MERGER ANTITRUST LAW

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Georgetown University Law Center
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Tuesdays and Thursdays, 3:30-4:55 pm
Dale Collins
dale.collins@shearman.com
www.appliedantitrust.com

Links to the required reading and the class notes may be found on the assignments page of Canvas and on the Merger Antitrust Law page of AppliedAntitrust.com.

Classes 24 (November 28): Nonhorizontal mergers

Next Tuesday we will finish the (very) short case studies in horizontal mergers[1] and begin the unit on nonhorizontal mergers, that is, mergers between firms that are not incumbent competitors of one another. There are two types of nonhorizontal mergers that attract attention in modern U.S. enforcement: potential competition mergers and vertical mergers.

We will start the nonhorizontal merger unit with an examination of potential competition mergers. Theories of anticompetitive harm premised on the elimination of potential rivalry through acquisition come in two related but distinct variants.

The first theory, known as the *actual potential competition doctrine*, looks directly to the elimination of possible future rivals through their acquisition before they can enter the market as independent participants. The idea here is that, in the absence of the acquisition, the potential entrant would have entered the market and its entry would have improved the competitive performance of the marketplace. Under this theory, the acquisition is anticompetitive because, on a forward-looking basis, the acquisition eliminated future rivalry and made the market less competitive than it would have been in the absence of the transaction.

The second theory, known as the *perceived potential competition doctrine*, looks to actions that incumbent firms in the market currently may be taking to discourage firms they perceive as potential future entrants from actually entering the market. These actions usually involve an increased level of competitive activity, which serves to lower returns from operating in the market and decrease the attractiveness of entry. According to this theory, if the perceived potential entrant is acquired, the incumbent firms will cease their efforts to discourage entry, and, as a result, the competitive performance of the marketplace will decline.

The Supreme Court has expressly recognized the elimination of perceived potential competition as an anticompetitive harm cognizable under Section 7.[2] The Court, however, has reserved judgment on the elimination of actual potential competition.[3] Lower courts, the FTC, and the 1984 DOJ Merger Guidelines, have recognized the elimination of actual potential competition as

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[1] If you are interested, I have posted the class slides on the short horizontal merger case studies on Canvas and AppliedAntitrust.com.

[2] United States v. Marine Bancorporation, Inc., 418 U.S. 602, 639-40 (1974); United States v. Falstaff Brewing Corp., 410 U.S. 526, 533-34 (1973); *see* FTC v. Procter & Gamble Co., 386 U.S. 568, 581 (1967).

[3] United States v. Marine Bancorporation, Inc., 418 U.S. 602, 625, 639 (1974); United States v. Falstaff Brewing Corp., 410 U.S. 526, 537-38 (1973).

an anticompetitive harm under Section 7. The federal enforcement agencies have not litigated a potential competition case since the 1980s, although they occasionally have alleged the elimination of actual potential competition in complaints predicting consent settlements.

Eliminating actual potential competition

An actual potential competitor is a firm that does not currently compete in the relevant market but would enter sometime in the future, either de novo or through a "toehold" acquisition of a small, competitively insignificant incumbent firm. If, however, the actual potential entrant merges with a significant incumbent firm, its incentives to enter the market independently disappear and the market will lose that measure of additional competition that the new entry would have entailed.

Given this concept, several conditions are required for anticompetitive harm to result from the elimination of an actual potential entrant:

1. *Non-competitiveness*. The relevant market in which the anticompetitive effect may occur must be operating non-competitively prior to the acquisition. If the market is operating competitively, new entry cannot improve the competitive performance of the market.
2. *Uniqueness*. The putative potential entrant must be somewhat unique in its incentives and ability to enter the relevant market. If there are numerous other similarly situated potential entrants, the elimination of one through acquisition is unlikely to affect the long-run level of competition in the market. The conventional wisdom is that the agencies are unlikely to challenge a transaction under the actual potential competition doctrine if the entry advantages ascribed to the putative potential entrant is shared by three or more other firms.
3. *"Available, feasible means" of procompetitive entry*. The putative potential entrant must have the means of entering the market in a way that could possibly improve the competitive performance of the target market. Courts recognize two types of procompetitive entry alternatives: de novo entry and "toehold" entry. For de novo entry to qualify as an "available, feasible means" of procompetitive entry, any barriers to entry into the market must not be so high as to be preclusive. For a toehold acquisition to qualify as an "available, feasible means" of procompetitive entry: (a) toehold firms must exist in the target market, which if acquired would provide a viable avenue to developing a significant market presence; and (b) such firms must be available for acquisition, presumably on objectively reasonable terms.
4. *Incentive*. But for the acquisition, the putative potential entrant must have sufficient incentive to enter the market using one of the above means to make entry in the near future likely. Evidence of intent to enter may be objective, but subjective intent reflected in regular course of business documents or management testimony is usually the most compelling.
5. *Procompetitive effect*. Assuming it occurred, such entry must materially improve the competitive performance of the market.

Fashioning a remedy in an actual potential can be difficult. In some cases, there may be no remedy. In other cases, however, it may be possible to create actual entry by a viable competitor. When Actavis sought to acquire Warner Chilcott, the FTC alleged that the transaction would eliminate actual potential competition against three Warner Chilcott branded pharmaceutical

products, since in the absence of the transaction Actavis would be the first to enter into the manufacture and sale of a generic competitor.[4] As a remedy, the Commission accepted a consent order that required Actavis to divest all of its rights and assets relating to generic versions of the drugs to Amneal Pharmaceuticals, a New Jersey-based generic pharmaceutical company that at the time marketed 65 products and maintained an active product development pipeline.[5] Actavis was also required to enter into an agreement to supply generic versions of the two of the products to Amneal for a period of two years, which Amneal could extend at its option for up to two additional one-year terms.[6]

Eliminating perceived potential competition

A perceived potential competitor is a firm not currently selling in the market that incumbent firms regard as "on the wings" of the market, that is, ready, willing and able to enter the market as a new independent participant but waiting because the financial returns on entry are not sufficiently attractive to it. The idea behind the perceived potential entrant doctrine is that incumbent firms, recognizing this threat of entry and the likely harm to them individually if entry occurs, act "more competitively" than they would in the absence of this threat in order to keep the financial returns on entry low and to continue to discourage the potential entrant from actually entering. If, however, the perceived potential entrant merges with a significant incumbent firm in the market, it essentially becomes a "member of the club" and ceases to be a threat, allowing incumbent firms to cease their endeavors to discourage the firm's independent entry by keeping the market more competitive. In this sense, the elimination of a perceived potential entry through acquisition is anticompetitive because the procompetitive force exerted by the threat of independent entry is removed by the acquisition.

Many of the necessary conditions for an anticompetitive effect to arise from the elimination of perceived potential rivalry are closely related to the conditions of the actual potential competition doctrine. These conditions reflect the fact that firms are unlikely to be perceived as potential entrants unless they are actually likely potential entrants.

1. *Non-competitiveness*. In order for elimination of perceived potential competition to have any anticompetitive effect, the market must be susceptible to coordinated interaction. An oligopolistic market structure is sufficient to satisfy this condition.
2. *Uniqueness*. As under the actual potential competition doctrine, the perceived potential entrant must be perceived as somewhat unique in its incentives and ability to enter the relevant market. If there are numerous other similarly situated potential entrants in the minds of incumbent firms, the elimination of one through acquisition is unlikely to affect the long-run level of competition in the market. The conventional wisdom is that the

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[4] Complaint ¶¶ 8-10, 12(b)-(c), *In re* Actavis, Inc., No. C-4414 (F.T.C. issued Sept. 27, 2013) (settled by consent order).

[5] Decision & Order, *In re* Actavis, Inc., No. C-4414 (F.T.C. issued Sept. 27, 2013); *see* Analysis of Agreement Containing Consent Orders To Aid Public Comment, *id*.

[6] For a related remedy, see Complaint ¶¶ 10, 12(b), *In re* Novartis AG, No. C-4364 (F.T.C. issued July 16, 2012) (alleging the elimination of actual potential generic competition against Solaraze, a branded drug sold by Fougera that is used to treat actinic keratosis), and Decision & Order, No. C-4364 (F.T.C. issued July 16, 2012) (consent decree requiring Novartis to withdraw from a marketing arrangement with Tolmar for a forthcoming generic version of Solarze, return all rights in the generic version to Tolmar, and precluding Fougera from pursuing patent infringement litigation against Tolmar with respect to its generic product).

agencies are unlikely to challenge a transaction under the actual potential competition doctrine if the entry advantages ascribed to the putative potential entrant is shared by three or more other firms.

3. *Perception as a likely potential entrant*. Incumbent firms must perceive the firm as a likely potential entrant.

4. *Incumbent reaction to threat of entry*. Incumbent firms must be shown to be responding to the perceived threat of entry by lowering their prices, improving their product quality, or engaging in some other procompetitive activities in order to discourage the entry of the perceived potential entrant.

5. *Anticompetitive effect*. It must be in the profit-maximizing interest of incumbent firms to cease some or all of their procompetitive entry-deterring conduct as a result of the acquisition in question to the detriment of competition in the market.

Ironically, although the Supreme Court has recognized the elimination of perceived potential competition as a valid theory of anticompetitive harm, the agencies have used the theory rarely (if at all) since 1980. There is no remedy for the elimination of perceived potential competition short of enjoining the transaction.

The reading materials include some of the cases in which consent decrees have been entered on the actual potential competition theory (pp. 6-162). My suggestion is that you read the materials from front to back. If you hit three hours of reading, are not finished, and do not have the time or the time to continue to the end of the section, feel free to quit. We will cover the most interesting points in the cases in class.

There is also a deck on nonhorizontal mergers. The section on potential competition mergers is relatively short.

Enjoy the reading! Email me if you have any questions.

Dale