

BUYERS BEWARE: DOJ CHALLENGE TO BOOK PUBLISHERS MERGER HIGHLIGHTS MONOPSONY CONCERNS IN M&A

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In another example of more aggressive antitrust enforcement under the Biden Administration, on November 6, 2021, the U.S. Department of Justice (“DOJ”) filed a complaint in federal court seeking to block Penguin Random House LLC’s \$2.175 billion acquisition of Simon & Schuster, two of the so-called “Big Five” book publishing companies. Notable among merger challenges, the DOJ’s Complaint is not centered around claimed harm to downstream customers, but rather authors who seek to have their books published and how much those authors are paid for their works. The DOJ alleges that the transaction should be blocked because it will significantly reduce bidding competition for authors’ works.

Buyer power (“monopsony,” in antitrust parlance) has long been a consideration in antitrust merger reviews, but historically it has been more of a theoretical than practical concern for enforcers. Analytically, these transactions are evaluated in much the same way as mergers between competing sellers, as described in the U.S. antitrust agencies’

Horizontal Merger Guidelines. Consider, for example, the distinction between the potential anticompetitive effects arising from mergers of competing buyers (e.g., charging *lower* prices to suppliers) versus competing sellers (e.g., charging *higher* prices to final consumers). A critical difference is that mergers among competing buyers do not necessarily result in direct anticompetitive effects for customers or consumers. Indeed, many merging parties tout the same reductions in costs from *suppliers* as an efficiency that will ultimately benefit *consumers*. Due to that complexity, over the past few decades, antitrust authorities have focused their resources on transactions that have a more direct nexus to potentially anticompetitive downstream effects, such as higher prices, on customers.

That approach changed with the Biden

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Administration. The White House and leadership at both the Federal Trade Commission (“FTC”) and the DOJ have emphasized that anticompetitive effects from consolidation can extend beyond direct effects on downstream customers. This summer, President Biden released an executive order on competition outlining 72 initiatives to combat “excessive” corporate consolidation and increase competition across the U.S. economy, using a mix of regulation, deregulation, and aggressive antitrust enforcement.¹ The Order focuses particular scrutiny on labor markets, as well as concentration in the agricultural, healthcare, and tech industries. The Chair of the FTC also has been outspoken on the subject, recently advocating for the FTC to “take a holistic approach to identifying harms, recognizing that antitrust and consumer protection violations harm workers and independent businesses as well as consumers.”² The DOJ had operated under acting leadership until the President’s nominee to lead the Antitrust Division, Jonathan Kanter, was confirmed in November. In a recent press release, the acting head of the DOJ indicated that the agency was conducting a review to ensure that government merger guidelines are “appropriately skeptical of harmful mergers.”³

The DOJ’s Challenge to Penguin/Simon & Schuster

The DOJ’s challenge to the proposed Penguin/Simon & Schuster transaction reflects those pro-enforcement views of the Biden Administration. The Complaint alleges that Penguin’s acquisition of Simon & Schuster will substantially lessen competition in two upstream markets: (i) the acquisition of U.S. publishing rights to books from authors, and (ii) the acquisition of the U.S. publishing rights to anticipated top-selling books. According to the DOJ, book publishers compete to acquire publishing rights from authors, typically by offering advance payments and royalties as well as better editorial, marketing, and other services that are critical to the success of a book. Penguin and Simon & Schuster are two of the Big Five U.S. book publishers. Penguin is the largest of the Big Five, and Simon & Schuster is the fourth-largest. The Complaint alleges that the combined firm would control close to half of the U.S. book publishing market for anticipated top-selling books.

The DOJ argues the transaction will harm competition in two ways:

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First, by eliminating head-to-head competition between Penguin and Simon & Schuster, the DOJ alleges the transaction will allow the combined firm to “pay less and extract more” from authors—and, in particular, from “bestselling authors and celebrities” who command higher advance payments and fees. The Complaint cites several instances of that head-to-head competition, which allegedly resulted in higher payments to authors. Smaller publishers will be unable to fill this gap, according to the DOJ, because they lack the resources to pay the high advances and provide the “unique” services needed to secure publishing rights to anticipated top-selling books.

While the Complaint focuses on the harm to authors by making it harder for authors to earn a living by writing books, resulting in reduced quantity of variety of books published, the DOJ also asserts that the merger will “ultimately” harm consumers. The DOJ claims that “[b]y harming authors, the merger is also likely to harm consumers.” Notably, however, the Complaint does not provide detail on how such harm would occur or allege that the transaction would affect the prices charged for books.

Second, the Complaint alleges that further consolidation in the book publishing industry will facilitate coordination among the remaining four major publishers. The “coordinated effects” theory of harm is common in many merger challenges. In partial support of its allegations, the DOJ references the government’s 2012 complaint alleging that the Big Five publishers conspired with Apple to raise the price of e-books. The Complaint notes that the Second Circuit affirmed a decision by the district judge that Apple and the publishers had engaged in a “price-fixing conspiracy.” The DOJ asserts that the past coordination demonstrates that the industry

would be conducive to further coordinated behavior.

In response to the DOJ’s concerns, on September 20 (about 45 days before the DOJ filed its Complaint), Penguin’s CEO announced that it would allow competitive bidding between Penguin and Simon & Schuster imprints post-transaction, thereby preserving competition for authors’ works. The DOJ, however, dismissed this proposal in its Complaint by calling it an “unenforceable promise” that “defies economic sense.” Although there are exceptions, recent DOJ and FTC practice favors structural remedies, such as divestitures, and rejects conduct remedies that require ongoing commitment by the merging parties. For example, the FTC rejected a similar non-structural remedy earlier this year as part of its ongoing challenge to the proposed Illumina/GRAIL transaction, currently pending in FTC administrative court. The DOJ also rejected a proposed conduct remedy in its challenge to the 2019 AT&T/Time Warner transaction, though the DOJ lost its case in federal court.

It is notable that the DOJ’s press release announcing the Penguin/Simon & Schuster challenge included a strong statement by Attorney General Merrick Garland that the Complaint “is the latest demonstration of the Justice Department’s commitment to pursuing economic opportunity and fairness through antitrust enforcement.” This case is a clear signal that the Biden Administration is willing to push the antitrust envelope, litigating non-traditional harms involving alleged upstream effects in labor markets. The DOJ brought this high-profile case despite arguments by the merging parties that the transaction will result in significant cost savings (improving efficiency rather than leading to a reduction in books and amounts paid to authors) and that the combined firm will continue

to compete with other publishers, including newer entrants like Amazon.

Practical Takeaways for M&A Advisors

Penguin/Simon & Schuster is one of the first merger challenges of the Biden Administration's DOJ. Companies and their M&A advisors should take away four key points from this challenge.

1. Expect a renewed focus on labor markets in merger reviews. Buyer power, particularly for labor (employees), has been a priority of the Biden Administration. In fact, President Biden's recent Executive Order directed the antitrust agencies to consider a transaction's impact of "monopoly and monopsony—especially as those issues arise in labor markets." The Penguin/Simon & Schuster Complaint demonstrates that the DOJ's interest in those issues is not merely academic. Any pre-signing antitrust due diligence should include an assessment of potential buyer power, including over both upstream suppliers of input materials as well as employees/labor. In addition, M&A advisors should be careful about how these issues are described in company documents, including materials prepared by or for the Board and senior management. Those documents carry substantial weight during agency merger reviews and may have to be produced early in an investigation, potentially as part of the parties' initial HSR filings.

2. The DOJ is not afraid to pursue non-traditional theories. Penguin/Simon & Schuster does not fit the mold of traditional merger challenges, in several respects. As noted, the DOJ's Complaint focuses on harm to suppliers (authors), rather than a more traditional antitrust focus on downstream effects (consumers). In addition, the transaction leaves four of the "Big Five" book publishers, plus Amazon and over a dozen smaller publishers. That level of concentration is in line

with transactions not challenged by the antitrust agencies in the past, including in recent administrations. The current challenge, which defines antitrust markets in a way that discounts non-Big Five competitors and rejects Penguin's proposed remedy, confirms that the Biden Administration is willing to move away from traditional cases and embrace more aggressive antitrust theories of harm in litigation.

3. Antitrust agencies remain unwilling to credit conduct remedies. As noted, the DOJ did not credit Penguin's proposed conduct remedy, which would allow competitive bidding between the merging parties' imprints post-transaction. Although there have been exceptions, the U.S. antitrust agencies increasingly favor structural remedies—*i.e.*, divestitures of assets. The Biden Administration has now challenged at least two transactions in which the merging parties proposed non-structural "fixes" (Illumina/GRAIL, Penguin/Simon & Schuster). Litigating the proposed remedy is a common strategy for merging parties. Penguin has indicated publicly that it is "committed to keeping [Simon & Schuster's] imprints as separate, external bidders from [Penguin] imprints in auctions post-closing, just as they do today, even if they are the only ones left in an auction (up to an advance level well in excess of \$1 million)."

Merging parties should assume that the agencies would continue to have a strong preference for structural divestitures. Standalone conduct remedies will be viewed with skepticism, but they might still be accepted during merger investigations (*i.e.*, thereby helping to avoid litigation) in narrow circumstances in which (1) a divestiture is not possible, (2) when accompanied by strong evidence of efficiencies, (3) when a conduct remedy completely cures the potential anticompetitive harm, and (4) the government can effectively enforce the remedy.

4. Pointing to claims of strong downstream competition (and to Amazon) is not an automatic panacea for monopsony issues. The DOJ's Complaint suggests that the agencies will not assign much, if any, significance to evidence of strong competition *downstream* to mitigate *monopsony* concerns *upstream*. The Agencies' *Horizontal Merger Guidelines* state that "the Agencies [do not] evaluate the competitive effects of mergers between competing buyers strictly, or even primarily, on the basis of effects in the downstream markets in which the merging firms sell." However, this is easier said than done, especially in litigation. It might be difficult for the government to decouple alleged upstream harms from the reality of downstream effects as it seeks to prove its case in court.

Penguin and Simon & Schuster released a joint statement in response to the Complaint in which they stated that the publishing industry is and will remain highly competitive following the transaction. The companies indicate that they "compete with many other publishers including large trade publishers, newer entrants like Amazon, and a range of mid-size and smaller publishers all capable of competing for future titles from established and emerging titles." The Complaint attempts to diminish the significance of that competition, including from Amazon—one of several "Big Tech" firms that have been subject to scrutiny by the Biden Administration for its alleged market power. Threading that needle (among others) could prove challenging for the government during the litigation.

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 are associated.

ENDNOTES:

¹See Michael A. Gleason & Lauren Miller Forbes, Executive Order Signals New Era in Antitrust Enforcement and Merger Review, 25 *The M&A Lawyer* 7, 1 (July/Aug. 2021).

²Memo from Federal Trade Comm'n Chair Lina M. Khan to Commission Staff and Commissioners re Vision and Priorities for the FTC of Sept. 22, 2021, available at https://www.ftc.gov/system/files/documents/public_statements/1596664/agency_priorities_memo_from_chair_lina_m_khan_9-22-21.pdf.

³Press Release, Justice Department Issues Statement on the Vertical Merger Guidelines (Sept. 15, 2021), available at <https://www.justice.gov/opa/pr/justice-department-issues-statement-vertical-merger-guidelines>.

THE EU ANTI-SUBSIDY REGULATION: IMPLICATIONS FOR M&A

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The European Union is readying revolutionary new powers for the European Commission ("the Commission") to combat distortions of competition resulting from subsidies from non-EU governments. The new regime, laid out in a proposed regulation ("the Anti-Subsidy Regulation") published in May 2021,¹ could be in effect as soon as mid-2023. The regulation includes new mandatory notification and approval requirements triggered by certain acquisitions, mergers and joint ventures that will apply alongside the existing EU and national merger control and foreign direct investment screening regimes.

The Anti-Subsidy Regulation addresses concerns that non-EU State-owned enterprises ("SOEs")