14. Potential Competition Mergers

Merger Antitrust Law

Georgetown University Law Center
Dale Collins

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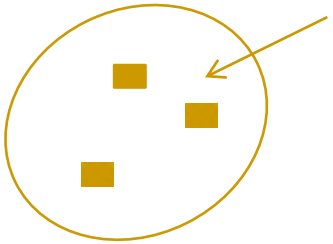
Two potential competition theories

1. Elimination of actual potential competition
   - This theory 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
2. Elimination of perceived potential competition
   - This theory 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

Actual potential competition

- The idea
  - Acquire a firm that that otherwise would have entered the market, reduced concentration, and increase competition—Acquisition eliminates in increase in future competition



Actual potential entrant

Theory: Entry would deconcentrate an oligopolistically performing market and make it more competitive

  - Acceptance by courts
    - The Supreme Court has reserved judgment on the elimination of actual potential competition[1]
  - Not yet approved by the Supreme Court
    - But provisionally accepted by lower courts
    - Lower courts, the FTC, and the 1984 DOJ Merger Guidelines recognize the elimination of actual potential competition as an anticompetitive harm under Section 7
  - Agencies have used to obtain consent decrees when:
    - The market is highly concentrated
    - Entry is almost certain in the immediate future

[1] *See* 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).

Actual potential competition

- Elements of the actual potential competition theory of harm
  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 market's competitive performance
  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

Actual potential competition

- Elements of the actual potential competition theory of harm
  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.

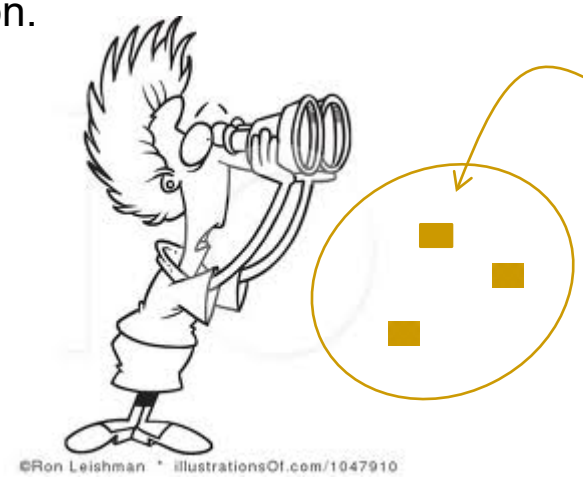
Actual potential competition

- Application
  - *Typical application*: Pharmaceutical acquisition of a company with a competitive product near the end of the FDA approval process
  - *Example*: Actavis/Warner Chilcott
    - 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[1]
    - 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.
    - 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

[1] Complaint ¶¶ 8-10, 12(b)-(c), *In re* Actavis, Inc., No. C-4414 (F.T.C. issued Sept. 27, 2013) (settled by consent order).
[2] 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*.

Perceived potential competition

- The idea
  - Acquire a firm that incumbents fear will enter the market and hence have moderated their prices ("limit pricing") to discourage that firm from actually entering
    - Acquisition eliminates the threat of entry and incumbent firms no longer have an incentive to moderate prices
  - Theory recognized by the Supreme Court
    - 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 since it is almost impossible to show that incumbent firms have engaged in limit pricing to discourage entry
  - There is no remedy for the elimination of perceived potential competition short of enjoining the transaction.



Perceived potential entrant

Theory: Threat of entry causes incumbent firms in an oligopolistically structured market to perform more competitively

Perceived potential competition

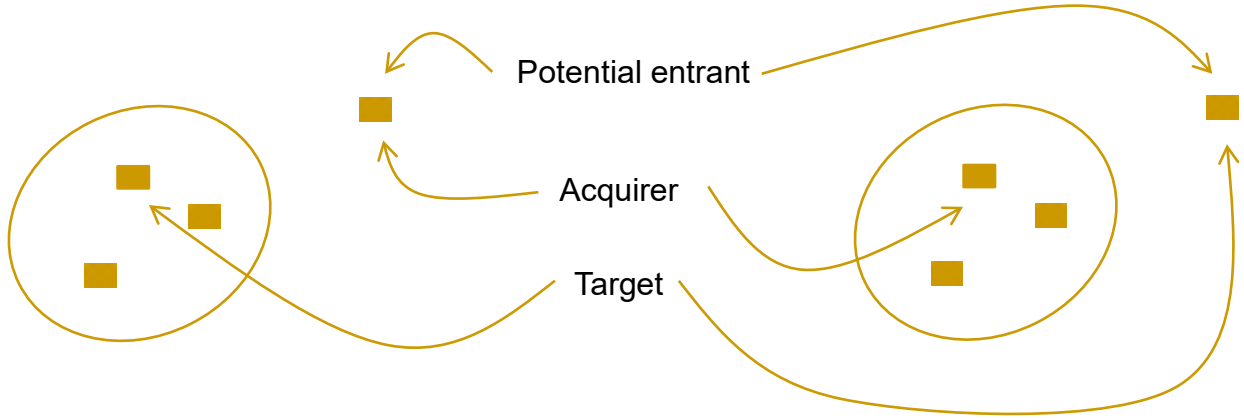
- Elements of the perceived potential competition theory of harm
  1. Non-competitiveness
     - In order for elimination of perceived potential competition to have any anticompetitive effect, the market must be susceptible to coordinated interaction.
     - An oligopolistic market structure is sufficient 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 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.

Perceived potential competition

- Elements of the perceived potential competition theory of harm
  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

Elimination of potential competition

- Under either theory, the potential entrant may be either the target or the acquirer



Scenario 1
Potential entrant as the acquirer

Scenario 2
Potential entrant as the target