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8
9 UNITED STATES DISTRICT COURT
10 NORTHERN DISTRICT OF CALIFORNIA
11 SAN FRANCISCO DIVISION

12 _____
13 UNITED STATES OF AMERICA, et al.,

14 Plaintiffs,

15 v.

16 ORACLE CORPORATION

17 Defendant.
18
19 _____

) CASE NO. C 04-0807 VRW

) Filed July 8, 2004

) **PLAINTIFFS' PROPOSED**
) **CONCLUSIONS OF LAW**

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1 **Conclusions of Law**

2 **1.1 Clayton Act Section 7 Standards**

3 1.1.1 Section 7 of the Clayton Act, as amended, bars acquisitions “where in any
4 line of commerce in any section of the country, the effect of such acquisition may be
5 substantially to lessen competition, or to tend to create a monopoly.” 15 U.S.C. § 18.
6 “Section 7 of the Clayton Act was intended to arrest the anticompetitive effects of
7 market power in their incipiency.” *FTC v. Procter & Gamble Co.*, 386 U.S. 568, 577
8 (1967).

9 1.1.2 “Section 7 itself creates a relatively expansive definition of antitrust liability:
10 To show that a merger is unlawful, a plaintiff need only prove that its effect ‘*may be*
11 substantially to lessen competition.’” *California v. American Stores Co.*, 495 U.S. 271,
12 284 (1990). “Congress used the words ‘*may be* substantially to lessen competition’ . . .
13 to indicate its concern with probabilities, not certainties.” *Brown Shoe Co. v. United*
14 *States*, 370 U.S. 294, 323 (1962). A plaintiff need not show “even a high probability”
15 that the proposed transaction will substantially lessen competition. *FTC v. Elders*
16 *Grain, Inc.*, 868 F.2d 901, 906 (7th Cir. 1989) (Posner, J.). “[T]he statute requires a
17 prediction, and doubts are to be resolved against the transaction.” *Id.*

18 1.1.3 The transaction should be enjoined under Section 7 if it has the “potential for
19 creating, enhancing, or facilitating the exercise of market power—the ability of one or
20 more firms to raise prices above competitive levels for a significant period of time.”
21 *United States v. Archer-Daniels-Midland Co.*, 866 F.2d 242, 246 (8th Cir. 1988), *cert.*
22 *denied*, 493 U.S. 809 (1989) (“*ADM*”). In addition to price increases, the exercise of
23 market power can lead to other anticompetitive effects, for example a decline in
24 product or service quality. *See, e.g., United States v. Philadelphia Nat’l Bank*, 374 U.S.
25 321, 368-69 (1963).

26 1.1.4 In *Philadelphia National Bank* the Supreme Court held that “a merger which
27 produces a firm controlling an undue percentage share of the relevant market, and
28 results in a significant increase in the concentration of firms in the market is so

1 inherently likely to lessen competition substantially that it must be enjoined in the
2 absence of evidence clearly showing that the merger is not likely to have such
3 anticompetitive effects.” 374 U.S. at 363. Once “market share statistics” have “made
4 out a prima facie case of a violation of § 7,” it is “incumbent upon [the defendant] to
5 show that the market-share statistics gave an inaccurate account of the acquisitions’
6 probable effects on competition.” *United States v. Citizens & S. Nat’l Bank*, 422 U.S.
7 86, 120 (1975). *See FTC v. H.J. Heinz Co.*, 246 F.3d 708, 715 (D.C. Cir. 2000); *Olin*
8 *Corp. v. FTC*, 986 F.2d 1295, 1305 (9th Cir. 1993); *United States v. Baker Hughes Inc.*,
9 908 F.2d 981, 982-83 (D.C. Cir. 1990). Nevertheless, “the ultimate burden of
10 persuasion remains with the [plaintiff] at all times.” *H.J. Heinz*, 246 F.3d at 715; *Baker*
11 *Hughes*, 908 F.2d at 983.

12 1.1.5 It should be noted that “[m]arket share is just a way of estimating market
13 power, which is the ultimate consideration. When there are better ways to estimate
14 market power, the court should use them.” *Ball Mem’l Hosp., Inc. v. Mutual Hosp.*
15 *Ins.*, 784 F.2d 1325, 1336 (7th Cir. 1986). Hence, in addition to indirect evidence of
16 market power, such as market shares and market concentration figures, courts have
17 considered direct evidence of market power in Section 7 cases when available. *See,*
18 *e.g., FTC v. Swedish Match*, 131 F. Supp. 2d 151 (D.D.C. 2000) (econometric and
19 documentary evidence on the competitive interaction between the merging brands);
20 *FTC v. Staples, Inc.* 970 F. Supp. 1066, 1075-76 (D.D.C. 1997) (econometric and
21 documentary evidence that prices were higher where there were two competitors than
22 where there were three).

23 1.1.6 In the merger context, the standard under Section 1 of the Sherman Act and
24 Section 7 of the Clayton Act is the same. *United States v. Rockford Mem’l Corp.*, 898
25 F.2d 1278, 1281-83 (7th Cir. 1990). Courts frequently use direct evidence to evaluate
26 market power in Section One Sherman Act cases. *See, e.g., Eastman Kodak Co. v.*
27 *Image Technical Servs., Inc.*, 504 U.S. 451, 477, 469-71 & n.15 (1992); *FTC v. Indiana*
28 *Federation of Dentists*, 476 U.S. 447, 460-61 (1986).

1 **1.2 Relevant Market Definition**

2 1.2.1 Courts usually begin an inquiry into market power by defining the relevant
3 product and geographic markets. *Rebel Oil Co. v. Atlantic Richfield Co.*, 51 F.3d 1421,
4 1434 (9th Cir. 1995). However, the “Government is not required to delineate § 7
5 markets by ‘metes and bounds.’” *United States v. General Dynamics Corp.*, 415 U.S.
6 486, 521 (1974).

7 1.2.2 Market boundaries are defined by the “reasonable interchangeability of use”
8 or the “cross-elasticity of demand between the product itself and substitutes for it.”
9 *Brown Shoe*, 370 U.S. at 325. *See also United States v. E.I. duPont de Nemours & Co.*,
10 351 U.S. 377, 400 (1956). Markets “must be drawn narrowly to exclude any other
11 product to which, within a reasonable variation in price, only a limited number of
12 buyers will turn.” *Times-Picayune Publishing Co. v. United States*, 345 U.S. 594, 612
13 n.31 (1953). “The proper question to be asked . . . is not where the parties to the
14 merger do business or even where they compete, but where in the area of competitive
15 overlap, the effect of the merger on competition will be direct and immediate.”
16 *Philadelphia Nat’l Bank*, 374 U.S. at 357.

17 1.2.3 “A ‘market’ is any grouping of sales whose sellers, if unified by a
18 monopolist or a hypothetical cartel, would have market power in dealing with any
19 group of buyers.” *Rebel Oil*, 51 F.3d at 1434. *See also Image Tech. Servs., Inc. v.*
20 *Eastman Kodak Co.*, 125 F.3d 1195, 1203-04 (9th Cir. 1997); *Coastal Fuels of P.R., Inc.*
21 *v. Caribbean Petroleum Corp.*, 79 F.3d 182, 197 (1st Cir. 1996); *Olin Corp.*, 986 F.2d
22 at 1299-1300; *California v. Sutter Health Sys.*, 130 F. Supp. 2d 1109, 1120, 1128-32
23 (C.D. Cal. 2001). The “hypothetical monopolist” test is derived from Supreme Court
24 precedent – *see E.I. duPont de Nemours*, 351 U.S. at 391-92, 400-01 – and has been
25 refined and made operational by government guidelines. U.S. Department of Justice
26 and Federal Trade Commission, *Horizontal Merger Guidelines* § 1, *reprinted in* 4
27 Trade. Reg. Rep. (CCH) ¶ 13,104 (1992, rev’d 1997) (“*Merger Guidelines*”).

1 1.2.4 The best evidence of the likely purchaser response to a price increase is the
2 views of consumers of the products. *FTC v. Butterworth Health Corp.* 946 F. Supp.
3 1285, 1292 (W.D. Mich. 1996), *aff'd*, 1997-2 Trade Cas. (CCH) ¶ 71,863 (6th Cir.
4 1997).

5 *Relevant Product Markets*

6 1.2.5 “The touchstone of market definition is whether a hypothetical monopolist
7 could raise prices.” *Coastal Fuels*, 79 F.3d at 198. Thus, only products that prevent a
8 hypothetical monopolist from significantly increasing price should be included in the
9 relevant market. *See, e.g., United States v. Microsoft Corp.*, 253 F.3d 34, 51-54 (D.C.
10 Cir. 2001) (affirming exclusion of “middleware” and other products from the relevant
11 market for Intel-compatible PC operating systems as, *inter alia*, either too costly or not
12 sufficiently similar to constrain defendant’s prices).

13 1.2.6 Products that are not functionally similar to those sold by the merging firms
14 generally should be excluded from the relevant market. *See id.* at 53-54 (excluding
15 middleware products from the relevant market for operating systems because no such
16 “product could now, or [will] soon, . . . serve as a platform for popular applications
17 [comparable to Microsoft’s Windows], much less take over all operating system
18 functions.”)

19 1.2.7 Products do not compete in the same relevant market merely because they
20 offer functionality that is similar to that offered by the products of the merging firms.
21 *See U.S. Anchor Mfg. v. Rule Indus., Inc.*, 7 F.3d 986, 995-96 (11th Cir. 1993); *ADM*,
22 866 F.2d at 246; *Staples*, 970 F. Supp. at 1074-75, 1078; *United States v. Gillette Co.*,
23 828 F. Supp. 78, 82-83 (D.D.C. 1993).

24 1.2.8 Products that are substantially similar to those sold by the merging firms, but
25 which nevertheless would not prevent a hypothetical monopolist from raising prices,
26 should not be included in the relevant market. *See ADM*, 866 F.2d at 246 (holding that
27 sugar was not in the relevant market for high fructose corn syrup, despite being
28 functionally interchangeable, because the price of sugar was sufficiently high that

1 buyers of high fructose corn syrup would not switch in the event of a five to ten percent
2 price increase).

3 1.2.9 The appropriate relevant product markets in which to analyze the
4 competitive effects of the proposed acquisition are the high-function FMS and high-
5 function HRM software markets. *Relevant Geographic Market*

6 1.2.10 The relevant geographic market is defined using the same “hypothetical
7 monopolist or cartel” test used to define a relevant product market. The smallest
8 geographic area in which the hypothetical monopolist could raise prices constitutes a
9 relevant geographic market. *Merger Guidelines* ¶ 1.21. *See also Philadelphia Nat’l*
10 *Bank*, 374 U.S. at 359 (a geographic market is the “area in which the seller operates,
11 and to which the purchaser can practicably turn for supplies”); *Coastal Fuels*, 79 F.3d
12 at 197-98 (applying hypothetical monopolist test to determine relevant geographic
13 market).

14 1.2.11 When the relevant competitors in the market can be readily identified, it is
15 not necessary to draw the precise boundaries of the relevant geographic market. *See*
16 *United States v. Rockford Mem’l Corp.*, 717 F. Supp. 1251, 1277 (N.D. Ill. 1989), *aff’d*,
17 898 F.2d 1278 (7th Cir.), *cert. denied*, 498 U.S. 920 (1990) (“[A] metes-and-bounds
18 description of the geographic market is not necessary since the identification of the
19 relevant competitors . . . is the aim of defining a geographic market in the first place”).

20 1.2.12 A court can enjoin a proposed merger on the basis of a finding that it would
21 substantially lessen competition in a geographic market broader than that proposed by
22 the Plaintiffs. *See Rockford Mem’l*, 717 F. Supp. at 1262-78 (finding merger unlawful
23 in a market broader than proposed by plaintiff but narrower than proposed by
24 defendants); *California v. American Stores Co.*, 697 F. Supp. 1125, 1129-31 (C.D. Cal.
25 1988) (enjoining merger without deciding between proffered geographic markets), *aff’d*
26 *in relevant part*, 872 F.2d 837 (9th Cir. 1989).

27 1.2.13 The geographic market must “correspond to the commercial realities’ of the
28 industry.” *Brown Shoe*, 370 U.S. at 336. “[I]ndustry or public recognition of the

1 [market] as a separate economic' unit matters because we assume that economic actors
2 usually have accurate perceptions of economic realities.” *Rothery Storage & Van Co.,*
3 *v. Atlas Van Lines*, 792 F.2d 210, 219 n.4 (D.C. Cir. 1986), quoting *Brown Shoe*, 370
4 U.S. at 325; *see also Olin Corp.*, 986 F.2d at 1299. While these cases referred to the
5 product dimensions of markets, the same principles apply to the analysis of a market’s
6 geographic dimensions. *Brown Shoe*, 370 U.S. at 336 (“The criteria to be used in
7 determining the appropriate geographic market are essentially similar to those used to
8 determine the relevant product market.”).

9 1.2.14 In the high-function FMS and HRM software markets alleged in Plaintiffs’
10 Complaint, the economic reality is that consumers in the United States demand that
11 vendors have a sales, marketing, and service organization in the United States. As a
12 practical matter, any producer wishing to sell in the United States must therefore have a
13 presence here. Further, the ability of sellers to price discriminate prevents sales outside
14 the United States from disciplining competition within the United States.

15 1.2.15 The appropriate geographic market in which to analyze the competitive
16 effects of the proposed acquisition is the United States.

17 **1.3 The Proposed Acquisition Would Substantially Lessen Competition in the** 18 **Relevant Markets**

19 1.3.1 Once the Government proves, by a preponderance of the evidence, that the
20 merged firms would control a substantial share of a relevant market and that the merger
21 would significantly increase concentration, a presumption arises that the transaction or
22 combination is illegal. *See Citizens & S. Nat’l Bank*, 422 U.S. at 120; *Philadelphia*
23 *Nat’l Bank*, 374 U.S. at 363; *H.J. Heinz*, 246 F.3d at 715; *FTC v. University Health*,
24 938 F.2d 1206, 1218 (11th Cir. 1991); *Rockford Mem’l*, 898 F.2d at 1285.

25 1.3.2 Evidence that a merger will result in the combined firm having a large
26 market share, particularly in cases where there will be fewer than three significant
27 rivals left in the market post-merger, is sufficient to demonstrate a likelihood of
28 anticompetitive effects. *R.C. Bigelow, Inc. v. Unilever N.V.*, 867 F.2d 102, 107-111

1 (2nd Cir. 1989). Indeed, according to the D.C. Circuit “no court has ever approved a
2 merger to duopoly under similar circumstances.” *H.J. Heinz*, 246 F.3d at 717.

3 1.3.3 A growing number of courts, including courts of this Circuit, apply the
4 *Merger Guidelines*’ approach for assessing pre- and post-merger concentration through
5 use of the Herfindahl-Hirschman Index (“HHI”). *See, e.g., H.J. Heinz*, 246 F.3d at 716;
6 *AlliedSignal, Inc. v. B.F. Goodrich Co.*, 183 F.3d 568, 574 (7th Cir. 1999); *American*
7 *Stores*, 697 F. Supp. at 1128. The HHI for a market is calculated by summing the
8 squares of the individual market shares of all firms participating in the market. *Merger*
9 *Guidelines* ¶ 1.5. When the HHI is above 1800, and an acquisition would result in an
10 increase of more than 50 points, the acquisition is presumed to be “likely to create or
11 enhance market power or facilitate its exercise.” *Id.* ¶ 1.51. “Sufficiently large HHI
12 figures establish [a] . . . *prima facie* case that a merger is anti-competitive.” *H.J. Heinz*,
13 246 F.3d at 716.

14 1.3.4 Oracle’s acquisition of PeopleSoft would significantly increase concentration
15 in the already highly concentrated high-function FMS and HRM software markets. In
16 high-function FMS, the pre-merger HHI is 2,813, and it would rise by 1,020 points to
17 3,833 post merger; the combined Oracle-PeopleSoft share would be 47.4%. In high-
18 function HRM, the pre-merger HHI is 3,835, and it would rise by 1,872 points to 5,707
19 post merger; the combined Oracle-PeopleSoft share would be 69.7%. These figures are
20 significantly above the *Merger Guidelines*’ thresholds (§ 1.51) for presuming that the
21 transaction would substantially reduce competition.

22 1.3.5 Even if the relevant geographic market were worldwide, there would only be
23 three suppliers in the market. The pre-merger HHI in such a market would exceed
24 3,000 (a mathematical certainty with only three sellers in the market), and the post-
25 merger HHI would increase by a substantial amount. Accordingly, the acquisition
26 presumptively harms competition regardless of whether the geographic market is the
27 United States or worldwide.

1 1.3.6 Transactions that eliminate head-to-head competition in markets with very
2 few competitors generally have been found to result in anticompetitive effects. *See*
3 *H.J. Heinz*, 246 F.3d at 716-17; *Staples*, 970 F. Supp. at 1083; *Swedish Match*, 131 F.
4 Supp. 2d at 169. The elimination of head-to-head competition is particularly likely to
5 lead to anticompetitive effects if the products of the merging firms are close substitutes
6 for a significant number of consumers. *See FTC v. Libbey, Inc.*, 211 F. Supp. 2d 34,
7 47-48 (D.D.C. 2002); *Swedish Match*, 131 F. Supp. 2d at 169; *Merger Guidelines* §
8 2.21.

9 1.3.7 The evidence presented at trial – including Defendant’s discount request
10 forms, customer testimony regarding limited alternatives, expert regression analyses,
11 and a merger simulation analysis – further demonstrates that the elimination of head-to-
12 head competition between Oracle and PeopleSoft will result in substantial
13 anticompetitive effects in the high-function FMS and HRM markets.

14 1.3.8 The proposed acquisition would likely result in substantial anticompetitive
15 effects, and is accordingly unlawful.

16 **1.4 Entry or Repositioning Will Not Overcome the Anticompetitive Effects**

17 1.4.1 Defendant may rebut the presumption of illegality by showing that
18 anticompetitive effects are not likely to result because of other market forces, such as
19 the lack of barriers to entry. *See Baker Hughes*, 908 F.2d at 985-89; *United States v.*
20 *Syufy Enters.*, 903 F.2d 659, 664-69 (9th Cir. 1990).

21 1.4.2 The defendant must show that entry would be timely, likely, and of sufficient
22 magnitude to prevent a significant exercise of market power. *See Rebel Oil*, 51 F.3d at
23 1440 (citing *Merger Guidelines*’ “timely, likely, and sufficient” test); *Swedish Match*,
24 131 F. Supp. 2d at 168-69 (defendant has burden to demonstrate repositioning
25 sufficient to “fill the competitive void that would result if the [defendant] is permitted
26 to acquire [the target company].”); *Merger Guidelines* ¶¶ 2.212 n.23 & 3.0. To be
27 “timely,” entry must take place within two years. *See FTC v. Cardinal Health, Inc.*, 12
28 F. Supp. 2d 34, 55 (D.D.C. 1998) (citing *Merger Guidelines*). To be “likely,” entry

1 must be highly probable and not speculative. *See id.* at 57 (“the likelihood of entry . . .
2 is theoretical at best. For the purposes of this case, the Court cannot engage in
3 speculation”). To be sufficient, entry must offset the increase in price or reduction in
4 output or innovation that otherwise would be caused by the acquisition. *See id.* at 58
5 (entry must “be sufficient to offset any post-merger pricing practices that would result
6 from a lack of competition”).

7 1.4.3 Defendant has not offered sufficient evidence that entry or repositioning by
8 companies such as Microsoft, Lawson, or AMS would be timely, likely, and of
9 sufficient magnitude to replace the competition lost because of the transaction.
10 Therefore, Defendant’s entry defense fails as a matter of law.

11 **1.5 Efficiencies Will Not Overcome the Anticompetitive Effects of the Transaction**

12 1.5.1 Once Plaintiffs show that the proposed transaction gives rise to a
13 presumption that anticompetitive effects are likely to result, the Defendant may attempt
14 to rebut this presumption with evidence “that the intended acquisition would result in
15 significant economies and that these economies ultimately would benefit competition
16 and, hence, consumers.” *University Health*, 938 F.2d at 1223.

17 1.5.2 To carry its burden, the defendant must show that the transaction will
18 achieve significant efficiencies that (a) are supported by “credible evidence,” *Staples*,
19 970 F. Supp. at 1089; *see University Health*, 938 F.2d at 1223; and (b) are merger-
20 specific, *H.J. Heinz*, 246 F.3d at 721-22; *Cardinal Health*, 12 F. Supp. 2d at 62-63;
21 *Staples*, 970 F. Supp. at 1090.

22 1.5.3 In addition, there is no efficiency, and no consumer benefit, from simply
23 reducing output or quality. *See Rockford Mem’l*, 717 F. Supp. at 1290 (headcount
24 reductions may not qualify as efficiencies for antitrust purposes if they “occur not so
25 much because of the economics effected by the merger, but from a drop in
26 production”); 4A Philip E. Areeda, et al., *Antitrust Law* ¶ 974b3, at 64 (rev’d ed. 1998)
27 (noting that “layoffs are not necessarily evidence of efficiencies,” particularly when
28 they result from the combined firm “reducing its output in order to reflect newly

1 acquired market power”). Costs always can be reduced by eliminating one of the
2 merging products, but that is a clear case of an anticompetitive effect, rather than of a
3 consumer-welfare promoting efficiency.

4 1.5.4 Furthermore, “a merger the effect of which ‘may be substantially to lessen
5 competition’ is not saved because, on some ultimate reckoning of social or economic
6 debits and credits, it may be deemed beneficial.” *Philadelphia Nat’l Bank*, 374 U.S. at
7 371. Oracle argues that it needs the money it will gain from the transaction to fund its
8 growth and compete with IBM and Microsoft. The law requires that the “efficiency”
9 reverse the anticompetitive effect, not that the transaction will provide some net social
10 benefit. For this reason, Defendant’s “technology stack” argument fails as a matter of
11 law.

12 1.5.5 Defendant has not offered credible evidence that the proposed transaction
13 will result in significant, merger-specific efficiencies sufficient to off-set the
14 anticompetitive effects of the proposed transaction in the relevant markets.

15 Defendant’s efficiencies defense therefore fails as a matter of law.

16 **1.6 The Plaintiff States Have Met Their Standing Requirements**

17 1.6.1 Section 16 of the Clayton Act authorizes states to seek injunctive relief
18 against threatened loss or damage arising from the proposed acquisition. 15 U.S.C. §
19 26. *See Georgia v. Pennsylvania R.R. Co.*, 324 U.S. 439, 447 (1945).

20 1.6.2 The threatened loss or damage from the proposed acquisition gives rise to the
21 Plaintiff States having standing in two different capacities: (1) as *parens patriae* on
22 behalf their citizens and each states’ general welfare and economies; and (2) as
23 representatives of government agencies that are past purchasers or likely future
24 purchasers of high-function HRM and FMS software. *See Hawaii v. Standard Oil Co.*,
25 405 U.S. 251, 259-61 (1972).

26 1.6.3 The Plaintiff States have satisfied the requirements for standing, and are
27 therefore proper plaintiffs in this case.

1 Dated: July 8, 2004

Respectfully submitted,

3 /s/

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CERTIFICATE OF SERVICE

I hereby certify that on July 8, 2004, I caused a true and correct copy of the foregoing **PLAINTIFFS' PROPOSED CONCLUSIONS OF LAW**, to be served on the individuals listed below.

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