United States v. Energy Solutions—Perspectives on Litigating Antitrust Merger Challenges

by Maria Garibotti; Analysis Group, Inc.

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Maria Garibotti

On September 26, 2017, the Transportation and Energy Industries Committee of the ABA Section of Antitrust Law hosted a panel discussion on the recently enjoined acquisition of Waste Control Specialists (WCS) by Energy Solutions, the latest in a series of successful merger challenges by the Antitrust Division of the Department of Justice (DOJ). The case,[1] decided in June 2017, raised several issues of interest to antitrust practitioners, and the panel held a lively discussion that touched on several issues, including the interplay between economic evidence and ordinary course documents, the boundaries of the failing firm defense, and the procedural constraints that may be found outside the District Court of DC.

Energy Solutions and WCS both own disposal facilities for low level radioactive waste (LLRW). Because of the regulatory framework governing the disposal of radioactive waste, the Energy Solutions facility in Clive, Utah and the WCS facility in Andrews, Texas are the only licensed LLRW disposal options available for LLRW generated in 36 states, plus the District of Columbia, and Puerto Rico. The case centered on commercial LLRW—that generated by power plants, hospitals, and research centers.

LLRW can be classified for disposal as Class A, B, or C waste based on its radioactive content. Class A waste is the least hazardous and has less stringent requirements

for its disposal than Class B or C waste. The Clive facility owned by Energy Solutions is licensed to accept Class A waste only, while the WCS facility at Andrews is licensed to receive all three classes of LLRW. LLRW that is Class A when it is generated is typically called "lower activity" waste by market participants, while LLRW that is Class B or C when generated is called "higher activity" waste. Higher activity waste can sometimes be "dispositioned," meaning it can be processed and reclassified as Class A waste for disposal.

The panel was moderated by John R. Seward, Counsel at the DC office of Andrews Kurth Kenyon. The panel included the lead trial attorneys for each side in the merger, as well as an economic expert who was not involved in the transaction:

Julie Elmer (DOJ): Trial attorney in the networks and technology enforcement section of the Antitrust Division. Ms. Elmer joined the Division in April 2015 and has played a key role in merger investigations in various industries.

Tara Reinhart (Energy Solutions): Antitrust Partner with Skadden, Arps, Slate, Meagher & Flom. Ms. Reinhart focuses on civil litigation and government investigations. She is the former chief trial counsel for the FTC Bureau of Competition, and led the FTC team that successfully challenged Staples' proposed acquisition of Office Depot.

Dr. Chetan Sanghvi: Managing Director with NERA Economic Consultants. Dr. Sanghvi is an expert in industrial organization and antitrust economics. He was previously with the FTC, where he was Economics Advisor to the office of Commissioner Brill, a testifying economics expert, and lead economist on FTC litigations.

Product Market Definition

The panel started by discussing product market definition. Mr. Seward noted that the different Classes of radioactive waste and the differences in the two disposal facilities created interesting issues around relevant product market and the extent of competition. He pointed out that the Division had argued four relevant product markets, yet the Court decided that the industry did not need to be divided so granularly, and instead found that there were two product markets: lower and higher-activity commercial LLRW.[2]

Ms. Elmer noted that as long as it is supported by the evidence, a market "need not have the precise contours" of the market as defined in the complaint.[3] The Government had provided evidence from ordinary course documents, corroborated by executive testimony at trial, that the companies drew the same dividing line between lower and higher activity waste as the government did, and that pricing and disposal options also differed along the same dividing line.[4] The Court agreed with the Government's split of the industry into lower and higher-activity LLRW, but stopped short of further subdividing waste depending on how it had been generated—whether in the course of normal operations or during the nuclear plant decommissioning process.[5]

The Defendants argued that the companies were not very close competitors because of the differences in the waste received by each facility.[6] Ms. Reinhart noted that while the Court ultimately sided with the Government, customer documents used at

trial pointed to the existence of three segments, rather than two. The three segments included: a sub-segment of lower activity waste at "the lowest end of Class A," which could be sent to any ordinary landfill with minimal paperwork; a "middle category" with the remainder of the Class A waste that was mostly sent to Energy Solutions; and higher activity waste that could only be sent to WCS. This division of the industry would have resulted in no overlap between the parties.

Ultimately, the Court may have been persuaded by ordinary course documents. Ms. Elmer noted that the parties' story conflicted with some of their past positions. For example, Energy Solutions had filed an antitrust counterclaim against WCS in 2015,[7] arguing that its ability to process and "downblend" high activity waste to be disposed in Clive was the only competitor to disposal of Class B and C waste at WCS. While not all higher activity waste can be processed in this manner, ordinary course documents showed that Energy Solutions had been innovating and expanding the boundary of the waste they could process. As a legal matter, the Government did not have to prove perfect overlapping competition across all product lines. Documents supported that the parties did compete for important segments of the market.[8]

As an aside, both Ms. Reinhart and Ms. Elmer pointed out that they felt constrained by the rules set by the Court. Ms. Reinhart indicated that the 25-hour limit on trial testimony and the Court's preference for live rather than video testimony limited the Defendants' ability to present evidence from customers regarding the granularity of the market. Ms. Elmer noted that there was no bulk admission of exhibits—the Court required that all documents be sponsored by either live witnesses or deposition testimony played at trial. That limited the number of ordinary course documents that the Government could present.

Entry and Self-Help

Turning to economic evidence relevant to competitive effects, Ms. Reinhart highlighted two arguments. The first was that entry into processing was relatively easy for anyone so interested, including utilities themselves: a witness testified that "all you need is $100,000 and a tank." The second was the possibility of long-term storage of higher activity waste as a constraint on the merged firm. On this point, she pointed to three things: testimony from customers, documentary evidence showing that WCS pricing was constrained by the potential for storage, and a "natural experiment" when the industry had to adjust to the shutdown of the only existing Class B and C facility in 2007, prior to WCS entry.

Ms. Elmer noted that, in its decision, the Court rejected processing as an alternative because processed waste has to be disposed, and the merging parties would still be the only disposal options. The Court had also found no evidence of generators entering the market.[9] With regards to storage, Ms. Elmer pointed to Defendants' witnesses admitting that storage and disposal are not the same—while storage is an interim step, disposal is a final step. Ms. Elmer also alluded to testimony from customers that they would not respond to a SSNIP by resorting to storage, as it was costly and risky, and they preferred disposal to storage.

With the discussion turning towards economics, Dr. Sanghvi joined in. Self-help should be evaluated the same way as any other alternative available to customers: it cannot be just a theoretical possibility, and it should be sufficient to replicate the existing pricing dynamic. Dr. Sanghvi found storage to be a very interesting economic question, and felt that the Court and the Government had not given it its due attention by failing to take into account the time value of money. Although the Government rebutted the relevance of self-help by noting that generators would either "pay now" or "pay later," Dr. Sanghvi pointed out that the choice to charge a competitive price today or an anti-competitive price tomorrow cannot be set aside as a matter of economics. It needs to be rebutted empirically, based on the time value of money, magnitude of the potential price premium, and the parties' discount factors.

Looking for lessons learned on trial advocacy, Ms. Reinhart noted that the Judge had ignored the economic evidence for storage, on which the Defendants relied heavily, in favor of fact evidence. Ms. Elmer's takeaway was that the companies' decision to allege a product market that excluded self-storage in their private antitrust action resonated with the Court, and suggested that private parties should think about potential ramifications when bringing an antitrust action and alleging a product market.

The Failing Firm Defense

The opinion outlined two prongs to a successful failing firm defense: (1) a grave probability of business failure by the target, and (2) no other prospective purchaser for the target. The Court declined to opine on the first prong, and decided that the Defendants had not met their burden on the second. The panel discussed both components.

First Prong: Grave Probability of Business Failure

Ms. Elmer noted that WCS was not behaving like a firm that was "poised to fail," noting that it was meeting all of its financial obligations, competing for and winning long-term projects, and representing to its project owners, regulators and people in the community that it had the financial resources to stand behind its current and potential projects.

Ms. Reinhart stated that the Government's criticism was unfair and compared it to "telling a drowning man [to] stop trying to swim." WCS had never made a profit. It also produced a detailed financial analysis showing that even under the best conceivable scenario, the company would be operating at a loss in five years. In sum, WCS showed the potential for failure was met.

Dr. Sanghvi found that the government's position was singularly focused on the short run. In industries with specific assets and very large fixed costs, firms can find themselves below the minimum viable scale. This is a disequilibrium: firms are not making money, even though in the short run they may be covering their marginal costs and operating. Dr. Sanghvi stated his belief that antitrust enforcement should not be about preserving low prices in disequilibrium, but about preventing high prices in equilibrium. According to Dr. Sanghvi, very aggressive antitrust enforcement seeking to

prolong disequilibrium can lead to adverse effects and reduce the incentives to invest or enter.

Ms. Elmer pointed out that the failing firm defense is an affirmative defense that must meet a high bar, because it gives a "free pass" for an otherwise anticompetitive merger. By design, it is a tough defense to meet. Ms. Reinhart acknowledged the high bar, but indicated that the Government's position appeared to be that a company needs to go out and keep trying to sell, and accept any offer higher than liquidation value. She pointed to testimony by the Government's financial expert, who agreed that the DOJ would not bless a deal with a competitor if a company valued at a net negative value had an offer for a dollar. Ms. Reinhart pointed out that the financial analysis she had previously mentioned was unrebutted, and the government had argued that it had been produced as a litigation tactic.

Ms. Elmer provided additional arguments made by the Government against the claim that WCS was facing imminent business failure. She noted that WCS had filed an application with the NRC in Spring 2016 to store high level radioactive waste—much more dangerous than LLRW—for 100 years. In the application, WCS's president affirmed under oath that WCS had the financial wherewithal to meet its obligations. The CEO of WCS's parent company, Valhi, had been deposed in April 2017 and testified that Valhi had not made determinations about what it would do if the merger did not go through—there had been no discussions with creditors or regulators. This evidence weighed against the relevant legal standard that exit be imminent.

Second Prong: No Other Prospective Purchasers

Ms. Elmer summarized the process that Valhi was trying to cast as a Horizontal Merger Guidelines (HMG) shop process.[10] In 2014, Valhi hired an investment banker to find an investor willing to pay fair value for a minority share in WCS, rather than looking to sell WCS outright. Valhi fired the investment banker in August 2014 and did not retain another one, instead conducting negotiations on its own. The ordinary course documents showed that Valhi executives felt that offers were not high enough, and that it would be fully acceptable to continue to operate WCS as a subsidiary. This process was not enough to meet the requirements in the HMG.

Ms. Reinhart added that Valhi had also attempted to sell in 2015, leading to the Energy Solutions offer. At that time, WCS believed that there were no additional companies that were interested. Ms. Reinhart characterized the Government's position as presenting a "chicken and egg" problem that could never result in an acquisition by a rival, as any such acquisition would result in additional steps taken exclusively for litigation.

Ms. Elmer pointed out that the Court suggested a potential work-around: after entering the merger agreement with Energy Solutions in October 2015, the Valhi board should have retained the right to consider other offers.

Dr. Sanghvi agreed with Ms. Reinhart that the Government's position would result in most acquisitions by competitors being a non-starter. He noted that mergers and acquisition deals do not just happen—they involve agency problems and other frictions. Such

deals are "sensitive enough" when a party retains the right to obtain a topping bid, but the Government's proposal that parties retain the right to consider not just a topping bid, but any bid, could stop deals before they begin. Dr. Sanghvi expressed concern that Hart-Scott-Rodino was not meant to be interpreted this way.

Trial Practice Outside the District of DC

The panel then discussed certain procedural constraints in this case that are unusual for merger litigation. Ms. Elmer indicated that both sides presented *ex parte* proposed findings of fact and conclusions of law before the trial. As a result neither side saw what the other side had argued, although she noted that the Judge issued an order to present and explain certain topics specifically, giving each side a clue about what the other side had presented. Instead of post-trial briefings, the Judge gave the parties two hours to present closing arguments and requested a comprehensive slide deck with the evidence that each side wanted her to consider. Ms. Reinhart noted that the *ex parte* nature of the legal filings was odd, and did not allow for the usual advocacy and back-and-forth between the parties. She also found that the two hours for closing arguments went by fast, and were not an adequate substitute for a briefing.

Mr. Seward observed that the opinion did not discuss economic testimony in detail. Ms. Reinhart agreed, noting that the Defendants relied heavily on the testimony of their economic expert, who was not mentioned by name anywhere in the decision. She thought the Judge had avoided giving economic evidence its proper weight, opting instead for relying on ordinary course documents.

Ms. Elmer noted that the Court did not see expert reports in this case, and that with the story told by the documents and customer testimony, the Government did not need to lean heavily on its economic expert. She offered the conclusion that economic evidence may not be sufficient to contradict "hot" documents produced in the ordinary course of business.

Dr. Sanghvi closed by stating his surprise at the lack of substantive economics in the opinion, and more generally at the procedural rules that limited the dialog between the parties. Economic testimony is a central way to organize and structure each side's narrative in merger litigation, and he would have wanted the Court to engage more with economic analysis.

Dr. Garibotti is a manager in the Chicago office of Analysis Group. Dr. Garibotti specializes in the application of economics and statistics to questions arising in antitrust and other litigation. Dr. Garibotti was part of the team that supported the DOJ's economic expert, Professor John Mayo, in the Energy Solutions-Waste Control Specialists merger .

Endnotes

1 United States v. Energy Solutions, Inc., No. 1:16-cv-01056-SLR (D. Del. filed July 13, 2017), https://www.justice.gov/atr/case-document/file/1007831/download.
2 Energy Solutions, slip op. at 41.
3 Complaint, United States v. Energy Solutions, Inc., No. 1:99-mc-09999 (D. Del. filed Nov. 16, 2017)
4 Energy Solutions, slip op. at 33-34.
5 *Id.* at 33.
6 *Id.* at 35-36.
7 *Id.* at 16.
8 *Id.* at 37-38.
9 *Id.* at 46-48.
10 U.S. Dep't of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines (2010), https://www.justice.gov/sites/default/files/atr/legacy/2010/08/19/hmg-2010.pdf.