EnergySolutions—Waste Control Specialists Merger Challenge Takeaways

By Sonia Kuester Pfaffenroth and Seth Wiener

A year and a half after it had been announced and following a two week trial, the proposed acquisition of Waste Control Specialists (WCS) by EnergySolutions came to an end following the decision by the U.S. District Court for the District of Delaware to enjoin the merger on June 21, 2017.[1] The court determined that the combined company would have at or near monopoly shares in two relevant markets -- 100 percent share for higher-activity low-level radioactive waste (LLRW) disposal and a 96.7 percent share for lower-activity LLRW disposal.[2] Despite the parties' assertion that WCS was a failing firm, the court held that the defense was inapplicable because the parties failed to show WCS had made a good faith effort to seek reasonable alternative offers.

This district court's opinion is instructive with respect to its approach to market definition, the importance of ordinary course documents in assessing competitive effects, and the requirements of the failing firm defense.

Background

EnergySolutions's acquisition of WCS would have combined two providers of LLRW disposal services. These services involve the treatment, storage, and disposal of any waste other than spent uranium fuel or waste materials remaining after spent fuel is reprocessed.[3] Commercial sources of LLRW include hospitals and research facilities, but nuclear power plants generate more than 90% of LLRW.[4] The Antitrust Division of the Department of Justice (DOJ) sued to enjoin the acquisition in November 2016, arguing that the transaction would reduce competition for LLRW disposal services in four separate product markets.[5]

DOJ defined the relevant markets as: (i) lower-activity operational LLRW disposal; (ii) lower-activity decommissioning LLRW disposal; (iii) higher-activity operational LLRW disposal; and (iv) higher-activity decommissioning LLRW disposal.[6] These distinctions were based on whether the waste generated came from an operational facility or from the decommissioning process (operational vs. decommissioning) and on the level of radiation emitted from the waste (higher vs. lower activity). Defendants argued that there was no overlap with respect to higher-activity LLRW as they offered different services and had

[1] Opinion, United States v. Energy Solutions, Inc. et al., Civ. No. 16-1056-SLR at *52 (D. Del. June 21, 2017). The parties formally terminated the transaction agreement on June 23, 2017.
[2] *See id.* at *40-*42.
[3] *Id.* at *5.
[4] LLRW generated by federal government entities is regulated under a separate scheme and have access to disposal alternatives that commercial entities do not. *See* Complaint, United States v. Energy Solutions, Inc. et al., Civ. No. 16-1056-SLR at ¶¶ 57 (D. Del. Nov. 16, 2016), *available at* https://www.justice.gov/atr/case-document/file/911051/download.
[5] *Id.* at ¶¶ 2-3.
[6] *Id.* at ¶¶ 53-56.

different capabilities for disposing of higher-activity LLRW -- WCS could dispose of the waste directly while EnergySolutions had to use an additional process before it could dispose of higher-activity waste. Defendants further claimed that the government's lower-activity LLRW markets were too broad.

The defendants also attempted to mount a "failing firm" defense. They claimed that absent the merger, WCS was likely to exit the market as a competitor. According to defendants, WCS had not been profitable as it faced high fixed costs due to regulatory requirements and decreasing volume of LLRW services business. WCS also regularly missed its projections.[7] Moreover, WCS stated that the costs of pursuing new business strained its financial resources and, though lucrative, would not provide the "near-term cash" WCS needed to survive.[8]

DOJ argued that WCS was not in imminent danger of exiting the market thanks to a credit facility provided by its parent, Valhi. In addition, WCS had met its financial responsibilities, such as debt repayments and payroll, and had made investments in new growth opportunities. DOJ also indicated that WCS had pursued new business from customers under long-term agreements with EnergySolutions.[9]

Valhi had explored a sale of WCS to EnergySolutions on and off since May 2013. When the transaction was signed on November 18, 2015, the agreement included a "no-talk" provision prohibiting Valhi from negotiating with alternative buyers and a "no-shop" provision prohibiting Valhi from seeking, initiating, or encouraging an alternative transaction. Though Valhi had contacted another potential buyer prior to signing, it did not respond to that potential buyer's due diligence requests or provide access to WCS' physical sites or data room. Valhi did provide an opportunity for this alternative buyer to make an offer, but Valhi had already agreed to exclusivity with EnergySolutions when the alternative buyer responded.[10] Others expressed interest after the transaction with EnergySolutions signed, but neither Valhi nor WCS responded.[11]

Relevant Product Markets

The district court considered DOJ's proposed market definition and adopted it in part, recognizing the differentiation between the processing of lower-activity and higher-activity LLRW.[12] The district court declined, however, to further divide the market between operational or decommissioning LLRW. The court concluded that although there were differences, including how the companies would bid, the volumes of waste generated, and the methods by which the waste streams were generated,[13] the disposal options were substantively the same and that these differences did not justify segmenting higher- and lower-activity LLRW disposal services further.

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[7] Opinion at *24.
[8] *Id.* at *26-*27.
[9] *Id.* at *24-*25.
[10] *See id.* at *27-*31.
[11] *Id.* at *30.
[12] *Id.* at *33.
[13] *Id.*

The district court also did not find persuasive defendants' argument that there was no overlap. According to the district court, the differences in the method of disposal "are not meaningful, because products put to the same end use are reasonably interchangeable even though the method by which they are produced or consumed are the same."[14] Because the court considered these processes for higher-activity LLRW disposal to be reasonably interchangeable, and customers would "switch back and forth" between products depending on discounting, the companies could be considered competitors.[15] Similarly, the district court rejected defendants' argument that the market for lower-activity LLRW was overly broad because "the evidence shows that all of the facilities disposing of lower-activity LLRW . . . compete against each other."[16] Finally, the district court rejected the defendants' argument that they did not compete because they did not have complete product offering overlap.[17]

The court's decision focused on the reasonable interchangeability of the parties' services when ruling on the relevant markets. In so doing, the court's fact-specific inquiry cut both ways. It considered the further segmentation that DOJ alleged unnecessary while also rejecting the defendants' argument that their businesses did not compete against one another. The nature of the inquiry means that a court need not accept the relevant market asserted by either party, but can draw from evidence presented by both parties to interpret the facts in the record. A party that seeks to draw formalistic or overly technical distinctions in tension with market realities may not find a receptive judicial audience.

Ordinary Course Evidence

As has become increasingly common in merger challenges, DOJ underscored its case with the parties' own internal documents to demonstrate head-to-head competition. For example, an Energy Solutions internal email references the need "to change pricing approach in order to compete with WCS continued price spiral downward."[18] A WCS email noted that "EnergySolutions is the only competitor . . . . WCS's offering is designed to be competitive with the ES option . . . ,"[19] while a WCS Business Plan stated, "ES is attacking on every front . . . ."[20] The court's conclusion that the defendants were competitors found support in these types of documents.[21] Indeed, the court cited as evidence of head-to-head competition EnergySolution's antitrust suit against WCS in which EnergySolutions claimed to be "WCS's only competition in the market for disposal of Class B and C waste."[22]

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[14] *Id.* at *34.
[15] *Id.* at *34-*35.
[16] *Id.* at *36
[17] *See id.* at *37-*38.
[18] Plaintiff's Opening Statement, United States v. Energy Solutions, Inc. et al., Civ. No. 16-1056-SLR at *8 (D. Del. Apr. 24, 2017), *available at* https://www.justice.gov/atr/case-document/file/959896/download.
[19] Plaintiff's Closing Statement United States v. Energy Solutions, Inc. et al., Civ. No. 16-1056-SLR at *49 (D. Del. May 5, 2017), *available at* https://www.justice.gov/atr/case-document/file/964601/download.
[20] Opening Statement at *5.
[21] *See* Opinion at *17-*18, *23-*24.
[22] *See id.* at *16.

These kinds of ordinary course statements, contained in both internal and external documents and emails, can be persuasive both to the agency investigating a proposed transaction and ultimately to a finder of fact because they contain the parties' own views about competition and their competitors. Overcoming ordinary course statements can be an uphill battle when these documents contradict the arguments and theories of competition a company may wish to assert to the antitrust agencies or in court.

Failing Firm Defense

The district court acknowledged that there was "evidence to support both sides" with respect to WCS' ongoing viability, but did not reach the issue.[23] Rather, the court focused on the manner in which the sale process unfolded and determined its deficiencies sufficient to reject the failing firm defense because the merging parties failed to demonstrate a "good-faith effort" to seek reasonable alternative offers from another buyer. When WCS' parent, Valhi put WCS up for sale in 2016, Valhi "left [the only other potential bidder] in the dark about the sale process before abruptly ending discussions without obtaining a bid." The court explained that this meant Valhi "essentially engaged in a single bidder process," rather than a good faith effort to elicit reasonable alternative offers.[24] The court also criticized the merger agreement's "no talk" provision, which prohibited WCS from negotiating with other buyers, even though there was evidence of other potential suitors interested in acquiring WCS.[25]

As this case demonstrates, parties seeking to assert the failing firm defense must clear a high bar. To successfully raise the defense, merging parties must go beyond a demonstration of the target's inability to meet its financial obligations and to reorganize successfully. The merging parties must show that the firm is likely to exit the market without the proposed transaction. In addition, the target firm must have, through a good-faith process, sought reasonable alternative offers that would present fewer competitive concerns. In other words, the parties must show that following a good faith effort, the target firm's only alternative to the instant transaction is to go out of business. But where the transaction agreement explicitly prohibits exploring alternatives, as the EnergySolutions-WCS agreement did, asserting the "failing firm" defense is significantly more risky.

Conclusion

Merging parties should consider carefully the manner in which they compete with one another and the degree to which customers can substitute the parties' product or service offerings in assessing the potential impact of a transaction. Documents created not only during the pendency of the merger, but also in the ordinary course, can be persuasive evidence of the nature and degree of competition between the parties and in the market. Finally, merging parties that may wish to rely on the failing firm defense should remember

[23] *Id.* at *49.
[24] *See id.* at *50.
[25] *Id.*

that even if the company in question is technically failing, where the procedural requirements of the defense regarding alternate buyers are not met, the defense may be rejected.

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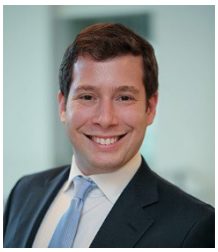

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