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Peabody and Arch Coal Walk Away from Joint Venture After District Court Grants FTC’s Request for Preliminary Injunction

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On September 29, 2020, Judge Sarah Pitlyk, a 2019 Trump appointee to the Eastern District of Missouri, granted the Federal Trade Commission’s request for a preliminary injunction barring two thermal coal producers, Arch Resources and Peabody Energy Corporation, from creating a joint venture of their Wyoming coal mining facilities. The case is instructive for multiple reasons, including as a reminder that Section 7 of the Clayton Act is not limited to acquisitions, but can be used to challenge joint ventures. In this case, all of the typical merger litigation issues came into play, with the principal focus, as in many litigated merger cases, on product market definition.

The joint venture between Peabody and Arch arose in the context of the highly-complicated world of electricity generation in the United States, which added to the length of Judge Pitlyk’s comprehensive and well-reasoned 88-page ruling. Peabody and Arch are two of the largest coal producers in the United States. Without getting into the great level of detail necessary to fully understand the electrical distribution system, here, despite the increasing prevalence of natural gas largely due to its plummeting prices, the FTC was able to sustain a product market definition of one type of coal mined in the Southern Powder River Basin (SPRB)—the precise focus of the parties’ joint venture.

Product Market Leads the Way

As the court put it in identifying the government’s burden here, definition of a product market is a “mission-critical” task for the FTC.[1] Here, the FTC sought to define the product market in two ways. First, the FTC utilized economic modeling described in the merger guidelines, to which it regularly turns—the hypothetical monopolist test. Secondly, the agency introduced evidence analyzing the traditional *Brown Shoe* factors that have been part of product market jurisprudence for nearly 60 years.[2]

The FTC presented the expert opinion of Dr. Nicholas Hill, who offered an application of the hypothetical monopolist test (HMT). In that test, economists model whether a potential monopolist in

a proposed market could profitably increase the price of its product by a small but significant amount, often 5%. If modeling shows that a hypothetical monopolist could do so, the market is appropriately defined. Utilizing the HMT, the FTC defined a narrow market of SPRB coal; that is, coal mined at the Southern Powder River Basin, the geography in which the parties' JV was to operate.

The court next analyzed the *Brown Shoe* factors. Those factors are qualitative factors that lend credence to whether a product market is appropriately defined. They include: industry/public recognition of the market as a separate economic entity; the product's peculiar characteristics and uses; unique production facilities; distinct consumers; distinct prices; sensitivity to price changes; and specialized vendors.

Judge Pitlyk's analysis of the *Brown Shoe* factors can best be described as leading to a draw, slightly favoring the FTC. In essence, while the FTC made a showing of industry recognition of a SPRB coal market, distinct SPRB coal customers, and unique production facilities, the Defendants also made numerous arguments pointing out that SPRB competed directly with natural gas and alternative fuels, arguing that natural gas pricing affected and disciplined SPRB pricing and suggesting that a market involving interfuel competition might satisfy some of the factors. The Defendants' arguments, however "d[id] nothing to counter the evidence—both quantitative and qualitative—that SPRB coal qualifie[d] as a relevant product market within which to evaluate the effects of the proposed JV."

Utilizing both the quantitative and qualitative analyses of product market definition, Judge Pitlyk sided with the FTC and agreed with the agency's market definition. Once the product market was defined, the FTC was more or less "home free." To demonstrate potential anticompetitive effects, the parties moved to econometric measures of market concentration, the Herfindahl-Hirschman Index (HHI). By these measures, the parties seek to measure how concentrated a market is, and the effect of a particular transaction on that concentration.

Dr. Hill calculated that the joint venture would increase the SPRB coal market's HHI by over 2,200 points, resulting in a market concentration of 4,965. This change in HHI would bring the market from slightly categorized as "highly concentrated" to one clearly within the "highly concentrated" category, and is more than enough for the government to be given a presumption of anticompetitive harm. This is unsurprising given that the proposed JV combination of Peabody and Arch's SPRB mining assets would lead the two companies to control approximately 65-70% of all SPRB coal produced, and the JV would operate five of the top ten most productive mines in the United States.

Efficiencies Analysis

While no court has ever held that efficiencies, on their own, will be sufficient to rebut a finding of anticompetitive harm, the parties here, as do most merger defendants, advanced a full-fledged efficiency defense. Judge Pitlyk noted that she was "not aware of any case, and Defendants have cited none, where the merging parties have successfully rebutted the government's prima facie case on the strength of efficiencies." Nevertheless, she gave some credence to the Defendants' efficiencies arguments, particularly calculations from their expert economist, Dr. Mark Israel, that the JV would achieve $337.4 to $495.1 million in variable cost savings and $164.4 to $277.8 million in variable cost savings in the first five years of the JV. Dr. Israel asserted that the JV would therefore result in lower prices.

With all efficiencies arguments, purported efficiencies must be cognizable, meaning they must be verifiable and merger-specific (here, JV-specific). Basically, the parties must prove that the efficiencies are real and one could not obtain them absent the transaction. Moreover, the efficiencies

cannot be due to anticompetitive reductions in output or service.[3] Judge Pitlyk reviewed the sides' various efficiencies arguments, and held that many of the parties' efficiencies arguments were in fact verifiable and merger-specific (although not all). But even after crediting some portion of efficiencies, Judge Pitlyk ultimately held that efficiencies did not rebut the presumption of likely anticompetitive effect. That is because "even granting Defendants every dollar of their claimed efficiencies . . . and making the implausible assumption that they would pass every penny of those efficiencies on to their customers, Defendants' claimed efficiencies still would not offset the likely competitive harm to those same customers . . . ." This holding is not surprising, given the non-existence of a true "efficiencies defense."

Uncertainty Regarding the Future of Coal Production Insufficient to Rebut Standard Economic Modeling

Arch and Peabody sought to enter into this joint venture to mitigate the effects of the coal industry's overall decline on their employees and investors. Recognizing the shift in energy generation away from coal, Arch Resources had previously changed its name from Arch Coal in May of this year. The company was seeking to "shrink [its] operational footprint" in the SPRB, and allowing Peabody to largely operate the JV would go a long way in allowing it to do so.

Given the declining future of the coal industry due to the shift towards natural gas and renewable sources of energy, the State of Wyoming filed an amicus brief in support of the joint venture. Wyoming asserted that the industry was at risk of unforeseen abrupt mine closures and bankruptcies, which could adversely affect the entire state. It asserted that the court needed to choose between "a haphazard consolidation via bankruptcies and '[t]he thoughtful planned consolidation of coal mines in Wyoming. . . .'" The state further argued that the parties' JV could help avoid unplanned job losses in the state. The arguments were unavailing, showing once again that typical economic analysis of market definition, market concentration, and the like, most often carry the day in merger litigation. Even though the court was aware at the time that the parties would abandon the JV should an injunction be granted—which they now have—Judge Pitlyk granted the government's motion.

This case serves as a reminder that joint ventures are not safe from antitrust scrutiny, and indeed, litigation. The Clayton Act provides the government with the authority to challenge JVs, and antitrust risk analysis should be performed at the beginning of a JV contemplation. In performing this risk analysis, parties must recognize that an antitrust analysis could very well find that the products involved in the JV are a distinct antitrust product market.

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[1] Earlier in 2020, the FTC was denied a preliminary injunction in its challenge of a merger of Evonik and PeroxyChem, two of the five North American suppliers of hydrogen peroxide. The district court held that the agency failed to meet its burden to define *both* a relevant product and geographic market. *F.T.C. v. RAG-Stifung et al.*, 2020 WL 53290 (D.D.C. Feb. 3, 2020).

[2] Some, including now Justice Kavanaugh, have attacked that precedent as "free-wheeling" and not in line with modern merger practice. *See F.T.C. v. Whole Foods Market, Inc.*, 548 F.3d 1028, 1058-59 (D.C. Cir. 2008) (Kavanaugh, J., dissenting). Nevertheless the *Brown Shoe* factors are still regularly utilized by the courts in merger litigation.

[3] *See* Horizontal Merger Guidelines, § 4.

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