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The FTC Wins a Merger Preliminary Injunction: *FTC* v. *CCC Holdings, Inc.*

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The Federal Trade Commission (FTC) recently persuaded a district court to issue a preliminary injunction to block a transaction pending an administrative trial. The matter combined two of the three leading companies that sell specialized computer software to insurers and automotive repair shops for use in dealing with automobile insurance claims: CCC Information Services, Inc. (CCC) and Mitchell International, Inc. (Mitchell) (together, Defendants). That the FTC would win a case that involved a merger from three to two competitors is not particularly surprising. What is interesting about the 85-page opinion by Judge Collyer of the District Court of the District of Columbia is that (i) it provides further guidance on the standard to be used when the FTC seeks a preliminary injunction and (ii) it contains a thoughtful discussion of the elements required to show the likelihood of either coordinated or unilateral anticompetitive effects arising from a transaction.

THE PROCEEDINGS AND THE STANDARD

In an early hearing in the proceeding[1], the FTC argued that the decisions in the *Heinz*[2] and *Whole Foods*[3] matters allowed the court to decide the FTC's request for a preliminary injunction on the papers. Defendants argued that a full evidentiary hearing was appropriate. In the course of that discussion, the court asked the FTC to "tell me what you think Whole Foods stands for, in its most recent iteration… I mean, do we have a decision?" The FTC responded that "on the standard of what the likelihood of success means, which is 'Are there serious and substantial questions?'," the judges agreed with each other, and "that part of the case is controlling." The FTC indicated that under *Heinz*, *Whole Foods*, and *Food Town*[4], it is not the court's role "to try to iron out all the disputes and figure out who's right and who's wrong. That's for the judge over at the FTC to do." Counsel for Defendants agreed with that standard, but indicated that the question is what was needed for the court to make a fair and informed decision and that an evidentiary hearing was necessary.

The court agreed with Defendants and held a total of nine days of evidentiary hearings and legal arguments.[5] At the end of the hearing, and after consideration of 15 boxes of documentary evidence and nearly 300 pages of proposed findings of fact, along with "highly refined and informative legal briefing," the court found for the FTC. In

1 Scheduling Conference, *FTC* v. *CCC Holdings, Inc.,* No. 1:08-cv-02043 (D.D.C. Dec. 3, 2008).
2 *FTC* v. *H.J. Heinz Co.*, 246 F.3d 708 (D.C. Cir. 2001).
3 *FTC* v. *Whole Foods Mkt., Inc.*, 548 F.3d 1028 (D.C. Cir. 2008).
4 *FTC* v. *Food Town Stores, Inc.*, 547 F.2d 247 (4th Cir. 1977).
5 *FTC* v. *CCC Holdings, Inc.*, No. 1:08-cv-02043, slip op. at 3 (D.D.C. Mar. 18, 2009).

rendering her opinion, Judge Collyer indicated at the outset that she was issuing the requested injunction "because the FTC has raised questions going to the merits so serious, substantial, difficult, and doubtful as to make them fair ground for thorough investigation, study, deliberation, and determination by the FTC in the first instance and ultimately by the Court of Appeals," citing *Heinz* and *Whole Foods*.[6]

While the court may not "simply rubber-stamp an injunction whenever the FTC provides some threshold evidence,"[7] the analysis of likelihood of success "measure[s] the probability that, after an administrative hearing on the merits, the Commission will succeed" in proving that the effect of a merger "may be to substantially lessen competition."[8]

The court reiterated this standard when finding that coordination was likely to occur. The court stated:

> Whether the Defendants' argument that the unique combination of factors in these markets negates the probability that the merger may tend to lessen competition substantially, or whether the FTC is correct that the market dynamics confirm the presumptions that follow its *prima facie* case is ultimately not for this Court to decide. [As the *Whole Foods* court said] "the district court's task is not 'to determine whether the antitrust laws have been or are about to be violated. That adjudicatory function is vested in the FTC in the first instance'." The Defendants' arguments may ultimately win the day when a more robust collection of economic data is lain before the FTC. On this preliminary record, however, the Court must conclude that the FTC has raised questions that are so "serious, substantial, difficult and doubtful" that they are "fair ground for thorough investigation, study, deliberation and determination by the FTC."[9]

This decision further solidifies the standard set forth in *Heinz* and *Whole Foods* that the FTC need not prove that the transaction is anticompetitive, nor that it will win at an administrative trial. It must only raise sufficient questions to warrant a further trial. However, there is nothing about the district court opinion that makes the court's determination a rubber stamp. The court, contrary to the FTC's wishes, held a full evidentiary hearing.

Nor did the court end its analysis after concluding that the transaction reduced the number of meaningful competitors from three to two. Noting in the introductory comments that the FTC "[posits] that a three-to-two merger in the partial loss and total loss software markets would obviously and substantially harm competition," the court went on to say that it "finds the evidence more complicated and uncertain."[10] Again, in discussing the market structure, the court held that "[t]he FTC repeatedly proclaimed that this transaction represents a 'merger-to-duopoly,' that is, a three-to-two merger, as if that settles the question."[11] The FTC relied on *Heinz* for the proposition that no merger to duopoly has been approved "under similar circumstances."[12] The court, however, found that the FTC "over-reads" the *Heinz* case by ignoring the high barriers to entry and total transparency in pricing that underscored the risk of coordination.[13]

The court also examined the "public equities," as that is a separate analysis from the "likelihood of success analysis."[14] The court noted that "[o]nly 'public equities' that benefit consumers can override the FTC's showing of serious questions on the merits."[15] As discussed in the next section, however, the court found no reliable evidence that significant efficiencies would be realized and that cost savings would benefit consumers, nor that innovation benefits were definite or would be realized in the near-term.

MARKET DEFINITION AND CONCENTRATION

CCC and Mitchell make software products that assess the cost of repairing an automobile or, in the event of a total loss, the cost of replacing it. Software products that assess

6 *Id.* at 2 (citing *Heinz*, 246 F.3d at 714–15; *Whole Foods*, 548 F.3d at 1035).
7 *Id.* at 12 (quoting *Whole Foods*, 548 F.3d at 1035).
8 *Id.* at 13 n. 11 (quoting *Heinz*, 246 F.3d at 714).
9 *Id.* at 67–68 (quoting *Whole Foods*, 548 F.3d at 1042 (Tatal, J., concurring); *Heinz*, 246 F.3d at 714–15).

10 *Id.* at 2.
11 *Id.* at 29.
12 *Id.* at 30.
13 *Id.*
14 *Id.* at 82.
15 *Id.* at 82–83. The Court indicated that extraordinary efficiencies might outweigh the FTC's likelihood of success "even when the same efficiencies might not suffice to overcome the presumption in favor of the FTC's *prima facie* case" but provided no explanation as to how that might occur. *Id.* at 83.

the cost of repairs are known as "Estimatics," and software products that assess the replacement value of an automobile are called "total loss software systems" (TLV). Insurance companies and automobile repair facilities use Estimatics, but only insurance companies use TLV.

CCC and Mitchell did not dispute that Estimatics is a relevant product market[16] or that the relevant geographic market for Estimatics is the United States.[17] Two types of Estimatics products exist: "communicating" products that can relay information about the status of partial loss claims between insurance companies and repair facilities, and "non-communicating" products that lack this capability.[18] In the United States, all major automobile insurers and the majority of the 45,000 repair facilities subscribe to at least one Estimatics product.[19]

Although the FTC argued this was a merger of three competitors to two, there are five companies selling Estimatics in the United States: CCC, Mitchell, Audatex North America, Inc. (Audatex), Web-Est LLC (Web-Est), and Applied Computer Resources.[20] However, as of 2007, CCC, Mitchell, and Audatex had approximately a 99% share of the revenue in the US Estimatics market.[21] CCC's share was 48%, Audatex's was 30%, and Mitchell's was 21%.[22] Moreover, Web-Est and Applied Computer Resources only sell "non-communicating" Estimatics, and they sell these only to repair facilities, not to insurers.[23] Based on these market share figures and the corresponding Herfindahl-Hirschmann Indexes (HHIs), the court concluded that the FTC had established a "strong *prima facie* case that a merger between CCC and Mitchell would violate Section 7 of the Clayton Act" with respect to Estimatics.[24]

Although both sides agreed that the United States was the relevant geographic market for total loss valuations, Defendants challenged the FTC's definition of this market as including only TLV sold by CCC, Mitchell, and Audatex.[25] TLV contain comprehensive databases of vehicle sales information that is compiled from many sources and localities.[26] Defendants contended that the FTC's definition fails to account for the fact that insurance companies can calculate total losses in-house by using "book" providers (such as NADA Appraisal Guides (NADA), the Kelley Blue Book, the Red Book, or the Black Book), supplemented by market research provided by their internal staff.[27] Insurance companies use TLV for approximately 90% of all total loss valuations, whereas they use the books and other methods for around 10%.[28] After considering the conflicting assertions of the two sides' experts, the court concluded that "the real-world evidence" shows that the book providers are not in the same product market as TLV.[29] The district court cited statements made by the book providers that they do not consider themselves to be in competition with TLV providers and statements made by insurance companies that the books are not an adequate substitute for TLV.[30] In addition, the court observed that TLV has "substantially different valuation methodologies" than the books, and that the information in the books is not as specific as the information that TLV provides.[31] Finally, the court stated that "there is no evidence to suggest that the price of TLV is sensitive in any way to changes in pricing by Book vendors, or vice-versa."[32] This evidence was enough for the court to conclude that TLV is a separate product market.

According to 2007 market share figures, CCC held 60.7% of the TLV market, Audatex held 34.8%, and Mitchell held only 4.5%.[33] Given these shares and the resulting concentration in the market, the court held that this established a *prima facie* case that the proposed merger would violate Section 7.[34] Even if the books and other valuation methods were included in the relevant product market, the district court

16 *Id.* at 17.
17 *Id.* at 26.
18 *Id.* at 5.
19 *Id.* at 4.
20 *Id.* at 5.
21 *Id.*
22 *Id.* at 28.
23 *Id.* at 5–6.
24 *Id.* at 30.
25 *Id.* at 18.
26 *Id.* at 7–8.
27 *Id.* at 18.
28 *Id.* at 19.
29 *Id.* at 21.
30 *Id.*
31 *Id.* at 23.
32 *Id.* at 24.
33 *Id.* at 29.
34 *Id.*

concluded, the combined entity would still have 50% of this market, and the HHIs would be high enough "to establish a strong *prima facie* case for the FTC."[35]

ENTRY

Having found a *prima facie* case, the court shifted the burden to Defendants "to show that traditional economic theories of the competitive effects of market concentration are not an accurate indicator of the merger's probable effect on competition in these markets or that the procompetitive effects of the merger are likely to outweigh any potential anticompetitive effects."[36] The Defendants attempted to rebut the FTC's *prima facie* case by asserting that the Estimatics and TLV markets lack significant barriers to entry and that existing competitors are "poised for future expansion." The court's opinion rejects this conclusion and includes an extensive analysis of the parties' arguments.

First, the court discussed the recent history of entry in the Estimatics and TLV markets, noting that history of entry is a "central factor" in assessing the likelihood of future entry.[37] With respect to Estimatics, the Defendants cited several examples of entry. The district court was not impressed with this list of supposedly successful entries because only two of the entrants had survived and their combined market share remains below 1%.[38] Moreover, the district court observed that the total number of Estimatics providers had fallen to five, compared to almost a dozen in the 1990s.[39] As for the TLV market, the only recent entrant is Mitchell, which entered in 2005 after two failed attempts.[40] The district court concluded that Mitchell's successful entry into the TLV market was largely attributable to its strong reputation in Estimatics and that no firm without an Estimatics product had ever successfully entered the TLV market.[41]

35 *Id.* at 26. The Court noted, however, that "In any event, the FTC is not 'required to settle on a market definition at this preliminary stage,' and inclusion of the Books in the market would have an insignificant effect on the market shares because over 90% of total loss claims are calculated using TLV." *Id.* at 25 (quoting *Whole Foods*, 548 F.3d at 1036).
36 *Id.* at 31.
37 *Id.* at 32 (quoting *Cardinal Health*, 12 F. Supp. 2d 34, 56 (D.D.C. 1998)).
38 *Id.* at 33–34.
39 *Id.*
40 *Id.* at 35.
41 *Id.*

Second, the court cited several statements that Defendants had made about the existence of barriers to entry in the Estimatics and TLV markets. Mitchell and its majority owner have "advertised the barriers to entry in countless financing and internal documents over the past few years."[42] Similarly, CCC and its owner "have repeatedly noted high barriers to entry in these markets" in sources such as press releases and statements to rating agencies.[43] In a footnote, the court dismissed Defendants' argument that the industry representatives who made such statements were not antitrust lawyers and were not referring to entry barriers in an "antitrust sense."[44] The court said that it "recognizes the caution but, even discounting the statements as puffery, finds that they are supported by the preliminary record."[45]

Third, the court discussed a variety of "technical barriers" to entry. Estimatics and TLV products must include a database, and the court found that creating a database for either product would take several years and cost millions of dollars.[46] Although the court acknowledged that new entrants could purchase a license to use an existing database, it said that the costs of doing so would probably be prohibitive.[47] In addition, the court found that the complex software component of a competitive Estimatics or TLV product would take one to two years to develop.[48] Even if a new entrant could develop a comparable Estimatics or TLV product, the court concluded, it would be difficult to persuade most customers to switch. Insurance companies often require or recommend that repair shops use the same Estimatics product that the insurance company uses, making it difficult for repair shops to make a unilateral decision to switch.[49] The court also cited the time and cost involved in changing vendors as a significant obstacle to any new entrant's efforts to gain market share.[50]

42 *Id.* at 35.
43 *Id.* at 36.
44 *Id.* at 35 n.26.
45 *Id.*
46 *Id.* at 38–39, 41.
47 *Id.* at 39–40.
48 *Id.* at 41–42.
49 *Id.* at 44.
50 *Id.* at 44–45.

The court proceeded to discuss three "lesser barriers to entry": reputation, scale, and relationships.[51] Although it acknowledged that "[t]he significance of reputational barriers to entry in antitrust analysis is a somewhat unsettled question," the court concluded that reputation can be relevant in markets in which customers have emphasized its importance.[52] The court identified evidence in the record suggesting that insurance companies place a high value on reputation, such as the fact that many of them require multiple years of audited financial statements and multiple references from other customers before choosing an Estimatics or TLV vendor.[53] With regard to scale, the court pointed out that it would be difficult for new entrants to match the resources of the three major players, which have hundreds of employees around the country to provide customer service and technical support.[54] In terms of relationships, the court said that the three largest companies have a "large head start" over recent and potential new entrants.[55]

Fourth, the court considered the possibility that "predictive analytics," which is "an internal method of calculating future estimates based on an insurance company's own empirical data," may render Estimatics software obsolete in the near future.[56] The court deemed this possibility too speculative, noting that no insurance company has yet implemented predictive analytics.[57]

LITIGATING THE "FIX"

Although buried in a discussion of the barriers to entry, the court also discussed Defendants' attempt to remedy the anticompetitive concerns by making Web-Est, a supplier of a non-communicating Estimatics product to repair facilities, a more formidable competitor. Although the government often tries to preclude evidence of actions Defendants will take contingent on the merger closing, the court freely considered this evidence. Defendants' proposed remedy was for Mitchell to enter into a license agreement with Web-Est, effective only upon closing of the merger.[58] The license would remove restrictions on Web-Est's rights to sell to certain customers and expand its rights in other ways.[59] Although Web-Est does not currently offer a communicating Estimatics product, its software contains a dormant communicating product that it can "turn on" at any time.[60] According to Defendants, Web-Est provides a "web-based" alternative to the "brick and mortar" Estimatics business model that could revolutionize the Estimatics industry just as Netflix revolutionized the movie rental industry.[61] The court was not persuaded. It said that it was impossible to tell whether insurance companies and repair facilities would deem Web-Est's communicating product to be comparable to the established Estimatics products.[62] Moreover, the court expressed doubt about whether Web-Est would be a truly independent actor, given Mitchell's role in establishing Web-Est and the fact that Web-Est would continue to license Mitchell's database for at least five years after the merger.[63]

RISK OF ANTICOMPETITIVE EFFECTS

The court considered two theories of anticompetitive harm: coordinated effects and unilateral effects. It found that coordinated effects were likely, but deemed the FTC's evidence of likely unilateral effects insufficient.

With respect to coordinated effects, the court stated that "because the FTC has established a *prima facie* case, the burden is on the Defendants to demonstrate 'structural barriers,' unique to this industry, that are sufficient to defeat the 'ordinary presumption of collusion' that attaches to a merger in a highly concentrated market."[64] The court began by noting that the Estimatics and TLV are highly competitive today.[65] Defendants further argued that "[t]he undisputed market realities here present a perfect storm of factors that impede coordination."[66]

51 *Id.* at 45.
52 *Id.*
53 *Id.* at 46.
54 *Id.* at 46–47.
55 *Id.* at 48.
56 *Id.* at 54.
57 *Id.* at 54–55.

58 *Id.* at 49
59 *Id.*
60 *Id.* at 50.
61 *Id.* at 51.
62 *Id.* at 52.
63 *Id.* at 53.
64 *Id.* at 55 (quoting *Heinz*, 246 F.3d at 725).
65 *Id.* at 56.
66 *Id.* (quoting Defs.' Post-Trial Brief at 16).

As to Defendants' argument that product heterogeneity made reaching terms of coordination difficult, the court found that while the products and offerings were somewhat different, "CCC, Mitchell, and Audatex have essentially the same suite of product offerings and add-ons, and are therefore unable to separate themselves from the pack on a consistent basis through unique sets of products."[67] The court also addressed Defendants' arguments that the lack of pricing transparency impeded coordination. The court noted that "pricing for insurance company contracts is not 'routinely available'"[68] but also stated that pricing is not as obscure in the repair facility segment and that TLV prices are more transparent.[69] The court concluded that "the pricing information in these markets is…neither as transparent as the FTC would wish nor as secret as the Defendants would now prefer."[70]

Defendants also argued that large contracts and "the bargaining power and sophistication of their insurance company customers further impede coordination."[71] The court found that the insurance customers were not in a concentrated market, but that "the larger automobile insurance companies have enough buying power to demand customized products and to use their leverage regularly to keep Estimatics prices low."[72] In sum, the court concluded "the heterogeneity of the base products and customized bundling, the largely confidential pricing, and the high-value insurance contracts tend to make tacit coordination less likely than the huge HHIs might predict."[73]

The court went on to note, however, that "Defendants ignore a number of other factors present in these markets that would tend to confirm the HHI's predictions regarding the likelihood of coordination."[74] First, both Estimatics and TLV are "'stable' markets in which the same three companies have been competing against each other for over a decade."[75] Since the markets have little room for growth, the competitors have not tried to engage in price wars to gain market shares.[76] The court also pointed to high switching costs and the risk of product heterogeneity leading to segmentation of the market and more entrenched shares.[77] The court concluded that "[i]n a highly concentrated market, with stable market shares, low growth rates and significant barriers to entry, there are few incentives to engage in healthy competition. Although the FTC has exaggerated the legal significance of the 'merger-to-duopoly' inquiry, it is clear that CCC/Mitchell and Audatex will likely be the only major players in these markets for the foreseeable future."[78]

The FTC also considered whether unilateral effects were likely. "The unilateral effects theory surmises that firms do not recognize their shared interest in elevating price, whereas the coordinated effects theory assumes that they do."[79] The key point for determining whether unilateral anticompetitive effects were likely is "whether a significant percentage of consumers view CCC and Mitchell as their first and second choice, and Audatex is a 'more distant third'."[80] Although the FTC's economist had theoretical models showing price effects, "[t]he main problem with Dr. Hayes's models is that data and predictions cannot reasonably be confirmed by the evidence on this record."[81] The FTC argued there is a presumption that a significant share of customers view the merged firms' products as their first and second choices if the merged firm has a share of at least 35%.[82] However, the court, quoting the Merger Guidelines, noted that such a presumption is warranted only if "each product's market share is reflective of not only its relative appeal as a first choice to consumers of the merging firms['] products but also its relative appeal as a second choice, and hence as a competitive constraint to the first choice."[83] The court found the evidence "sorely lacking" on these points.[84]

67 *Id.* at 58.
68 *Id.* at 59–60.
69 *Id.* at 60–61.
70 *Id.* at 61–62.
71 *Id.* at 62.
72 *Id.* at 63.
73 *Id.*
74 *Id.*
75 *Id.*

76 *Id.* at 64–65.
77 *Id.*
78 *Id.* at 66–67.
79 *Id.* at 68.
80 *Id.* at 69.
81 *Id.* at 72.
82 *Id.*
83 *Id.* (quoting Merger Guidelines § 2.211).
84 *Id.* at 74.

EFFICIENCIES AND INNOVATION

Defendants argued that the merger would generate efficiencies that would offset any potential anticompetitive effects. Observing that "the trend among lower courts" is to recognize an efficiencies defense in Section 7 cases,[85] the court considered Defendants' arguments but ultimately rejected them. The court stated that when the relevant market is highly concentrated and high barriers to entry exist, the parties opposing a preliminary injunction must provide "proof of extraordinary efficiencies" to rebut the presumption of anticompetitive effects.[86] The defendants asserted that the merger would produce cost savings of from US$48 to US$55 million per year through elimination of overlapping functions.[87] Although the court acknowledged that this projected savings would be substantial, it also noted that it would take at least two to three years for the merged entity to eliminate redundancies and perhaps as many as 10 years to complete the firms' integration.[88] In light of the instruction in the Merger Guidelines that delayed benefits from efficiencies should be given less weight than short-term ones, the district court declined to place much importance on the projected cost savings.[89] The court also stated that the extent of the cost savings was not clear, especially because Defendants' own financial consultants had provided much lower estimates of savings.[90] Even if Defendants could achieve significant and timely cost savings, the court said, any benefits to customers would be offset by the fact that many customers would incur costs from switching to the software platform that survived the merger.[91] Moreover, the court quoted several representatives of the companies who said that the savings could lead to higher profits rather than lower prices.[92]

Defendants also argued that the merger would spur innovation by allowing the merged entity to spend part of its cost savings on research and development.[93] The court was not persuaded that the company would use any cost savings for this purpose.[94] The court also expressed doubt that such a benefit would be merger-specific, citing testimony by a CCC representative that CCC could already afford to spend more on research and development as long as its shareholders were willing to accept a smaller return.[95] Also, the court cited (but did not explicitly adopt) a statement from the Areeda antitrust treatise that the "innovations" defense should be limited to firms in the market whose small size "forces them to accept higher per-unit costs for research and development than larger firms in their market must pay…."[96] As two of the three largest firms in both relevant markets, Defendants would not be eligible for the defense under this standard.

CONCLUSION

The court gave the FTC the win it had been looking for in a merger case for some years. In doing so, it upheld a standard that gives considerable—but not complete—deference to the FTC's views on a merger. At the same time, the court refused to decide this matter on the papers and conducted a full hearing, giving Defendants an opportunity to present their case as they chose. And ultimately, the court decided the case on the facts as it saw them.

If you would like more information about any of the matters discussed in this advisory, please contact your Arnold & Porter attorney or:

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85 *Id.* at 76 (quoting *Heinz*, 246 F.3d at 720).
86 *Id.* at 77 (quoting *Heinz*, 246 F.3d at 720).
87 *Id.* at 77–78.
88 *Id.* at 78.
89 *Id.* (quoting Merger Guidelines § 4 n. 37).
90 *Id.* at 79.
91 *Id.* at 79–80.
92 *Id.* at 80.
93 *Id.* at 81.
94 *Id.*
95 *Id.* at 81–82.
96 *Id.* at 81 (citing Phillip E. Areeda, *et al*, IVA *Antitrust Law* ¶ 975g, at 94 (2d ed. 2006)).