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Competition & Antitrust Guide 2005

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Competition and Antitrust

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What United States v. Oracle says about high-tech merger review in the US

By *Scott A. Sher* and *Charles T. (Chris) Compton.*

Merger antitrust enforcement is peculiar. Very few cases are ultimately litigated in the courts. Instead, antitrust challenges by the U.S. agencies are often resolved by consent decree, rather than tried to a decision in court. As a result, when a merger decision is reached by a federal court, and an opinion issued, it often assumes great importance to the antitrust bar and their clients.

Of these few published decisions, only one concerns exclusively a transaction between high-technology companies: United States v. Oracle Corporation, decided in September 2004. That decision came more than 18 months from the time the merger was announced. Because it takes so much time to litigate a merger case –time that technology companies in particular do not have– it is unlikely that another Oracle will come around anytime soon. The decision therefore will be highly influential for years to come. High-tech companies considering a merger should understand the opinion, and what it means for U.S. antitrust jurisprudence.

Overview of the Oracle decision

In United States v. Oracle Corp., Chief Judge Vaughn Walker of the Northern District of California rejected the DOJ's attempt to enjoin Oracle's $(U.S.)7.7 billion hostile tender offer for PeopleSoft, Inc., concluding that the DOJ failed to meet its burden of demonstrating a relevant market comprised of only three providers of "high-function" enterprise application software. In addition, Chief Judge Walker concluded that the parties failed to demonstrate any evidence of competitive harm arising from the merger, focusing specifically on a theory of competitive harm commonly referred to as "unilateral effects."

Oracle and PeopleSoft developed and sold specialized application software, called enterprise resource planning (ERP) software. The case focused on two particular types of ERP software – Financial Management Systems (FMS) and Human Resource Management (HRM) software, with the DOJ contending that each constituted a "relevant market" that included only three companies: Oracle, PeopleSoft and SAP.

The DOJ's case relied heavily on two areas of evidence: (1) customer testimony, and (2) documentary evidence showing that Oracle and PeopleSoft were often the two most significant choices for large enterprises. Historically, customer opinion or testimony has been a key determinant in the antitrust agencies' decision on whether to challenge a transaction as harmful to competition. In Oracle, the government relied upon a parade of large corporate customers to testify about the contours of the relevant product market.

In addition, the government provided evidence – most in the form of Oracle and PeopleSoft business planning and competitive field documents – tending to show that large enterprises with complex resource planning needs most often relied upon Oracle and PeopleSoft's solutions for FMS and HRM needs. Specifically, discount forms and won/loss reports demonstrated that when competing for accounts of certain sizes, Oracle and PeopleSoft were often customers' first and second choices, and that the parties tended to more aggressively discount to win the business when they competed head-to-head.

The district court was not persuaded. According to Judge Walker, the evidence proffered was vague and unreliable. First, Judge Walker concluded that the customer testimony, which he called "speculative," seemed too coached by the government. It was unpersuasive because it represented only a small and non-representative sample of the market. The court further found the testimonial evidence about how each customer reached its choice for an ERP vendor insufficient by itself to prove the contours of the market. The court explained that it needed contemporaneous business documents explaining how each customer chose its ERP vendor, the factors that went into such decision-making processes, the list of vendors considered, and how vendors were eliminated from the competitive bidding process (begging the question whether such documents existed here).

Second, Judge Walker concluded that the documentary evidence produced by the DOJ was too anecdotal and insufficiently econometric in nature to prove that Oracle, SAP and PeopleSoft were the only companies that could provide such services. The court chastised the government for not conducting sufficient analyses on the evidence to exclude other sources of competition reflected in the companies' business documents. Specifically, the court concluded that other ERP vendors, including Microsoft and Lawson, and outsourcing companies like ADP either competed now or could reposition themselves to compete if Oracle tried to raise prices post-merger.

What does Oracle mean for high-tech companies? The Peculiar Nature of Software Mergers

The Oracle decision is significant for a number of reasons. Most prominently, it demonstrates the difficult burden the government has in demonstrating that high-tech markets are susceptible to market dominance, even when they become concentrated. Judge Walker was convinced that other companies currently in segments of the market, or at the periphery, could quickly enter or reposition and become competitive. As a result, even in the face of significant concentration, this court was reluctant to interfere with what it saw as a dynamic market.

The Oracle decision seems to subtly undercut the U.S. antitrust agencies' reliance on the joint FTC/DOJ 1992 Horizontal Merger Guidelines in evaluating mergers. Two aspects of the Merger Guidelines analysis – market definition and ease of entry – tend to embroil a large number of technology mergers in extended investigations or enforcement action. The lynchpin of the government's analysis – defining the relevant market – is especially difficult where new, rapidly changing and poorly understood technologies are at issue. Oracle suggests that the agencies should be reticent in bringing enforcement actions in such industries because of the difficulty of proving market definition and the transient nature of market dominance in such industries.

The Growing Necessity of Economic Experts

Second, Oracle provides insight for other high-tech companies as how to present difficult merger cases to the courts and to the antitrust agencies. Reliance on customer testimony that is either anecdotal or unadorned by documentary support is no longer prudent. In Oracle, the court suggested that a more rigorous examination of the market contours by expert economists was more appropriate in defining the market. Judge Walker's opinion in fact relied heavily upon Oracle's economic experts. This reflects a trend within the antitrust community to place even more emphasis on economists, econometric data and other hard or documented evidence in reaching conclusions about markets and the likely competitive effects arising from mergers. Companies should consider that these $800/hour expert economists may be a worthwhile investment.

Look Out, Early On

Oracle teaches us to be on the look-out for potential antitrust problems early on in the process. The case also gives us some analytical guidance to determine at the outset whether a proposed high-tech merger raises competitive concerns likely to be challenged. The court explained that the following inquiries were most relevant:

» Is there evidence that customers consider the merging parties one another's closest substitutes?

» Is there evidence that the parties price or discount more aggressively when both companies are involved in competitive bidding?

» Is there evidence that competition is occurring on levels other than pricing, such as innovating against each other?

» Are customers going to complain? Are their complaints going to be based upon empirical evidence about, e.g., formal bidding, where records will make such complaints far more compelling?

Is there a Divide between the Agencies and the Courts?

Finally, the Oracle decision may suggest that the government and the courts are somewhat out of sync in their view of the appropriate analytical framework in which to examine mergers. Although historically the government rarely lost merger cases in federal court, the FTC and DOJ have lost several in the recent past. In each of these decisions, courts employed a fundamentally different framework of analysis than the antitrust agencies presented. One wonders whether the government will further recalibrate their review framework of mergers in order to come more in line with current judicial thinking. cf

Biographies

Charles (Chris) T. Compton heads Wilson Sonsini Goodrich and Rosati's antitrust practice, focusing on merger regulatory and intellectual property issues.

Since joining the firm in 1980, Chris has overseen the antitrust regulatory work in nearly 700 mergers, acquisitions and joint ventures--many of which involved formal investigations by the Federal Trade Commission, Department of Justice, the European Commission and other international competition agencies. The firm's record of success, including Hewlett Packard's $18.7 billion acquisition of Compaq Computer in 2002, has been unparalleled.

Scott Sher is a partner at Wilson Sonsini Goodrich & Rosati's, where he focuses on antitrust and trade regulation issues, and has significant experience working with high-tech clients. In particular, Scott has advised clients on issues pertaining to mergers and acquisitions, joint ventures, the Robinson-Patman Act, pricing and distribution issues, trade association and patent pooling matters, and the Sherman Act. In addition, he assists clients with antitrust issues that arise throughout the merger and acquisition process.