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'Arch' and 'Oracle' Cases

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In *Federal Trade Commission v. Arch Coal Inc.*, 2004 U.S. Dist. Lexis 15996 (D.D.C. Aug. 16, 2004), the Federal Trade Commission (FTC) brought a preliminary injunction action seeking to bar the acquisition of Triton Coal Co. and its coal mines by Arch Coal. The district court denied the FTC's request for a preliminary injunction, finding that the plaintiffs were "not likely to succeed on the merits of their claim of a Clayton Act violation based on the novel theory of prospective tacit coordination on production limits." The U.S. Circuit Court for the District of Columbia denied the FTC's motion for a stay pending appeal, and the FTC has abandoned the appeal in favor of administrative litigation.

In *United States v. Oracle Corp.*, 2004 U.S. Dist. Lexis 18063 (N.D. Calif. Sept. 9, 2004), the Department of Justice (DOJ) brought an action to enjoin the acquisition of enterprise application software provider PeopleSoft Inc. by rival Oracle Corp. After trial, Judge Vaughn R. Walker held for Oracle because he found that DOJ had failed to sustain its burden of proof. The decision creates a precedent that may impair the enforcement agencies' use of unilateral-effects theory in their future merger enforcement efforts. DOJ has decided not to appeal.

Market definition was critical to the analyses

In both cases, the agencies faltered in part because of failures in market definition. The agencies and courts typically first define the relevant product and geographic market, which allows the identification of the firms in that market and an assessment of market concentration created by the deal; they then consider the competitive effects of the increased concentration. Under the agencies' Horizontal Merger Guidelines, mergers that result in a highly concentrated market are presumed to create market power and enhance the risk of successful coordination by firms in the market. Alternatively, the guidelines state that a deal in a market involving differentiated products (i.e., products within the market are distinguishable based on factors other than price) may allow the buyer to exercise market power if it acquires its closest competitor. That test also requires that the merged firm have a substantial market share (the guidelines suggest greater than 35%) and that rivals be unable to reposition their products to become closer substitutes.

In *Arch*, the FTC defined the market as 8,800 British thermal unit (Btu) South Powder River Basin (SPRB) coal, claiming that SPRB coal was one of the few coal sources that complied with the Clean Air Act, and that many public utilities could not substitute a lower-Btu coal. The court concluded, however, that the market included lower-Btu coal. Judge John D. Bates cited 15 customer witnesses who buy and use both 8,800- and 8,400-Btu coal, and said that both are used interchangeably by customers. In that market, the post-merger concentration levels were much lower, and barely created a presumption of market power.

In *Oracle*, the court held that DOJ had failed to prove both the product and geographic market alleged in the complaint. In the absence of a properly defined market, DOJ could not prove market shares that raised a presumption of market power under a unilateral-effects theory. In doing so, the court also concluded that DOJ had not proved that the market was limited to three firms. Despite contrary evidence from customers, it found that other firms compete with Oracle and PeopleSoft, and that additional firms might reposition themselves to constrain a post-merger exercise of market power.

The *Oracle* opinion narrows the unilateral-effects doctrine to circumstances in which the merged firm would have a monopoly or dominant position in the relevant market. Despite the merger guidelines' presumption, Walker concluded that a "presumption of anticompetitive effects from a combined share of 35% in a differentiated products market is unwarranted." Indeed, he held that "to prevail on a . . . unilateral effects claim, a plaintiff must prove a relevant market in which the merging parties would have essentially a monopoly or dominant position." This standard may be highly problematic for the agencies' challenges to mergers under unilateral-effects theory because it would require that the combined market share be much higher than 35% to create a presumption of market power.

In *Arch*, Bates articulated the standard in coordinated-effects cases as requiring a showing that it is "probable and imminent" that the merger will "increase the risk of coordinated interaction that will likely substantially lessen competition in the . . . market." The FTC submitted what appeared to be weighty evidence of enhanced risk of coordination based on past efforts by Arch and other firms to encourage rivals to reduce output. For example, Arch's chairman and chief executive officer gave a speech to producers and customers advocating self-imposed limitations on production to avoid oversupply and low prices, and in 2002, Arch issued a press release announcing cuts in production. Despite this proof, Bates called the FTC's coordinated-effects case "novel" because it involved restrictions on output rather than price.

Although the FTC presented evidence that other producers reduced output after Arch suggested output restraints, the court found that several mines closed because they were unprofitable. The court said that coordination was unlikely because there was no evidence of any ability to detect and punish producers who cheat on tacit

coordination efforts because SPRB firms are blind to price and production levels. The court held that the FTC failed to show that SPRB producers engaged in price or output coordination in the past.

Bates commented that the FTC's "novel" coordinated-effects theory requires a showing of "projected future tacit coordination, which itself may not be illegal, which is speculative and difficult to prove, and for which there are few if any precedents." Although the D.C. Circuit denied the FTC's motion to stay pending appeal, it "agreed with the FTC that there is nothing novel about the [reduced-output] theory it has advanced in this case." *FTC v. Arch Coal Inc.*, 2004 U.S. App. Lexis 18620, at 1 (D.C. Cir. Aug. 20, 2004). Thus, this aspect of the *Arch* decision may have less precedential value for defendants than it first appeared.

These decisions are especially noteworthy because both courts disregarded testimony by concerned customers voiced in opposition to the deals. In contrast, other courts and the agencies have relied heavily on customer evidence. For example, FTC statistics show that the likelihood of a challenge to a merger increases substantially if customers object. Horizontal Merger Investigation Data, Fiscal Years 1996-2003, available at www.ftc.gov/opa/2004/08/fyi0450.htm.

Both courts found customer testimony unpersuasive

In both cases, the agencies presented substantial customer testimony. In *Arch*, on the issue of probable effects of the merger, the court found customers' testimony that they feared that fewer suppliers would lead to higher prices subjective and unpersuasive: "[T]he substance of the concern articulated by the customers is little more than a truism of economics: a decrease in the number of suppliers may lead to a decrease in the level of competition in the market. Customers do not, of course, have the expertise to state what will happen in the SPRB market, and none have attempted to do so." Bates gave no weight to customer testimony indicating that after the merger was announced, Arch had insisted on price increases that it expected to enforce as a result of the merger.

In *Oracle*, Walker ultimately chose to disregard the customer witnesses' testimony both in defining the relevant market and in determining the probable effects of the merger. Ignoring customer testimony about the inadequacies of other firms' software, which led customers to conclude that there was no acceptable alternative to Oracle or PeopleSoft, he essentially concluded that the customers were simply wrong when they testified that the merger reduced their choices from three firms to two, and that there were more competitive alternatives that the customers had failed to consider. He faulted the customers' testimony because "none gave testimony about the cost of alternatives to the hypothetical price increase a post-merger would charge." The *Oracle* opinion suggests that customers' testimony will only be useful when it is substantiated by analysis of all alternatives that might fall within the relevant product market.

The real key to the defense verdict in *Arch* may have been that, prior to trial, Arch had agreed to sell one of Triton's mines to Kiewit, a mining company outside the SPRB. The FTC claimed that the sale was "insufficient to 'materially change the acquisition or its likely effect on competition.' " But it is clear that the sale had a substantial effect on Bates' decision. The court noted that "post-merger, there will still be five significant producers of SPRB coal, with Kiewit replacing Triton as an SPRB producing entity." The court also noted Kiewit's plans to increase production from the mine it was acquiring. It denied a preliminary injunction in large part because it found that Arch's plan to sell the mine to Kiewit resolved the competitive concerns resulting from the merger. This may have substantial importance in future agency merger challenges, and may influence the strategy for parties seeking clearance for a contested merger.

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