of Commissioners Phillips and Wilson censures the withdrawal decision as part of a "disturbing trend of [the FTC] pulling the rug out under from honest businesses and the lawyers who advise them, with no explanation and no sound basis of which we are aware."[12] The dissent describes the procompetitive benefits that may flow from vertical transactions, emphasizing that such mergers are "different animals from mergers of competitors" and "on the whole, more likely to improve efficiency, bolster competition, and benefit consumers." The dissent accuses the majority of conflating procompetitive benefits with merger efficiencies and ignoring court recognition that "procompetitive effects may render a competition-eliminating merger procompetitive on the whole." Finally, it expresses concern that the FTC's withdrawal will result in uncertainty, confusion, and the chilling of legitimate merger activity at a time when the economy is recovering from the effects of the pandemic.

On the same day as the FTC vote to withdraw, the acting head of the DOJ, Richard Powers, issued a statement explaining that the Guidelines "remain in place" at the DOJ. He noted, however, that the agency "is conducting a careful review of the Horizontal Merger Guidelines and the Vertical Merger Guidelines to ensure they are appropriately skeptical of harmful mergers," and he listed several areas where the Guidelines may need to be scrutinized through a "robust public engagement process."[13] Finally, he expressed a commitment to work closely with the FTC on merger guideline updates (a commitment echoed in the FTC majority's statement).

Significance of the FTC's Withdrawal: What Can We Expect Moving Forward?

In many respects, the FTC's withdrawal of the Guidelines is not particularly surprising. The vote to approve the Guidelines last year was narrow (3-2) and strictly along party lines, and the ensuing election meant that the previously minority viewpoint was likely to prevail once three sitting Democratic commissioners were installed. As noted above, similar withdrawals of agency guidelines historically have occurred when presidential administrations change. Unlike the DOJ's withdrawal of its Section 2 report in 2009, however, the FTC's rescinding of the Guidelines creates a divide between the two agencies that results in uncertainty for the business community and brings questions of fairness to the forefront if the agencies are to conduct investigations using different analytical frameworks for vertical mergers.

Overlapping jurisdiction between the DOJ and FTC has resulted in the agencies drawing their own lines on which agency reviews particular transactions. Those lines are based roughly on each agency's historical expertise with particular industries, though in recent years there have been reports of an increasing number of so-called clearance fights—disputes over which agency should run point on a given investigation that have been resolved only after being escalated to leadership at both agencies.[14] This dynamic could become more pronounced in the future to the extent there are procedural and substantive differences between the FTC and DOJ. Unfortunately, the length and/or outcome of a vertical merger investigation now may depend on which agency is cleared to review the deal, which provides additional fodder for those on Capitol Hill who call for a one-agency approach to antitrust enforcement in order to reduce bureaucracy and increase fairness.[15]

The FTC majority's views on procompetitive benefits and efficiencies from vertical mergers are noteworthy and have already drawn strong criticism from significant voices in the antitrust community.[16] Those voices note that the majority's limited view of the elimination of double marginalization is incorrect as a matter of economic theory, and they question whether such a statement was ever vetted by the FTC's own economists.[17] They also critique the FTC's statement that the Guidelines are inconsistent with the language of the Clayton Act, and note that pro-competitive benefits must be considered for the statutory text to have any meaning.[18]

In practical terms, the FTC's position means that companies with vertical deals at the FTC may find that investigations take longer and proceed along novel paths as the agency looks to explore new theories of harm and find test cases.[19] This is particularly true in light of the FTC's September 28, 2021 announcement that it was making its merger review process "more rigorous" by "[p]roviding heightened scrutiny to a broader range of relevant market realities," including how proposed mergers will impact cross-markets and labor markets.[20] Parties will likely face an uphill battle at the Commission if they intend to heavily rely on efficiencies arguments, particularly the elimination of double marginalization, to justify their transactions. And finally, convincing the FTC on solely behavioral remedies to fix perceived harms may be even more challenging in light of the current composition of the Commission.[21] The scope and speed with which these changes are implemented, however, may be slowed by the agency's current limited resources and practical difficulties in making quick changes to established views among agency staff, including in the FTC Bureau of Economics.

Ultimately, we do not expect the FTC's withdrawal of the Guidelines significantly to change the outcome in the vast majority of vertical merger reviews. It is possible, however, that the withdrawal will have at least some chilling effect on vertical merger activity overall, especially in transactions involving high-profile merging parties in sectors that are subject to heightened antitrust scrutiny, such as technology. The FTC itself has complained that the recent increase in merger filings has taxed federal antitrust enforcers and resulted in agency resources spent reviewing "anticompetitive transactions that should have never been contemplated."[22]

In the end, however, the agencies must go to court to enjoin a merger, and the agencies' limited resources mean that they will need to act judiciously in the cases they bring and the theories they advance.[23] Indeed, very few vertical merger cases have been litigated, and the sparse case law that exists takes a less hostile view than the FTC majority on points such as balancing pro- and anticompetitive effects and recognizing efficiencies.[24] The government has significant leverage over merging parties during the investigation phase, with the ability to craft wide-ranging information requests, extend the timeline of merger reviews through timing agreements, and extract onerous remedies by threatening to block the deal in court. However, if parties are willing to litigate, the government will need to satisfy its burden of proof before an independent federal judge. This is typically more challenging in vertical deals, but courts have found that the government failed to meet its burden even in horizontal transactions, as the 13 states and the District of Columbia discovered in challenging T-Mobile's acquisition of Sprint. In that case, District Judge Marrero rejected the plaintiffs' effort to block the transaction. Although the court was "mindful of the uncertainty in the state of the law regarding efficiencies" and emphasized that they were only one of many factors to consider, efficiencies figured prominently in the court's analysis.[25] According to the court, "Defendants' proposed efficiencies are cognizable and increase the likelihood that the Proposed Merger would enhance competition in the relevant markets to the benefit of all consumers."[26] Procompetitive arguments are not a silver bullet—and never have been—but antitrust enforcers that are overly dismissive of well-supported efficiencies claims (along with other credible evidence pointing to lack of competitive harm) may find a skeptical judiciary.

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

ENDNOTES:

[1]U.S. Dep't of Justice & Fed. Trade Comm'n, Vertical Merger Guidelines, June 30, 2020, *available at* https://www.ftc.gov/system/files/documents/reports/us-department-justice-federal-trade-commission-vertical-merger-guidelines/vertical_merger_guidelines_6-30-20.pdf.

[2]Fed. Trade Comm'n, Commentary on Vertical Merger Enforcement, Dec. 22, 2020, *available at* https://www.ftc.gov/system/files/documents/reports/federal-trade-commissions-commentary-vertical-merger-enforcement/p180101verticalmergercommentary_1.pdf.

[3]Press Release, U.S. Dep't of Justice, Justice Department Issues Statement on the Vertical Merger Guidelines (Sept. 15, 2021), *available at* https://www.justice.gov/opa/pr/justice-department-issues-statement-vertical-merger-guidelines.

[4]*See United States v. AT & T Inc.*, 310 F. Supp. 3d 161, 2018-1 Trade Cas. (CCH) ¶ 80407 (D.D.C. 2018), aff'd, 916 F.3d 1029, 2019-1 Trade Cas. (CCH) ¶ 80685 (D.C. Cir. 2019).

[5]*See, e.g.*, Carl Shapiro and Herbert Hovenkamp, *How Will the FTC Evaluate Vertical Mergers?*, ProMarket (Sept. 23, 2021), https://promarket.org/2021/09/23/ftc-vertical-mergers-antitrust-shapiro-hovenkamp/.

[6]Letter from Am. Bar Ass'n Antitrust Law Sec. to Fed. Trade Comm'n and Dep't of Justice, Comments on the Draft Vertical Merger Guidelines Issued by the Department of Justice and Federal Trade Commission Comments (Feb. 24, 2020), *available at* https://www.americanbar.org/content/dam/aba/administrative/antitrust_law/comments/february-2020/comment-22420-ftc-doj.pdf.

[7]Comm'r Rohit Chopra, Fed'l Trade Comm'n, Dissenting Statement of Commissioner Rohit Chopra Regarding the Publication of the Vertical Merger Guidelines (June 30, 2020), *available at* https://www.ftc.gov/system/files/documents/public_statements/1577503/vmgchopradissent.pdf; Comm'r Rebecca Kelly Slaughter, Fed'l Trade Comm'n, Dissenting Statement of Commissioner Rebecca Kelly Slaughter In re FTC-DOJ Vertical Merger Guidelines (June 30, 2020), *available at* https://www.ftc.gov/system/files/documents/public_statements/1577499/vmgslaughterdissent.pdf.

[8]Comm'rs Rohit Chopra and Rebecca Kelly Slaughter, Fed'l Trade Comm'n, Joint Dissenting Statement of Commissioners Rohit Chopra and Rebecca Kelly Slaughter Regarding the Vertical Merger Commentary (Dec. 22, 2020), *available at* https://www.ftc.gov/system/files/documents/public_statements/1585062/p181201chopraslaughtervmcdissent.pdf.

[9]Michael A. Gleason and Lauren Miller Forbes, *Executive Order Signals New Era in Antitrust Enforcement and Merger Review*, 25 The M&A Lawyer 7 (July/August 2021), at 1.

[10]DOJ's Antitrust Division remains under acting leadership. Jonathan Kanter's confirmation hearing before the Senate Judiciary Committee was held on Oct. 6, 2021.

[11]Comm'rs Lina M. Khan, Rohit Chopra, Rebecca Kelly Slaughter, Fed'l Trade Comm'n, Statement of Chair Lina M. Khan, Commissioner Rohit Chopra, and Commissioner Rebecca Kelly Slaughter on the Withdrawal of the Vertical Merger Guidelines (Sep. 15, 2021), *available at* https://www.ftc.gov/system/files/documents/public_statements/1596396/statement_of_chair_lina_m_khan_commissioner_rohit_chopra_and_commissioner_rebecca_kelly_slaughter_on.pdf.

[12]Comm'rs Noah Joshua Phillips and Christine S. Wilson, Fed'l Trade Comm'n, Dissenting Statement of Commissioners Noah Joshua Phil-

lips and Christine S. Wilson Regarding the Commission's Rescission of the 2020 FTC/DOJ Vertical Merger Guidelines and the Commentary on Vertical Merger Enforcement (Sept. 15, 2021), *available at* https://www.ftc.gov/system/files/documents/public_statements/1596388/p810034phillipswilsonstatementvmgrescission.pdf.

[13]Those areas include: "(1) Whether the Vertical Merger Guidelines create confusion as to the merging parties' burden to establish that the elimination of double marginalization is verifiable, merger specific and will likely be passed through to consumers. (2) Whether the Vertical Merger Guidelines unduly emphasize the quantification of price effects, which is not the only means to determine that a vertical merger is unlawful. (3) Whether the Vertical Merger Guidelines appropriately account for the traditional burden shifting framework applied by U.S. courts in their review of mergers. . . . (4) Whether the Vertical Merger Guidelines should more fully explain, as some have suggested would be appropriate, the range of circumstances that can lead to a concern that a merger may have anticompetitive effects. (5) Whether the Vertical Merger Guidelines would benefit from further elaboration of the circumstances in which mergers raise concerns of harm related to the evasion of regulation." Press Release, Dep't of Justice, Justice Department Issues Statement on the Vertical Merger Guidelines (Sep. 15, 2021), *available at* https://www.justice.gov/opa/pr/justice-department-issues-statement-vertical-merger-guidelines.

[14]*See* Jeremy Morrison, Kate Brockmeyer, and Charlie Stewart, *The Mystifying Antitrust Agency Clearance Process; or How I Learned to Accept Disorder and Move Forward*, 25 The M&A Lawyer 8 (September 2021), at 9; Jeremy Bryan Koenig, *For DOJ and FTC, Clearing Deals Remains a Gray Area*, Law360 (Mar. 20, 2020), *available at* https://www.law360.com/articles/1255073/for-doj-and-ftc-clearing-deals-remains-a-gray-area (describing the clearance process as "more fraught than ever" and occasionally resulting in a coin toss to resolve the agency dispute).

[15]*See* One Agency Act, S. 633, 117th Cong. § 4 (2021). *See also* The House Judiciary Republican Agenda for Taking on Big Tech (July 6, 2021), https://republicans-judiciary.house.gov/wp-content/uploads/2021/07/2021-07-06-TheHouse-Judiciary-Republican-Agenda-for-Taking-on-Big-Tech.pdf ("The current system of splitting antitrust enforcement between the Department of Justice and the Federal Trade Commission is inefficient and counterproductive. The arbitrary division of labor empowers radical Biden bureaucrats at the expense of Americans. This proposal will consolidate antitrust enforcement within the Department of Justice so that it is more effective and accountable.").

[16]*See, e.g.,* Carl Shapiro and Herbert Hovenkamp, "How Will the FTC Evaluate Vertical Mergers?" Stigler Center ProMarket.Org, (Sept. 23, 2021) *available at* https://promarket.org/2021/09/23/ftc-vertical-mergers-antitrust-shapiro-hovenkamp/ (calling the FTC's majority statement "flatly incorrect as a matter of microeconomic theory and . . . contrary to an extensive economic literature about vertical integration").

[17]*Id.* ("In some cases, EDM justifies a vertical merger, but in other cases it does not. . . . EDM applies (a) to multi-product firms, (b) regardless of whether the firms at either level have monopoly power or charge monopoly prices, and (c) regardless of whether the downstream production process involves fixed proportions. All of this has been included in economics textbooks for decades, building on a seminal 1950 paper by Joseph Spengler. None of the conditions cited by the majority are required for EDM to apply, although they are clearly relevant when one is measuring EDM in a specific vertical merger. While EDM does not save every vertical merger, it should be part of any vertical merger inquiry and is not nearly as limited as the majority's statement suggests. In drafting its statement, the majority appears not to have consulted with the FTC's own Bureau of Economics. As a result, we have the spectacle of a federal agency basing its policies on a demonstrably false claim that ignores relevant expertise.").

[18]*Id.* ("If a merger will generate procompetitive effects and thus will promote competition, on what basis can the Chair claim that the merger

will substantially lessen competition, a requirement that is explicit in the text of the statute?").

[19]Of note, this appears to be occurring for all kinds of transactions, not simply vertical deals. Last month, the Commission announced that it has begun issuing letters to some parties at the end of the initial waiting period, warning parties that the investigation remains "open" and that parties who close their transaction risk a post-closing challenge. *See* Holly Vedova, "Adjusting Merger Review to Deal with the Surge in Merger Filings," FTC Competition Matters Blog (Aug. 3, 2021), *available at* https://www.ftc.gov/news-events/blogs/competition-matters/2021/08/adjusting-merger-review-deal-surge-merger-filings?utm_source=govdelivery. While the agency announcement states that the letters are necessary to deal with a significant uptick in merger filings, it also hints at a broadening of the FTC's views on potential harms that may result from transactions. *Id.* (noting that the FTC may challenge deals that "threaten to reduce competition and harm consumers, workers, and honest businesses"). *See also* Bryan Koenig, "Nontraditional Question Appearing in FTC Merger Probes," Law360 (Sept. 24, 20201), *available at* https://www.law360.com/competition/articles/1425218/-nontraditional-questions-appearing-in-ftc-merger-probes?nl_pk=17d1415f-068a-48b3-987f-c955d401b121&utm_source=newsletter&utm_medium=email&utm_campaign=competition (noting that FTC staff have begun raising novel questions not relevant to an analysis of competition concerns, such as queries around unionization at the merging companies, environmental issues, and corporate governance practices).

[20]Holly Vedova, Bureau of Competition, Fed'l Trade Comm'n, Making the Second Request Process Both More Streamlined and More Rigorous During this Unprecedented Merger Wave (Sep. 28, 2021), https://www.ftc.gov/news-events/blogs/competition-matters/2021/09/making-second-request-process-both-more-streamlined?utm_source=govdelivery.

[21]*See* Letter from Lina Khan, Chair, Fed'l Trade Comm'n, to Elizabeth Warren, Senator, U.S. Congress (Aug. 6, 2021), *available at* https://www.warren.senate.gov/imo/media/doc/chair_khan_response_on_behavioral_remedies.pdf ("While structural remedies generally have a stronger track record than behavioral remedies, studies show that divestitures, too, may prove inadequate in the face of an unlawful merger. In light of this, I believe the antitrust agencies should more frequently consider opposing problematic deals outright"). The FTC majority statement promises to evaluate past remedy practices and provide clear guidance on when remedies are unlikely to be effective.

[22]Holly Vedova, Bureau of Competition, Fed'l Trade Comm'n, Making the Second Request Process Both More Streamlined and More Rigorous During this Unprecedented Merger Wave (Sep. 28, 2021), https://www.ftc.gov/news-events/blogs/competition-matters/2021/09/making-second-request-process-both-more-streamlined?utm_source=govdelivery.

[23]Existing case law makes clear that the government needs particularly strong evidence—in the form of third-party testimony, business documents, and most importantly economic analysis—if it is to be successful in a vertical merger challenge, and the *AT&T/Time Warner* matter illustrates well the litigation risk of bringing such cases.

[24]*See, e.g., United States v. AT&T, Inc.*, 916 F.3d 1029, 2019-1 Trade Cas. (CCH) ¶ 80685 (D.C. Cir. 2019); *New York v. Deutsche Telekom AG*, 439 F. Supp. 3d 179, 2020-1 Trade Cas. (CCH) ¶ 81082 (S.D. N.Y. 2020) ("Sprint/T-Mobile").

[25]Sprint/T-Mobile, at 217.

[26]*Id.*

COURT OF CHANCERY DECISION UNDERSCORES NEED TO EXCLUDE "WILLFUL BREACHES" FROM THE "EFFECT OF TERMINATION" PROVISION IN A MERGER AGREEMENT: *YATRA V. EBIX*

By Gail Weinstein, Brian T. Mangino, Randi Lally, and Andrea Gede-Lange

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The Delaware Court of Chancery's recent decision in *Yatra Online v. Ebix*[1] serves as a reminder that, under the "Effect of Termination" provision in most merger agreements, a party's termination of the agreement extinguishes all liability of both parties for pre-termination breaches of the agreement, except as the parties may have otherwise specifically provided in the agreement. The *Ebix* case illustrates that, depending on how the parties have drafted the provision, a party can be left with no remedy for the other party's willful breaches and wrongful failure to close.

Ebix, Inc. allegedly had a change of heart about proceeding with its agreed acquisition of Yatra Online, Inc. after the deal became less attractive to Ebix when the COVID-19 pandemic emerged. Allegedly, Ebix then blatantly breached its representations and covenants in the Merger Agreement and "strung along" Yatra with pretextual delays while in fact Ebix never intended to close. Yatra ultimately became "fed up" with Ebix's misconduct, and, when several renegotiated end dates had passed with no sign that Ebix intended ever to close, Yatra sued Ebix for damages and exercised its right to terminate the Merger Agreement. The court held, however, that Yatra had no remedy because it had terminated the Merger Agreement and the Effect of Termination provision, as drafted, extinguished liability for both parties for pre-termination breaches (with an exception for fraud but not for willful breaches).

The case underscores that, before terminating an agreement, a party should know what the agreement provides with respect to the effect of a termination on its rights and remedies; and, when drafting the language of an "Effect of Termination" provision, the drafters should not consider the provision as mere "boilerplate."

Key Points

The decision serves as a reminder that an "Effect of Termination" provision may eliminate all liability for pre-termination breaches. The court explained that, under the provision at issue (as drafted without an exclusion for willful breaches), the target company had the choice *either* (a) to seek damages for the buyer's breaches and/or to seek specific performance of the agreement (in both cases, while *not* terminating the agreement), *or* (b) to terminate the merger agreement (in which case neither party would have liability for any pre-termination breaches). We would note that a party generally would choose to terminate the merger agreement, rather than to seek damages or specific performance, when: the party has concerns over its own potential liability (and prefers to terminate the agreement to eliminate that risk); the party has decided that it too would prefer not to proceed with the transaction for whatever reasons; and/or the party is single-focused on moving on to find an alternative deal or strategy—notwithstanding, in each case, having to forego the potential of obtaining damages for the counterparty's breaches.

Drafters should carefully consider the language of the "Effect of Termination" provision. In most cases, drafters exclude liability for fraud or for willful breaches from the extinguishment of liability upon termination. Drafters also should consider (although this is not typical) defining the concept of "willful breach" given the ambiguity as to whether "willfulness" means an intention to commit the act that was committed or an intention to breach the agreement. Finally, although not an issue in *Ebix*, drafters should be careful to ensure that the Effect of Termination provision is consistent with related merger agreement provisions with respect to survival, fraud carveouts, termination fees, and others.

Background

After extensive negotiations, Ebix and Yatra entered into a Merger Agreement on July 16, 2019, pursuant to which Ebix would acquire Yatra in a reverse triangular merger in which Yatra stockholders would receive shares of Ebix convertible preferred stock (the "Preferred Stock"), at a fixed exchange ratio, for each share of Yatra common stock. In addition, Yatra stockholders would be issued a right, exercisable in the 25th month after closing, to require Ebix to exchange any then-unconverted shares of Preferred Stock for a specified amount of cash per share in cash (the "Put Right") (thus providing the Yatra stockholders with a floor under which the merger consideration for their shares could not fall).

After signing, Ebix's stock price fell due to the emergence of the COVID-19 pandemic. As a result, the value of the Put Right ballooned as compared to Ebix's market capitalization, making the deal far less attractive to Ebix. Allegedly, Ebix then, in an effort to "sabotage" the deal, breached certain representations and warranties and certain covenants in the Merger Agreement. Among these were the covenant to use its reasonable best efforts to have the closing conditions satisfied and to close. Also, Ebix (allegedly in secret) negotiated with its lenders an amendment to its credit agreement (the "Credit Agreement Amendment") which effectively would have caused an immediate default under the credit agreement if Ebix ever issued the Put Right. After Yatra had (reluctantly) agreed to numerous extensions of the End Date in the Merger Agreement, and then a series of renegotiated End Dates had passed with "no hint" that Ebix intended ever to close, Yatra sued Ebix for damages and exercised its right to terminate the Merger Agreement.

The court, at the pleading stage, dismissed Yatra's claims against Ebix for breach of the Merger Agreement, ruling that the Effect of Termination provision in the Merger Agreement barred post-termination claims for pre-termination contractual breaches. The court also dismissed Yatra's claims against Ebix for fraud, as well as its claims against Ebix's lenders for tortious interference with the Put Right.

Discussion

Ebix's alleged misconduct included the following:

- ***Repeatedly delaying the filing of a registra-***

tion statement with the SEC to register the Preferred Stock—notwithstanding its obligation under the Merger Agreement to file promptly;

- ***Continually seeking to renegotiate key deal terms post-signing***—including elimination of the Put Right even though it was a critical component of the merger consideration;
- ***Failing to take any of the specified actions set forth in an "Extension Agreement" it entered into when seeking Yatra's consent to yet another extension of the End Date***—including, specifically, not providing revised drafts clearly reflecting its requested modified terms; not responding to Yatra's requests for basic due diligence information; and repeatedly trying to renegotiate additional terms; and
- ***Secretly entering into the Credit Agreement Amendment***—which effectively provided that any implementation of the Put Right would cause an immediate default under the Credit Agreement.

The court wrote that, notwithstanding Ebix's alleged misconduct, "Yatra agreed [in the Effect of Termination provision] that termination of the Merger Agreement would terminate liability for breach of that contract." Yatra terminated the Merger Agreement, the court wrote, and the court "will not redline the parties' bargained-for limitations of liability."

The court rejected Yatra's alternative interpretation of the "Effect of Termination" provision. The provision read as follows:

> **Section 8.2. Effect of Termination.** In the event of any **termination of this Agreement** as provided in Section 8.1, the **obligations of the parties shall terminate and there shall be no liability on the part of any party with respect thereto**, except for [specified provisions relating to confidentiality, disclaimers, expenses, termination fees and miscellaneous provisions], each of which shall survive the termination of this Agreement and remain in full force and effect; provided, however, that . . . **nothing contained herein shall relieve any party from liability for damages arising out of any fraud occurring prior to such termination**, in which case the aggrieved party shall be entitled to all rights and remedies available at law or equity.

Ebix argued that the phrase "with respect thereto" meant with respect to *its obligations under the Merger Agreement* (*i.e.*, for Ebix's alleged breaches of the Merger Agreement). Yatra argued that "with respect thereto" meant with respect to the *termination of the Merger Agreement* (*i.e.*, it did not eliminate either party's damages for prior breaches of obligations under the Merger Agreement, but eliminated only damages caused by the act of terminating the Merger Agreement). In Yatra's view, the provision did not extinguish all claims for breach of the Merger Agreement, but, instead, served only to make clear which contractual obligations carried forward after a termination of the Agreement and which did not. Yatra contended that, at best, the provision was "ambiguous" with respect to the effect of termination on a party's post-termination remedies for pre-termination breaches.

Vice Chancellor Slights disagreed with Yatra and held that the provision extinguished liability for all claims for pre-termination breaches of the Merger Agreement (other than any liability for fraud). The Vice Chancellor observed that, under the common law, termination of an agreement results in all obligations under the agreement becoming void and of no further force and effect, but that termination of an agreement does not, standing alone, result in an elimination of liability for pre-termination breaches. However, when parties provide in their agreement that "there shall be no liability on the part of either party" upon termination, they "alter the common law rule and broadly waive contractual liability and all contractual remedies," he wrote.

Further, the Vice Chancellor found that the language and structure of the parties' Effect of Termination provision supported an interpretation that, if the Agreement were terminated, the parties intended that all liability for pre-termination breaches (other than fraud) would be extinguished. For example, he found that Yatra's position that the provision only extinguished liability arising from a termination was inconsistent with the language immediately following "with respect thereto," which refers to exceptions for certain specified *obligations* under the Merger Agreement from the effects of the contractual limitation of liability. He also found that Yatra's contention that a termination left claims for pre-termination breaches of contract unaffected was inconsistent with the express carveout of liability for "fraud occurring prior to such termination" (which carveout, in the court's view, implied that liability for *all other* claims for acts "occurring prior" to termination would *not* survive post-termination).

The court also held as follows:

- ***There was no separate remedy available for breach of the Extension Agreement***, as the Extension Agreement was intended to modify the terms of the Merger Agreement and nothing suggested that it was not subject to the Effect of Termination provision in the Merger Agreement.
- ***The implied covenant of good faith was not applicable***, as the best efforts clause in the Merger Agreement left no "gap" for the implied covenant to fill with respect to Ebix's obligations to act to satisfy the closing conditions.
- ***Yatra did not establish that Ebix's alleged fraud, or the lenders' alleged tortious interference, caused Yatra's loss***. Yatra asserted that Ebix's secretly entering into the Credit Agreement Amendment and making fraudulent extra-contractual promises about proceeding to closing harmed Yatra by precluding it from pursuing specific performance. The court reasoned that, irrespective of Ebix's and the lenders' actions, Yatra could not have obtained specific performance because, at the time of termination, the registration statement for the Preferred Stock was not yet effective and therefore neither the Preferred Stock nor the Put Right could not have been issued in any event. (We would note that Ebix allegedly delayed the filing of the registration statement as part of its alleged efforts to sabotage the deal.)

Practice Points

Drafters of "Effect of Termination" provisions should consider whether to carve out both fraud and *willful breaches* from the general extinguishment of liability upon a termination of the agreement—and also should consider defining "willful breaches." In its *Hexion* decision (2008), the Delaware Court of Chancery stated that, under the common law, a "knowing and intentional" breach of a merger agreement occurs when a party knowingly (in other words, consciously rather than by accident) takes an action that results in a breach, with no requirement that the breaching party knew or intended that the action would breach the agreement. Since then, some merger agreements have defined the phrase to avoid that interpretation—for example, defining "willful breach" to mean "a material breach of the Agreement that is the consequence of an act or omission by a party with the actual knowledge that the taking of such act or failure to take such action would be a material breach of the Agreement."

The *timing* of termination of a merger agreement generally would not change the result under a standard "Effect of Termination" provision. In *Ebix*, Yatra argued that the provision's extinguishment of liability was inapplicable because Yatra had not yet terminated the Merger Agreement when it filed suit against Ebix for its breaches (although it sued and terminated on the same day). The court found the timing of the termination irrelevant given that the provision (as is typical) stated that liability would be extinguished upon "*any* termination" of the agreement.

A party to a merger agreement should not terminate the agreement before consulting with legal counsel as to the parties' respective post-termination rights and remedies. At the time the agreement is executed, counsel may wish to provide its client with a summary of its obligations, rights, and remedies that apply pre- and post-closing or termination.

Any exclusion from the extinguishment of liability under an Effect of Termination provision should be consistent with other relevant contractual provisions. For example (although not an issue in *Ebix*), if a party has a right to receive a termination fee (or reverse termination fee) after termination of the agreement under specified circumstances, the agreement should clearly provide that liability continues post-termination and is (or is not) an exclusive remedy if the counterparty has breached (or willfully breached) the agreement.

ENDNOTES:

[1]*Yatra Online, Inc. v. Ebix, Inc.,* C.A. 2020-0444-JRS (Del. Ch. Aug. 30, 2021).

NORTHERN DISTRICT OF CALIFORNIA DISMISSES PUTATIVE CLASS ACTION AGAINST CYBERSECURITY COMPANY RELATED TO ITS MERGER FOR FAILURE TO ALLEGE SUBJECTIVE FALSITY

By Jeffrey Resetarits, Daniel Lewis and Grace J. Lee

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On September 13, 2021, Judge Edward M. Chen of the United States District Court for the Northern District of California dismissed with prejudice a putative class action against a cybersecurity company (the "Company") and its CEO for violations of Section 14(e) and 20(a) of the Securities Exchange Act of 1934.[1] Plaintiff alleged that defendants made material misrepresentations about the value of the Company in connection with the sale of the Company through a tender offer (the "Merger") and that the CEO was motivated by his desire to retain his position at the Company. The Court dismissed the claims, holding that (i) the sales process indicated that the offer price reflected the market value of the Company's stock, and (ii) plaintiff failed to present particularized evidence that the CEO had a motive to mislead shareholders.

The Merger was the culmination of the Company's exploration of strategic alternatives, which began in March 2018 and lasted over two years. The sales process included, among other things, the Company's financial advisor reaching out to more than 50 parties to explore a potential transaction and entering into confidentiality agreements with 11 of those parties, five of which proceeded with due diligence. Ultimately only two parties—the acquiring company ("the Acquiror") and another strategic acquiror ("Party B")—remained interested. Both the Acquiror and Party B made competing offers with different transaction structures, in the range of $3.00 to $3.40 per share, which offers were subsequently lowered after further due diligence. After a series of negotiations with both parties—including a pause in the discussions as the Company briefly decided to continue as an independent entity—the Company's Board unanimously approved a merger agreement with the Acquiror at $1.55 per share, and recommended that shareholders tender their shares. The Merger was consummated in July 2020.

Plaintiff's claims—amended once after dismissal for failure to allege subjective falsity—were based on select portions of the Form Schedule 14D-9 (the "Recommendation Statement") that was disseminated to the Company shareholders prior to their making a decision on whether to tender their shares in the offer. Specifically, plaintiff claimed that defendants' statement that the offer of $1.55 per share was reasonable based on the Company's then-current revenue projections was false and that, just six months earlier, defendants had stated that they expected to generate greater revenue than the projections on which the Recommendation Statement was based. Plaintiff also claimed that the CEO had a motive to make misrepresentations undervaluing the Company because the Merger, as compared to a combination with another bidder, presented an opportunity for the CEO to continue "his lucrative position, with the 'obvious benefits [of] leading a private company, including avoiding strict formalities, legal requirements, and oversight that come with serving as the CEO of a publicly traded corporation.' " In support of these allegations, plaintiff pointed to statements in the Recommendation Statement describing the sales process in which Party B sent a letter criticizing the sales process and expressing its desire to deal directly with the Company's Board.

As an initial matter, the Court noted that plaintiff had selectively focused on certain events of the sales process described in the Recommendation Statement while ignoring others. Upon considering the full contents of the Recommendation Statement under the incorporation-by-reference doctrine, the Court dismissed the complaint, holding that it had "serious doubts" as to whether plaintiff sufficiently alleged objective falsity and that plaintiff had failed to allege subjective falsity.

First, the Court stated that it "continue[d] to have serious questions as to whether [plaintiff has] sufficiently alleged objective falsity." Although plaintiff claimed that the offer of $1.55 per share undervalued the Company, it did not dispute that Party B's offer was similar, at $1.50

per share. Moreover, those bids were a result of a "true and tested sales process" that was described in the Recommendation Statement—including the continued negotiations with two competing potential acquirors, each of which knew about the competitor—and thus suggested that the valuation was "reflective of true market value" rather than "mere happenstance." The Court, however, did not reach a definitive ruling because it found that plaintiff failed to plead subjective falsity.

Next, the Court held that plaintiff had failed to allege subjective falsity, and that the allegations in the amended complaint regarding the CEO's purported motive to undervalue the Company was "of no help." Plaintiff had conceded that the "golden parachute of approximately $1 million" that was alleged as a purported motive only would be available if the CEO was terminated in certain circumstances, which undermined plaintiff's claim that the CEO was motivated to undervalue the Company in favor of the Acquiror's bid to continue his position post-Merger. Moreover, there were no factual allegations to support plaintiff's allegation that Party B's criticism of the process and desire to deal directly with the Company Board was directed to the CEO individually, rather than the management generally, the committee formed to evaluate strategic alternatives, or the Company's counsel. Finally, plaintiff's claim that the CEO stood to gain $310,000 from the accelerated vesting of equity grants was equally insufficient. Not only was that benefit available to all restricted stock unit ("RSU") holders, but the benefits of such grants also would be increased by a higher tender offer and it would have been contrary to the CEO's financial interest in the RSUs to undervalue Company shares.

Because the Court had previously given plaintiff an opportunity to amend its complaint to address the deficiency in its allegations of subjective falsity and those deficiencies remained, the Court dismissed the complaint with prejudice.

ENDNOTES:

[1] *In re Finjan Holdings, Inc. Sec. Litig.*, No. 20-cv-04289 (N.D. Cal. Sep. 13, 2021).

DELAWARE SUPREME COURT ENFORCES WAIVER OF STATUTORY APPRAISAL RIGHTS

By Adrian S. Broderick, Andrew D. Cordo, Ryan J. Greecher, Leah E. León, Amy L. Simmerman and Brad Sorrels

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In mid-September, the Delaware Supreme Court issued a significant decision reinforcing Delaware's strong policy favoring private ordering and giving effect to agreements among sophisticated stockholders. The decision particularly affirms important practices in the private company context. In its majority opinion in *Manti Holdings, LLC et al. v. Authentix Acquisition Company, Inc.*, authored by Justice Tamika Montgomery-Reeves, the Delaware Supreme Court upheld a waiver of statutory appraisal rights contained in a stockholders agreement and reached other noteworthy conclusions about the interpretation of the stockholders agreement.

The decision arises from the 2017 acquisition of Authentix in an all-cash deal. A group of common stockholders, who received almost no consideration in the deal, petitioned for statutory appraisal of the fair value of their shares in the Court of Chancery pursuant to Section 262 of the Delaware General Corporation Law ("DGCL"). Authentix moved to dismiss, relying on a provision in the company's stockholders agreement signed by the petitioners contractually waiving their rights to statutory appraisal. The Court of Chancery agreed and dismissed the petition, noting that the contract was entered into, following negotiations, by sophisticated parties with bargaining power who were represented by counsel. The petitioners subsequently appealed to the Delaware Supreme Court.

On appeal, the Delaware Supreme Court considered whether Section 262 prohibits a Delaware corporation from enforcing an advance waiver of appraisal rights against its stockholders. It concluded that Section 262 "does not prohibit sophisticated and informed stockholders, who were represented by counsel and had bargaining power, from voluntarily agreeing to waive their appraisal rights in exchange for valuable consideration." Echoing its recent decision in *Salzberg v. Sciabacucchi*, which upheld the validity of federal forum provisions in certificates of incorporation of Delaware corporations, the court began its analysis by emphasizing that "[a]t its core, the DGCL is a broad enabling act that allows immense freedom for businesses to adopt the most appropriate terms for the organization, finance, and governance of their enterprise." It further noted that Delaware's corporate statute is considered the "most flexible in the nation," and that public policy favoring private ordering is found throughout the DGCL.

In light of this strong public policy preference for freedom of contract and private ordering, the Delaware Supreme Court concluded that the plain language of Section 262 does not broadly prohibit stockholders from agreeing to waive their appraisal rights. Although the statute grants stockholders a mandatory right to seek judicial appraisal, the court held that "does not prohibit stockholders from alienating that entitlement in exchange for valuable consideration."

In upholding the waiver of appraisal rights, the Delaware Supreme Court reached other significant conclusions. The court rejected the argument that companies cannot be parties to, and cannot enforce, stockholders agreements—which is important, given that private companies often rely on stockholders agreements to set forth various governance provisions. The court also determined that the surviving, post-merger company could enforce the terms of the stockholders agreement, both as a party to the agreement and as an intended beneficiary of the provision, and that the appraisal rights waiver did not fall away upon the termination of the agreement (which occurred, under the terms of the agreement, upon a consummation of the transaction). The court likewise rejected the argument that the waiver constituted a stock restriction that must be included in the certificate of incorporation, reasoning that the waiver imposed a personal contractual obligation on the stockholders party to the stockholders agreement, and not a restriction on the actual shares of stock.

In a rare dissenting opinion, Justice Karen Valihura disagreed with the majority opinion on several grounds. She viewed the waiver of appraisal rights as ambiguous and therefore inadequate. In her view, the waiver of appraisal rights expired on the closing of the transaction. And while she recognized the DGCL's preference for private ordering, she reasoned that because the right to appraisal is a fundamental feature of the DGCL—providing fair compensation to dissenting stockholders and, in her view, serving as a check on corporate transactions at an unfair price—it is a mandatory right that cannot be waived, and if the DGCL is amended to address the issue, modifications to that right should at most be permitted only in the corporation's certificate of incorporation. Notwithstanding Justice Valihura's dissent, the majority opinion reflects the current state of Delaware law.

Finally, in response to the types of concerns raised in the dissent, the majority opinion explained that the focus of an appraisal proceeding, which has already been limited in certain respects by the DGCL, is the payment of fair value for a dissenter's stock—not "policing misconduct or preserving the ability of stockholders to participate in corporate governance." Accordingly, the new decision does not directly address the enforceability of other types of waivers, such as waivers of stockholders' statutory rights to inspect a corporation's books and records. Nonetheless, the opinion provides welcome confirmation of corporate practices based on the issues that were before the Delaware Supreme Court.

ACCC PROPOSES SUBSTANTIAL CHANGES TO AUSTRALIAN ANTITRUST MERGER REVIEW

By Matthew Bull, Prudence Smith, Debra R. Belott, Jeremy P. Morrison and Dylan McIntyre

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The Situation: The leadership of the Australian Competition and Consumer Commission ("ACCC") has put forward a series of sweeping proposals that, if implemented, would be the most substantial changes to Australian antitrust merger laws in nearly 30 years.

The Context: Today, merger review in Australia is voluntary and, for the most part, nonsuspensory. If adopted, the proposed changes would establish mandatory merger reporting for transactions that meet certain thresholds and require that parties to such a transaction suspend closing until they obtain ACCC clearance.

Looking Ahead: Although the proposed changes are a long way from adoption, the ACCC's proposals would significantly increase antitrust scrutiny in Australia, particularly in the technology sector, and they would introduce a presumption that mergers involving a company with substantial market power are unlawful.

Recent Merger Review and Litigation in Australia

Australia's antitrust merger laws have remained largely unchanged since 1993. The law prohibits the acquisition of assets or shares with the effect or likely effect of substantially lessening competition in a market in Australia. In the 28 years since the last significant reform, the ACCC has not, in its own words, "won outright in a contested merger case," including two recent high-profile losses in federal court.

In a number of public statements in recent years, the ACCC chairman, now in the final year of his third (and expected final) term, has expressed his view that Australia's merger laws are weak and therefore unable to adequately address anticompetitive mergers. He recently questioned whether "Australia's merger control regime remains fit for purpose."

To address that perceived shortcoming, in late August 2021, the chairman put forward a number of proposed changes to Australian merger law and the ACCC's review methodology ("Proposals"). The Proposals already have attracted significant attention given the scope of the changes, and in the coming months, the ACCC will advocate strongly for adoption of the chairman's Proposals. The pressure to adopt the Proposals will likely increase after next year's anticipated Australian federal government elections.

Proposed Changes to Australian Merger Review

Below, we highlight the most significant changes to Australian merger review and notification regimes.

Mandatory Merger Review

Merger review in Australia is voluntary and, unlike in many countries, there is no revenue threshold above which parties must notify a transaction. However, the ACCC "encourages" parties to submit a notification if the parties' products are substitutes or complements and combined post-merger market share exceeds 20%, and it regularly investigates deals that are not notified. The ACCC primarily uses an informal merger review process in which parties approach the ACCC on an informal (sometimes confidential) basis, followed by an ACCC review, to obtain clearance. There is also a (rarely used) formal clearance process.

The ACCC has proposed a single mandatory and suspensory merger notification and review process to replace the current informal and formal clearance systems. Parties to all mergers that meet certain, not yet specified, thresholds would be required to notify their transaction to the ACCC. Like in the United States, Europe, and a number of other jurisdictions, parties would be prohibited from consummating the transaction until the ACCC has cleared it. In addition, the ACCC would also have a "call-in" power that would allow the ACCC to review certain mergers below the thresholds if the ACCC has reason to believe that there are potential competition issues. The call-in power could extend for several years after closing.

Increased Scrutiny of Companies with Substantial Market Power

The Proposals would introduce a presumption that transactions where a merging party possesses "substantial market power" ("SMP") would be deemed to substantially lessen competition (and therefore be prohibited), if that transaction is likely to entrench, materially increase, or materially extend that SMP.

The Proposals do not indicate how this additional test would work, or on what basis SMP would be established. However, the focus is similar to the current approach of the U.S. Department of Justice Antitrust Division ("DOJ") and Federal Trade Commission ("FTC"). Under the DOJ/FTC Horizontal Merger Guidelines, mergers in highly concentrated markets "are presumed to be likely to enhance market power," a presumption that the merger parties must rebut. The Proposals also do not make clear whether the merging parties will have an opportunity to rebut the presumption of a substantial lessening of competition arising from SMP.

Additional Merger Factors

The Proposals add two new factors, initially proposed in the ACCC's 2019 Digital Platforms report, that the ACCC must consider when analyzing whether a transaction is unlawful: (i) the likelihood that the transaction will result in a potential competitor exiting the market; and (ii) the nature and significance of assets being acquired, with a focus on data and technology. Those changes are intended to capture acquisitions of "nascent competitors" and so-called "killer acquisitions." A killer acquisition occurs when a company acquires a product or service in development that could compete with its own product and then terminates development of the newly acquired product (or integrates it into its existing product or service) to prevent competition. In Australia, killer acquisitions have attracted particular attention in the technology and finance sectors.

Defining "Likely"

As noted above, Australian competition law prohibits transactions that would have the effect or that are likely to have the effect of substantially lessening competition in any market in Australia. Since a court decision in 2011, "likely" has widely been considered to mean a "real chance or possibility." The Proposals include a new legislative definition that would lower the "likely" standard to mean a "possibility that is not remote."

Large Digital Platforms

The Proposals would introduce special rules for acquisitions involving a large digital platform; however, they do not define a "large digital platform" or what thresholds would apply. The ACCC has promised to provide more specific rules in this area in September 2022 as part of its Digital Platform Services Inquiry report.

Consideration of Other Agreements in Merger Reviews

Under existing guidance, the ACCC must consider the competitiveness of a marketplace both with and without the transaction. The ACCC compares post-merger competition to what is likely to happen in the absence of the proposed transaction (i.e., the "counterfactual").

In response to the ACCC's loss in the Aurizon/Pacific National case (where side agreements, which the ACCC considered were relevant to the overall analysis, could not be considered as part of the merger review), the Proposals would permit the ACCC to consider other agreements between the parties in its assessment to "stop parties taking steps to change the counterfactual or take advantage of the anti-overlap provisions" that are available under Australia's antitrust laws.

The U.S. Experience with Presumptions Offers Guidance for Australia

Overseas experiences can provide helpful guidance on the approach that might be taken if the Proposals are adopted in Australia. The United States has long had a rebuttable presumption that certain mergers are anticompetitive, which provides useful guidance on the likely starting point for the proposed deeming provisions for parties with SMP.

The federal courts may enjoin a merger that results in a company "controlling an undue share of the relevant market, and results in a significant increase in concentration" in the absence of evidence clearly showing that the transaction is not likely to have such anticompetitive effects. In recent years, courts have often referred to language from the existing DOJ/FTC Merger Guidelines that establish a presumption of harm based on market concentration. Based on our merger review and litigation experience in the United States, there are at least two significant consequences of such a presumption for merger review:

- First, a presumption provides (some) guidance and offers (some) clarity to merging parties regarding whether they are likely to face an in-depth merger investigation, and potentially litigation.

- Second, there is a significant advantage for the party (the government or the merging parties) who wins the battle over the presumption.

In the United States, the emphasis on market definition is most pronounced during the litigation phase. Almost by definition, because it is easier to win a case in which the other side has the burden, the existence of the presumption places increased emphasis on the battle over what is the appropriate product and geographic market in merger cases. In litigation, the DOJ or FTC will typically advocate for a court to adopt narrow product and geographic markets to establish the presumption of competitive harm based on high market shares and concentration. In response, parties focus on alternative markets that could undermine the presumption. That focus leads to a battle regarding market definition that can overshadow the ultimate question—the net competitive effect of the transaction.

In contrast, DOJ/FTC merger investigations tend to focus more on the competitive effects of a transaction rather than market definition. Aside from cases they settle, the DOJ/FTC do not challenge a number of transactions in court that might trigger the presumption. In those cases, the DOJ/FTC typically has determined that anticompetitive effects are unlikely or that it lacks evidence to meet its burden of proof in court.

If implemented, the introduction of an anticompetitive presumption for certain mergers in Australia would likely lead to a similar narrow focus on market definition (for the purposes of SMP assessment). A presumption also may encourage the ACCC to challenge more cases involving marginal competitive effects if it believes it can meet its burden on market definition.

Conclusion

In recent years, the ACCC has successfully lobbied to change Australian antitrust law to enhance its authority. For example, following the ACCC's lead, in 2017,[1] Australia amended its "misuse of market power" law to enhance the ACCC's authority to bring market power cases. Despite that success, any change will be a slow process, with many more months of debate. Indeed, the Proposals are just the first step on a long road to potential changes, and they are likely to face opposition from the business community and potentially members of the federal legislature. The ACCC chairman has acknowledged that no change is likely before next year's federal election.

Four Key Takeaways

- The ACCC has proposed sweeping changes to Australian antitrust merger review—the most significant updates in nearly 30 years. Although there will be much debate (and perhaps many months or years) before any of the Proposals are adopted, the Proposals may influence ACCC merger reviews in the meantime.

- Merger notification in Australia is historically voluntary and, in most cases, non-suspensory. The ACCC's Proposals recommend adoption of mandatory merger reporting that would require parties meeting certain thresholds to suspend closing until they obtain ACCC clearance.

- The existing informal merger clearance regime benefits both the government and merging parties in that it allows for quick clearance of no-issue deals, while also permitting the ACCC to commit resources to more substantial transactions. The ACCC and lawmakers should carefully consider whether the Proposals detract from the benefits of the current flexible regime.

- The Proposals include a presumption of anticompetitive harm in merger cases involving companies with "substantial market power." Based on experience with presumptions in the United States, a presumption in Australia could lead to focus on narrow market definition arguments rather than the substantive arguments about the likely impact of the merger.

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

ENDNOTES:

[1] https://www.jonesday.com/en/insights/2017/12/amendments-to-australian-antitrust-regime-take-effect,

ON VIGILANT MERGER ENFORCEMENT

By Vanita Gupta

Vanita Gupta is Associate Attorney General at the U.S. Department of Justice. The following is edited from remarks she gave at Georgetown Law's 15th Annual Global Antitrust Enforcement Symposium, on Washington D.C. on September 14, 2021.

I am excited to be overseeing the Antitrust Division at this dynamic time in antitrust. What was once regarded as a narrow, highly technical field has become an important part of our national dialogue. The concentration of economic power is on the minds of members of Congress and people across America. It has captured headlines and the attention of governments around the world. What explains this renewed interest in antitrust? I think it's the realization that robust antitrust enforcement is critically important for advancing economic justice. As President Biden said in his recent Executive Order on Competition, "the American promise of a broad and sustained prosperity depends on an open and competitive economy." ... Unlawful monopolies only benefit monopolists. A lack of competition means fewer new products and higher prices. It means the owners of powerful firms make more without having to grow the size of the pie for anyone else. As the President's Executive Order explained, weak competition "den[ies] Americans the benefits of an open economy and widen[s] racial, income, and wealth inequality." I believe our country can do better.

The department's antitrust enforcement efforts prevent and restrain the abuse of market power by dominant corporations, resulting in more choice, more products in people's hands and more money in their wallets. Robust competition grows the size of the pie for everyone.

We therefore welcome Congress' interest in providing new tools and resources for antitrust enforcement. The department also stands ready to work with other federal agencies in implementing the President's Executive Order on Competition and in advancing sound competition policy more generally. But we recognize that antitrust policy is not a solution for all of the economic and social issues facing us today. That is why we must build strong partnerships with other federal agencies to combine competition policy with a whole-of-government approach to building a more fair and inclusive economy.

This work is urgently needed. In many industries, consolidation is greater now than it was even just 20 years ago. For example, today, dominant health systems can approach 50% control of a relevant local or regional market. The largest shipping alliances control 80% of the market. The four largest beef packers have a similar share in their industry. Major airlines control over 80%. Millions of Americans have only one or two high-speed internet providers available to them. America has ten thousand fewer banks today than it did in the mid-1980s, and since the Great Recession, 25% of bank branch closures in rural communities occurred in communities of color. A few digital platforms exercise an incredible control over what we read, how we communicate and what happens to our personal information.

This kind of consolidation can be detrimental to our economy. And the harm is far from abstract or academic. It directly affects millions of families by growing the digital divide, creating banking deserts in too many communities of color and making it more difficult or expensive for Americans to eat, to travel or to go to the doctor. The list of industries that are increasingly consolidated is long, but the trend is not inevitable. The fair enforcement of our country's antitrust laws can help stop, and in some cases, reverse this trend. Antitrust enforcement can also deter conduct that forces consumers to pay higher prices and forces workers to accept lower wages.

The Justice Department will therefore vigorously enforce the antitrust laws to protect consumers, workers and less advantaged communities, and to promote a more free and fair economy for everyone. That starts with many of the initiatives already underway at the department. . .

Acquisitions involving potential or nascent competitors are one category of particularly concerning transactions because they undermine competition that can disrupt monopolies. As the D.C. Circuit recognized in Microsoft, acquiring firms before they can become a competitor—sometimes called a "killer acquisition"—is a classic tool for monopolists. The department's case against Visa's proposed acquisition of Plaid is a prime example. Our investigation revealed that Visa was trying to buy up a rival before it could disrupt the industry and so we sued to block the merger. In response, the parties abandoned their transaction. Plaid now remains an independent company.

The department will not shy away from similar challenges in the future. Killer acquisitions can sideline or silence ideas that might eliminate the barriers keeping too many Americans out of banking, housing and health care markets. We will therefore closely scrutinize acquisitions involving dominant firms and would-be rivals. In doing so, we should be careful not to discourage investment in new startups. But we should also remember that startups cannot thrive without a competitive economy.

The department's lawsuit against Google for monopolizing search and search advertising markets remains a major priority as well. Our complaint focuses on how Google's anticompetitive conduct has harmed competition, similar to how Microsoft did decades ago in favoring Internet Explorer and locking out Netscape. It also highlights how Google's anticompetitive conduct has affected a huge range of consumer choices.

The bottom line is that we will not stand by and watch dominant digital platforms thwart competition. Digital markets may involve new technologies, but the tactics of these digital platforms are nothing new. Buying would-be rivals. Boxing out firms who won't be bought. Leveraging a monopoly position in one market to grow a position in another. The Department of Justice has dealt with these tactics from the likes of Standard Oil and Microsoft. We will do so again whenever the facts and the law demand action to protect the economy, no matter how powerful the violator.

Our merger enforcement must remain vigilant in the range of other industries undergoing consolidation as well. Most of us understand that when we have fewer choices for where to work or where to buy goods then prices go up and quality goes down. Corporate mergers work the same way. They can leave Americans with fewer choices, shifting power away from consumers and workers and concentrating it among fewer and fewer large companies. That is particularly true when mergers leave just a few competitors in the market. For example, in July 2021, the department successfully blocked a merger between Aon and Willis Towers Watson, two of the three largest insurance brokers in the world. The merger would have turned an industry dominated by a "Big Three" into an industry dominated by a "Big Two." It would've left companies that rely on insurance brokers to lower the cost of health care and retirement plans with little to no alternatives. Ultimately, that means higher prices and lower quality for employees and retirees.

The department's success in stopping the merger of Aon and Willis Towers Watson was an important victory. It is also an important warning sign to companies contemplating similar deals. I know Antitrust Division officials have said this before, but I hope companies are, in this moment, paying close attention: anticompetitive mergers should not make it out of the boardroom. If they do, we will not hesitate to challenge those mergers. And, if we litigate, the department—from leadership to our extremely talented career attorneys, economists and staff— is committed to winning these cases.

The department is also committed to criminally prosecuting executives and companies who violate the antitrust laws. When executives or companies make the decision to collude, rather than compete, they cheat consumers, workers and taxpayers out of the benefits of market competition.

The department has been particularly focused on executives and businesses who fix wages or allocate workers through so-called "no-poach" agreements. For example, the department recently indicted a medical care center "for agreeing with competitors not to solicit senior-level employees." We took a similar approach with a healthcare staffing company and one of its executives who entered into agreements with competitors not to raise wages for nurses in a Las Vegas-area school district. These kinds of agreements deprive people of the chance to bargain for better work or better working conditions. They are also per se illegal. The department is therefore committed to investigating, prosecuting and ultimately ending these kinds of practices. American workers who are struggling to make ends meet may not always be able to stand up to their employer, but the department can and will. . .

The department is also committed to working with our international partners on civil and criminal antitrust enforcement. We communicate with our international counterparts nearly every day to identify issues of common interest, strengthen our approach on those issues, and avoid inconsistent outcomes. That includes cooperating with 14 jurisdictions on 21 civil merger and non-merger matters just since January. . .

The department takes antitrust enforcement seriously. That means if conduct threatens to harm competition, we will dedicate the time and energy necessary to challenge it. Companies, executives, boardrooms and shareholders should take note: if your company approves a merger that may lessen competition, we will block it. If you fix prices, rig bids or divide markets, we will prosecute you whether your scheme cheats consumers or harms workers. And if you monopolize markets to maintain a dominant position, even in a high-tech industry, we will intervene to put a stop to it. The department's responsibility to pursue justice in the American economy demands no less.

FROM THE EDITOR

Discordant Antitrust Activism?

Kicking off with President Biden's executive order that created a counsel to address "overconcentration, monopolization, and unfair competition," the Federal Trade Commission and the Department of Justice have been on course towards an increasingly comprehensive and aggressive take on antitrust enforcement.

"The department takes antitrust enforcement seriously," said the DOJ's Vanita Gupta, in a speech she gave in September that's excerpted in this issue. "That means if conduct threatens to harm competition, we will dedicate the time and energy necessary to challenge it. Companies, executives, boardrooms and shareholders should take note: if your company approves a merger that may lessen competition, we will block it."

Yet so far, the FTC has been pulling ahead. There was the FTC's reversal of its 15-year-old policy statement limiting the use of prior notice and prior approval provisions in merger settlements. Then in August, the agency's announcement that for transactions that FTC staff cannot fully investigate in the initial 30-day Hart-Scott-Rodino waiting period, it would issue a warning letter before the waiting period expires if the FTC has competitive concerns, letting merging parties know that the FTC's investigation remains open and may continue post-closing. (These actions were explored in the July/August and September issues of *The M&A Lawyer*.)

Now it's time for vertical mergers. As our lead article, by Jones Day's Ryan Thomas, Aimee DeFilippo and Lauren Miller Forbes explores, in September, the FTC voted along party lines to withdraw its support for the Vertical Merger Guidelines and related FTC commentary on vertical merger enforcement. Meanwhile, the acting head of the Antitrust Division of the DOJ issued a statement indicating that the Guidelines "remain in place" at the DOJ while it conducts a "careful review" of its process for making enforcement decisions.

As the authors write, "while the Guidelines' demise seemed to be a matter of when, not whether, the FTC's decision to withdraw its approval of the Guidelines without the DOJ's backing is surprising and unfortunate. Independent of whether one believes the policy statements require revisions, we are now confronted with different policy standards at two federal agencies that have overlapping jurisdiction."

They add that "this dynamic could become more pronounced in the future to the extent there are procedural and substantive differences between the FTC and DOJ . . . the length and/or outcome of a vertical merger investigation now may depend on which agency is cleared to review the deal, which provides additional fodder for those on Capitol Hill who call for a one-agency approach to antitrust enforcement in order to reduce bureaucracy and increase fairness."

Chris O'Leary

Managing Editor

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