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A force to be reckoned with

Robert Schlossberg and Jan Rybnicek of Freshfields Bruckhaus Deringer examine the rising issue of private merger litigation in the US

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A FORCE TO BE RECKONED WITH

Robert Schlossberg and **Jan Rybnicek** examine the rising issue of private merger litigation in the US – a phenomenon that can affect many deals

Through a combination of experience, considerable resources, institutional integrity, economic content and international co-operation, the US government antitrust merger review process is arguably the best in the world. It is not perfect, though. For instance, the length and expense of the review has been criticised[1] and has been the subject of numerous reform efforts.[2] The many ways in which the US antitrust laws permit mergers to be challenged is also far from perfect. For instance, mergers can be challenged by (1) the federal government when not subject to the US merger control statute – the Hart-Scott-Rodino Antitrust Improvements Act;[3] (2) the federal government after closing;[4] (3) the federal government even after the merger has been cleared;[5] (4) state governments before closing;[6] and (5) state governments after closing.[7]

Recent high-profile transactions serve to remind us of a potentially more pernicious source of challenges to transactions, and one often not fully considered by transaction parties – private antitrust litigation. Section 7 of the Clayton Antitrust Act affords private parties a significant role in the US merger enforcement process by authorising private parties to institute merger challenges irrespective of government action.[8] Although plaintiffs can often find it difficult to prevail in private merger litigation, such suits nevertheless are on the rise, and plaintiffs appear to understand that merger challenges put parties in the difficult position of risking a material delay in the closing or paying a considerable amount of money in settlement.[9] Indeed, private litigation is used by a variety of plaintiffs across a wide range of industries today.

After providing some background on a number of the recurring issues private merger litigants face and surveying the specific types of private antitrust actions a transaction may encounter, this article will conclude with some observations regarding how to incorporate the possibility of private litigation into deal management and document drafting.

I. Hurdles to Private Litigation

Private parties seeking to challenge a merger must overcome obstacles that federal and state authorities typically can satisfy more easily as a result of their public mission. Not least among these is the requirement that private plaintiffs must have "antitrust standing," i.e., suffer "antitrust injury" to bring suit against a merger. An "antitrust injury" is defined narrowly to include "injury of the type the antitrust laws were intended to prevent and that flows from that which makes the defendants' acts unlawful."[10] It is not sufficient for the plaintiff merely to allege that it will suffer harm from the merger; the injury needs to flow directly from a reduction in competition. Moreover, if a private party hopes to recover damages in addition to or instead of obtaining injunctive relief, the courts will also inquire into whether there are other parties more directly harmed that would serve as better plaintiffs, or if permitting the suit to go forward would create the potential for duplicative relief.[11] As is discussed in more detail below, how a private party attempts to show antitrust injury often will depend on that party's relationship to the merging firms.

Private parties also may face difficulties in showing that any actual relief is warranted as a result of the proposed merger. The antitrust laws permit private parties to seek preliminary and permanent injunctive relief, as well as damages. With respect to preliminary injunctions, private parties seeking to block a transaction must show that the transaction would cause "irreparable harm." Unlike federal and state agencies that are essentially permitted to aggregate the harm caused to the general public when presenting a case for preliminary injunctive relief, private parties must demonstrate that the personal harm

caused to them alone is so great as to warrant an injunction.[12] Nevertheless, private parties have been successful in showing harm by, for example, arguing that it would be impossible to "unscramble the eggs" if the merger were consummated prior to a hearing on the merits.[13] Again, how a private party demonstrates harm resulting from a merger will depend on the party's relationship with the merging firms.

We, therefore, organise our brief survey below of US private merger litigation by whether the plaintiff is a (i) distributor or sales agent, (ii) consumer, (iii) competitor, (iv) target, or (v) supplier in relation to the transaction parties.

II. Types of Private Antitrust Actions

A. Distributor and Sales Agent Challenges

Distributors and sales agents who lose the business of the merging parties following a transaction generally lack standing to challenge the merger.[14] This is true regardless of whether the reason for termination is the manufacturer's subsequent vertical integration into distribution,[15] or its elimination of redundancies in distribution.[16] Courts typically view both scenarios as the mere efficiency effects of the merger.

Merger challenges put parties in the difficult position of risking a material delay in closing or paying a considerable amount in settlement

For example, in *John Lenore & Co. v. Olympia Brewing Co.*, a defendant beer manufacturer, Olympia, acquired a competing beer manufacturer and subsequently terminated that competitor's distributors. In denying standing to a terminated distributor, the court reasoned that if Olympia's acquisition of the competitor had violated the antitrust laws, it was because competition was reduced in the manufacture of beer, a market in which the distributor was neither a competitor nor a consumer. The antitrust laws were not intended to protect against this type of harm, and therefore, the distributor lacked standing to sue as an antitrust plaintiff.

B. Consumer Challenges

Consumers are the most likely private plaintiffs to be able to satisfy the antitrust injury requirement and demonstrate standing to challenge a transaction, because the antitrust laws were designed precisely for the purpose of protecting consumers. As a result, allegations that the challenged transaction will reduce competition and thereby create supracompetitive prices often are sufficient to demonstrate antitrust standing for private-party consumers. However, as noted above, because consumers can only offer personal harm as grounds for blocking a merger, consumers often face difficulties in showing that the proposed transaction is so harmful as to warrant injunctive relief.

In *Reilly v. Hearst Corp.*, a newspaper consumer who purchased both the San Francisco Chronicle ("Chronicle") and the San Francisco Examiner ("Examiner") challenged the proposed combination of the competing newspapers.[17] The consumer alleged that the publisher of the Examiner planned to stop production of the Examiner after acquiring the Chronicle, thereby eliminating one of only two newspaper providers of news, features and opinion content in the relevant geographic area. The court held that the plaintiff had standing to bring a claim as an injured consumer who would lose an economically viable source for news, features, and opinions. Although the transaction was enjoined preliminarily pending trial, the district court ultimately concluded that the acquisition did not lessen competition, and the transaction was subsequently approved.

More recently, in *Malaney v. UAL Corp.*, a district court denied a request by 49 individual travel agents and passengers to enjoin preliminarily the merger of United Airlines and Continental Airlines.[18] To demonstrate antitrust injury and establish standing, each of the plaintiffs submitted an affidavit stating that they had either purchased, or planned to purchase, commercial airline tickets for personal use. The district court concluded that the travel agents and passengers had established standing by showing they were purchasers of commercial airline tickets, and could be harmed if the merger resulted in higher airline fares. However, despite finding that the plaintiffs had standing, the court denied the travel agents and passengers' request for injunctive relief because the plaintiffs failed to show substantial personal harm resulting from the merger. Significantly, the court refused to consider the harm that the plaintiffs alleged would be suffered by the general flying public as a result of the merger when determining whether plaintiffs had shown "irreparable harm." Although the litigation continues (the case is on appeal), United and Continental consummated the transaction in October, 2010.

C. Competitor Challenges

Competitors often have the most difficulty in showing antitrust injury, because the very nature of competitors' interests when compared to those of the merging parties raises scepticism as to the true motivation for the challenge. A transaction that is expected to result in the type of harm the antitrust laws were enacted to protect against – namely increased prices or reduced quality or variety for consumers – would not draw the ire of competitors, because competitors would benefit from the opportunity to win dissatisfied customers. Instead, the mergers or acquisitions that are challenged by competitors often are those that threaten to erode the competitor's profits by providing a new, more efficient or diverse alternative. Such

private challenges face an uphill battle, as it is axiomatic that the US antitrust laws are designed to protect consumers and not competitors.[19] Competitors who are successful in presenting a challenge against a merger often do so on the basis of a predation theory.[20] Such competitors argue that the merger produces a dominant firm that will lower prices below cost in an effort to drive competitors from the market and subsequently benefit from monopoly prices.[21]

For example, in *Hart Intercivic, Inc. v. Diebold, Inc.*, a competitor sought to enjoin preliminarily the acquisition of Diebold, Inc.'s ("Diebold") election systems business by Election Systems & Software ("ES&S"), two leading companies in the concentrated market for voting machine and election services in the US.[22] The plaintiff alleged that ES&S would control approximately 68 percent of the market following the proposed transaction, allowing ES&S to raise prices and decrease quality to consumer voting precincts. The plaintiff further claimed that the acquisition would lessen competition, because competitors would be charged a "risk premium" by customers who feared that the voting machines provided by the merged firm would become the industry standard.

Competitors who are successful in presenting a challenge against a merger often do so on the basis of a predation theory

The court acknowledged that the plaintiff's theory resembled a claim of predatory pricing in that customers may overwhelmingly choose ES&S post-transaction on the assumption that it would become an industry standard, allowing ES&S to increase prices once ES&S did become the industry standard. However, the court found insufficient evidence to support the claim that competitors actually faced any increased cost in the form of "risk premiums" as a result of the transaction. Indeed, the court found no evidence to suggest ES&S would price below cost post-transaction. As a result, the court concluded that the plaintiff had not alleged harm to competition to establish the requisite antitrust standing necessary to challenge the merger. In the end, although the transaction was not reportable under the US merger notification law, the Antitrust Division of the Department of Justice later conducted an eight-month investigation of the transaction and ultimately required ES&S to divest much of what it had acquired from Diebold.

In another case involving competitors, the plaintiff successfully showed irreparable harm to warrant a preliminary injunction. In *Tasty Baking Co. v. Ralston Purina, Inc.*, a bakery business challenged the combination of two bakery divisions belonging to competitors. Tasty Baking Co. ("Tasty") argued that Hostess' acquisition of Drake should be enjoined preliminarily pending trial to prevent interim predatory pricing by Hostess, and to ensure Drake adequately could be divested should the transaction later be found to be unlawful. Specifically, Tasty claimed, and the district court agreed, that any injury to Drake would irreparably harm Tasty (as well as consumers), because Tasty was in a better position to compete with Hostess in those markets where Hostess faces strong competition from Drake. The court concluded that the merger, if not preliminarily enjoined, would allow Hostess the opportunity to displace Drake management and personnel, and alter operations in such a way that Drake could not easily survive if ordered to be divested. Moreover, the court found that in the absence of an injunction, Hostess would learn much about Drake's business pending trial, and would therefore have an unfair advantage in the event of divestiture. As a result, the court required Hostess and Drake to be held separately pending trial.

D. Target Challenges

Targets of an attempted hostile acquisition rarely are able to satisfy the antitrust injury requirements necessary to pursue a private challenge against a merger. This is often because any alleged lessening of competition resulting from a merger is likely to benefit the target and its shareholders once the target becomes part of the merged entity. Courts have also typically rejected arguments that targets can be harmed by an acquisition as a result of a loss in jobs or other local economic effects. Such harms are generally considered to be unrelated to competition and the focus of the US antitrust laws.[23] However, at least one court has found that targets can demonstrate antitrust injury by showing a loss in the ability to make independent decisions related to price and output.[24]

In *Atlantic Coast Airlines Holding, Inc. v. Mesa Air Group, Inc.*,[25] one regional air carrier challenged its acquisition by another regional air carrier. Atlantic Coast Airlines ("ACA") had decided that it wanted to expand into the low-fare airline marketplace. Mesa Air Group ("Mesa") submitted an unsolicited proposal to acquire ACA for the purpose of maintaining ACA as a regional carrier for major airlines. The ACA Board rejected the proposal and Mesa sought to replace the ACA Board with Mesa nominees. ACA thereafter moved for a preliminary injunction, asking the court to prevent Mesa from pursuing its efforts to replace the ACA Board. ACA alleged that Mesa sought to block ACA's planned expansion into the low-fare airline marketplace in order to prevent increased competition with a major airline for which Mesa provided regional service.

The court held that ACA lacked standing to challenge the proposed transaction under Section 7 of the Clayton Act. The court found that ACA would not lose its independent decision-making ability as a result of the transaction, and that Mesa had no incentive to structure the deal such that it would harm its own operation. Most importantly, the court concluded that the takeover process, which allowed shareholders to vote to

determine whether Mesa's board nominees could sit on ACA's board, afforded ACA adequate opportunity to determine on its own whether to be acquired by Mesa. In short, the court concluded that through the takeover process, ACA essentially approved the acquisition and therefore could not later complain of being a victim of anticompetitive effects resulting from the transaction. Nevertheless, the court enjoined the consent solicitation preliminarily pending resolution of ACA's separate antitrust claim under Section 1 of the Sherman Act.

E. Supplier Challenges

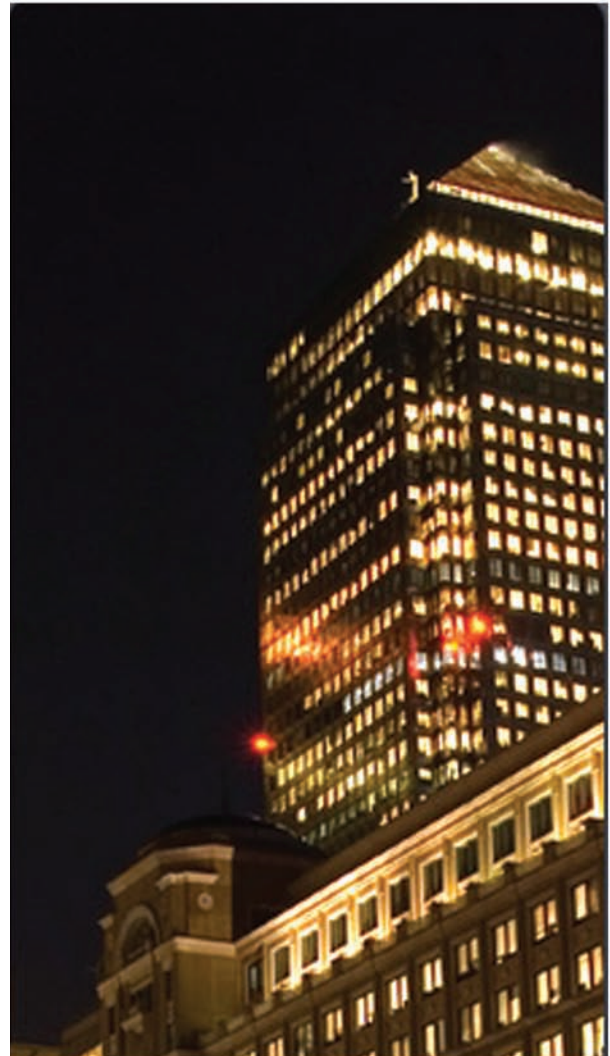
It is theoretically possible for a supplier to challenge a transaction where the merging parties are each customers of the supplier. The supplier would presumably allege that the merged entity would have achieved monopsony power. We are not aware of such a private challenge, although the creation of monopsony power has been the basis for US government challenges.[26]

The possibility of private litigation arising from a merger is not limited to alleged adverse competitive effects arising from the combination. It is well accepted in the US that merging parties must behave as independent competitors prior to closing, and to that end, exercise caution in the information they share in due diligence. In a recent case, the plaintiff, the nation's largest institutional pharmacy, alleged that two insurance companies conspired during the due-diligence phase of their merger talks to co-ordinate their negotiations with the plaintiff, and thereby reduce what they paid the plaintiff for its services. After years of discovery, the trial court held that there was not sufficient evidence of a conspiracy, a holding just recently affirmed by the Court of Appeals.[27]

III. Deal Management and Document Drafting

Antitrust assessment and preparation are among the keys to good drafting of definitive deal documents. As part of that assessment, the parties should consider the prospects and potential sources of private litigation. This in turn will enable the parties to consider how, if at all, to address this possibility in a number of the otherwise standard provisions such as (i) the obligation of the buyer to offer antitrust remedies, (ii) the extent of the buyer's antitrust co-operation, and (iii) the absence of litigation as a closing condition.

It is relatively common in strategic acquisitions for the parties to negotiate heavily over the extent to which the buyer will need to offer remedies to obtain approval of the transaction from the antitrust authorities. These provisions come in many varieties and can include a limit on the buyer's obligation measured against various metrics, and also include an obligation to avoid or resolve government litigation in those countries, like the US, where the authorities must obtain a court order to block a transaction. It is far less common for the obligation to extend



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to resolving private litigation – but there is no conceptual reason why the obligation could not be so extended.

In terms of buyer co-operation, private litigation pre-closing is likely to be captured within the standard co-operation obligations. It may not be clear whether those obligations would extend post-closing. Thus, in a transaction where, for instance, the target is not being acquired completely by the buyer, it may well be useful for the buyer to obtain an explicit commitment of the seller to co-operate post-closing in the buyer's defence of private litigation.

Finally, if there is a meaningful prospect of private litigation, the parties should examine the standard closing condition language for whether and how it would apply in the context of private litigation. If the private litigant obtained an injunction, presumably that would be covered and the closing could not occur. It is less clear under standard language whether the closing can proceed if the private litigation is simply pending – no injunction issued – and the buyer should decide whether it is willing to close under those potential circumstances. ■

Robert Schlossberg is an antitrust partner in the Washington, DC office of Freshfields Bruckhaus Deringer US LLP. Jan Rybnicek is an associate. They counsel clients on the full range of merger issues; Robert has represented clients in merger litigation not discussed in this article. In addition, Freshfields successfully represented Continental Airlines in the private litigation challenging its merger with United Airlines.

Footnotes

1 See, e.g., Antitrust Modernization Comm'n, Report and Recommendation 151-83 (April 2007), available at http://govinfo.library.unt.edu/amc/report_recommendation/amc_final_report.pdf.

2 See, e.g., Press Release, Dep't of Justice, Antitrust Division, Antitrust Division Announces Amendments to its 2001 Merger Review Process Initiative: Changes Designed to Further Streamline Merger Review Process (Dec. 15, 2006), available at http://www.justice.gov/atr/public/press_releases/2006/220302.htm; Press Release, Fed. Trade Comm'n, FTC Chairman Announces Merger Review Process Reforms: Changes are Designed to Further Streamline Merger Review Process (Feb. 16, 2006), available at http://www.ftc.gov/opa/2006/02/merger_process.shtm.

3 See United States v. Microsemi Corp., No. 1:08-cv-1311 (E.D. Va. Dec. 22, 2008) (complaint); FTC v. Ovation Pharm., Inc., No. 08-cv-06379 (D. Minn. Dec. 16, 2008) (complaint); In re Polypore Int'l, No. 9327 (FTC Sept. 10, 2008) (complaint).

4 See, e.g., FTC v. Inova Health Sys. Found., No. 1:08-cv-460 (E.D. Va. May 12, 2008) (complaint).

5 See, e.g., Chicago Bridge & Iron Co. v. FTC, 534 F.3d 410 (5th Cir. 2008).

6 See, e.g., Press Release, Cal. Attorney Gen., Attorney General Lockyer Announces Approval of Federated-May After Winning Federated's Agreement to Sell More California Stores: Firm Will Divest At Least 26 Macy's and Robinson-May Outlets in Southern California (Aug. 31, 2005), available at http://oag.ca.gov/news/press_release?id=1209&p=3&y=2005.

7 See, e.g., City of New York v. Group Health Inc., No. 06-cv-13122 (S.D.N.Y. May 11, 2010).

8 See Midwestern Machinery, Inc. v. Northwest Airlines, Inc., 167. F.3d 439 (8th Cir. 1999) (finding that private parties may challenge a merger even after it had been consummated); see also Midwestern Machinery, Inc. v. Northwest Airlines, Inc., 392 F.3d 265 (8th Cir. 2004) (holding the four-year statute of limitations under Section 7 of the Clayton Act begins to run at the time the merger is closed).

9 Ginny LaRoe, *Antitrust Plaintiffs Ask Federal Judge to Ground United-Continental Merger*, The Recorder, Sept. 1, 2010, available at http://www.law.com/jsp/article.jsp?id=1202471429709&slreturn=1&hbxlogin=1 (noting that an antitrust action against Delta Airlines' acquisition of Northwest Airlines resulted in a $5 million settlement).

10 Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc., 429 U.S. 477, 489 (1977)

11 Cargill, Inc. v. Monfort of Colorado, Inc., 479 U.S. 104, 111 n.6 (1986).

12 See United States v. Borden Co. 347 U.S. 514, 518 (1954).

13 See Tasty Baking Co. v. Ralston Purina, Inc., 653 F. Supp. 1250, 1277 (E.D. Pa. 1987).

14 See, e.g., Florida Seed Co. v. Monsanto Co., 915 F.Supp. 1167 (M.D. Ala. 1995); Eisai Inc. v. Sanofi-Aventis U.S., 2010-2 Trade Cas. (CCH) P77,168 (D.N.J. 2010).

15 See G.K.A. Beverage Corp. v. Honickman, 55 F.3d 762 (2d Cir. 1995); Port Dock & Stone Corp. v. Oldcastle Northeast, Inc., 507 F.3d 117 (2d Cir. 2007).

16 See John Lenore & Co. v. Olympia Brewing Co., 550 F.2d 495 (9th Cir. 1977).

17 Reilly v. Hearst Corp., 107 F. Supp. 2d 1192 (N.D. Cal. 2000); see also Reilly v. Medianews Group, No. 06-04332, 2007 WL 1068202 (N.D. Cal. 2007) (finding that newspaper subscriber has standing to challenge acquisition).

18 Malaney v. UAL Corp., No. 3:10-cv-02858 (N.D. Cal. Sept. 27, 2010); see also Golden Gate Pharmacy Serv. v. Pfizer, Inc., No. 3:09-cv-03854 (N.D. Cal. Apr. 16, 2010) (finding plaintiff pharmacies and pharmacists were unable to establish a cognizable relevant product market after two amended complaints); Ginsburg v. InBev, 649 F. Supp. 2d 294 (E.D. Mo. 2009) (dismissing suit by beer drinkers seeking to block acquisition of Anheuser-Busch by InBev because InBev did not intend to enter US beer market), affirmed, 623 F.3d 1229 (8th Cir. 2010).

19 Brown Shoe Co. v. United States, 370 U.S. 294, 320 (1962).

20 See, e.g., Cargill, Inc. 479 U.S. at 117-18.

21 See, e.g., Cassan Enterprises, Inc v. Avis Budget Group, No. 2:10-cv-1934 (W.D. Was. filed Nov. 30, 2010) (alleging that merger of second largest and fourth largest car rental companies would permit the merged entity to price car rentals at predatory prices in an effort to eliminate competitors).

22 No. 1:09-cv-0678 (D. Del. Sept. 30, 2009).

23 See, e.g., Pennsylvania v. Russell Stover Candies, Inc., No. 93-1972, 1993 WL 145264 (E.D. Pa. May 6, 1993).

24 Consol. Gold Fields PLC v. Minorco, S.A., 871 F.2d 252, 258 (2d Cir. 1989). But see Anago, Inc., v. Tecnol Med. Prods., 976 F.2d 248, 251-52 (5th Cir. 1992) (finding that "loss of independence" is not an injury related to lessened competition).

25 295 F. Supp. 2d 75 (D.D.C. 2003).

26 United States v. AETNA, Inc., No. 3-99-cv-1398 (N.D. Tex June 23, 1999) (complaint) (approved subject to divestiture); United States v. Cargill, Inc., No. 1:99-cv-01875 (D.D.C. July 8, 1999) (complaint) (same).

27 Omnicare, Inc. v. United Health Group, Inc., No. 09-1152 (7th Cir. Jan. 10, 2011).