Class 21 slides

14. Elimination of Potential Competition

Professor Dale Collins
Merger Antitrust Law
Georgetown University Law Center

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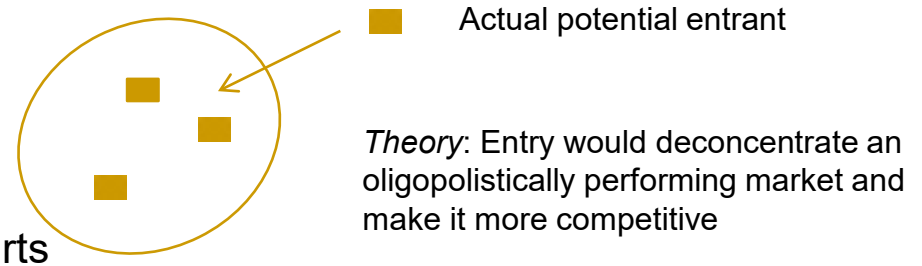
Three potential competition theories

1. Elimination of actual potential competition
2. Elimination of perceived potential competition
3. Elimination of a nascent competitor by a dominant firm

Actual potential competition

- The idea
  - An incumbent firm acquires a target that otherwise would have entered the market, reduced concentration, and increased competition
  - → The acquisition of the "actual potential entrant" eliminates an increase in future competition that would have occurred but for the acquisition



  - Acceptance by courts
    - The Supreme Court has reserved judgment on the elimination of actual potential competition[1]
    - Lower courts, the FTC, and the 1984 DOJ Merger Guidelines recognize the elimination of actual potential competition as an actionable anticompetitive harm under Section 7
  - Agencies have used this theory to obtain consent decrees when—
    1. The market is highly concentrated,
    2. There are few if any other similar or better situated actual potential entrants, *and*
    3. 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

- Five elements of the actual potential competition theory of harm
  1. *Noncompetitiveness*: The relevant market is operating noncompetitively
  2. *Uniqueness*: The actual potential entrant is relatively unique in its ability to enter the relevant market
  3. *Ability*: The actual potential entrant must have an "available, feasible means" of procompetitive entry
  4. *Incentive/likelihood of entry*: In the absence of the acquisition, the actual potential entrant would likely enter the relevant market "in the near future"
  5. *Procompetitive effect*: If the actual potential entrant in fact entered the market, it would enter at a scale that would materially improve the competitive performance of the market

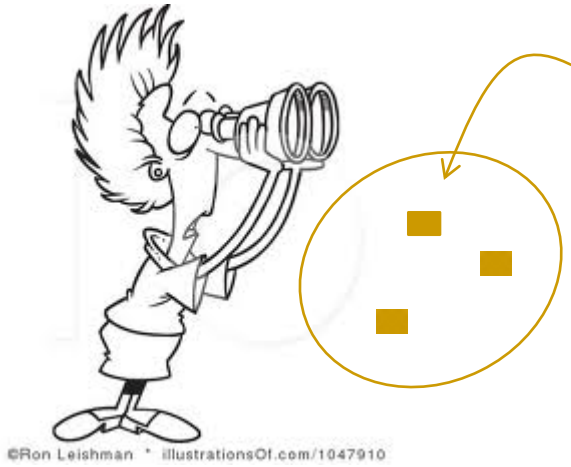
Actual potential competition

- Remedies
  - Typically, requires the divestiture of the incumbent product
  - Divestiture of assets of the actual potential entrant can be problematic—
    - Oftentimes, little to divest from the actual potential entrant (especially if only in the planning stages)
    - May be difficult to ascertain the commitment of the divestiture buyer to enter or the degree of success it is likely to have
  - Exception: When—
    1. There are substantial assets related to entry to be divested, *and*
    2. There is strong reason to believe that the divestiture buyer will have at least as much success in entering as the divestiture seller

    the agencies will accept the divestiture of entry-related assets

Perceived potential competition

- The idea
  - Incumbents firm fear the perceived potential entrant will enter the market and hence have moderate their prices ("limit pricing") to discourage that firm from actually entering
  - An acquisition by an incumbent firm of the perceived potential entrant eliminates the threat of entry and incumbent firms no longer have an incentive to moderate prices
- Theory recognized by the Supreme Court
  - The Supreme Court has recognized the elimination of perceived potential competition as a valid theory of anticompetitive harm
  - Ironically, 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



Perceived potential entrant

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

Perceived potential competition

- Five elements of the perceived potential competition theory of harm
  1. *Noncompetitiveness*: The relevant market must be susceptible to operating noncompetitively
  2. *Uniqueness*: The perceived potential entrant is relatively unique in its ability to enter the relevant market
  3. *Perception*: Incumbent firms must perceive the firm as a likely potential entrant
  4. *Incumbent reaction*: Incumbent firms must be responding to the perceived threat of entry by lowering their prices ("limit pricing"), 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*: Removing the perceived threat of entry through the acquisition of the perceived potential entrant must likely result in incumbent firms ceasing some or all of their procompetitive entry-deterring conduct and so lessen competition in the relevant market

Perceived potential competition

- Remedies
  - There is no remedy to preserve competition in a perceived competition case other than enjoining the acquisition

Potential expander cases

- *A slight variation*: "Potential expander" cases
  - A large firm enters the target market to "test the waters" and obtains a small market share
    - Typically by shipping into the target market from another market
  - But finding de novo entry unattractive, the firm acquires a substantial incumbent firm in the target market

    At one time, the agencies have attacked these types of acquisitions as eliminating actual potential competition by the large firm

    - Technically, the agencies may try these cases as horizontal acquisitions since the acquirer did have a "toehold" position in the relevant market. The agencies then argue that given the acquirer's interest in expanding into the market, the acquirer's small current market share significantly understates its future competitive significance in the absence of the acquisition
    - Acquirers defend by showing that de novo entry is not in their profit-maximizing interest and that they are neither an actual potential entrant or a "potential expander" in the absence of the acquisition
    - The agencies did not fare well in these cases, and they have not brought one recently on this theory

A final note

Under any of these theories, the potential entrant may be either the target or the acquirer

Mylan/Perrigo

Mylan/Perrigo (2015)

- The deal
  - On September 14, 2015, Mylan launched a hostile tender offer to acquire all outstanding ordinary shares of Perrigo for approximately $27 billion (stock and cash)
- Mylan
  - American global generic and specialty pharmaceuticals company
    - Makes the EpiPen (~ 40% of Mylan's profit)
  - 2015 revenues: $9.42 billion
- Perrigo
  - American international manufacturer of private label over-the-counter pharmaceuticals
  - 2013 revenues: $3.45 billion
- Backstory
  - Mylan may have wanted to acquire Perrigo to fend off a $40 billion hostile offer from Teva Pharmaceuticals

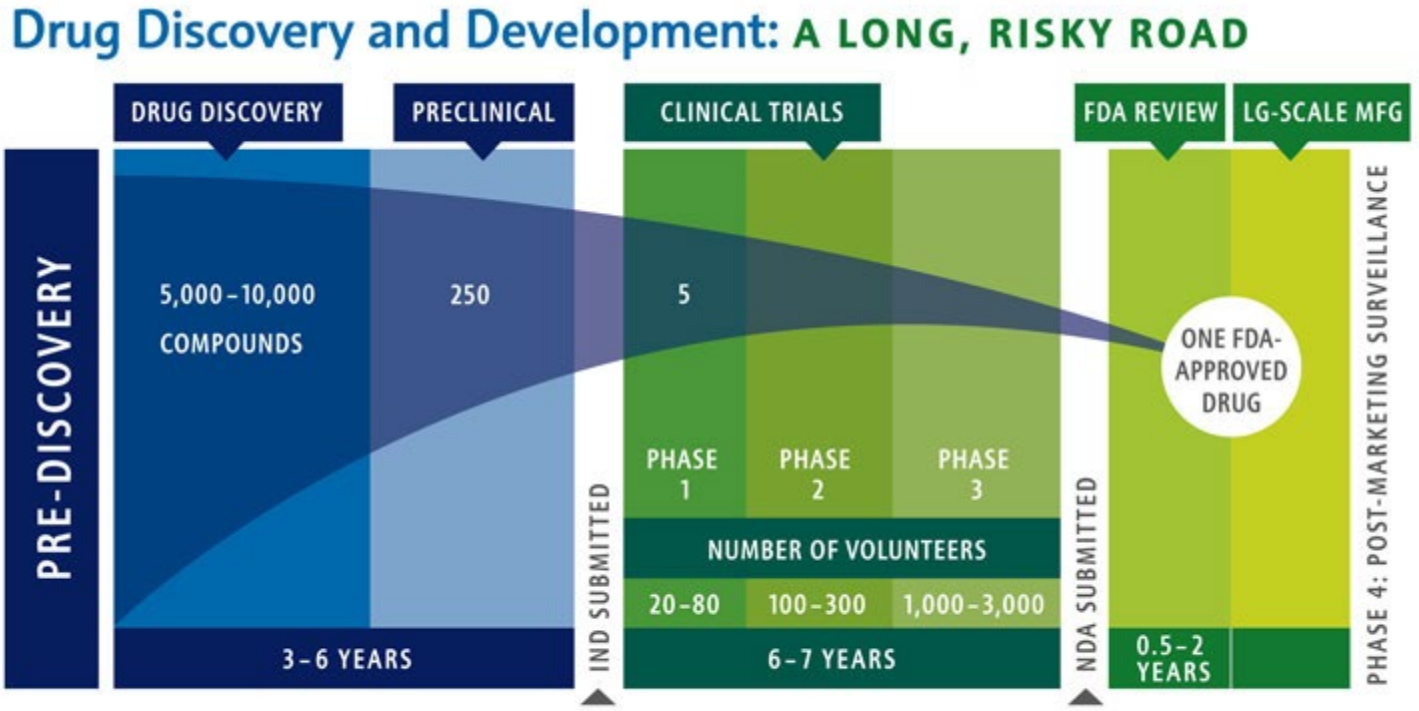
Mylan/Perrigo (2015)

- Actual overlaps (4)
  1. Bromocriptine mesylate tablets
     - Treat conditions including type 2 diabetes and Parkinson's disease
  2. Clindamycin phosphate/benzoyl peroxide gels
     - Treat acne
  3. Liothyronine sodium tablets
     - Treat hypothyroidisms
     - Treats or prevents enlarged thyroid glands
  4. Polyethylene glycol 3350 OTC oral solution packets.
     - Laxative used to treat occasional constipation
- Potential future overlaps—Actual potential competition by Mylan (3)
  1. Acyclovir ointment
     - Slows the growth and spread of the herpes virus in the body
  2. Hydromorphone hydrochloride extended-release tablets
     - Treats moderate to severe pain in narcotic-tolerant patients
  3. Scopolamine extended-release transdermal patches
     - Prevents symptoms associated with motion sickness
     - Helps patients recover from anesthesia and surgery

Query: Why did the FTC conclude that Perrigo was an "actual potential entrant" into these drugs "in the near future"?

Mylan/Perrigo (2015)

- New drug approval process



Source: Pharmaceutical Research and Manufacturers of America

Mylan/Perrigo (2015)

- Generic drug approval process
  - Definition
    - A generic drug is comparable to an existing brand name drug in dosage form, strength, route of administration, quality, performance characteristics, and intended use
      - Essentially a knockoff of a brand-name drug
  - Regulatory approval under the Hatch-Waxman Act[1]
    - *ANDA*: To encourage the introduction of generic drug equivalents as soon as a name-brand drug's patent expires (or is shown to be invalid), Congress and the FDA have created an abbreviated new drug application (ANDA) process
      - The application is "abbreviated" because it does not require the drug company to include preclinical (animal) and clinical (human) data to establish safety and effectiveness
      - Instead, the generic applicant must scientifically demonstrate that its product is *bioequivalent* to the name-brand drug
    - *FDA approval*: Once the FDA approves the application, the applicant may manufacture and market the generic drug product
    - *Exclusivity*: Under the Hatch-Waxman Act, the first approved applicant has 180 days of marketing exclusivity from the date it commercially introduces the product
      - Alternatively, if the applicant challenges the validity of the name brand patent, the exclusivity runs from the date of a court decision finding the patent invalid, unenforceable or not infringed (if that is an earlier date)

[1] Drug Price Competition and Patent Term Restoration Act of 1984, Pub L. No. 98-417, 98 Stat. 1585 (1984).

Mylan/Perrigo (2015)

- FTC challenges by stage of product development
  - Goes to the question of whether there will be actual entry in the absence of the acquisition
- Mylan/Perrigo (2015)—Approved ANDA
  - Mylan ordered to all rights, title and interest in and to all assets related to the United States in the four Mylan existing overlapping products and the three Mylan ANDA-approved products to Alvogen Group, Inc., an experienced generic pharmaceutical company
- Hikma/Custopharm (2022)
  - Custopharm ordered to retain Custopharm's assets related to the corticosteroid drug triamcinolone acetonide (TCA) to Long Grove Pharmaceuticals, LLC, another portfolio company owned by the seller that would not be acquired
  - Long Grove ordered to operate and maintain Custopharm's TCA assets for four years
  - FTC may appoint a monitor to report on the companies' compliance with the order's requirements

Mylan/Perrigo (2015)

- FTC challenges by stage of product development
  - Allergan/Inamed (2006)—Phase III
    - Inamed ordered to divest its rights to clinical trials for the cosmetic botulinum toxin product Reloxin, which was in Phase III clinical trials
  - Sanofi/Aventis (2004)—Phase II/III
    - Aventis was ordered to divest its rights to clinical trials for the drug Camptosar, which included a study for treatment of metastatic gastric cancer which was in Phase II/ Phase III of development
  - Cephalon, Inc./CIMA labs (2004)—Phase III
    - Cephalon was ordered to divest Actiq, a cancer pain drug, in Phase III of clinical testing
  - Glaxo Wellcome/SmithKline Beecham (2001)—Phase III
    - Glaxo was ordered to divest its rights in DISC-HSV Prophylactic Vaccines, which included a prophylactic herpes vaccine in Phase III clinical trials

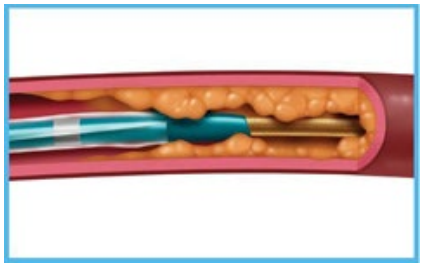
Medtronic/Covidien (2014)

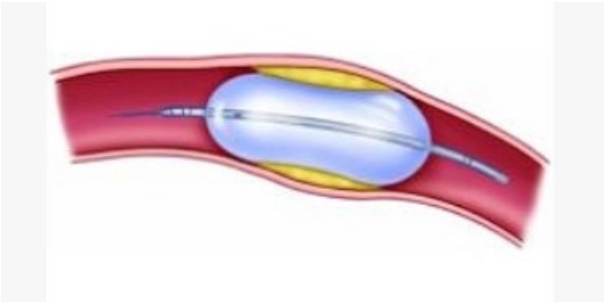
Medtronic/Covidien (2014)

- The deal
  - Medtronic to acquire Covidien for $42.9 billion
    - Announced June 15, 2014
    - 29% premium to Covidien's closing stock price the day before announcement
    - Expect $850 million in annual pretax cost synergies
    - Medtronic commits $10 billion in additional U.S. technology investments over 10 years
- Medtronic
  - Global medical technology and services company
- Covidien
  - Global healthcare products company
- Combined company
  - Combined revenue: $27 billion
  - 87,000 employees in more than 150 countries

Medtronic/Covidien (2014)

- The FTC concern
  - C.R. Bard was the only company manufacturing and selling drug-coated balloon catheters
    - Used primarily to treat peripheral artery disease, a narrowing of the peripheral arteries to the legs, stomach, arms, and head





  - Medtronic and Covidien were developing drug-coated balloon catheters for the femoral popliteal (fem-pop) artery to compete with Bard
    - Only companies with products in clinical trials in the FDA approval process (but the complaint does not indicate what phase)
    - → Merger of two actual potential entrants

- Consent decree
  - Medtronic to sell Covidien's rights and assets related to Covidien's drug-coated balloon catheters business to Spectranetics
    - Spectranetics was a leader in peripheral vascular solutions with a portfolio of products that is highly complementary to Covidien's drug-coated balloon catheter

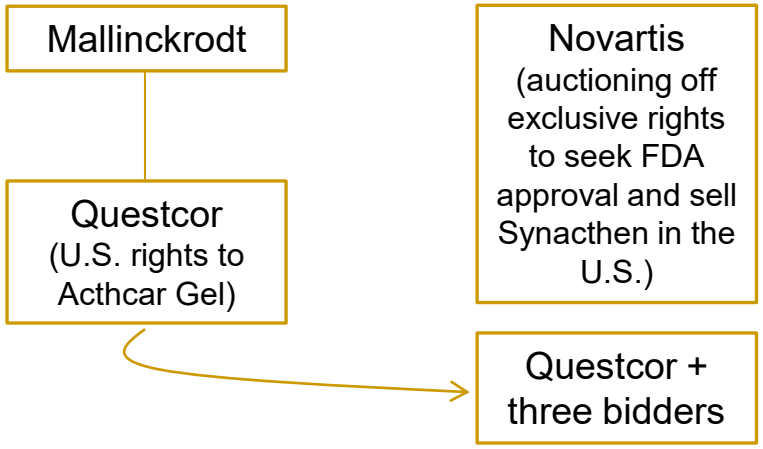
Mallinckrodt/Novartis AG (2017)

Mallinckrodt/Novartis AG (2017)

- The deal
  - In June 2013, Questcor Pharmaceuticals acquired the rights to sell Synacthen Depot in the United States from Novartis
    - On August 14, 2014, Mallinckrodt plc acquired Questor for $5.8 billion
- Background
  - Questcor's H.P. Acthar Gel was the only therapeutic adrenocorticotropic hormone ("ACTH") product sold in the United States
    - ACTH is the standard of care for infantile spasms ("IS"), a rare but extremely serious disorder involving seizures within the first two years of life
    - Questor acquired the rights to Acthar in 2001
    - Since 2001, Questcor has repeatedly raised Acthar's price from $40 per vial in 2001 to more than $34,000 per vial in 2017
    - A course of Acthar treatment for IS requires multiple vials and can cost well over $100,000

Mallinckrodt/Novartis AG (2017)

- The FTC's concern
  - Synacthen is a synthetic ACTH drug sold in other parts of the world to treat IS
  - In 2011, Novartis decided to sell the exclusive rights to seek FDA approval for Synacthen and commercialize it in the United States
  - Three firms submitted formal offers to Novartis
  - Subsequently, Questcor entered the bidding and outbid the other companies to acquire the U.S. rights to Synacthen



  - *Allegation*: Questcor acquired the Synacthen rights to prevent another company from entering into competition with Acthar in the United States

Mallinckrodt/Novartis AG (2017)

- The FTC's challenge
  - Complaint filed January 18, 2017 (post-acquisition)
  - Action brought in federal district court by FTC and five states
  - Questcor's acquisition of the Synacthen rights violated—
    - Section 2 of the Sherman Act (monopolization)
    - Section 5 of the FTC Act
    - Various state statutes
- Outcome
  - Mallinckrodt settled and stipulated to the entry of a permanent injunction:
    - No actual litigation—Stipulation filed simultaneously with the complaint
    - Pay $100 million (disgorgement)
    - Grant a license to develop Synacthen to treat infantile spasms and nephrotic syndrome to an FTC-approved licensee within 120 days of the entry of the order
    - Pay $2 million to states for attorney's fees and costs
    - Monitor to oversee compliance

Steris/Synergy Health (2015)

Steris/Synergy Health (2015)

- The deal
  - Steris to acquire SynergyHealth for $1.9 billion
    - Announced October 13, 2014
- Steris
  - Second largest sterilization company in the world (2014 revenues: $604 million)
  - Largest provider of gamma radiation sterilization services in the United States with 12 facilities
  - Also has 10 ethylene oxide ("EO") gas sterilization facilities
- SynergyHealth
  - Third largest sterilization company in the world
  - Operates more than 36 contract sterilization facilities outside of the United States
    - Primarily gamma radiation facilities
    - Daniken, Switzerland—a gamma ray/x-ray facility
      - Only facility in the world providing x-ray sterilization services on a commercial scale
  - BUT currently offers only e-beam and EO sterilization services in the United States

Steris/Synergy Health (2015)

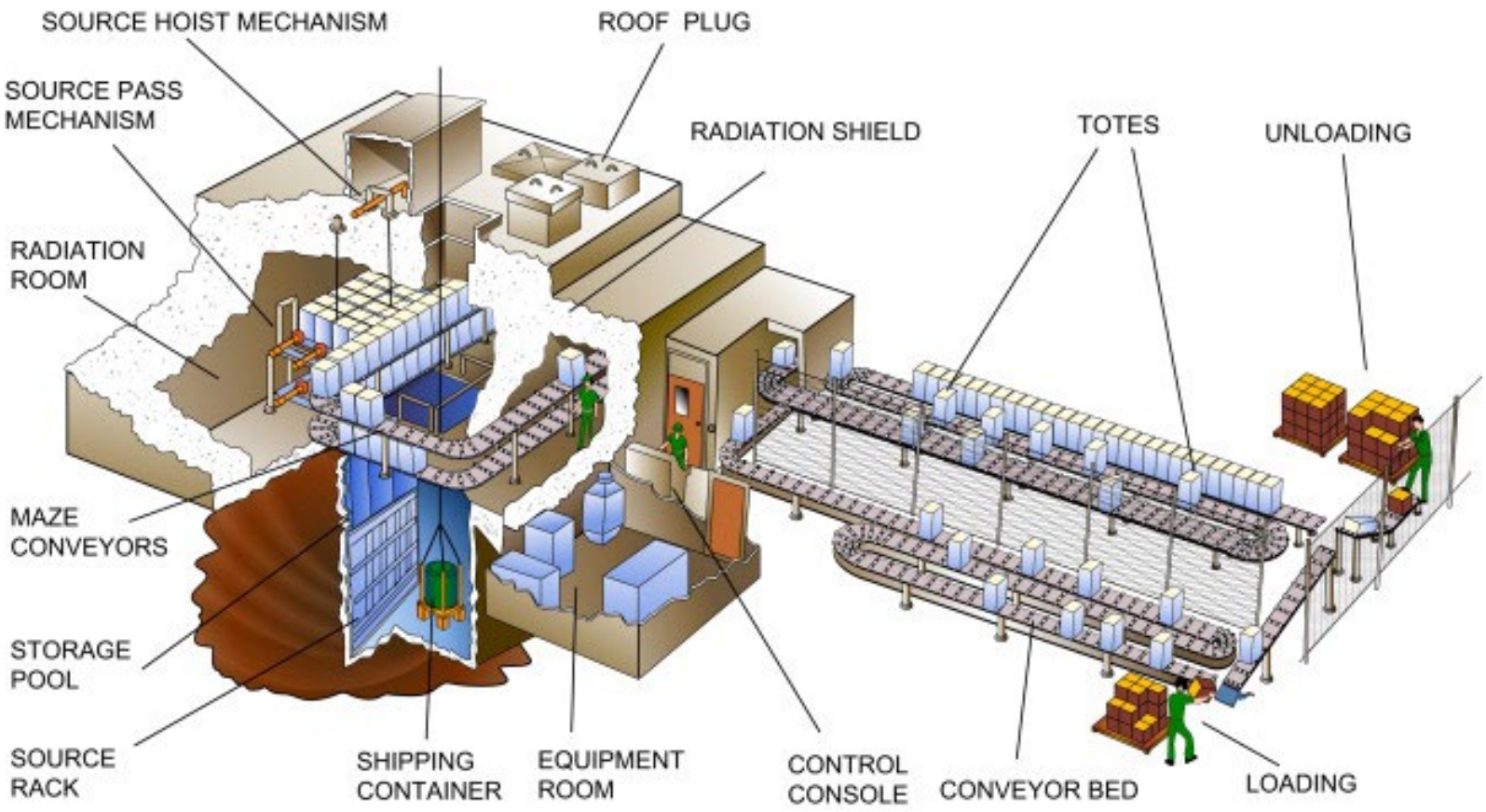
- Three primary methods of contract sterilization used in the U.S.
  1. Gamma sterilization
     - Sterilizes by exposing products to photons from radioactive isotope Cobalt–60
     - Good penetration complete even at high densities
     - Compatible with most materials
     - Only viable option for dense products and products packaged in larger quantities
     - Turn-around time: Hours
  2. E-beam sterilization
     - Sterilizes by exposing products to ionizing energy (electrons) from electron beam
     - Does not penetrate as deeply as gamma radiation
     - Can be effective for low-density products sterilized in low volumes
     - Represents only 15% of all contract radiation sterilization in the United States
     - Turn-around time: Minutes
  3. Ethylene oxide gas (EO)
     - Sterilizes by exposing products to a sterilant gas to kill unwanted organisms
     - Requires gas permeable packaging and product design
     - Turn-around time: 9-10 days

Steris/Synergy Health (2015)

- Customer choice calculus
  - Customers choose sterilization methods based on their products' physical characteristics and packaging

Steris/Synergy Health (2015)

Gamma Irradiation Services Plant

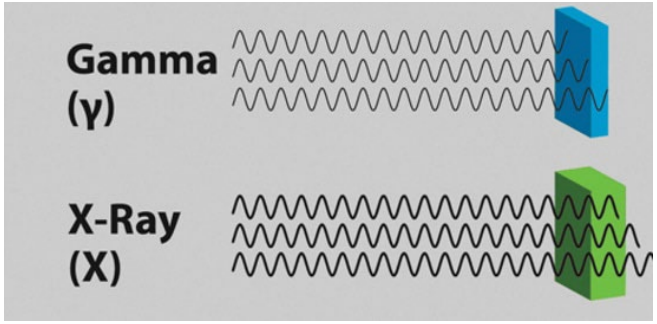


Steris/Synergy Health (2015)

Gamma Irradiation Services Plant

Steris/Synergy Health (2015)

- The FTC concern
  - There are only two gamma radiation sterilization providers in the United States:
    - Sterigenics (14 facilities)
    - Steris (12 facilities)
  - *Allegation*:
    - Absent the acquisition, SynergyHealth would have entered the U.S. with a new x-ray sterilization facility to compete directly with Sterigenics' and Steris' gamma sterilization services
    - According to the FTC, x-ray sterilization is a competitive alternative to gamma sterilization because it has comparable, "and possibly superior," depth of penetration and turnaround times



  - *Claim*: Steris's acquisition of SynergyHealth insulated Steris' gamma sterilization services from SH's entry with x-ray sterilization

Steris/Synergy Health (2015)

- FTC complaint
  - Relevant product markets
    - Contract radiation sterilization services
    - Contract gamma and x-ray sterilization services to targeted customers that cannot economically or functionally switch to e-beam sterilization
  - Relevant geographic markets—defined by facility location
    - "[W]ithin approximately [redacted] miles of each of the locations where Synergy planned to build an x-ray sterilization plant"
  - Likely anticompetitive harm
    - Elimination of a unique actual potential entrant

Steris/Synergy Health (2015)

- District court
  - Following a three-day evidentiary hearing, the court denied the FTC's request for a preliminary injunction
  - Assumed the elimination of actual potential competition is a cognizable theory
    1. Highly concentrated market
    2. Alleged potential entrant "probably" would have entered the market
    3. Such entry would have had procompetitive effects
    4. Few if any other firms could enter the market effectively

    NB: This test differs somewhat from the test we developed since it lacks a timing element SynergyHealth's entry but for the acquisition (but not important here)
  - *Court*:
    - Prior to the hearing, the Court directed the parties to focus their attention on the second element of the actual potential competition theory (likelihood of entry)
    - After the hearing, found that the FTC failed to show that Synergy probably would have entered the U.S. but for the transaction

Steris/Synergy Health (2015)

Remember, the deal was announced on October 13, 2014

- The evidence
  - March 2012
    - SH acquires Daniken from Leoni Studer Hard
      - Provides gamma and x-ray irradiation sterilization services to the medical device, pharmaceutical, and packaging industries
      - Includes a Swiss x-ray sterilization facility but only operating at 20% capacity
    - Possible entry into the United States
      - Dr. Richard M. Steeves, SH CEO, pursued the LSH acquisition thinking about possible entry into the United States with x-ray sterilization in up to five locations
      - Recognized the opportunity to use x-ray technology to compete with the gamma ray facilities of Sterigenics and Steris and capture more than $120 million of revenue away from them
      - A project of this size would require approval of SH's Board of Directors
  - October 2012 — November 2013
    - Steeves and his project team made several presentations to Senior Executive Board and the Board of Directors regarding possible entry into the United States
      - Believed that SH could compete in the U.S. only through x-ray sterilization given the lock on gamma radiation sterilization by Sterigenics and Steris
    - But also recognized certain business needs to make entry viable and receive Board approval:
      1. Lowering the capital costs of entry
      2. Overcoming customer reluctance to switch sterilization modalities
      3. Obtaining revenue commitment from a base load of customers in the form of take-or-pay contracts

Steris/Synergy Health (2015)

- The evidence
  - May 2014
    - Presentation to the Senior Executive Board
      - SEB approval a prerequisite to Board approval
      - SEB raised concern that "it would be difficult to guarantee getting take or pay contracts to support the financial model for building these facilities"
  - July 2014
    - Second presentation to the Senior Executive Board
      - Same concern about customer recruitment
      - Despite substantial customer interest, no customer had "given an indication that they would be willing to enter into a long term take or pay contract"
  - September 2014
    - Third presentation to the Senior Executive Board
      - Sought SEB approval for a strategy offering dual x-ray/e-beam sterilization at a network of four to five facilities in the United States in two phases
        - Assumed a 15% market share in gamma/x-ray sterilization in 2018
        - Assumed 100% capacity utilization of the first two plants by the end of year 6
        - Assumed a lower price for x-ray ($2.50/cubic foot) vs. gamma ($3-$4/cubic foot)
      - SEB approved strategy (but not funding for execution)—But expressed concern that:
        - None of the assumptions were locked down
        - "[D]ifficult to get a base load customer to bear any risk of X-ray given that it is new and unproved in the US"

Steris/Synergy Health (2015)

- The evidence
  - October 2014
    - *October 9*: SH asks its sales staff to solicit customer letters of interest in using a new x-ray facility
    - *October 13: Steris/SynergyHealth deal announced*
    - *October 21:* Project leader tells team that "the x-ray project was proceedings as planned"
    - *October 30*: SH pays £600k to IBA for an exclusive option for x-ray technology to be deployed in the U.S.
      - IBA was the only manufacturer in the world that could possibly make an x-ray machine powerful enough to sterilize medical devices on a commercial scale
      - Had the effect of excluding third parties from using IBA to build an x-ray machine in the United States, but it was not a contract to build for IBA to build any machine for SH
      - Also unclear whether IBA could build a machine at the power level required by SH
  - November 2014
    - *Steris files HSR form for SH acquisition*
    - SH scouts locations in Dallas/Fort Worth to develop costs for locating a facility there
  - December 2014
    - *December 10: Steris pulls and refiles HSR form for SH acquisition (to expire on January 9, 2015)*

Steris/Synergy Health (2015)

- The evidence
  - January 2015
    - *January 9: FTC issues second request*
    - IBA informs SH that the price of an x-ray machine is increasing significantly
  - February 2015
    - SH project management lacks confidence that IBA could produce an x-ray machine at the required power:

> "Their story kept changing so I was skeptical. I was probably more than 50 percent confident that they could ultimately get there over time, but there were no guarantees."

    - Undisputed that there was no machine in existence at the time that satisfied SH's requirements
    - *February 24*: SH sends declaration to the FTC saying that it is terminating its U.S. x-ray project
      - Despite "full-court efforts," no success in obtaining customer commitments
        - SH provided full documentation of efforts made with the 34 best candidates to provide a viable processing volume
        - No significant customer remained to be contacted
        - All SH could obtain was six nonbinding letters of interest
        - Five of SH's top customers stated that they have no present interest in using x-ray sterilization
      - The $40 million Phase I cost would consume SH's entire discretionary budget for 2016

Steris/Synergy Health (2015)

- The evidence
  - March 2015
    - *Extends drop-dead date to July 15, 2015*
  - April 2015
    - *April 30: Parties certify compliance with second requests*
  - May 2015
    - *May 29: FTC informs parties that it will challenge the transaction and files Section 13(b) complaint*

Steris/Synergy Health (2015)

- FTC argument on likelihood of entry
  1. Synergy was poised to enter the U.S. market in Fall 2014 by constructing one or more x-ray facilities
  2. The merger with Steris caused Synergy to abandon the effort
  3. Documents created and testimony given after the merger was announced should be viewed with a high degree of suspicion

Steris/Synergy Health (2015)

- Court: Rejects FTC's arguments
  1. While Synergy's PLC Board had endorsed the U.S. x-ray strategy in September 2014—
     - The business plan had not been approved
     - There were significant obstacles that the project team knew needed to overcome in order to win Board approval
     - The only Board-approved expenditures were two payments of £300K to IBA to obtain exclusivity in the United States
  2. The announced merger with Steris in October 2014 had no significant impact on Synergy's plans for U.S. x-ray
     - The project team continued to mobilize the employees under their direction to—
       - Obtain customer buy-in
       - Try to bring down the cost of the new facilities, and
       - Work with IBA to develop a dual-capability machine of sufficient power to meet Synergy's needs
  3. It was the project team leader, not CEO Steeves, who made the decision in February 2015 to discontinue the U.S. x-ray project after he concluded that there was little to no likelihood of obtaining SEB approval, let alone approval from a combined Synergy/Steris board

Meta/Within (2022)

Eliminating “Nascent” Competition

"Nascent competitors"

- An emerging concern in 2020 was the failure of the enforcement agencies to block acquisitions of "nascent competitors" by large tech companies
  - A "nascent competitor" is a firm that has the potential present 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 a new product that could possibly shift share away from the dominant firm
- Nature of the competitive threat to the dominant firm
  - The "nascent competitor" may itself develop a product that competes with the dominant firm, or
  - The "nascent competitor" may be acquired by, or license its technology to, another firm that would use the technology to develop a product that competes with the dominant firm

"Nascent competitors"

- Typically cited examples:
  - Facebook's acquisition of Instagram and WhatsApp[1]
    - At the time of Facebook's acquisition, neither Instagram nor WhatsApp posed an immediate competitive threat to Facebook, but if left independent of Facebook they might have developed a competitive product or be acquired by another firm that would use their technology to develop a product competitive with Facebook
  - Visa's proposed acquisition of Plaid[2]
    - Challenging Visa Inc.'s proposed $5.3 billion acquisition of Plaid Inc. under Clayton Act § 7 and Sherman Act § 2 (monopoly maintenance). The complaint alleged that Visa is a monopolist in online debit transactions (70%) and that Plaid was developing a new technology that could be used as a part of a disruptive, lower-cost option for online debit payments. The complaint alleged that Visa's CEO viewed the acquisition as an "insurance policy" to protect against a "threat to our important US debit business" and that if Plaid remained free to develop its competing payment platform, then "Visa may be forced to accept lower margins or not have a competitive offering." The complaint concluded that if Visa was allowed to acquire Plaid, consumers would be deprived of a low-cost alternative to visa debit and new innovators in online debit payment solutions would face increased barriers to entry.
    - *Note*: The complaint also alleged that Plaid was in fact developing an alternative to Visa online debit card, although it did not allege when Plaid's alternative would be available in the market or how successful it was likely to be.

[1] First Amended Complaint for Injunctive and Other Equitable Relief, FTC v. Facebook, Inc., No. 1:20-cv-03590 (D.D.C. filed Aug. 19, 2021).
[2] Complaint, United States v. Visa Inc., No. 3:20-cv-07810 (N.D. Ca. Nov. 5, 2020).

"Nascent competitors"

- Nascent competitors and the potential competition doctrine
  - The actual potential competition doctrine requires, among other things, that:
    - But for the acquisition, the putative potential entrant must have sufficient incentive and ability to enter the market to make entry in the near future likely, and
    - Assuming it occurred, such entry must materially improve the competitive performance of the market
  - By their nature, "nascent competitors" fail to satisfy these requirements
    1. 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
    2. It may be uncertain that, in the absence of the acquisition, the nascent competitor (or a third-party acquirer or licensee) would create a product competitive with the dominant firm
    3. Even if the nascent competitor contemplates entry with a competitive product, the timing for entry may be more distant that in "the near future"
    4. Even if the nascent competitor contemplates entry in the near future, the technological and commercial success of this entry—and the competitive impact of entry—may be highly speculative
  - Under the further rigid requirements of the actual potential doctrine, it does not appear very likely that the doctrine makes the acquisition of a "nascent competitor" actionable under Section 7

"Nascent competitors"

- The policy argument for challenging "nascent competitor" acquisitions[1]
  - Some academics and antitrust enforcers argue that antitrust law should prohibit well-entrenched dominant firms (think Facebook, Google, Amazon) from acquiring nascent competitors either:
    - At all, *or*
    - Without a compelling procompetitive justification on which the dominant firm would bear the burden of proof
  - Proponents of aggressive enforcement action against "nascent competitor" acquisitions by a well-entrenched dominant firm argue that it is so socially important to competitively undermine the dominant firm and restore some degree of competition in the market that it is in the public interest—
    - to accept large numbers of Type 1 overinclusiveness errors (blocking acquisitions that in fact would never develop into a meaningful competitive threat to the dominant firm either on their own or in the hands of another acquirer)
    - in order to preserve the opportunity for those few companies that, if not acquired by the dominant firm, would develop into a meaningful competitive threat

[1] *See, e.g.*, Lina Khan, *The Separation of Platforms and Commerce*, 119 Colum. L. Rev. 973 (2019); Jonathan B. Baker & Fiona Scott Morton, *Confronting Rising Market Power*, *Economics for Inclusive Prosperity* (May 2019), C. Scott Hemphill & Tim Wu, *Nascent Competitors*, 168 U. Pa. L. Rev. 1879 (2019); Eleanor M. Fox, *Platforms, Power, and the Antitrust Challenge: A Modest Proposal to Narrow the U.S.-Europe Divide*, 98 Neb. L. Rev. 297, 313-14 (2019).

The Section 2 solution

- Sherman Act § 2
  - To deal with the apparent inability of Section 7 under prevailing case law to reach acquisitions of nascent competitors by well-entrenched dominant firms, proponents of aggressive intervention have suggested that enforcers use Sherman Act § 2
  - Section 2 prohibits "monopolization" and "attempts" to monopolize
    - Monopolization: Two elements (*Grinnell*)—
      - "(1) the possession of monopoly power in the relevant market and (2) the willful acquisition or maintenance of that power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident."[1]
      - Conduct satisfying the second element is called an anticompetitive exclusionary act
    - Attempted monopolization: Three elements (*Spectrum Sports*)—
      - The defendant must have engaged in predatory or anticompetitive conduct
      - with a specific intent to monopolize, *and*
      - as a consequence of its acts and intent, have a dangerous probability of achieving monopoly power[2]

[1] United States v. Grinnell Corp., 384 U.S. 563, 570-71 (1966); *accord* Pacific Bell Tel. Co. v. Linkline Commc'ns, Inc., 555 U.S. 438, 447-48 (2009); Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398, 407 (2004); Aspen Skiing Co. v. Aspen Highlands Skiing Corp., 472 U.S. 585, 595-96 (1985).
[2] Spectrum Sports, Inc. v. McQuillan, 506 U.S. 447, 456 (1993).

The Section 2 solution

- Sherman Act § 2
  - The idea
    - The idea—as yet untested in the courts—is that the acquisition of a nascent competitor by a firm with monopoly power is an anticompetitive exclusionary act that maintains the dominant firm's monopoly power and so can predicate monopolization or attempted monopolization
    - The principal authority is the D.C. Circuit's *Microsoft* decision, where the court required only a showing that "as a general matter, the exclusion of nascent threats is the type of conduct that is reasonably capable of contributing significantly to a defendant's continued monopoly power."[1]
      - Arguably, this requirement focuses on the "general tendency" of the anticompetitive conduct, not its specific effects in any acuisition[2]
      - There is also an argument that evidence of the "intent" of the acquiring dominant firm to protect its position by making the acquisition should have significantly greater weight in a Section 2 than in a Section 7 case

[1] United States v. Microsoft, 253 F.3d 34, 78-79 (D.C. Cir. 2001) (en banc).
[2] D. Bruce Hoffman, Dir. Bureau of Competition, Fed. Trade Comm'n, *Antitrust in the Digital Economy: A Snapshot of FTC Issues* 10 (May 22, 2019).

Reinterpreting Section 7

- The incipiency standard
  - Section 7 prohibits mergers and acquisitions that "may be substantially to lessen competition, or to tend to create a monopoly"[1]
  - Courts have interpreted this language to adopt an *incipiency standard* requiring only a showing of a "reasonable probability" at the time of suit of anticompetitive harm[2]
- A possible reinterpretation
  - Under the case law, Section 7's incipiency standard looks just to the *likelihood* of harm to competition
    - *Conventional (defense) wisdom*: The acquisition of a nascent competitor does not violate Section 7 because the likelihood of anticompetitive harm is speculative and hence not "reasonably probable"
  - *Argument*: But from a consumer welfare perspective, reasonableness should be interpreted in terms of the *expected value* of the harm, not just likelihood
    - So a low probability of anticompetitive harm should be "reasonable "within the meaning of the incipiency standard if the magnitude of the harm, should it occur, is high enough
    - This interpretation could reach nascent competitor acquisitions, if the foregone competitive benefit of entry, should it occur, is sufficiently high
    - An expected value analysis also should consider any offsetting procompetitive benefits of the acquisition

[1] 15 U.S.C. § 18.

[2] United States v. E. I. du Pont de Nemours & Co., 353 U.S. 586, 589 (1957); *accord* United States v. ITT Cont'l Baking Co., 420 U.S. 223, 242 (1975); Brown Shoe Co. v. United States, 370 U.S. 294, 325 (1962).

The legislative solution

- Other proponents see a judicial extension of Section 2 law to cover acquisitions of nascent competitors by dominant firms as likely to succeed in the courts and therefore seek a legislative solution[1]

[1] *See, e.g.*, Steven C. Salop, *New U.S. Antitrust Legislation before Congress Must Mandate an Anticompetitive Presumption for Acquisitions of Nascent Potential Competitors by Dominant Firms* (Washington Center for Equitable Growth June 22, 2021).

The opponents respond

"Nascent competitor" acquisitions tend to add useful new features to products consumers already love, eliminate little or no current competition, supply the acquired firm's users with far greater support and innovation, and provide a valuable exit ramp for investors, encouraging future investments in innovation. Consumer harm is at best speculative. And most importantly, critics have identified no instances in which meaningful competition has been lost or consumers harmed.

This is not to say that antitrust should ignore theories of future competition: The standards for intervening in potential competition cases have been too strict and should be expanded, but antitrust intervention should still be based on reasonable probabilities, not ephemeral possibilities. Nascent competitor acquisitions should not be prevented absent proof of at least a reasonable probability of a lessening of competition in the foreseeable future.[1]

[1] Jonathan Jacobson & Christopher Mufarrige, *Acquisitions of "Nascent" Competitors*, The Antitrust Source, Aug. 2020., at 1-2 (footnote omitted).

Some questions

- Whether through an extension of the actual potential competition doctrine under Section 7, the application of Section 2, or the creation of a new statutory provision, some questions arise:
  1. How dominant must the acquiring be?
     - Is it enough that the acquiring firm has a high market share?
     - Or does the acquiring firm have to be a well-entrenched, durable monopoly?
  2. How much of a threat is required to be of competitive concern?
     - What is the nature of the required evidence of the threat?
       - Bad documents and statements of the acquiring company could be very probative here
         - But companies should quickly adjust to minimize the creation of this evidence
       - Documents and statements of the target company as to its plans and risks in developing and commercializing its technology
         - Documents created and statements made before the prospect of the acquisition arose will be the most persuasive
       - Testimony by third-party experts as to the potential of the technology?

Some questions

3. How big does the threat have to be?
   - Is it enough if the nascent competitor could be expected to eventually capture 2% (or 5% or 10%) of the market?
4. How unique does the threat have to be?
   - What if there are other companies are developing similar or substitute technologies that are not being acquired by the dominant firm?
   - Does it matter if the target is significantly ahead of its competitors in developing the technology by six months? One year? Two years?
5. How likely does the threat need to be?
   - If there is no probability that the nascent firm will become a significant competitor, there is no sound basis to block the deal
   - But how high does the probability need to be (even qualitatively)?
6. How quickly must the threat be likely to materialize into real-world competition in the absence of the dominant firm's acquisition?
   - Two years? Three years? Any time in the foreseeable future?

Some questions

7. What kind of defenses, if any, are available to a dominant firm acquiring a nascent competitor?
   - What if the acquiring dominant firm can prove that significant consumer welfare benefits will result from the acquisition?
   - There is a subsidiary question of which party should bear the burden of proof (production or persuasion) on any defenses

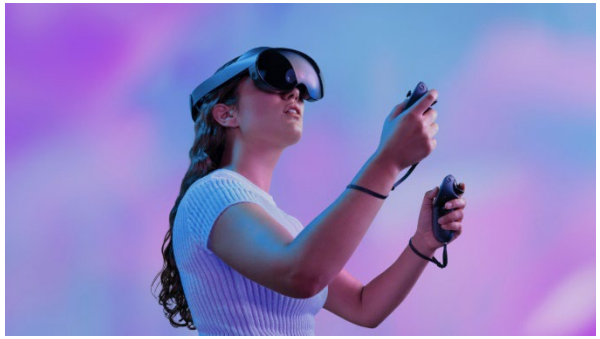
Some questions

- We can also imagine three types of nascent competitor acquisitions
  1. Acquisitions where the acquiring dominant firm plans on investing significantly in the new technology and bringing it to market either as a new product or a feature improvement on an existing product
  2. Acquisitions where the acquiring dominant firm does not plan on investing in the new technology but instead will redirect the efforts on the acquired company's R&D and product development teams to different technologies or products
  3. "Killer acquisitions," where the acquiring dominant firm intends to suppress the acquired technology postmerger[1]

[1] *See* Colleen Cunningham, Florian Ederer & Song Ma, *Killer Acquisitions*, 129 J. Pol. Econ. 649 (2021) (estimating that estimate that 6 percent of all acquisitions in the U.S. pharmaceutical sector (or 45 of acquisitions each year) are "killer acquisitions").

Meta/Within (2022)

- The deal
  - Meta for acquire Within Unlimited (reportedly for around $400 million)
    - Announced November 1, 2021
- *The buyer*: Meta
  - Formerly known as Facebook
  - The leading developer of virtual reality ("VR") devices and apps through its Reality Labs division
    - Since 2017, has invested 36 billion in Reality Labs for an operating loss of $30.7 billion
    - Leading hardware product: Oculus Quest VR headset
      - Flagship product: Meta Quest Pro ($1499)
    - Leading software product: Beat Saber



Meta/Within (2022)

- *The target*: Within Unlimited
  - A privately held virtual and augmented reality company
  - Flagship product: *Supernatural*, a VR subscription fitness service
    - The leading VR fitness app (monthly subscription: $18.99)
    - Offers over 800 fully immersive VR workouts, each set to music and located in a virtual setting such as the Galapagos Islands and the Great Wall of China

Meta/Within (2022)

- The background
  - Challenges Meta's proposed acquisition of privately-owned Within Limited, Inc., the maker of the popular virtual reality-dedicated fitness app Supernatural.
- The amended complaint
  - Alleges that the acquisition would eliminate competition in the relevant market for VR dedicated fitness apps
  - Does not allege that Meta currently competes in the relevant market or that Meta is currently developing or has plans to develop a competing dedicated fitness app
  - Rather, alleges that Meta would develop its own dedicated fitness app (perhaps extending the functionality of its Beat Saber rhythm app) if it was prevented from acquiring Within given its hopes of "controlling a VR 'metaverse.'"
  - The complaint also alleges that "[t]he acquisition of new users, content, and developers each feed into one another, creating a self-reinforcing cycle that entrenches the company's early lead" (entrenchment—Compl. ¶ 6) and a "wings" effect, including on Within (perceived potential competition—Compl. ¶¶ 11, 106, 111-116 (all redacted)).

Postscript: Meta/Within

- Significance
  - This is an extension beyond what current law recognizes under the actual potential competition theory of anticompetitive harm
- Note
  - The original complaint did try to make out a horizontal overlap by alleging that Within and Meta's Beat Saber are both in the VR fitness app market (Compl. ¶ 12), although this appears to be more of afterthought to enable the Commission to invoke the *PNB* presumption than a central theory of anticompetitive harm
    - The FTC abandoned this claim in its Amended Complaint filed October 7, 2022

Meta/Within (2022)

- Sounds like an actual potential competition case
- BUT the complaint does not allege—
  - The VR dedicated app fitness market is operating noncompetitively
  - Meta is one of the few firms positioned to enter the VR dedicated fitness app market in the near future
  - Meta was developing or had plans to develop a competing dedicated fitness app absent the acquisition, or
  - Meta's entry, if it occurred, would make the VR dedicated fitness app market more competitive

Meta/Within (2022)

- Procedural status

July 27, 2022	Section 13(b) complaint in the Northern District of California
August 5, 2022	So ordered stipulation that merging parties would not close the transaction until after 11:59 p.m. ET on December 31, 2022
August 23, 2022	Joint stipulation dismissing Mark Zuckerburg as a respondent
August 26, 2022	Answers filed
October 7, 2022	Amended complaint filed (dropping the horizontal count)
October 13, 2022	Defendants' move to dismiss the complaint as contrary to law
October 31, 2022	FTC files its memorandum of points and authorities in support of its motion for a preliminary injunction
December 8, 2022	Trial starts (providing for five trial days between December 8 and December 20)