[28]*Supreme Court Decision*, at *8.

[29]*Supreme Court Decision*, at *7.

[30]*Supreme Court Decision*, at *8.

[31]*Dell*, 177 A.3d at 25 ("In these circumstances, a mass of investors quickly digests all publicly available information about a company, and in trading the company's stock, recalibrates its price to reflect the market's adjusted, consensus valuation of the company."); *DFC*, 172 A.3d at 370 ("[C]orporate finance theory reflects a belief that if an asset—such as the value of a company as reflected in the trading value of its stock—can be subject to close examination and bidding by many humans with an incentive to estimate its future cash flows value, the resulting collective judgment as to value is likely to be highly informative and that, all estimators having equal access to information, the likelihood of outguessing the market over time and building a portfolio of stocks beating it is slight.").

[32]*Paramount Commc'ns Inc. v. Time Inc.*, 1989 WL 79880, at *19 (Del. Ch. July 14, 1989) ("But just as the Constitution does not enshrine Mr. Herbert Spencer's social statics, neither does the common law of directors' duties elevate the theory of a single, efficient capital market to the dignity of a sacred text. Directors may operate on the theory that the stock market valuation is 'wrong' in some sense, without breaching faith with shareholders. No one, after all, has access to more information concerning the corporation's present and future condition."); *see also Unitrin, Inc. v. American General Corp.*, 651 A.2d 1361, 1376 (Del. 1995) ("[T]he directors of a Delaware corporation have the prerogative to determine that the market undervalues its stock and to protect its stockholders from offers that do not reflect the long-term value of the corporation under its present management plan."); *cf. Cede & Co. v. Technicolor, Inc.*, 684 A.2d 289, 301 (Del. 1996) ("[T]he market price of shares may not be representative of true value.").

WHEN ONE DOOR CLOSES: COURT REQUIRES DIVESTITURE IN LONG-CONSUMMATED MERGER

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Congratulations! Your deal navigated through antitrust review, you closed the transaction, and you are making your way through the three-year integration plan. The target's corporate office was closed, you have transitioned the back-office functions to your personnel and systems, and you have consolidated product lines. Concerns about antitrust risk are long past. "Not so fast," says one federal court.

The U.S. District Court for the Eastern District of Virginia ordered JELD-WEN, Inc. to divest a plant from its October 2012 acquisition Craftmaster International ("CMI"). This is the first case in the Hart-Scott-Rodino Act era (since 1976) in which a court ordered a divestiture in a private merger challenge following a government decision to investigate but not challenge the transaction in court. Although JELD-WEN has appealed the decision, this case may embolden customers or competitors who want to sink a transaction, and escalate risk for merging parties.

One Door Closed

Doorskins are decorative coverings of interior molded doors. For more than a decade, JELD-WEN, CMI, and Masonite were the only doorskin suppliers to independent manufacturers of molded doors. Each company was vertically-integrated and also competed with downstream molded door manufacturers.

After announcing its CMI acquisition in July 2012, JELD-WEN notified the U.S. Department of Justice Antitrust Division ("DOJ"), which opened a preliminary investigation into the competitive effect of the transaction. Prior to the deal, JELD-WEN executed long-term supply agreements with independent door manufacturers as a strategy to "assuage the [antitrust] concerns of the DOJ" and the independent door manufacturers. During its investigation, DOJ interviewed Steves & Sons, Inc. ("Steves"), JELD-WEN's customer (in doorskins) and competitor (in finished doors). Steves did not oppose the acquisition because of price protections in its JELD-WEN supply agreement. DOJ closed its investigation in September and the parties closed the acquisition a month later.

Another One Opens

The supply agreement, which covered 80% of Steves' doorskin requirements, prohibited JELD-WEN from increasing doorskin prices unless JELD-WEN documented increased raw materials costs. Between 2013 and 2015, JELD-WEN increased doorskin prices each year despite declining input costs. Following the merger, Steves also experienced reduced quality.

Nearly two years after the merger, Masonite, the only other doorskin manufacturer in the United States, announced that it would no longer sell doorskins to competing door manufacturers. JELD-WEN sent the announcement to Steves with a letter terminating the supply agreement effective in 2021. The letter also included a demand for a capital charge (not authorized in the supply agreement) to offset improvements to JELD-WEN's plant that makes doorskins sold to Steves. JELD-WEN also reduced its reimbursement to Steves for defective products.

To remedy its situation, Steves renegotiated the supply agreement with JELD-WEN. Steves also tried to purchase doorskins from Masonite, but Masonite would only agree to spot sales at high prices. Steves then investigated foreign supply and building its own doorskins plant, but those efforts proved unsuccessful. In addition, Steves complained to DOJ, which led the latter to open a second investigation and issue a new subpoena to JELD-WEN. However, DOJ closed its investigation without taking action.

Thereafter, negotiations for a new contract failed and Steves sued JELD-WEN in June 2016, alleging that its acquisition of CMI was anticompetitive. Steves' complaint sought both treble monetary damages and equitable relief. Following a jury trial in the U.S. District Court for the Eastern District of Virginia, unusual in antitrust merger cases, a jury awarded Steves nearly $176 million in antitrust damages.

After a hearing on equitable relief, the court ordered JELD-WEN to divest the doorskin manufacturing plant in Towanda, Pennsylvania, including equipment and intellectual property, that it acquired from CMI. The court's order also permits other independent door manufacturers to terminate, without penalty, their supply agreements with JELD-WEN, and contemplates that the buyer of the Towanda plant will enter into a new supply agreement with Steves. The court's order also requires Towanda's new owner to satisfy the requirements of the independent door manufacturers before supplying a certain number of doorskins to JELD-WEN.

Steves is not entitled to a remedy for both divestiture and damages for future lost profits and the court issued a final judgment that awards Steves $36.5 million for past damages and requires JELD-WEN to divest the Towanda facility. If the appellate court overturns the divestiture order, in the alternative, the court ordered JELD-WEN to pay the full $176 million. JELD-WEN appealed the jury verdict and the court's divestiture order to the U.S. Court of Appeals for the Fourth Circuit.

Can a Private Party Challenge a Merger Even if DOJ Cleared the Deal?

Yes. DOJ clearance under the Hart-Scott-Rodino Act does not preclude a private challenge. Clayton Act Section 7 prohibits transactions that "substantially lessen competition, or tend to create a monopoly." In addition to authorizing DOJ lawsuits to enjoin an anticompetitive transaction, the Clayton Act permits private parties to sue for violations of Section 7 for treble damages (Section 4) or for an injunction (Section 16).

The DOJ twice reviewed the JELD-WEN/CMI transaction but chose not to act. Although several courts have found the DOJ's decision not to take action in a merger persuasive, the court in *Steves* excluded evidence of the DOJ's decision from the jury. The court held that DOJ's inaction would risk confusing the jury and had only "marginal relevance" to the substance of the case.

Why Hasn't There Been More Private Merger Litigation?

Standing Is a High Bar and Courts Are Skeptical of Competitor Suits

Private parties play a limited role in merger litigation because the Clayton Act and Supreme Court set a high bar for private parties to get into court. A private plaintiff in any federal case must demonstrate that it has standing to pursue a claim. A party has standing to sue if it suffered a personal injury that the court can redress and the defendant's conduct caused the injury. In antitrust cases, the injury must be "more than injury causally linked to an illegal presence in a market." Instead a plaintiff must prove an "antitrust injury," *i.e.*, an "injury of the type the antitrust laws were intended to prevent and that flows from that which makes the defendants' acts unlawful." An antitrust plaintiff's injury therefore must flow from conduct that harms competition, for example, increased prices, reduced output, lower quality, predatory prices, or foreclosure.

In many merger cases, competitors cannot suffer an antitrust injury because they either benefit from the anticompetitive harm (*e.g.*, higher prices) or suffer losses from increased competition. For example, in *Brunswick Corp. v. Pueblo Bowl-O-Mat Inc.*, the plaintiff alleged that if Brunswick had not acquired competing bowling alleys in violation of Clayton Act Section 7, those bowling alleys would have failed, depriving the plaintiff of lost profits. The Supreme Court rejected the plaintiff's theory because the lost profits flowed from increased competition rather than the competition that would have been lost had the bowling centers closed. Likewise in *Cargill, Inc. v. Monfort of Colorado, Inc*., the Supreme Court rejected a competitor request to enjoin a merger because the alleged injury flowed from "vigorous competition." The plaintiff, Monfort (a beef packer), alleged that Excel (a competitor) would bid up the input price for cattle and reduce its output price for boxed beef following its acquisition of a competitor. The Supreme Court rejected Monfort's price-cost squeeze theory because the lost profits from the first stage of the price-cost squeeze derived from more, rather than less, competition. As these cases demonstrate, where a merger's anticompetitive effects benefit a competitor or its procompetitive effects (*e.g.*, efficiencies, entry, improved distribution) harm a competitor, that competitor does not suffer an antitrust injury.

Although most courts since *Brunswick* and *Monfort* have rejected competitor merger challenges for lack of standing, some courts have found standing where predatory or exclusionary conduct could harm a competitor. For example, in *Tasty Baking Co. v. Ralston Purina, Inc*., the U.S. District Court for the Eastern District of Pennsylvania held that Tastykake had standing to challenge its competitor Hostess' consummated acquisition of certain baked good assets from Borden. Tastykake argued that antitrust injury could arise from 1) Hostess charging predatory prices in geographies where it competed with Tastykake or other competitors; 2) reduced access to retail outlets, many of which refuse to carry more than three or four lines of snack cakes; and 3) less favorable shelf space or promotional slots. After the court issued a preliminary injunction enjoining the transaction, Hostess sold the assets to a private group led by management.

Customers or consumers have fared better in showing antitrust injury. For example, in *Glen Holly Entertainment Inc. v. Tektronix Inc.*, the court found that a customer plaintiff had standing where a transaction between the only two manufacturers of certain film editing machines led to them withdraw one party's machines from the marketplace. The transaction harmed customers like the plaintiff who could no longer attract customers to film editing services that used the discontinued product.

Antitrust Litigation Is Costly and Time Consuming, While Complaining to the DOJ or FTC Is Easy

The cost, time, and risk associated with merger litigation likely dissuades some plaintiffs. Antitrust litigation can drag on for years. Even in the U.S. District Court for the Eastern District of Virginia, a court known for its speedy justice, more than two-and-a-half years elapsed between the time that Steves filed its complaint and the court issued its remedy order, which will not take effect until JELD-WEN exhausts its appeals. JELD-WEN predicts that appeals could take an additional nine months to three years.

Antitrust cases are fact intensive and usually require voluminous document productions, as well as economic experts to model the effects of a transaction. In the *Steves* case, there are nearly 1,900 docket entries, and Steves alone filed nearly 100 substantive briefs. There were 25 fact and expert witnesses, more than 500,000 documents, 15 hearings, a week-long final pre-trial conference, and a two-week jury trial. Steves requested more than $28 million in attorney's fees and expenses from JELD-WEN and claims JELD-WEN has reserved nearly $40 million to pay such fees. Steves' estimate does not include more than $4 million in expert's fees that are not recoverable.

Given the cost and time, it is not a surprise that most marketplace participants who have some objection to a merger prefer to complain to the antitrust agencies rather than risk litigation. Steves did just that when it encouraged DOJ to reopen its investigation. Private parties can free ride on the work of the antitrust agencies, which have a large staff of lawyers and economists, power to issue broad subpoenas, rights to premerger clearance in many deals, no requirement to prove standing, and arguably, in the case of the FTC, a lower injunction standard. In addition, to the extent a potential plaintiff fears reprisal from the merging parties, the antitrust agencies treat complaints confidentially (at least until litigation).

Is the *Steves* Case Likely to Lead to More Private Merger Litigation?

Probably not. Private merger litigation is still a costly, time-consuming, and risky bet, and until JELD-WEN exhausts its appeals or gives up, it will not have to pay damages or divest the Towanda plant. This case hardly changes that balance, though on the margin, the outcome might embolden some parties, with the right facts, to try to block a deal.

If Private Merger Litigation Is Rare and Difficult, Why Is the *Steves* Case Different?

The *Steves* case is a perfect storm of facts. First, DOJ chose not to take action in a transaction that combined two of the three doorskin manufacturers. Although DOJ has not disclosed publicly why it closed its initial investigation, the court reports that long-term supply contracts with customers may have alleviated any DOJ (and Steves) concerns about the competitive effect of the transaction. With no complaining customers and long-term contracts that pegged prices to raw material costs, DOJ may have been reluctant to bring a case.

Second, the marketplace facts changed (*i.e.*, Masonite's exit, JELD-WEN termination of the supply agreement) in a way that threatened Steves. Third, and perhaps most significant, termination of the supply agreement threatened to put Steves, a customer and competitor of JELD-WEN, out of business. In most cases, if an input price increases, a manufacturer could reduce its own margin or attempt to pass along the cost increase to its customers. Without a source of doorskin supply, Steves faced an existential threat, "the loss of its business."

The supply agreement events also were critical to the court's standing analysis. The court found that JELD-WEN's increased market power led it to terminate the supply agreement. Without a source of doorskins, the court (and jury) found that Steves would have gone out of business.

Is There Any Post-Merger Time Period After Which Parties Are Safe from a Private Merger Lawsuit?

In the United States, there is a four-year statute of limitation on damage claims arising from a merger, though the statute may not start to run until the plaintiff is injured and could be tolled for various reasons (*e.g.*, conduct that is fraudulently concealed). Although there is no statute of limitations on claims for equitable relief under Clayton Act § 16, courts have applied the same four-year period as a guideline when defendants assert that a plaintiff's unreasonable delay should bar its claim.

Should Merging Parties Now Wait to Integrate Operations?

No. The *Steves* case should not affect the plans of merging parties to achieve post-merger integration and efficiencies. Private merger challenges remain the small minority of cases.

However, post-merger integration is not likely to immunize otherwise unlawful conduct even though both courts and the antitrust agencies acknowledge the difficulty and hardship of unwinding a transaction. JELD-WEN argued that it should not have to sell the Towanda plant because Steves' lawsuit came long after it announced acquisition, it made substantial investments in the plant, and it closed two of its own plants. The court rejected JELD-WEN's arguments about delay because Steves only became aware of an antitrust injury when JELD-WEN terminated the supply agreement in August 2014. Likewise, the court was not concerned with JELD-WEN's cost of unwinding the merger because JELD-WEN had recouped investments in Towanda and could reopen at least one of the closed plants.

By the time the court issued its decision, JELD-WEN had owned CMI for about six years and it is now in the unenviable and costly position of "unscrambling the eggs." Although the outcome of this case is troubling for merging parties and disincentivizes capital investments in acquired assets, for most mergers, the sky is not falling. The *Steves* case features unique facts, and successful private merger litigation should continue to be rare. Absent a reason to expect a private challenge, this case should not dissuade merging parties from post-merger integration.

What Can I Do to Avoid Becoming a Target?

The primary takeaway from *Steves* is that DOJ clearance is not a box for merging parties to check and forget. Increasing prices beyond competitive levels, punishing customers or competitors, or reducing quality post-transaction creates risk. This is particularly true in the *Steves* case where JELD-WEN allegedly breached the contract that protected customers against price increases.

Parties also should be aware of marketplace facts that make the risk of private challenge more likely. For example, because Steves had no alternative source of doorskin supply, termination of the supply agreement did not "merely" result in higher input costs, it threatened Steves' ability to stay in business. Steves had nothing to lose from a private challenge. Faced with similar circumstances, merging parties should consider whether they are better off continuing to serve a similarly situated customer.

A private merger lawsuit also is more likely in industries where, as in the *Steves* case, customers are also the merging parties' competitors. Customers are the most obvious candidates to raise antitrust concerns about a merger and, as described above, are more likely than competitors to have standing. In addition, both courts and the antitrust agencies take customer concerns seriously. Competitors may oppose a transaction because it helps the merging parties become a more efficient or successful competitor. Customer-competitors therefore may have the most to lose from a transaction and the most to gain from breaking up the deal.

Conclusion

Although the outcome in the *Steves* case is troubling for merging parties, it does not signal more private merger litigation. Most mergers are unaffected because they do not present the kind of significant antitrust issues present in the *Steves* case. Even among the small number of mergers that receive antitrust scrutiny, the facts in *Steves* are extraordinary: DOJ passed on enforcement in a three-to-two case, the only remaining competitor exited, and the merged company terminated a supply agreement that threatened the business of a customer-competitor. However, the *Steves* case is a reminder that DOJ clearance does not eliminate antitrust risk.

The views and opinions set forth herein are the personal views or opinions of the authors; they do not necessarily reflect views or opinions of the law firm with which they associated.

WELCOME TO THE R&W ERA?: THE MIDDLE-MARKET M&A PICTURE FOR 2019

Middle-market M&A (deals with a purchase price of under $1 billion) has achieved a level of remarkable stability in this decade. Trends emerging by the mid-2010s, such as the shift to a more seller-friendly market, have persisted despite various economic fluctuations, such as the late 2018 stock market dip, and continual wariness about political-related uncertainty.

The M&A Lawyer talked to Andrew Lucano, a partner in Seyfarth Shaw LLP's New York office, about his firm's annual survey of middle-market deals (see the May 2017 and May 2018 *M&A Lawyer* for articles on earlier surveys). For 2018, the firm analyzed key transaction terms from more than 160 middle-market private target acquisition agreements.

It was another strong year for the middle market in terms of deal issuance, cementing a positive growth trend underway when Seyfarth started conducting middle-market surveys in 2014. "Since we've been doing our survey, it's been a great run in the M&A space—things have gone really good," Lucano said. "There haven't been wild fluctuations over the years and it's become increasingly seller-friendly with every year. One thing that's embellished the market's seller-friendly nature is what's been going on with representations and warranties insurance: it's getting more and more popular every year."

Popular enough that, for the first time in its six-year history, Seyfarth's survey separates deals with R&W insurance from those in which no R&W insurance was used. By doing so, it found the former closing in on being a majority of middle-market deals: more than 40% of surveyed transac-