# 14. Potential Competition Mergers

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November 6, 2022

# Topics

- Eliminating potential competition
  - Elimination of actual potential competition
  - Elimination of perceived potential competition
- Eliminating “nascent” competition

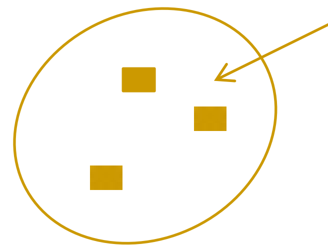
# Eliminating Potential Competition

# 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 (especially lower prices), 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 otherwise would have entered the market, reduced concentration, and increased competition: The acquisition eliminates an increase in future competition




  - 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 before 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 are 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.

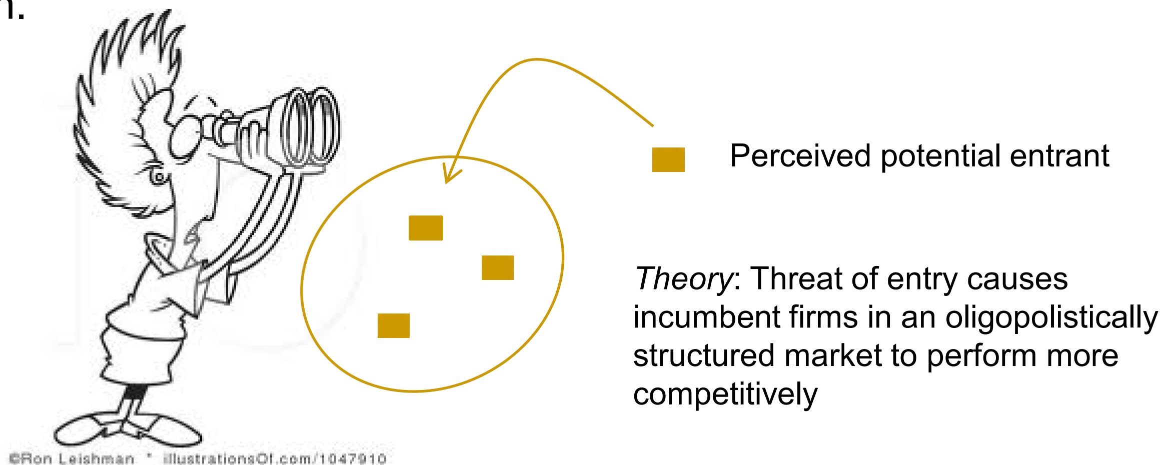
# Actual potential competition

- 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 agree to supply generic versions of the two products to Amneal for 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 removes the incentives of the incumbent firms 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 competition

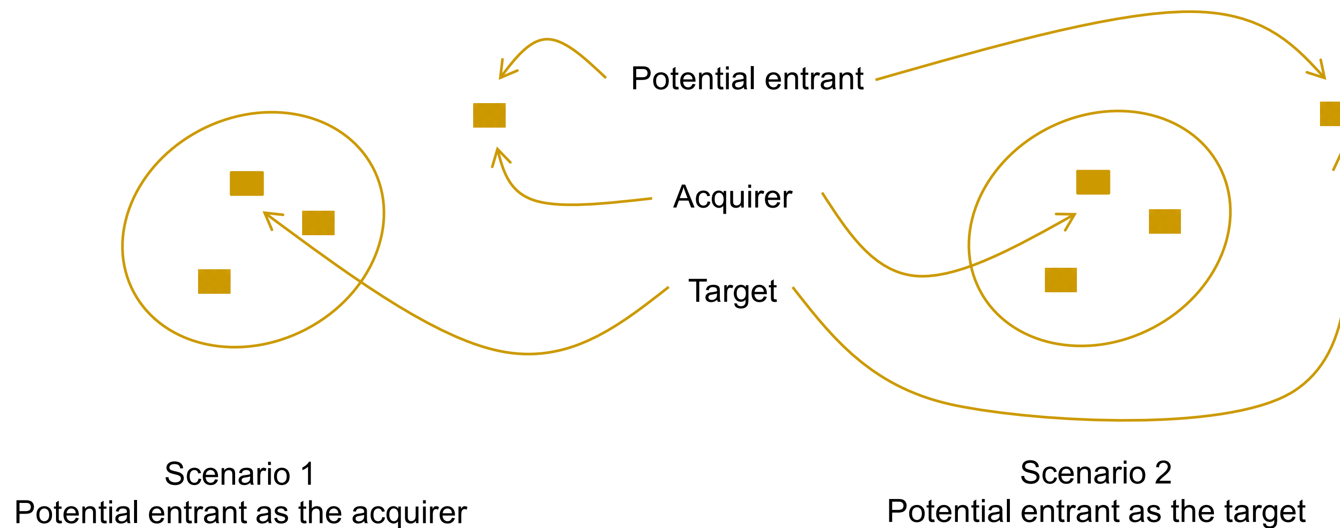
- Elements of the perceived potential competition theory of harm
  1. Non-competitiveness
     - In order for the elimination of perceived potential competition to have any anticompetitive effect, the market must be susceptible to coordinated interaction.
     - An oligopolistic market structure is sufficient to satisfy this condition.
  2. 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 are 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 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
     - The acquisition must incentivize the incumbent to cease some or all of their procompetitive entry-deterring conduct to the resulting detriment of competition in the market

# Elimination of potential competition

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



# 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
    - 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
    - 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
    - Even if the nascent competitor contemplates entry with a competitive product, the timing for entry may be more distant that in “the near future”
    - 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 "reasonable"
  - *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
     - A common situation is where the acquiring dominant firm will invest significantly but not license the resulting technology to its competitors
     - Will or should the agencies accept behavioral consent decrees requiring the acquiring dominant firm to make available the target's technology on reasonable licensing terms?
  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").

# Postscript: Meta/Within[1]

- 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