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Memorandum

Fifth Circuit Decision in *Illumina/Grail* Provides Much-Needed Boost to Biden Antitrust Agenda But Comes With Some Silver Linings for Merging Parties

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Introduction

On December 15, 2023 the United States Court of Appeals for the Fifth Circuit issued its decision in the *Illumina/Grail* merger case. That decision addresses how courts are to evaluate competitive harm in vertical merger cases and when parties attempts to "litigate the fix."

While the Fifth Circuit ultimately vacated the Federal Trade Commission's finding of illegality and remanded the case for further proceedings, this understates the importance of the decision for the FTC: at bottom, the Fifth Circuit found that the FTC had met its burden of showing the transaction would harm competition and endorsed the FTC's articulation of the tests that can be used to make such a showing in vertical mergers. Critically, the decision is the first time in decades that the antitrust agencies have successfully demonstrated competitive harm from a vertical merger.[1] The Fifth Circuit also endorsed the Commission's use of older analytical frameworks for market definition and competitive harm from the Supreme Court's *Brown Shoe* case, despite recent agency practice emphasizing other approaches.

In a silver lining for merging parties, the Fifth Circuit rejects the FTC's position that parties looking to litigate the fix must demonstrate that the proposed remedy will *completely restore* competition, and—provided the fix will be implemented regardless of the a court's decision on the merits—sides with Judge Nichols' recent opinion in the *UnitedHealth Group/Change Healthcare* merger,[2] holding that the merging parties must only show that competition *will not be substantially lessened.*

A Winding Procedural Path

Illumina first agreed to acquire Grail on September 21, 2020.[3] The FTC initiated an administrative proceeding to prohibit the transaction on March 30, 2021, and simultaneously filed for a preliminary injunction in federal

[1] The last successful vertical merger challenge of which we are aware was in 1972. *Ford Motor Co. v. United States*, 405 U.S. 562 (1972).

[2] Simpson Thacher represented Change Healthcare in this case.

[3] *See* https://investor.illumina.com/news/press-release-details/2020/Illumina-to-Acquire-GRAIL-to-Launch-New-Era-of-Cancer-Detection/default.aspx.

district court. Although the FTC continued to pursue the administrative proceeding, it subsequently dismissed the federal court preliminary injunction proceeding by May 2021 because the transaction was still under review by the European Commission, which imposed a standstill on the merger.[4] Despite the standstill, the parties closed the transaction on August 18, 2021, claiming that the European Commission's review was without a jurisdictional basis.[5]

Approximately one year later, in opinions issued at nearly the same time, the U.S. administrative law judge ("ALJ") overseeing the FTC administrative proceeding and the European Commission issued starkly contrasting decisions: the ALJ concluded on September 1, 2022 that the FTC had not met their burden and permitted the transaction to proceed,[6] while the European Commission prohibited the transaction on September 6, 2022.[7]

On April 3, 2023, in an internal appeal of the ALJ's decision, the FTC Commissioners overruled the ALJ and concluded that the transaction *would* harm competition and ordered Illumina to divest Grail. Illumina appealed this decision to the Fifth Circuit on April 5, 2023.[8]

The Fifth Circuit's recent decision remanded the case for further consideration in relation to the standard to apply to assess the proposed fix, but also found that substantial evidence supported the Commission's decision. Illumina agreed on December 18, 2023 to sell Grail, bringing the long saga to an end.

If the Shoe Fits: Fifth Circuit Holds That the FTC Correctly Applied the *Brown Shoe* "Practical Indicia" Test to Define the Relevant Market

The first step in proving harm to competition in any market is establishing what the relevant market is. In *Illumina/Grail*, the Commission utilized what is known as the *Brown Shoe* practical indicia test to determine the scope of the "relevant market." In recent years, the agencies have focused predominantly on another test, known as the hypothetical monopolist test ("HMT")—for instance, while the 2023 Merger Guidelines recently finalized by the FTC and DOJ refer to both the HMT and the practical indicia test[9], the prior 2010 Horizontal Merger Guidelines refer only to the HMT and do not reference the practical indicia test.[10]

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[4] *See* https://www.ftc.gov/legal-library/browse/cases-proceedings/201-0144-illumina-inc-grail-inc-matter.

[5] *See* https://investor.illumina.com/news/press-release-details/2021/Illumina-Acquires-GRAIL-to-Accelerate-Patient-Access-to-Life-Saving-Multi-Cancer-Early-Detection-Test/default.aspx.

[6] *See* https://www.ftc.gov/legal-library/browse/cases-proceedings/201-0144-illumina-inc-grail-inc-matter.

[7] *See* https://ec.europa.eu/commission/presscorner/detail/es/ip_22_5364. On July 12, 2023, the Commission also fined Illumina €432 million for closing the transaction during the Commission's review and in spite of the standstill obligation. *See* https://ec.europa.eu/commission/presscorner/detail/en/ip_23_3773.

[8] *See* https://www.ftc.gov/legal-library/browse/cases-proceedings/201-0144-illumina-inc-grail-inc-matter.

[9] Simpson Thacher has also published news alerts on the Merger Guidelines, available here and here.

[10] The 2010 Horizontal Merger Guidelines are available here.

The practical indicia test enables more flexibility and reliance on anecdotal market evidence than the HMT, and so a return to this *Brown Shoe* test would generally be beneficial to the agencies in defining relevant markets tailored to their purposes in any given case.

Ultimately, the Fifth Circuit sided with the FTC, framing the question as "merely whether [the relevant products] are 'similar in character or use' . . . albeit not *perfect* substitutes," and noting that they FTC was not "required to mathematically demonstrate cross-elasticity of demand" and that "requiring such hard metrics" might result in an unfairly narrow market in cases such as this one.

Another Tale of Two Tests: Fifth Circuit Also Holds That FTC Proved Harm to Competition Under Either the Ability/Incentive Test or the *Brown Shoe* Test

In recent years, the agencies and courts have generally focused their analysis of vertical mergers around what is called the "ability/incentive test," which looks to assess whether the merged firm would have both the ability and the incentive to engage in either full or partial foreclosure of a critical input or outlet, or else to engage in other practices that might raise rivals' costs. Indeed, this is the only test referenced at all in the agencies' 2020 Vertical Merger Guidelines.[11] This test relies more on economics and hard numbers to prove anticompetitive effects.

However, under the Biden administration, the agencies have made moves to reestablish the older *Brown Shoe* standard as the primary means of evaluating vertical mergers—the *Brown Shoe* standard features heavily in, for instance, the Commission decision in *Illumina/Grail* and in the 2023 Merger Guidelines. This test, as with market definition, relies more on anecdotal evidence and market realities to prove anticompetitive effects.

In this case, the Commission considered both standards, and therefore the Fifth Circuit analyzed the transaction under both standards as well, finding that it "need not resolve this issue" of whether one or both tests were appropriate because either way the FTC had met its burden.

In particular, on *Brown Shoe*, the Fifth Circuit observed:

> *At bottom, the record supports the Commission's findings that the merger will result in the potential foreclosure of a key input by the sole supplier, that it was intended to transform Illumina's business model by shifting its focus . . . to clinical testing, and that investment by other [Grail competitors] may be chilled, especially given the deferential nature of our review.*

We expect to continue to see the *Brown Shoe* standard feature prominently in future vertical cases, likely alongside the ability/incentive test until this issue is fully resolved.

[11] *See* https://www.ftc.gov/system/files/documents/reports/us-department-justice-federal-trade-commission-vertical-merger-guidelines/vertical_merger_guidelines_6-30-20.pdf.

In one other meaningful development, even under the ability/incentives test, the Fifth Circuit agreed with the FTC in acknowledging that there are more insidious alternatives than full foreclosure: "there are myriad ways in which Illumina could engage in foreclosing behavior without triggering suspicion in other customers, such as by making late deliveries or subtly reducing the level of support services."

Litigating the Fix: Fifth Circuit Provides Important Clarity for Cases Involving Remedies

WHOSE BURDEN IS IT, ANYWAY? FIFTH CIRCUIT HOLDS THAT PARTIES BEAR THE BURDEN DURING THEIR REBUTTAL CASE

When a remedy is proposed by the parties prior to the commencement of a merger trial, the discussion of the impacts of that proposed remedy during the trial—and the consideration of that proposed remedy by the decision-maker—is often referred to as "litigating the fix." In *Illumina/Grail*, on the same day the FTC filed their complaint, Illumina made a standardized supply contract (the "Open Offer") available to all for-profit U.S. oncology customers. The Open Offer was irrevocable, could be accepted by a customer at any time until August 18, 2027, became effective as of the merger's closing, and would remain effective until August 18, 2033. Among other terms, the Open Offer "required Illumina to provide its NGS platforms at the same price and with the same access to services and products that is provided to Grail."

A recent series of cases—including *AT&T/Time Warner*; *UnitedHealth Group/Change Healthcare*; and *Microsoft/Activision*—have involved questions regarding who bears the burden of proof in relation to a litigated fix, when that showing must be made, and exactly what standard is to be applied. The Fifth Circuit in Illumina/Grail summarized the main schools of thought as follows:

> *The first option—pressed by Illumina—is to require Complaint Counsel to account for the Open Offer as part of its prima facie case. The second option—adhered to by the Commission's majority opinion—is to only consider the Open Offer at the remedy stage following a finding of liability. The third option—suggested by Commissioner Wilson in her concurring opinion—is to place the burden of showing the Open Offer's competitive effects on Illumina as part of its rebuttal to the prima facie case.*

Ultimately the Fifth Circuit concluded the "Open Offer is somewhere in between a fact and a remedy" and thus elected for the third option: in litigating the fix cases, the parties bear the burden of showing a proposed fix's effects on competition as part of their rebuttal to the Government's prima facie case.

WHAT EXACTLY IS THE BURDEN? FIFTH CIRCUIT REJECTS THE "TOTAL-NEGATION STANDARD"

The FTC and DOJ have long claimed that remedies must completely restore competition, or totally negate any harm to competition. This claim finds support in a line of cases endorsing this perspective, beginning with *Sysco*,

113 F. Supp. 3d at 72, continuing in *Aetna*, 240 F. Supp. 3d at 60, and then again in *FTC v. RAGStiftung*, 436 F. Supp. 3d 278, 304 (D.D.C. 2020). In these cases, according to the Fifth Circuit, the remedy would only go into effect *if the court approved the transaction at issue*. In these circumstances, the court reasoned, a proposed remedy should be considered in a second phase of the trial, following the liability phase, where a total-negation standard may be appropriate.

By contrast, the Fifth Circuit cited to other cases in which the parties had pre-committed to undertaking the relevant remedial action, regardless of the court's decision, such as *AT&T/Time Warner* and *Microsoft/Activision*.[12] In such cases, a remedy should be taken into account at the liability phase, and not subject to the total-negation standard. In particular, the Fifth Circuit referenced the court in *UnitedHealth Group/Change Healthcare*, which explained its perspective that, in the liability phase, the total-negation standard "contradicts the text of Section 7."[13] As that court explained, "the text of Section 7 is concerned only with mergers that 'substantially . . . lessen competition,'" and by requiring a showing that the merger will "preserve exactly the same level of competition that existed before the merger, the Government's proposed standard would effectively erase the word 'substantially' from [the Clayton Act]."

The Fifth Circuit agreed, explaining:

> *The "Commission held Illumina to a rebuttal standard that was incompatible with the plain language of Section 7 of the Clayton Act, which only prohibits transactions that will "substantially" lessen competition. And this error pervaded the Commission's analysis of the Open Offer. . . . In effect, Illumina could only rebut Complaint Counsel's showing of a likelihood of a substantial reduction in competition with a showing that, due to the Open Offer, the merger would not lessen competition at all. This was legal error.*

Given the increasing frequency with which the agencies are rejecting settlements—and parties are then turning to the courts to opine on remedies—this is a critical development, and one bright spot in the decision for merging parties.

Other Notes of Interest From the Case

- **Constitutional Challenges Rejected.** Recent merger cases have raised a litany of constitutional challenges against the FTC, and the *Illumina/Grail* case was no different.[14] These were all swiftly and summarily rejected, providing some margin of relief to the agencies from the recent onslaught of constitutional issues being raised against them.

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[12] Simpson Thacher represented Microsoft in this matter.

[13] *United States v. UnitedHealth Grp. Inc.*, 630 F. Supp. 3d 118, 132 (D.D.C. 2022).

[14] See, for instance, the *ICE/Black Knight* transaction.

- **Efficiencies Claims Rejected.** Illumina claimed a range of efficiencies, but the Fifth Circuit observed that "at bottom, an efficiency defense is very difficult to establish" and that "substantial evidence supported the Commission's determination that Illumina failed to establish cognizable efficiencies here."

Key Takeaways

- The case provides the FTC with a much-needed win in court and will likely boost their confidence going into the final year of the Biden administration.
- On market definition, expect to see much more *Brown Shoe* in the future, as the *Brown Shoe* practical indicia test provides more flexibility to define markets based on anecdotal evidence and business practicalities than the hypothetical monopolist test. This means more "creative" market definitions are likely in store.
- On competitive effects, the story is much the same: expect to see more *Brown Shoe* going forward. The *Brown Shoe* factors provide a much more common-sense and user-friendly approach than the economics-focused ability/incentive framework. Critically, this may make it marginally easier for the U.S. agencies to show competitive harm in vertical cases.
- Finally, litigating the fix is here to stay, and this decision provides clarity for merging parties and, when the "fix" is not contingent on the outcome, makes it even easier for merging parties to demonstrate that the proposed remedy is adequate, given that it no longer needs to fully restore competition and now only needs to prevent a substantial lessening.

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