[top]

Post-Close Caution: Antitrust Agencies Challenge Two Consummated Mergers

Scott A. Sher and Valentina V. Rucker*

In the last two weeks of 2008, the Federal Trade Commission ("FTC") and the Department of Justice ("DOJ") brought two significant challenges to consummated mergers.[1] On December 16, 2008, the FTC challenged Ovation Pharmaceuticals' ("Ovation") 2006 acquisition of the drug NeoProfen (used for treatment of a congenital heart defect affecting premature infants) from Abbott Laboratories.[2] Two days later, the DOJ challenged Microsemi Corporation's ("Microsemi") 2008 acquisition of Semicoa Inc. ("Semicoa").[3] Microsemi and Semicoa both developed, manufactured and sold certain specialized electronic components—signal transistors and diodes[4]—used in military and space programs.

Scott A. Sher and Valentina V. Rucker *are a partner and an associate, respectively, in the Washington, DC office of Wilson, Sonsini, Goodrich & Rosati*

[1] On February 26, 2009, the Federal Trade Commission brought another consummated merger challenge, alleging that Lubrizol Corp.'s 2007 acquisition of the oxidate assets of Lockhart Co., a rival firm, violated the antitrust laws and lessened competition in the U.S. market for chemical rust inhibitors. Pursuant to a consent order, Lubrizol agreed to (a) sell the oxidate assets it acquired from Lockhart to third party Additives International LLC (AI) and (b) eliminate a non-compete provision contained in the original asset purchase agreement with Lockhart. Complaint, In re Lubrizol Corp. & Lockhart Co., No. 071 0230 (F.T.C. Feb. 26, 2009), available at http://www.ftc.gov/os/caselist/0710230/090226lubrizolcmpt.pdf; Order, In re Lubrizol Corp. & Lockhart Co., No. 071 0230 (F.T.C. Feb. 26, 2009), available at http://www.ftc.gov/os/caselist/0710230/090226lubrizoldo.pdf.

[2] Complaint, FTC v. Ovation Pharmaceuticals Inc., No. 08-cv-06379-JNE-JJG (D. Minn. Dec. 16, 2008), available at http://www.ftc.gov/os/caselist/0810156/081216ovationcmpt.pdf. It is worth noting that the State of Minnesota filed its own similar action the same day. Minnesota v. Ovation Pharmaceuticals Inc., No. 08-cv-06381-JRT-FLN (D. Minn. Dec. 16, 2008).

[3] Complaint, United States v. Microsemi Corp., No. 1:08 CV 1311 (E.D. Va. Dec. 18, 2008), available at http://www.usdoj.gov/atr/cases/f240500/240537.htm [hereinafter Microsemi Complaint]. The DOJ also filed a memorandum in support of emergency motion for a temporary restraining order and preliminary injunction, which resulted in an Order to Preserve and Maintain Assets on December 24, 2008. Order to Preserve and Maintain Assets, United States v. Microsemi Corp., 1:08 CV 1311 (E.D. Va. Dec. 24, 2008).

[4] "Transistors and diodes are semiconductor devices used to control the flow of electric current . . . transistors can be viewed as switches and diodes can be viewed as one-way valves. Both products begin as silicon wafers . . . [and] are then cut into small sections known as dies. These dies are packaged . . . into transistors and diodes." Microsemi Complaint at ¶10.

Neither transaction was reportable under the Hart-Scott-Rodino Act ("HSR Act").[5] Nonetheless, the enforcement agencies have the authority to review and challenge already consummated mergers, even though enforcement actions in such circumstances are relatively uncommon.[6] These two consummated merger challenges raise a significant question: were the facts of the two cases such that post-consummation review (and a subsequent challenge) was unavoidable, or did the parties' voluntary and avoidable actions cause the government agencies to act where they otherwise would not have?

Below, we describe the facts and the complaints from the *Ovation* and *Microsemi* cases, and make several modest points about the importance of careful post-close counseling—even where transactions are not subject to HSR Act review.

FTC v. Ovation Pharmaceuticals, Inc.

In *Ovation*, the FTC's complaint alleges that in August 2005, Ovation initially purchased rights to Indocin from Merck & Co. ("Merck"). At that time, Ovation did not compete against Merck in the market for therapies to treat a serious congenital heart defect in premature infants, known as patent ductus arteriosus ("PDA"). Merck agreed to manufacture Indocin and supply it to Ovation. Upon acquiring the rights to Indocin from Merck, Ovation raised the price of Indocin from approximately $26 to $36 per vial. The complaint alleges that "the price at which Merck supplied Indocin to Ovation was a small fraction of the $36 per vial that Ovation had previously charged for Indocin."[7]

Subsequently, in 2006, Ovation acquired NeoProfen, another PDA drug that was awaiting FDA approval at the time, from Abbott Laboratories. After the sale was finalized, Ovation raised the price of Indocin from $36 to approximately $500 a vial (a price increase of nearly 1,300 percent) and set the price of NeoProfen at approximately $483 per vial, once it had obtained FDA approval. Ovation then maintained these prices at or above the $500 level for several years.

According to the FTC's complaint, Ovation anticipated that NeoProfen's eventual approval by the FDA would reduce sales of Indocin, prompting Ovation to acquire NeoProfen from Abbott Laboratories.

The complaint further alleges that entry into the PDA market is difficult. The FTC's complaint contends that any future competitor of Ovation would need

---

[5] Hart-Scott-Rodino Antitrust Improvements Act of 1976, Pub. L. 94-435, 90 Stat. 1383 (1976) (current version at 15 U.S.C. § 18a (2008)).

[6] Clayton Act § 7, 15 U.S.C. § 18 (2008).

[7] Complaint at ¶19, FTC v. Ovation Pharmaceuticals Inc., No. 08-cv-06379-JNE-JJG (D. Minn. Dec. 16, 2008), available at http://www.ftc.gov/os/caselist/0810156/081216ovationcmpt.pdf [hereinafter Ovation Complaint].

to have its drug approved by the FDA in order to be sold in the United States, and that obtaining FDA approval is "a costly and time consuming process that takes substantially more than two years." Entry by a generic version of an existing drug product requires a manufacturer to develop and obtain FDA approval for the generic product as well. Although the FDA approved a generic version of Indocin in July 2008, to date, it has not entered the market.

Furthermore, characteristics of the market for PDA drugs also make entry unlikely. There are only approximately 30,000 infants affected by the illness, so the PDA drug therapy market is small relative to other pharmaceutical product markets.[8] Additionally, the patient population is "exceedingly fragile," so any new entrant will also have to overcome physicians' preferences.[9] Physicians who treat premature infants with PDA would have to forgo the use of a trusted product, used successfully (presumably) in the past, in favor of one that lacks such a history and may present unknown risks. Thus, the FTC posits, any savings gained by the use of a competitor's product would have to outweigh any risk that such use of an unfamiliar product on infants with severe illnesses would present.

Although the Commission unanimously approved the challenge to the NeoProfen acquisition—on the basis that the acquisition of NeoProfen eliminated a competitive price constraint on Ovation's pricing of Indocin—Commissioners Leibowitz and Rosch issued separate concurring statements stating that Ovation's earlier acquisition of Indocin from Merck should be challenged under Section 7 as well.[10] Specifically, Commissioner Rosch offered a novel theory, arguing that conduct that amounted to "evading a pricing constraint" was enough to incur liability for "tending to create a monopoly." He asserted that, when Merck was the owner of Indocin, it was unable to charge monopoly prices on Indocin because "the sale of Indocin at a monopoly price would damage [Merck's] reputation and sales of more profitable products." When Ovation purchased Indocin, it "had [in] effect . . . enabl[ed] Ovation to exercise monopoly power in its pricing of Indocin."[11] Commissioner Rosch made this contention even though, of course,

---

[8] Id. at ¶33.

[9] The FTC Complaint did not explain whether NeoProfen faced this barrier, but rather simply alleged that Indocin and NeoProfen are the only two FDA-approved drugs and physicians and hospitals consider them to be substitutes, or reasonable substitutes, for the majority of PDA patients.

[10] Concurring Statement of Commissioner J. Thomas Rosch, Federal Trade Commission v. Ovation Pharmaceuticals, Inc., available at http://www.ftc.gov/os/caselist/0810156/081216ovationroschstmt.pdf; Concurring Statement of Commissioner Jon Leibowitz, Federal Trade Commission v. Ovation Pharmaceuticals, Inc., available at http://www.ftc.gov/os/caselist/0810156/081216ovationleibowitzstmt.pdf.

[11] Concurring Statement of Commissioner J. Thomas Rosch, Federal Trade Commission v. Ovation Pharmaceuticals, Inc., available at http://www.ftc.gov/os/caselist/0810156/081216ovationroschstmt.pdf.

Ovation *did not* raise the price of Indocin to extreme price levels *until after* it acquired the rights to NeoProfen, as well.

United States v. Microsemi Corp.

In *Microsemi*, the DOJ's complaint alleged that before Microsemi's acquisition of Semicoa in July 2008, both companies manufactured small signal transistors certified by the Defense Supply Center Columbus ("DSCC"), a unit of the Department of Defense, at the Joint Army-Navy Technical Exchange-Visual Inspection ("JANTXV") and Joint Army-Navy Space ("JANS") levels of reliability on its qualified manufacturers list ("QML").[12] Further, Semicoa was positioning itself to manufacture and sell JANTXV and JANS diodes.[13]

The DOJ's complaint further asserted that as a result of Microsemi's acquisition of Semicoa, "prices for the relevant products have increased and likely will continue to increase."[14] The complaint specifically alleged that, without Semicoa as a competitor to Microsemi in the signal transistor market, Microsemi was able to selectively raise prices—*i.e.,* price discriminate—to customers it was aware could not substitute to lower grade components.[15] "One month after the acquisition, Microsemi warned the Department of Defense and the National Aeronautics and Space Administration ("NASA") to expect annual price increases in the 'lower teens.'"[16] Further, the CEO of Microsemi was quoted as stating: "I raised the prices because, simply, we could."[17]

The DOJ alleged that Microsemi's business strategy permits price discrimination against customers who require JANS products and would not be able to practically and cost-effectively switch to lower-grade products and perform their own testing in order to achieve the reliability built into a JANS qualification. Microsemi is "often aware of the individual projects for which . . . customers are seeking JANS components . . . [and] has even considered developing individualized sales strategies tailored to each customer."[18] With this

---

[12] Department of Justice, Press Release, Justice Department Files Antitrust Lawsuit Against Microsemi Corporation: Lawsuit Seeks to Restore Competition in Markets for Semiconductor Devices Used in Critical Military and Space Applications (2008) http://www.usdoj.gov/atr/public/press_releases/2008/240549.htm.

[13] Id.

[14] Microsemi Complaint at ¶3. The DOJ additionally alleged that "delivery times have become less reliable, and terms of service likely will become less favorable." Id.

[15] Id.

[16] Memorandum of United States in Support of Emergency Motion for a Temporary Restraining Order and Preliminary Injunction, United States v. Microsemi Corp., No. 1:08 CV 1311, 4 (E.D. Va. Dec. 18, 2008) (citing P. Ex. 20, Sampson Decl. ¶ 10.) [hereinafter Microsemi Memorandum in Support of TRO].

[17] Id.

[18] Id. at 10.

degree of customer awareness, Microsemi could profitably increase prices to only those customers who could not substitute.

The Complaint alleges that Semicoa was close to entering the diodes market and would have been a significant competitor to Microsemi: "Semicoa's entry into the market . . . likely would have benefited customers with lower prices, shorter delivery times, and more favorable terms of service, just as Semicoa's competition for sales of . . . small signal transistors benefited customers for those products."[19] Microsemi's acquisition of the Semicoa assets prevented this entry and therefore substantially lessened competition in the markets.

As in *Ovation,* the complaint alleges that entry was difficult. According to the DOJ, the market for the development, manufacture and sale of high reliability transistors and diodes is characterized by high entry barriers. These high reliability transistors and diodes are manufactured to exacting standards to ensure high performance under the most demanding conditions and are subject to a U.S. government system of qualification and certification to assure the required degree of reliability.[20]

Qualification includes a rigorous audit of a firm's production, assembly and testing facilities. Only if this audit requirement is satisfied can a company manufacture a sample lot of the product. And then, only if the testing of the lot is satisfactory can the company obtain a QML status. This process usually takes three to twelve months for a company that previously has QML qualified at least one of its products, and even longer if the company has never held such a qualification. The DOJ further notes that after achieving QML, "[q]ualifying to produce JANS parts takes additional time, effort, and money above that which is required to obtain qualification for lower-level QML parts."[21] Thus, "[e]ntry resulting in significant market impact likely would take more than two years."[22]

Importance of Post-Consummation Counseling

A few valuable lessons should be drawn from the *Ovation* and *Microsemi* challenges. Counsel should remind their clients that there is no "statute of limitations" on a merger challenge. In close cases, the agencies may decide not to challenge a transaction before consummation because they are not confident that the evidence supporting the likelihood of post-merger harm would be sufficient to persuade a court to enjoin the transaction. In some cases, a novel theory of harm may be deemed too speculative to pursue. Once a transaction is consummated, although market dynamics—*i.e.* eliminating a potential competitor, market share

---

[19] Microsemi Complaint at ¶42.

[20] Id. at ¶10.

[21] Microsemi Memorandum in Support of TRO at 4 (citing P. Ex. 20, Sampson Decl. ¶ 10.).

[22] Microsemi Complaint at ¶43.

increase, or high entry barriers—cannot be controlled by the acquiring company, post-merger conduct is in its sole discretion. When a firm implements post-merger price increases, the agencies' concerns are validated and the decision to take action becomes easier.

For these reasons, careful counseling concerning *post-merger* conduct is particularly important, as it can decrease the risk of a consummated merger challenge. In providing this advice, counsel should keep in mind the following issues:

First, dramatically rising prices will invite scrutiny and a potential challenge, even years after a transaction has closed, and even if the transaction was subject to an HSR review. This is especially the case in industries where cost containment is a high policy priority, as it is with healthcare and government spending. Although price changes could have nothing to do with the attainment of market power, a price increase following a merger may give customers ample reason to complain to the antitrust agencies and bring a transaction to the attention of the government, when the transaction otherwise might not have invited (or deserved) any scrutiny.

Indeed, although evidence of a price increase post-merger should not be sufficient to show an anticompetitive effect (and indeed, may not be evidence of such an effect),[23] it certainly can bring a transaction to the attention of the government agencies. In *Ovation,* the defendant raised prices by 1300 percent. In *Microsemi*, the defendant proposed significant price increases to select customers. To make matters worse, in both cases, the defendants raised prices to vocal and/or particularly vulnerable populations. Specifically, in *Microsemi*, the products acquired by Microsemi from Semicoa were used by the U.S. military services and the national security agencies in a wide range of applications. The DOJ's complaint and request for a hold separate agreement was accompanied by statements from customers for the high-reliability semiconductors at issue, including the Department of Defense, the United States Navy, the United States Air Force, and NASA.[24] Because transistors and diodes made by both Microsemi and Semicoa were used in large and complex military applications, including

---

[23] United States v. Archer-Daniels-Midland Co., 781 F. Supp. 1400 (S.D. Iowa 1991) (exclusively relying upon evidence concerning the post-close market structure and ignoring the behavioral evidence, including evidence of price increases or output reductions); see also United States v. Syufy Enters., 903 F.2d 659, 664, 666-67 (9th Cir. 1990) (relying on post-acquisition market structure—rather than on post-acquisition behavior—to conclude that a transaction did not raise competitive concerns); Complaint at 2, In re Lubrizol Corp. & Lockhart Co., No. 071 0230 (F.T.C. Feb. 26, 2009), available at http://www.ftc.gov/os/caselist/0710230/090226lubrizolcmpt.pdf (relying on the post-merger structure of the market, rather than behavioral issues, such a price changes, to support FTC complaint).

[24] Microsemi Memorandum in Support of TRO at 4 (citing P. Ex. 20, Sampson Decl. ¶ 10.) ("One month after the acquisition, Microsemi warned the Department of Defense and the National Aeronautics and Space Administration . . . to expect annual price increases in the 'lower teens.'").

satellites and submarines, when Microsemi raised the price to these government entities after the transaction closed, it alarmed important government constituencies, whose complaints carry special weight at the DOJ.

In *Ovation*, the facts were arguably even worse. The defendant raised the prices of critical prenatal medications to extraordinarily high levels. The price hike affected not only a vulnerable subset of the population, but also put further strain on the U.S. healthcare system. The FTC noted that "the artificially high prices that hospitals are forced to pay ultimately raise costs for families, tax-supported programs such as Medicaid, and other public and private purchasers."[25] In addition, the FTC alleged that Ovation's acquisition of NeoProfen raised cost to "federal and state agencies, [who] pay for drugs to treat PDA"[26] Notably, Commissioner Leibowitz, in his concurring opinion wrote: "Ovation's behavior is a stark reminder of why America desperately needs health care reform . . . ."[27]

At a minimum, the two cases illustrate that in concentrated markets, post-close price increases of significant magnitude will draw the attention of the agencies, particularly where prices are raised immediately following the closing of the transactions, and the customers paying those prices are important and vocal constituencies. Especially where price increases are unrelated to the exercise of market power, decisions to change the prices of products and/or services must be weighed against the potential that affected customers will complain to the antitrust authorities.

Of course, price increases, standing alone, are not themselves illegal. More than a price increase is needed to make out a case under Section 7 of the Clayton Act.[28] There must be a causal connection between the price increases and the merger in question. Predicting whether and how a merger may lead to higher prices is often difficult to do. However, where, as in the *Ovation* and *Microsemi* cases, market concentration is high, the merger removed an actual or potential competitor, and entry barriers are high, the agencies (and courts) are likely to infer such a causal connection.

---

[25] Ovation Complaint at ¶4.

[26] Id.

[27] Concurring Statement of Commissioner Jon Leibowitz, Federal Trade Commission v. Ovation Pharmaceuticals, Inc., available at http://www.ftc.gov/os/caselist/0810156/081216ovationleibowitzstmt.pdf.

[28] See Scott A. Sher, Closed but Not Forgotten: Government Review of Consummated Mergers Under Section 7 of the Clayton Act, 45 Santa Clara L. Rev. 41, 78 (2004).

> When considering post-acquisition evidence in a challenge to a closed merger, the courts and antitrust agencies cannot solely rely on evidence that following a merger, prices have increased, that the pace of innovation has slowed, or that output has decreased . . . . [T]he scope of admissible evidence must be extremely narrow and demonstrate that (1) any alleged anticompetitive effects are caused by a merger, rather than by subsequent and unrelated changes in the market, and (2) such effects are not merely short-term, transitory concerns.

Second, corporate communications are an important vehicle by which to inform customers about the effects and benefits of transactions, and customer messaging must carefully be considered. As in any pre-merger counseling context, in the post-merger context, companies must be aware of the content of the documents that they create, and recognize that such documents may end up in the hands of the DOJ or FTC, and serve as the basis to investigate and/or challenge even consummated transactions. The need for antitrust counsel to be involved in the creation of deal collateral, therefore, is important, and must not be ignored simply because a transaction did not require HSR reporting.

Third, the acquirer must be sensitive to its new customers' concerns, as these customers could be at the forefront of the enforcement agency's case. "Wronged" customers are more likely to provide affidavits and, if necessary, testimony to assist the enforcement agencies in building their cases. Thus, customer relations should be addressed with special care. Where the firm plans an eventual price increase, it is advisable to forewarn the customers and fully disclose the reasons for a price change and any benefits associated with such changes. For example, if the acquired product has been integrated into acquirer's products, adding value and improving the customer experience, these benefits should be fully communicated to customers before any price changes are effectuated.

Finally, if customer complaints are unavoidable, counsel should urge clients not to retaliate against complaining customers. In *Microsemi*, the defendant's threat of post-closing retaliation no doubt strengthened the government's hand in that case. As noted in the complaint: "Microsemi has already implemented significant price increases on the products sold to at least one major aerospace manufacturer and, moreover, has threatened to retaliate against that same customer for cooperating with the Department of Justice's investigation of the acquisition."[29]

Post-close counseling has become increasingly important as the HSR thresholds continue to rise (as of February 2009, the size-of-transaction threshold has reached $65 million), and as company valuations decline below that increasing threshold. Companies must consider the possibility of antitrust intervention in their post-close conduct, and plan accordingly. Particularly in concentrated markets, the specter of post-close review and challenge is significant. The risk of remedy is borne completely by the acquiring party, and the remedy in such circumstances often is divestiture of the businesses acquired, frequently at below-market prices (because purchasers know the assets must be sold to satisfy the government). In light of these significant risks, it is not only prudent, but vital, to make post-close planning a key part of evaluating and executing important acquisitions.

---

[29] Microsemi Memorandum in Support of TRO at 4 (citing P. Ex. 22, Bartmann Decl. ¶¶ 9, 16.).