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# ROLE OF CUSTOMER COMPLAINTS AND TESTIMONY IN MERGER ENFORCEMENT POST-*ARCH COAL* AND *ORACLE*

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## INTRODUCTION

"Never underestimate the power of the irate customer" warns a leading business consultant.[3] Strong opposition from customers to a proposed merger used to be a potential death sentence for a deal. But two recent defeats suffered by the government's antitrust authorities in major merger cases provide an interesting insight into the current use of customer complaints and testimony in merger enforcement decisions.

## BACKGROUND

The intuitive sense of most antitrust counsel has long been that both the US Department of Justice (DOJ) and the US Federal Trade Commission (FTC) give great weight to customer opinions in their enforcement decisions. This was recently confirmed by data released by the DOJ and FTC in advance of a three day Workshop on the Horizontal Merger Guidelines held in February last year. However, the DOJ and the FTC each suffered a significant defeat in merger litigation within the space of a few months last year. In each case, a federal district court ruled that the government had not established that the merger was likely to lessen competition.

Although the two cases were very different both factually and legally, there was one noteworthy similarity. In each case, numerous customers testified in support of the government's case, stating that they would suffer from a reduction in competition because of the transactions. But both courts dismissed the customer testimony as unpersuasive, describing it as speculative or subjective, and lacking hard support or analysis. We discuss these two cases, and the potential role of customer complaints in the government's merger enforcement strategy going forward.

## GOVERNMENT MERGER INVESTIGATION DATA SHED LIGHT ON MERGER REVIEW PROCESS

To increase transparency and facilitate discussion of its Workshop on the Horizontal Merger Guidelines, the FTC and DOJ released two data sets. The first release concerned merger enforcement data going back to the year 1999 and contained market share and concentration levels associated with the agencies' decisions to challenge mergers in a wide range of industries impacting many distinct product markets.[4] The second data set released by the FTC contained data on 151 horizontal merger investigations during fiscal years 1996 to 2003, and included data where no enforcement action was taken as well as data based on additional key facts.[5] For example, the data tabulated the FTC's enforcement decisions based on the presence of "hot documents'" and "strong customer complaints" identified during the investigation. Customer reaction was recorded as a "strong customer complaint" where customers expressed a credible concern that a significant anticompetitive effect would result

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3 Joel E. Ross, Total Quality Management: Text, Cases, and Reading, (3rd ed., CRC Press, 1999).
4 Department of Justice and Federal Trade Commission, Merger Challenges Data, Fiscal Years 1999-2003 (Dec. 18, 2003).
5 FTC Horizontal Merger Investigation Data, Fiscal Years 1996-2003 (Feb. 2, 2004).

were the transaction allowed to proceed. The data suggested that the presence of incriminating documents or significant customer complaints had a dramatic impact on enforcement decisions. Specifically, in almost every instance where one of those two factors (documents or complaints) was present, the FTC sought to prevent the proposed merger. In contrast, when those facts were not present, the FTC was far less likely to seek enforcement.

## *ORACLE* DECISION

However, in *United States v. Oracle Corporation*, 331 F. Supp.2d 1098 (N.D. Cal. 2004), the court discounted testimony from the government's impressive lineup of customer witnesses, which included high ranking corporate executives from DaimlerChrysler, Pepsi Americas, Verizon Communications, among others, and a state official responsible for the purchase of relevant products.[6] The case concerned Oracle's hostile bid for PeopleSoft. Both sell sophisticated enterprise resource planning (ERP) software to automate data processing for large business and government entities. Each company's ERP software offerings include human relations management (HRM) software; financial management systems (FMS) software; customer relations management (CRM) software; and supply chain management (SCM) software.

After an extensive review, in February 2004, the DOJ filed suit to enjoin Oracle from completing its acquisition of PeopleSoft, relying on an unilateral effects theory of harm. The DOJ complaint alleged that both Oracle and PeopleSoft make "high function" HRM and FMS. While it acknowledged that other software vendors produced sophisticated HRM and FMS software, the DOJ alleged that the "high function" HRM and FMS software products of Oracle and PeopleSoft, and to a lesser degree, SAP of Germany, compete in a market that is separate and distinct from that of other HRM and FMS products. As a result, according to the DOJ, PeopleSoft constrained Oracle's pricing in a way that other competitors would not after the merger. DOJ offered the testimony of numerous customers, including those highly sophisticated companies listed above, that PeopleSoft and Oracle were the only two companies that could provide software with the functionality that could meet their requirements.

Many of Oracle's and PeopleSoft's customers testified that they would not purchase software from other companies in the event a combined Oracle/PeopleSoft raised prices a small but significant amount. However, the court found the testimony of these customer witnesses, "contrary to plaintiffs' counsel before trial", was "largely unhelpful to plaintiffs' effort to define a narrow market of high function FMS and HRM". *Oracle, supra*, at 1130. The court acknowledged that the witnesses had an impressive background in the sector, and appeared knowledgeable and well informed about their respective organization's ERP needs and resources. In fact, the court acknowledged that the government's customer witnesses were "extremely sophisticated buyers and users of information technology…[with] decades of experience in negotiating in this field." *Id*. at 1131. It did not also doubt the sincerity of their testimony and, their evident preference for the functional features of Oracle and PeopleSoft products. However,

> [T]he issue is not what solutions the customers would *like* or *prefer* for their data processing needs; the issue is what they *could* do in the event of an anticompetitive price increase by a post-merger Oracle. Although these witnesses speculated on that subject, their speculation was not backed up by serious analysis that they had themselves performed or evidence they presented. There was little, if any, testimony by these witnesses about what they would or could do or not do to avoid a price increase from a post-merger Oracle. To be sure, each testified, with a kind of rote, that they would have no choice but to accept a ten percent price increase by a merged Oracle/PeopleSoft. But none gave testimony about the cost of alternatives to the hypothetical price increase a

6 In fact, ten customer witnesses were called by the DOJ during the Oracle trial. High level company executives and the chief information officer of a state appeared on behalf of the government to testify that the proposed merger was anticompetitive: (1) Daimler Chrysler; (2) CH2M Hill; (3) North Dakota; (4) Pepsi Americas; (5) AIMCO; (6) Nextel; (7) Greyhound Lines; (8) Neiman Marcus Group; (9) Verizon; and (10) Cox Communications. Oracle, on the other hand, called two buyers of information technology, one from Bank of America and the other from Emerson Electric Company.

> post-merger Oracle would charge: e.g., how much outsourcing would actually cost, or how much it would cost to adapt other vendors' products to the same functionality that the Oracle and PeopleSoft products afford. *Id*. at 1131 (emphasis in original).

The court thus confirmed that customer preferences for Oracle's and PeopleSoft's products did not negate their need to show actual lack of interchangeability. The court cited Robert Pitofsky, *New Definitions of the Relevant Market and the Assault on Antitrust,* 90 Colum. L. Rev. 1805, 1816, (1990),

> There will almost always be classes of customers with strong preferences but to reason from the existence of such classes to a conclusion that each is entitled to a separate narrow market definition grossly overstates the market power of the sellers.

However, the court provided important guidance as to the overall use of customer testimony. In essence, such testimony should not constitute the primary evidence of product market definition or economic injury, and should serve merely as useful human commentary to the underlying economic evidence of the injury to competition. The court stated,

> If backed by credible and convincing testimony of this kind [cost of alternatives to the hypothetical price increase a post-merger Oracle would charge] or testimony presented by economic experts, customer testimony of the kind plaintiffs offered can put a human perspective or face on the injury to competition that plaintiffs allege. But unsubstantiated customer apprehensions do not substitute for hard evidence. *Oracle, supra*, at 1131.

Thus, Judge Walker rejected the DOJ's product market definition, and held that 'high-function' HRM and FMS does not exist as a separate and distinct line of commerce. He concluded that the DOJ had not proven that HRM and FMS software products from vendors such as Lawson, AMS and Microsoft, and from outsourcing firms such as Fidelity, would not constrain a combined Oracle/PeopleSoft from imposing a small but significant non-transitory price increase. DOJ chose not to appeal.

## *ARCH COAL* DECISION

In F*ederal Trade Commission v. Arch Coal, Inc.,* 329 F. Supp.2d 109 (D.D.C. 2004), the FTC filed a complaint in April 2004, seeking an injunction to prevent the acquisition by Arch Coal Company LLC (Arch) of Triton Coal Company LLC (Triton). Both companies owned two coal mines in Wyoming's Southern Powder River Basin (SPRB). The SPRB is a source of coal with particular characteristics that are different from coal mined in other parts of the country. Specifically, coal mined from the SPRB (SPRB Coal) has energy content ranging from 8300 to 8800 British Thermal Units (Btu), and is lower in sulfur content than most coals mined in other regions of the country.

The complaint alleged that Arch's acquisition of Triton would increase concentration among the remaining SPRB coal producers and eliminate the substantial competition between Arch and Triton. It also would combine the two of the four producers of 8800 SPRB coal and substantially reduce competition in the 8800 Btu SPRB coal market, and would increase the likelihood of co-ordination among the remaining producers of SPRB coal. The government relied heavily on testimony from utility customers, sophisticated buyers of SPRB coal products. The following customer testimony was typical, "My biggest concern is that I will have one less person to do contract business with to purchase coal from in the Southern Power River Basin" and that "concentration of ownership in the PRB coal market would translate to higher prices." *Arch Coal, supra*, at 145. However, the court gave almost no weight to the customer testimony. In fact, the court noted:

> In many contexts….. antitrust authorities do not accord great weight to the subjective views of customers in the market. See 2A Areeda, et al., Antitrust Law 538b, at 239 ("[l]east reliable [evidence] is 'subjective' testimony by customers ... Though not irrelevant, such statements are often unreliable."); *FTC. v. Owens-Illinois, Inc.,* 681 F. Supp. 27, 38 (D.D.C.), vacated as moot, 850 F.2d 694 (D.C.Cir. 1988) ( "opinions of purchasers must be viewed in light of their actual behavior"). *Arch Coal, supra*, at 145-146.

In similar language to the later *Oracle* judgment, the court stated that it did not doubt the sincerity of the customers' concerns but that,

> [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 coal market, and none have attempted to do so. The Court therefore concludes that the concern of some customers in the SPRB coal market that the transactions will lessen competition is not a persuasive indication that coordination among SPRB coal producers is more likely to occur. *Id*. at 146.

The district court rejected the FTC's assertions that it should find a sub-market for 8800 Btu coal. The court concluded that, post-merger, coordination would be highly unlikely given that bidding processes are extremely competitive, there is usually at least one unpredicted "maverick" low bid, and there is little, if any, efficient and accurate information sharing between competitors. Finding no history of express or even tacit coordination, no clear indicia of future coordination and recognizing Triton's unlikely future as a "maverick" in the market, the court concluded that the FTC had failed to meet its evidential burden and denied its request for a preliminary injunction. The FTC filed an emergency motion with the United States Court of Appeals for the District of Columbia, requesting it to enjoin the acquisition pending the FTC's appeal of the lower court's decision. The Court of Appeals denied the FTC's motion. Later, the FTC withdrew its appeal and chose not to pursue a review of the district court's decision.

## ISSUES RAISED BY *ORACLE* AND *ARCH COAL* DECISIONS

The *Oracle* and *Arch Coal* decisions raise, in particular, fundamental questions with respect to the application and utility of customer testimony in the definition of a relevant product market and establishing anticompetitive effects, which are essential elements in any government merger enforcement action under the Clayton Act.

In *Oracle*, Judge Walker stated that, "the issue is not what solutions the customers would like or prefer for their data processing needs; the issue is what they *could* do in the event of an anticompetitive price increase by a post-merger Oracle". *Oracle, supra*, at 1131. But this appears inconsistent with the *Horizontal Merger Guidelines* standard for determining whether substitute products should be considered in establishing a relevant market for purposes of the Clayton Act. The *Horizontal Merger Guidelines* state that it is whether there are substitutes to which a customer *would* switch in response to a small but significant and non-transitory price increase in the product in question (emphasis added).[7] In considering the likely reaction of buyers to a price increase, the government should take into account all relevant evidence, including evidence that buyers *have* shifted or *have considered* shifting purchases between products in response to relative changes in price or other competitive variables (emphasis added).[8] The Guidelines suggest a practical test relating to switching, not a test relating to theoretical possibilities as suggested by the court.

The *Oracle* and *Arch Coal* cases also represent a move away from the persuasive evidential value of customer testimony and affidavits in determining how the court assesses their response to a

7 *DOJ and FTC Horizontal Merger Guidelines*, Section 1.11 General Standards, Market Definition, "That is, assuming that buyers would respond to an increase in price for a tentatively identified product group, only by shifting to other products, what *would* happen?" (emphasis added).
8 *Id.* above, Section 1.11 General Standards, Market Definition.

small but significant and non-transitory price increase (SSNIP) in preference of empirical customer evidence. Previously, customer testimony and affidavits as to how they would respond to a SSNIP have been regarded as persuasive evidence by the courts.[9] But customer testimony may now be perceived as "subjective" and "although not irrelevant….often unreliable"[10] without supporting underlying economic evidence.[11] But it is questionable whether it is the role of customers to engage in the often time-consuming and expensive task of conducting detailed economic analysis to ascertain the potential anticompetitive effects of a proposed acquisition, and to assess the potentially deleterious consequences for their business. This is true particularly in situations where sophisticated buyers do not engage in that type of analyses in making everyday buying decisions. If customer testimony is ignored simply because its lacks a formal economic basis, the courts risk ignoring the market realities of the category of persons who makes actual informed buying choices and whose interests it should be aiming to protect.

## USE OF CUSTOMERS IN FUTURE GOVERNMENT ENFORCEMENT DECISIONS

Certainly, customers are, and will continue to be, a primary source of information in a government merger investigation. They can tell the government about the history of an industry, about its products, and how the industry works. They can also provide information on the costs of production, prices, delivery practices, sources of supply, substitution, and competitive abilities and disabilities. Indeed, informed buyers can provide the government with detailed information on the buying decision process. However, the government should remain alert not only to customers' potential biases but also customers' inability to discern how the interplay of market forces will affect competition in the future. In addition, as one former FTC Commissioner, Mary L. Azcuenaga, perceived in a speech over two decades ago,

> Customers may lack access to all the facts that are relevant to assessing competitive implications, and they may not have the legal and economic training to assess those facts. …It is our job to examine the assertions and the underlying assumptions….The question in reviewing proposed transactions is whether anticompetitive effects are likely, not how many customer affidavits, pro or con, can be accumulated. *FTC Enforcement Under Section 7 of the Clayton Act,* Address at the Practicing Law Institute, Twenty-Fourth Annual Advanced Antitrust Workshop, March 9, 1984.

## INTERNATIONAL DIMENSION

In this context, it is important to note the international dimension of many mergers and the increasing cooperation between different countries' antitrust agencies, in particular between the FTC/DOJ and the European Commission. In the European Union, there has historically been an increased risk that customer concerns would lead to lengthy investigations and opposition to deals where the legal and economic evidence ran counter to customer concerns. But the European Commission's new best practice guidelines are illustrative of the role of customer complaints and the requirement placed on customers to provide empirical evidence to substantiate their antitrust concerns at the early stage of a merger investigation. This approach is not dissimilar to that suggested by Judge Walker when he noted with particularity the "failure of these [government] witnesses to present cost/benefit analyses of the type that surely they employ and would employ in assessing an ERP purchase." *Oracle*, supra, at 1131.

The European Commission's Best Practices on the Conduct of Merger Proceedings confirms that the EU Merger Regulation[12] views customers as having a "sufficient interest" in the

9 *See FTC v. Butterworth Health Corp.,* 946 F. Supp. 1285, 1292-93 (W.D. Mich. 1996), *aff'd* by 121 F.3d 708 (6th Cir. 1997) ("The most persuasive of these are the views of customers.") and *Bathe v. Casey's Gen. Stores, Inc.,* 64 F.3d 340, 346-7 (8th Cir. 1995) (most important dynamic evidence is that indicating where consumers could practicably turn for alternative services to avoid doing business with the antitrust defendant).

10 Philip E. Areeda and Herbert Hovenkamp, *Antitrust Law, An Analysis of Antitrust Principles and Their Application*, Volume 2A, Ch. 5 Market Power and Market Definition. Para. 538 (1980).

11 *See e.g. California v. Sutter Health Sys.,* 84 F. Supp. 2d 1057 (N.D. Cal. 2000) ("As stated by the court in *FTC v. Freeman Hosp.,* 911 F. Supp. 1213, 1220, 'while such non-empirical data may have some probative value as a starting point to evaluate this market, such data will not carry the [plaintiff's] burden. Informal, off-the-cuff remarks and anecdotal evidence concerning the marketplace are no substitute for solid economic evidence.'")

12 Council Regulation No 139/2004 on the control of concentration between undertakings, OJ L 24 29.1.2004

Commission's investigative procedure.[13] The primary way for customers to contribute is by means of replies to requests for information (known as Article 11 requests). However, customers that do not receive a questionnaire are still entitled to provide information and comments that they consider relevant for the assessment of a given transaction. Customers may also be invited to attend meetings to discuss and clarify their concerns.[14] The European Commission may, in certain cases, also provide customers with an edited non-confidential version of the merger filing submitted by the parties.[15] Importantly, the European Commission notes that if third parties, such as customers, wish to express competition concerns as regards the transaction in question or to put forward views on key market data or characteristics that deviate from the notifying parties' then, *[a]ny point raised* should be substantiated and supported by examples, documents, and other factual evidence (emphasis added).[16]

## CONCLUSION

If the government is to continue to heavily rely on customer testimony regarding the potential adverse effects of a transaction, their complaints must be viewed with more skepticism at the initial stages when deciding whether to challenge a merger. The *Oracle* and *Arch Coal* decisions may be limited in their precedential impact given their specific facts. However, these decisions indicate that under any theory of competitive harm, federal district courts will insist that the government offer concrete and objective evidence that the merger will substantially lessen competition. Evidence such as economic or expert testimony that is based on subjective analyses or unsubstantiated predictions about the future will not be sufficient. Antitrust counselors will, therefore, now be advising their clients that only irate customers with expert economic evidence and quantitative analyses demonstrating actual injury to competition should not be underestimated.

But in October 6, 2004, the newly appointed Chairman of the FTC, Deborah Majoras, announced at an antitrust seminar at George Mason University School of Law that the Commission would continue to base its merger challenges on customer complaints. Chairman Majoras noted that customer complaints represent a real world test of whether deals hurt competition.[17]

13 European Commission, Best Practices on the conduct of EC merger control proceedings, Para. 34.
14 *Id.* at Para. 35.
15 *Id.* at Para. 36.
16 *Id.* at Para. 37.
17 Jaret Seiberg, *The Daily Deal*, "DOJ says EC should clear Oracle-Peoplesoft," October 6, 2004.