MERGER ANTITRUST LAW

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Tuesdays and Thursdays, 3:03-5:00 pm
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Class 22 (November 16): Potential Competition Mergers (Unit 13)

We will spend the next three classes 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.

This unit examines 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 lowers returns from operating in the market and decreases 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.[1] The Court, however, has reserved judgment on the elimination of actual potential competition.[2] Lower courts, the FTC, and the 1984 DOJ Merger Guidelines have recognized the elimination of actual potential competition as an anticompetitive harm under Section 7. With one exception, the federal enforcement agencies have not litigated a potential competition case since the 1980s, although in a number of cases they have alleged the elimination of actual potential competition in complaints predicting consent settlements. The one exception is FTC v. Steris Corp.,[3] an actual potential competition

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[1] 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).

[2] *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).

[3] 133 F. Supp. 3d 962 (N.D. Ohio 2015).

case, which the FTC lost for failure to show that the target was a probable potential entrant into the relevant market.

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, eliminating 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 are 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 probably 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 to make entry difficult and hence unlikely. 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. For example, 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 Actavis would be the first in the absence of the transaction 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 its 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] The idea was that Amneal would "step into the shoes" of Actavis in the development of the generic versions and enter the market with these products once it obtained FDA approval. Actavis was also required to supply generic versions of two of the products to Amneal for 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. The idea behind the perceived potential entrant doctrine is that incumbent firms recognize this threat of entry and the likely harm to them individually if entry occurs. With this recognition, the incumbent firms then act "more competitively" than they would in the absence of this threat to keep the financial returns on entry low and continue to discourage the potential entrant from actually entering. If, however, the perceived potential entrant merges with a significant incumbent firm in the market, the perceived potential entrant essentially becomes a "member of the club" and ceases to be a competitive threat, allowing incumbent firms to cease their endeavors to discourage the firm's independent entry by keeping the market more competitive. In this sense, eliminating a perceived potential entry through acquisition is anticompetitive because the acquisition removes the procompetitive force exerted by the threat of independent entry.

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

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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 Solaraze, 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).

3. *Uniqueness*. Incumbent firms must perceive the perceived potential entrant 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 are shared by three or more other firms.

4. *Incumbent reaction to the 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 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 in the wake of the acquisition 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.

Read the class notes to get some more background on the theories of perceived and actual potential competition (slides 3-12). I will give you an overview in class of some of the cases in which consent decrees have been entered on the actual potential competition theory. To keep the reading materials contained, I have given you only the *Steris* case, the only litigated potential competition case since the 1980s (pp. 4-48).

Nascent competitors

In recent years, with increasing agitation by reformers that the antitrust laws need to do something about well-entrenched monopolies, especially in high tech industries, there has been a focus on so-called “nascent competitors.” A “nascent competitor” is a firm that has the potential of representing a serious threat in the future to a dominant firm. The threat usually resides in the nascent competitor’s development of a new technology or product that could possibly shift share away from the dominant firm.

The actual potential competition doctrine requires, among other things, that (1) but for the acquisition, the putative potential entrant would have sufficient incentive and ability to make entry in the market likely in the near future, and (2) assuming entry occurred, it must have a reasonable probability of materially improving the competitive performance of the market.

By their nature, “nascent competitors” almost always fail to satisfy these requirements. At the time of the acquisition, the nascent competitor may not be actively considering entering the market with a product competitive with the acquiring dominant firm. Even if the nascent competitor is considering entering the market—or selling itself or licensing its technology to another firm that would enter the market—entry may be more distant than in “the near future.” And even if entry is contemplated in the near future, the technological and commercial success of entry—and the competitive impact of entry—may be highly speculative.

To deal with the failure of the actual potential competition doctrine as currently interpreted by the courts to deal with nascent competitors, some commentators have suggested that the government enforcement agencies and other challengers allege a Section 2 monopolization or attempted monopolization violation. The idea is that an acquisition by a firm with monopoly power of a nascent competitor that could threaten its monopoly is an actionable exclusionary act to maintain the acquirer's monopoly. No court to date, however, has ruled on this theory.

First, read the slides on nascent competitors (slides 13-23) to get some more background. Then read the materials on the DOJ's challenge to the Visa proposed acquisition of Plaid (pp. 50-81). The case is not a pure nascent competitor case since, at least according to the DOJ's complaint, Plaid had indicated that it would enter with a product that could undermine Visa's market position in credit cards.[7] But what the case interesting are the concerns expressed by Visa management about the nascent competitive threat that Plaid posed if Visa did not acquire it, either on its own or, perhaps more concerning, in the hands of another acquirer. The case squarely raises the issue of what the enforcement agencies and the courts should do when there is substantial evidence that the acquisition was partly motivated by a desire to keep Plaid out of the hands of another acquirer to suppress possible future competition against Visa.

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

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7 The DOJ's complaint is surprising light on the allegations that Plaid was contemplating entry. This suggests that something else was going on here. What do you think it might be?