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Unit 2:

# Predicting Merger Antitrust Law Challenges

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# Topics

- Thinking systematically about antitrust risk
  - Inquiry risk
  - Substantive risk
  - Remedies risk
- Substantive risk
  - The governing statute: Section 7 of the Clayton Act
  - A predictive model
- Synergies/efficiencies
- Putting things together

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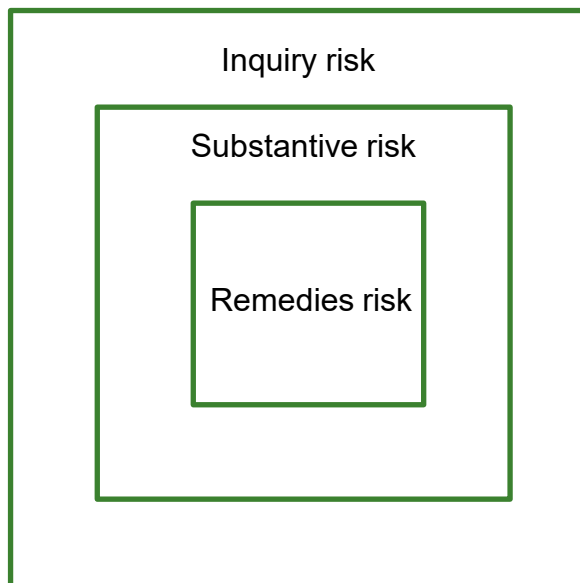
# Thinking Systematically about Antitrust Risk

# Types of antitrust risks

- *Inquiry risk*: The risk that legality of the transaction will be put in issue
  - Who has standing to investigate or challenge the transaction?
  - What is the probability that one of these entities will act?
- *Substantive risk*: The risk that the transaction is anticompetitive and hence unlawful
  - When is a merger anticompetitive?
  - How can we practically assess antitrust risk?
- *Remedies risk*: The risk that the transaction will be blocked or restructured
  - What are the outcomes of an antitrust challenge?
  - Will the transaction be blocked in its entirety?
  - Can the transaction be “fixed” to alleviate the agency’s concerns and if so how?

# Types of antitrust risks

- The three risks are nested
  - The substantive risk does not arise unless there is an inquiry
  - The remedies risk does not arise unless the transaction is found to be anticompetitive



Because the inquiry risk is dependent on the likelihood that the transaction violates the antitrust law, we will examine substantive risk first

# Possible outcomes of merger investigations

- Four possible ultimate outcomes:
  1. *Clearance*: The investigating agency clears transaction on the merits without taking enforcement action
  2. *Fix*: The parties restructure (“fix”) the deal to eliminate the substantive antitrust concern, typically through a divestiture of a line of business
    - a. Post-closing “fix” under a judicial consent decree (DOJ) or a FTC consent order
    - b. Restructure the deal preclosing to avoid a consent decree (“fix-it-first”)
  3. *Litigate*: The investigating agency initiates litigation and either—
    - a. The agency wins on the merits, the court issues an injunction blocking the closing, and the parties subsequently terminate their purchase agreement;
    - b. The agency and the parties settle the litigation through a consent decree; *or*
    - c. The parties win on the merits and subsequently close their deal
  4. *Terminate*: The parties voluntarily terminate the deal rather than settle or litigate

# Costs associated with antitrust risk

- Delay/opportunity costs
  - Possible delay in the closing of the transaction and the realization of the benefits of the closing to the acquiring and acquired parties
- Management distraction costs
  - Possible diversion of management time and resources into the defense of the transaction and away from running the business
- Out-of-pocket expense costs
  - Possible increased financial outlays for the defense of the transaction
- Remedies costs:
  - If the transaction is blocked, the foregone benefits to the merging parties of the transaction
  - If the divestiture of a business or assets is required—
    - Any discount from going-concern value that the divestiture seller likely will have to accept
      - Merger divestitures are usually quickly made under “fire sale” conditions
      - Only a limited number of potential buyers may be acceptable to the reviewing agency as the divestiture buyer
    - Any loss of synergies associated with the divested businesses
    - The transactions costs associated with the divestiture sale

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# Substantive Risk: Predicting Merger Enforcement Outcomes



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# The Statutes

# Clayton Act § 7

## ■ Provides the U.S. antitrust standard for mergers

No person engaged in commerce or in any activity affecting commerce shall acquire, directly or indirectly, the whole or any part of the **stock** or other share capital and no person subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the **assets** of another person engaged also in commerce or in any activity affecting commerce, where in **any line of commerce** or in any activity affecting commerce **in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly.** <sup>1</sup>

### □ *Simple summary:* Prohibits—

- acquisitions of stock or assets that
- “may substantially lessen competition or tend to create a monopoly”
- “in any line of commerce” (product market)
- “in any part of the country” (geographic market)

Called the *anticompetitive effects test*

Called the *relevant market*

## ■ Other statutes

- Sherman Act §§ 1-2 and FTC Act § 5 also regulate mergers
- BUT these statutes are either coextensive or less restrictive than Clayton Act § 7<sup>2</sup>

<sup>1</sup> 15 U.S.C. § 18 (emphasis added; remainder of section omitted).

<sup>2</sup> Progressives and Neo-Brandeisians argue that Sherman Act § 2 and FTC Act § 5 can reach certain mergers that Section 7 may not reach. This view has yet to be tested in court.

# Clayton Act § 7

## ■ The incipency standard

- *The law:* Beginning in 1957 with the Supreme Court's decision in *duPont/GM*, courts consistently have interpreted the “may be” and “tend to” language in the anticompetitive effects test to—
  - Require proof only of a *reasonable probability* that the proscribed anticompetitive effect will occur as a result of the challenged acquisition
  - Not require proof that an actual anticompetitive effect will result from the merger

Section 7 is designed to arrest in its incipency not only the substantial lessening of competition from the acquisition by one corporation of the whole or any part of the stock of a competing corporation, but also to arrest in their incipency restraints or monopolies in a relevant market which, as a reasonable probability, appear at the time of suit likely to result from the acquisition by one corporation of all or any part of the stock of any other corporation. The section is violated whether or not actual restraints or monopolies, or the substantial lessening of competition, have occurred or are intended.<sup>1</sup>

- Section 7 tests all mergers—horizontal, vertical, and conglomerate—under the same reasonable probability standard<sup>2</sup>

<sup>1</sup> *United States v. E.I. duPont de Nemours & Co.*, 353 U.S. 586, 589 (1957); *accord* *Brown Shoe Co. v. United States*, 370 U.S. 294, 325 (1962); *United States v. Penn-Olin Chem. Co.*, 378 U.S. 158, 173 (1964); *United States v. Cont'l Can Co.*, 378 U.S. 441, 444 (1964); *United States v. Von's Grocery Co.*, 384 U.S. 270, 272 (1966); *FTC v. Procter & Gamble Co.*, 386 U.S. 568, 576-77 (1967); *Ford Motor Co. v. United States*, 405 U.S. 562, 567 n.4 (1972); *United States v. Falstaff Brewing Corp.*, 410 U.S. 526, 531 (1973); *United States v. Marine Bancorporation, Inc.*, 418 U.S. 602, 616, 640-41 (1974);

<sup>2</sup> *Procter & Gamble*, 386 U.S. at 577 (“All mergers are within the reach of § 7, and all must be tested by the same standard, whether they are classified as horizontal, vertical, conglomerate.”).

# Clayton Act § 7

## ■ The incipency standard

### □ The practice

- In practice, courts do not employ any nuanced view of a “reasonable probability” although they give lip service to the term
- Rather, they appear to ask whether it is more likely than not that a challenged merger will have an anticompetitive effect

### □ The critics

- Critics argue that this is tantamount to requiring proof of an actual anticompetitive effect
- To critics, this is too high a standard: Proof of a “reasonably probability” should recognize violations when the mergers presents an appreciable risk of an anticompetitive effect, even if the merger is not more likely to be anticompetitive
- The problem for courts
  - Courts apply a preponderance of the evidence standard in everyday practice
  - It is unclear how—or even if—courts would deal with a probability threshold less than 50%

# Anticompetitive effects test

- *Distinction*: Downstream and upstream markets
  - Downstream markets
    - *Definition*: Sellers merge and customers sustain any anticompetitive harm
    - Almost all horizontal merger challenges historically have alleged anticompetitive harm in a downstream market
    - Consequently, the merger guidelines and almost all case law to date address downstream markets
  - Upstream markets
    - *Definition*: Buyers merge and suppliers sustain any anticompetitive harm
    - Very few horizontal merger challenges have alleged anticompetitive harm in an upstream market<sup>1</sup>
    - Consequently, the case law is almost nonexistent for upstream markets
      - The tests for anticompetitive effects from horizontal mergers in upstream markets are unsettled
    - Upstream markets are a focus of the Biden antitrust enforcers
      - Especially concerned that mergers can anticompetitively affect labor markets

<sup>1</sup> A notable recent example is *United States v. Bertelsmann SE & Co. KGaA*, No. CV 21-2886-FYP, 2022 WL 16949715 (D.D.C. Nov. 15, 2022), where the DOJ successfully challenged the acquisition of Simon & Schuster by Penguin Random House on the grounds that the transaction would anticompetitively harm authors in the market for publishing rights to anticipated top-selling books.

# Anticompetitive effects in downstream markets

- *Modern view under the consumer welfare standard:*<sup>1</sup> Transaction threatens—with a reasonable probability—to hurt some *identifiable* set of customers in the (downstream) market through:
  - Increased prices
  - Reduced market output
  - Reduced product or service quality
  - Reduced rate of technological innovation or product improvement
  - (Maybe) reduced product diversity<sup>2</sup>
- Forward-looking analysis
  - Compare the postmerger outcomes with and without the deal
  - Can view potential competitors today as future competitors tomorrow

These are called  
*anticompetitive effects*

A firm that has the power to produce or strengthen an anticompetitive effect is said to have *market power*

<sup>1</sup> The modern view dates from the late 1980s or early 1990s, after the agencies and the courts had assimilated the 1982 DOJ Merger Guidelines.

<sup>2</sup> The idea that reduced product diversity may be a cognizable customer harm was formally introduced in the 2010 DOJ/FTC Horizontal Merger Guidelines. A reduction in product diversity is typically accompanied by a reduction in costs, so the balance of whether a reduction in product diversity is anticompetitive or procompetitive can often be difficult to determine and hence is rarely a driver in merger antitrust decision making.

# Anticompetitive effects in downstream markets

- Other dimensions of possible anticompetitive effect
  - Historically, there have not been challenges on other dimensions (quality, rate of technological innovation, or product diversity) when there is no alleged price effect
    - Economic theory is not well-developed in predicting—
      - The consequences of transaction for nonprice market variables, *or*
      - The implications of changes in nonprice market variables for consumer welfare
    - *But* adverse effect on other dimensions is frequently mentioned in modern complaints that also allege an anticompetitive price effect
  - *The practice:* Agencies require strong direct evidence to proceed on a theory other than a price increase—Most likely will require:
    1. An “admission against interest” by the acquiring company or other compelling evidence that:
      - The merging companies compete significantly in product quality, innovation, or other nonprice dimension,
      - This competition in this dimension is costly and is materially reducing profits, *and*
      - A benefit of the transaction will be to eliminate this competition and increase profits by saving costs
    2. Evidence that other companies will not replace the nonprice competition lost due to the merger; *and*
    3. Evidence that customers will be significantly harmed by the loss of this nonprice competition
  - *Note:* Nonprice competition, especially innovation competition, is an important consideration in Europe

# Anticompetitive effects in upstream markets

- Antitrust merger challenges in upstream markets
  - Merger antitrust cases have been rare in upstream markets, where the concern is that the merging parties as buyers will act anticompetitively with respect to suppliers
    - One reason (perhaps) for the lack of upstream merger antitrust cases is that an anticompetitive upstream merger is frequently anticompetitive in the downstream market
    - The Biden administration enforcement officials believe that mergers are often anticompetitive in upstream markets (especially in labor markets) even when there is no corresponding anticompetitive effect in the downstream market

*A major initiative of the Biden administration is to bring cases where the mergers threaten to harm suppliers, especially workers*



# Anticompetitive effects in upstream markets

## ■ Antitrust merger challenges in upstream markets

- The consumer welfare standard—when strictly limited to consumer welfare—does not apply well to many upstream markets

- Three scenarios to consider—

Highly likely that a court would find a Section 7 violation

- *Scenario 1*: The merger reduces prices to suppliers (e.g., wage rates) in the upstream market and increases prices to customers in the related downstream market → Both suppliers and consumers are harmed
  - This is the easy case: Can challenge in the downstream market and ignore the upstream market
- *Scenario 2*: The merger reduces prices to suppliers in the upstream market but does not increase prices in the related downstream market → Suppliers but not consumers are harmed
  - *Example*: Merging firms purchase inputs in a concentrated local buyer's market but sell outputs in a highly competitive national or global market
  - *Notable recent case*: The DOJ successfully challenged the acquisition of Simon & Schuster by Penguin Random House on the grounds that the transaction would anticompetitively harm authors in the market for publishing rights to anticipated top-selling books
    - The DOJ did not allege that customers in the downstream market would be harmed
    - The merging parties failed to prove any significant downstream consumer benefits from the transaction

More difficult case

- *Scenario 3*: Same as Scenario 2, but the combined firm passes on some of the savings to consumers in reduced prices → Suppliers are harmed but consumers benefit
  - The conventional wisdom is that courts are reluctant to find antitrust violations in supplier markets when the cost savings is “passed on” to customers, resulting in significant consumer benefits

<sup>1</sup> United States v. Bertelsmann SE & Co. KGaA, No. CV 21-2886-FYP, 2022 WL 16949715 (D.D.C. Nov. 15, 2022).

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# A Predictive Model\*

\* Applies only to downstream markets (i.e., where sellers merge and any harm is to customers).

# First, a distinction

## ■ Basic distinction

- *Decision making*: How do the agencies decide whether a merger is anticompetitive and hence unlawful?
- *Explanation*: How do the agencies explain why they believe that a merger is anticompetitive?

- *How the agencies (or the courts) explain their decisions often does not reveal why they decided on that particular outcome*
- *What you read in judicial opinions may only be a defense of an outcome that the judge reached for other (unexplained) reasons*

# A predictive model

- What follows in the remainder of this section is the model I use in *predicting* agency enforcement outcomes in downstream markets in horizontal mergers that are pending (that is, have not yet closed)
  - This is the typical case: Most investigations and enforcement actions take place after the merger agreement has been signed but before the transaction has closed
  - Accordingly, we cannot observe how the merger in fact affected competition
  - Rather, we must predict how the merger, if consummated, is likely to affect competition

# A predictive model

- The model works very well in predicting enforcement outcomes
- The model does not attempt to describe—
  - how the agencies actually work,
  - how they explain their decisions, *or*
  - how they litigate their decisions in court
- It is *not* defense-biased, although it may appear so to some on a first reading
  - A biased model is not helpful to the client
  - The client needs accurate predictions, not wishful thinking
- Later in the course, we will examine—
  - how the agencies explain their enforcement decisions, *and*
  - how they advocate their positions in court

# Assessing substantive antitrust risk

- So how do the DOJ/FTC approach merger antitrust investigations?

- They ask a simple, basic question:

*Is the merger likely to result in anticompetitive harm to any identifiable customer group?*

- If the answer is YES, the investigating agency will find a way to package it into a theory of anticompetitive merger harm under merger antitrust law precedent and the Merger Guidelines and pursue enforcement action
- If the answer is NO, the investigating agency will close the investigation without taking enforcement action (and, in most cases, without providing any explanation of their decision)

- This is *the* central question in most merger antitrust investigations

- It will drive almost everything we do in this course

There is a lot of rhetoric from the heads of the FTC and the Antitrust Division that they are looking at a variety of factors in addition to a merger's effects on customer groups in assessing the merger's legality. BUT to date, there has been only one challenge that could not be predicted by the agency's expressed view on its effect on customers. See [United States v. Bertelsmann SE & Co. KGaA](#), No. CV 21-2886-FYP, 2022 WL 16949715 (D.D.C. Nov. 15, 2022) (finding the merger would likely produce an anticompetitive reduction in compensation to authors in a book publishing merger).

# Assessing substantive antitrust risk

- So how do the DOJ/FTC approach merger antitrust investigations?

*Rule 1. Absent compelling evidence of significant customer harm from other sources, only price increases count*

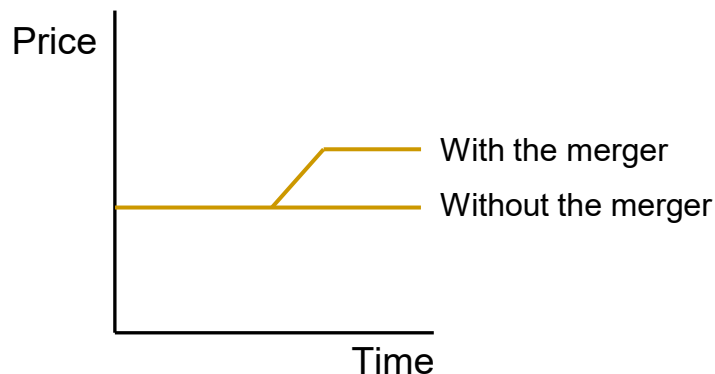
- Recall that a merger is anticompetitive if it is reasonably likely to result in—
  - Increased prices
  - Decreased product or service quality
  - Decreased rate of technological innovation or product improvement
  - [Maybe] decreased product variety
- But economic theory not well-developed in predicting—
  - The consequences of transaction for nonprice market variables
  - The implications of changes in nonprice market variables for consumer welfare
- *Practice implication:* The agencies need strong direct evidence to proceed on a theory other than a price increase

*The default test for the agencies and the courts is to look for anticompetitive price effects: Almost every merger antitrust complaint alleges that the merger is likely to increase prices in a downstream market*

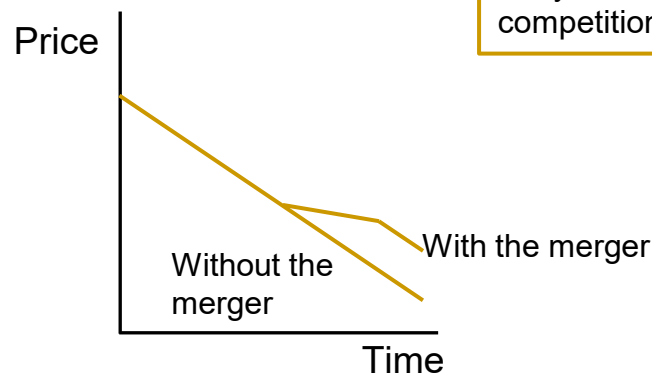
# Assessing substantive antitrust risk

- What is a “price increase” in the Section 7 context?
  - A price increase occurs as a result of a transaction whenever prices, *going forward, more likely than not* will result in higher prices with the transaction than without it
    - A decrease in the rate of a price decline is regarded as a price increase, even if price levels continue to decline postmerger
  - Two examples of price increases

NB: *This is important!* Section 7 is an “incipiency” statute: it looks to *reasonable probability* of an anticompetitive effect, which courts appear to interpret that the transaction is more likely than not to harm competition



Stable prices



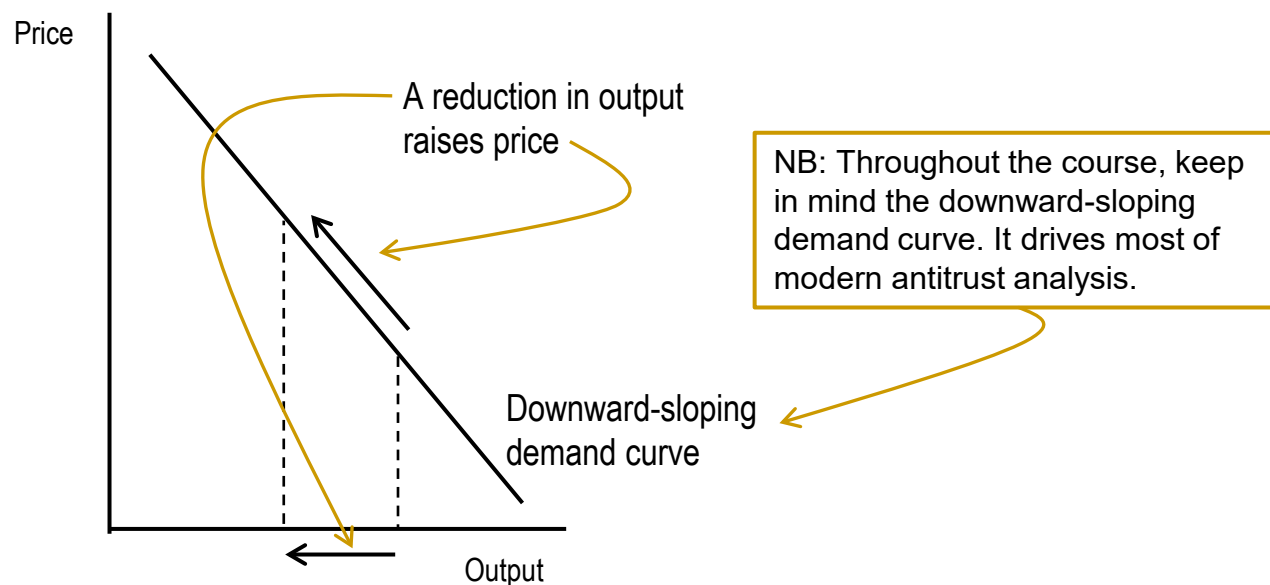
Declining prices



# Assessing substantive antitrust risk

- What is a “price increase” in the Section 7 context?
  - The agencies consider a reduction in market output to be effectively a price increase

*A reduction in output implies a price Increase*



- The idea is that when supply becomes limited, the customers who value the product the most bid up the price. This makes the demand curve *downward sloping*.
- The *market-clearing price* of a product is the price at which aggregate demand by consumers for the product is equal to aggregate amount of the product firms are willing to supply at that price

# Assessing substantive antitrust risk

- A quick aside on the application of the consumer welfare standard
  - Critics of the consumer welfare standard often complain that the standard looks only at price effects
  - *This is incorrect*: The consumer welfare standard considers *all* dimensions of consumer harm, not just prices
  - In practice, however, the problem is one of proof
    - The plaintiff bears the burden of proof on anticompetitive effect in court
    - The most available evidence of anticompetitive effect is a price increase—
      - From the merging parties' internal documents (especially merging valuation and planning documents)
      - From (sophisticated) customers that anticipate a reduction in competition for their patronage
      - From third-party industry analysts
      - From expert economists
    - Unless the merging parties admit to the merger's nonprice anticompetitive effects in documents or statements, there is unlikely to be any admissible evidence of such an effect
      - Third-party industry participants rarely or ever have admissible evidence of nonprice anticompetitive effects (speculation or lay opinions are not admissible)
      - There are no accepted economic models that predict a merger's effect on nonprice variables → Unlikely to have admissible expert economic testimony on nonprice anticompetitive effects

*The lack of evidence of anticompetitive nonprice effects  
necessarily forces the competitive analysis to focus on price effects*

# Assessing substantive antitrust risk

- Harm can be to *any identifiable group of customers*

*Rule 2. The agencies believe that no customer group is too small to deserve antitrust protection*

- The merger does not have to affect all customers
- Sufficient if it affects some identifiable group of customers
  - That is, some group that can be characterized systematically through objective criteria
- Some common groups
  - Customers in a particular geography
  - Customers of a particular type of product
  - Customers of a particular type of product in a particular geography
- The agencies will seek to define the relevant market around the customer group threatened with harm
  - Success in court has been mixed
  - Not always consistent with the market definition paradigms in the case law and 1992 Horizontal Merger Guidelines
  - 2010 Horizontal Merger Guidelines were drafted in part to provide more flexibility

# Assessing substantive antitrust risk

- The size of the deal is irrelevant

## *Rule 3. The agencies believe that no merger is too small to challenge*

- Indeed, there are staff members at the agencies who prefer to challenge small deals—or equivalently, small parts of large deals—because the costs of litigation to the parties typically outweigh the benefits of a successful defense in court
- Practice implications
  - The merging parties in small deals will often terminate their merger agreement and walk away from the deal at the end of an investigation rather than put the agency to its proof in litigation
  - The merging parties in large deals where the problem areas are small almost always will agree to a divestiture consent decree rather than delay the closing through the end of litigation (if the investigating agency is willing to agree to a consent settlement)
    - If the agency is unwilling to accept a consent settlement and the benefits of the deal are substantial, the parties will often “litigate the fix,” that is, enter into a definitive agreement with a buyer to divest the apparently problematic lines of business and then force the agency to litigate the adequacy of the “fix” in court<sup>1</sup>
  - This cost-benefit calculus prevails even when the merging parties have a high degree of confidence that they would ultimately prevail in litigation

<sup>1</sup> We will examine litigating the fix in Class 6.

# Assessing substantive antitrust risk

- Important factoids in agency prosecutorial decision making
  - Key factors in the decision to challenge horizontal mergers:
    1. The existence of incriminating documents (or occasionally incriminating public statements)
    2. Closeness and uniqueness of competition between the merging parties
    3. The number of other significant competitors
    4. Customer complaints
    5. “Natural experiments” (past events that can be probative of the transaction’s likely effect)
    6. History of actual or attempted collusion/coordination in the market
  - The 2010 DOJ/FTC Horizontal Merger Guidelines are rarely invoked by the agencies or the parties during the agency’s assessment of a transaction
    - The 2010 guidelines are sufficiently unpredictable that they can be used to support any enforcement decision
    - That said, the agencies do invoke the 2010 Guidelines retroactively when *explaining* an enforcement decision
    - The agencies also cite the Guidelines in their court filings, and courts are increasingly citing the Guidelines in opinions as “authority” (much to the consternation of defense counsel)
  - Formal market definition and HHIs play essentially no role and are rarely addressed in the investigation (although they are important in litigation)
    - Very information-intensive approach of questionable probative value
    - Consequently, not particularly useful for screening by either agencies or parties

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# Another basic distinction

- Truth v. evidence
  - The agencies (and the courts) deal in *evidence*
  - Having the truth on your side but being unable to prove it will not win the day
  - The investigating staff also needs evidence to be able to prove its case to the agency decision makers and, if necessary, in litigation

*So what are the sources of evidence?*

# Major sources of evidence

- Preconsummated (pending) transactions
  - Ordinary course of business documents of the merging firms
  - Company responses to second requests
    - Includes responsive documents and responses to data and narrative interrogatories
  - Interviews/testimony/public statements of merging firm representatives
  - Interviews with knowledgeable customers
  - Interviews with competitors
  - Customer and competitor responses to DOJ Civil Investigative Demands (CIDs) or FTC subpoenas
  - Analysis of bidding or “win-loss” data
    - Including the ability of customers to “play” the merging firms off one another
  - “Natural” experiments
  - Expert economics analysis
- Consummated (closed) transactions
  - Observed effects
    - Most notably, price increases enabled by the merger
  - PLUS all of the evidence probative in preconsummated transactions

# Defense menu in horizontal transactions

Empirically, these  
are the only  
defenses that work

- In decreasing order of strength—
  1. Parties do not compete with one another (and are unlikely to compete significantly with one another in the foreseeable future)
  2. Parties compete only tangentially
  3. Parties compete but have significant other close and effective competitors
  4. Parties do compete and have few existing competitors, but movement into market—
    - is easy (no barriers to entry or repositioning), *and*
    - would occur quickly if merged company acted anticompetitively
  5. Some other reason deal is not likely to harm any group of customers
- Special cases
  - Parties have competed in the past, but because of changing conditions would not compete with each other in the future even absent the merger
    - Includes the “failing company” defense
    - Invoked with some frequency but almost always fails for lack of proof of the essential elements of the defense<sup>1</sup>

<sup>1</sup> We will examine the details of the failing company defense later in the course.



# Basic structural test for horizontal mergers

## Reduction in Bidders/Competitors\*

- 5 → 4 Usually clears if no bad documents and no material customer complaints
- 4 → 3 Usually challenged unless there are no bad documents and there is a strong procompetitive business rationale, some customer support, *and* minimal customer complaints
- 3 → 2 Almost always challenged unless there are no bad documents, and there is a compelling business rationale that is strongly supported by customers and no material customer complaints
- 2 → 1 Always challenged

\* Critically, these must be meaningful and effective alternatives from the perspective of the customer; “fringe” firms that customers do not regard as feasible alternatives do not count

## Tightening in enforcement standards

- Up to 2015, 5 → 4 deals almost always cleared and the chart would be compressed to begin at 4 → 3
- In the Biden administration, it is likely we will see an attempt to further tighten the standards to begin at 6 → 5 (but surprisingly after two years we have not seen evidence of this)

# Exacerbating factors

## 1. Incriminating (“hot”) company documents:

- ❑ Suggest that a strategy of the merged firm will be to raise prices, reduce production or capacity, or reduce the rate of innovation or product improvement
- ❑ Suggest the merging companies are close competitors of one another in some overlapping product
- ❑ Suggest that customers have few realistic alternatives to merging firm
- ❑ Suggest that the competitors pay attention to each other’s prices and—
  - are careful not to destabilize high prices, *or*
  - have attempted to stabilize prices but failed
- ❑ Suggest that the target company is a “maverick” that does not go along with the higher prices that other companies in the market want to charge

## 2. Incriminating public statements:

- ❑ Occasionally, a senior executive of one of the merging parties (typically the buyer) will make an incriminating statement in a public forum, in the press, or on a blog

**Rule 4.** *Hot documents or incriminating public statements can be fatal to a deal—Expect them to be featured in any enforcement action*

# Exacerbating factors

## 3. Customer complaints: Canonical form—

- a. The merging companies are close competitors of one another in one or more overlapping products;
- b. Customer “plays” the companies off one another to get better prices; *and*
- c. Postmerger, there will be an insufficient number of realistic alternative suppliers to preserve price competition at premerger levels

*Customer conclusion:* Customer will pay higher prices as a result of the merger

*Rule 5. Customer complaints are second only to incriminating company documents or statements in their probative value to the DOJ and FTC*

## 4. High barriers to entry, expansion, and repositioning

- Apparent barriers (e.g., high cost, required scale, time, reputation)
- High gross margins of the merging parties
  - *Idea:* If high premerger gross margins did not precipitate entry, expansion, or repositioning, then a slightly higher margin due to a postmerger anticompetitive price increase is not likely to precipitate this type of market correction either
- The idea here is that higher prices resulting from the merger will not trigger competition-restoring entry by new firms or expansion by existing firms

# Exacerbating factors

## 5. High combined market shares

- ❑ Not helpful to the merging parties
- ❑ BUT not decisive if sufficient (realistic) alternatives exist for customers

## 6. “Dominant” firm

- ❑ If one of the merging firms is dominant (roughly speaking, has a very high market share) in an area of competitive overlap, the reviewing agency will be much more skeptical of the transaction

## 7. History of industry coordination

- ❑ If there is a history of coordination, much less illegal collusion, among the firms in the relevant market, the reviewing agency will be much more skeptical

### *Note:* Effect on competitors

- ❑ In U.S., historically irrelevant unless it hurts customers
  - BUT may be important in the Biden administration if the merger threatens the viability of smaller firms
  - However, to date we have not seen cases brought on this theory
- ❑ One of the best predictors of enforcement action in the EU

# Mitigating factors

- The chances of successfully defending a deal *improve* if—
  - There are demonstrable forces that constrain price increases or other anticompetitive behavior beyond the mere number of incumbent competitors
  - Three major possible forces (known as *downward pricing pressure defenses*):
    1. *Entry, repositioning, or output expansion* by third-party competitors in response to anticompetitive behavior by the combined company
      - Requires low barriers to entry, repositioning, or repositioning, *and*
      - The identification of one or more firms that enter, reposition, or expand in response to the merger
    2. *Powerful customers*, who can use their bargaining leverage to stop the combined firm from acting anticompetitively
      - Requires a detailed explanation of how the bargaining will work to constrain the combined firm
      - Defense on works firm-by-firm—Small firms without the requisite bargaining power can still be competitively harmed, resulting in a Section 7 violation
    3. *Efficiencies*, where the procompetitive pressure of the efficiencies outweighs the anticompetitive pressure of the increased market power
      - More on this below
      - Agencies *very* skeptical if not outright hostile (even in the Obama and Trump administrations) to efficiencies as a mitigating factor
        - The skepticism largely results from a belief that parties frequently claim efficiencies that do not exist or are unlikely to be achieved postmerger or that the efficiencies could be achieved without the merger rather than a rejection in principle of efficiencies as a mitigating factor
        - However, Neo-Brandeisians presumably reject efficiencies as a mitigating factor because their concerns over the existence of political or economic power outweigh any interest they have in the the efficient operation of the marketplace

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# Mitigating factors

- The practice
  - Before the agencies, the parties bear as a practical matter a heavy burden of proof on the downward pricing pressure defenses and the parties rarely prevail
  - In court, the parties technically bear the burden of production on these defenses
    - Empirically, however, no modern case has accepted any of these forces as sufficient to rebut the government's prima facie case of anticompetitive effect

# Mitigating factors

## ■ Defenses

- These forces are legal defenses if they are sufficient in likelihood and magnitude to completely offset the likely customer-harming aspects of the transaction
- Basic distinction
  - Negative defense: The merger is not anticompetitive in the first instance
  - Affirmative defense: Even if the merger is anticompetitive, it is nonetheless not unlawful
- Technically—
  - A negative defense negates an element of the plaintiff's prima facie case
  - An affirmative defense
    - accepts the elements of the prima facie case as true, but
    - raises matters outside of the prima facie case that provide a justification or an excuse to absolve the defendant from liability

*There are no affirmative defenses in modern antitrust law*

# Mitigating factors

## ■ Defenses

- Downward pricing pressure defenses are negative defenses
  - That is, the defense must completely offset the gross anticompetitive effect of the merger, so that the net effect of the merger on customers must be neutral or positive<sup>1</sup>

*When the agencies succeed in making out a strong prima facie case (which is not always), modern courts have consistently rejected the merging parties' legal defenses as insufficient to offset the proven likely customer-harming aspects of the transaction*

- Some enforcement history
  - In the 40 years prior to the Biden administration, the agencies have filed complaints only in cases where they believe that they can plead and prove a strong prima facie case of anticompetitive effect under existing judicial precedent
  - This has changed somewhat in the Biden administration when the agencies have either—
    - Filed complaints alleging judicially accepted theories of anticompetitive harm but lack the evidence to prove their prima facie case, or
    - Filed complaints alleging new or significantly expanded theories of anticompetitive harm



# Special cases

## 1. *Unilateral effects*: Elimination of “local” competition<sup>1</sup>

- In differentiated markets, some firms are close competitors with one another while other firms are more distant competitors
  - *Geographic differentiation*: Two pharmacies across the street from each other are closer competitors to each other than a pharmacy 10 miles away
  - *Product differentiation*: A Rolex watch and an Omega watch are closer competitors to each other than a Timex watch is to either, although all three watches tell time
- *Idea*: The combination of two sufficiently close competitors in a highly differentiated market, where there are few if any other close competitors, can result in the loss of “local” competition without any changes in the behavior by other, more distant competitors in the same relevant market
  - Can result, for example, in price increases by the merging firms but not by other firms in the market
- Two ways to think about this theory
  1. Supports challenges to mergers in large markets where the market shares of the combining firms are small and would not otherwise indicate a competitive problem
  2. Often supports defining the relevant market narrowly around the local competition and then applying the basic structural test

<sup>1</sup> Introduced as a concept in the 1992 DOJ/FTC Horizontal Merger Guidelines. We will explore unilateral effects in detail in Unit 9.

# Special cases

## 2. Elimination of a “maverick”<sup>1</sup>

- A “maverick” is a firm that is particularly disruptive in the marketplace and that plays a significant role in preventing other firms from tacitly coordinating their behavior to achieve an anticompetitive effect
  - Maverick firms often have sufficiently small market shares in the range that would not indicate that their acquisition would be otherwise anticompetitive
- *Idea*: The acquisition of a maverick firm by an “established” firm—
  - will eliminate the target firm as a disruptive source, thereby
  - facilitating tacit coordination among the remaining competitors postmerger and
  - resulting in higher market prices or less innovation
- This is a variant of the *coordinated effects theory*
- Final thoughts
  - The notion of a “maverick” is a very ill-defined concept—has a “you know it when you see it” quality
  - May be entirely dependent on the business strategy of the current management

<sup>1</sup> We will explore the acquisition of mavericks in detail in Unit 9.

# Special cases

## 3. Elimination of “actual” potential competition<sup>1</sup>

- An “actual potential competitor” is a firm that has not yet entered the market but will do so shortly in the future and in a substantial way in the absence of its acquisition<sup>2</sup>
- Idea:
  - If premerger the market is performing oligopolistically, the entry of a new competitor is likely to make the market perform more competitively
  - The acquisition of an actual potential entrant by an incumbent firm will eliminate the addition of a new competitor
    - The same would be true if the potential entrant acquired an incumbent firm
  - If entry by other (nonmerging) firms is either distant/not foreseeable or would not be substantial, then the acquisition of the potential entrant means that the market will not become as competitive in the future as it would absent the acquisition
  - Since merger antitrust law is forward looking—compares what would happen with the merger to what would happen absent the merger—the acquisition reduces future competition and hence is anticompetitive

<sup>1</sup> We will explore the acquisition of actual potential competitors (including nascent competitors) in detail in Unit 14.

<sup>2</sup> Although the acquisition of an actual potential entrant by an incumbent firm should be viewed analytically as a type of horizontal transaction, for historical reasons it is viewed as a type of conglomerate transaction and hence is not addressed in either the 1992 or 2010 Horizontal Merger Guidelines.

# Special cases

## 3. Elimination of “actual” potential competition (con’t)

- The practice
  - Until recently, all “actual potential competition” cases have been settled by consent decree or defeated in court
- A new related theory: Elimination of “nascent competition”
  - Beginning late in the Trump administration and continuing in the Biden administration, the agencies have brought several cases where:
    - The acquiring firm was so dominant in the relevant market that it was a monopolist or near-monopolist, *and*
    - The acquired firm uniquely had developed a technology that had the *theoretical potential* to undermine the acquiring firm’s dominant firm either in the hands of:
      - the acquired firm, *or*
      - A third-party (which could either acquire or license the technology)
    - Even if:
      - The technology needed further development before it could be used against the dominant firm, *and/or*
      - The likelihood that the technology could be successfully deployed to undermine the dominant firm was small
  - The agencies have yet to test the nascent competition theory in court
  - BUT the merging parties have abandoned several deals on this theory
    - Probably because the expected value of the acquisition to the buyer was relatively low and the buyer did not want the disruption to its business of extensive litigation<sup>1</sup>

<sup>1</sup> We will explore the nascent competition theory in more detail in Unit 14.

# Special cases

## 4. Elimination of “perceived” potential competition

- ❑ A “perceived” potential competitor is a firm that is perceived by incumbent firms as about ready to enter the market, even if the firm has no intention of entering the market
- ❑ Idea
  - If the market has an oligopolistic structure but incumbent firms have moderated their prices (“limit pricing”) to discourage the perceived potential entrant from actually entering the market, the acquisition of the perceived potential entrant by an incumbent firm will eliminate this threat of entry and allow the incumbent firms to increase their prices
  - The perceived potential must be a uniquely downward price-constraining force: if other perceived potential entrants exist, the incumbent firms will continue to limit price
- ❑ Not seriously used in the U.S. as a theory of anticompetitive harm for over 35 years
  - Required facts are very restrictive and difficult to prove
  - Historically has had almost no success in the United States when it was invoked

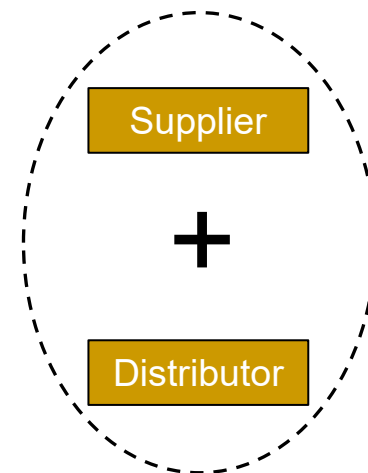
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<sup>1</sup> We will explore the acquisition of perceived potential competitors in detail in Unit 14.

# Special cases

## 5. Vertical theories

- ❑ A vertical transaction is one where the merging firms are on different levels of the chain of manufacture and distribution of a product and so do not compete with one another
- ❑ Vertical mergers are usually viewed as unlikely to be anticompetitive
- ❑ Some theories of vertical harm<sup>1</sup>
  - Exclusionary effects (foreclosure/raising rivals' costs)
    - ❑ “Input foreclosure”
    - ❑ “Output foreclosure”
  - NB: “Foreclosure” in this context is loosely used. It includes competitively disadvantaging rivals by raising their costs as well as complete exclusion from the market.
  - Coordinated effects
    - ❑ Elimination/disciplining of new disruptive competition
    - ❑ Elimination of a disruptive buyer
    - ❑ Create greater firm homogeneity
    - ❑ Anticompetitive information conduits



<sup>1</sup> There is no need to know anything now about these theories other than they exist. We will cover them in detail in Unit 15.

# Special cases

## 6. Modern entrenchment

- This theory is being tested in court by the Biden administration
  - Entrenchment is a “conglomerate” merger theory, that is, a theory applying to transactions that are neither presently nor in the foreseeable future horizontal nor vertical
  - The idea is that somehow the combination of the products of the merging firms will “entrench” the dominant positions of the some of the products of the merging firms
    - The DOJ and FTC used the theory in a few cases in the 1960s, but the theory never gained any meaningful traction
    - The theory has been essentially dormant in the United States since before the mid-1970s
    - Modern antitrust law almost surely will be hostile to entrenchment theories as too speculative to establish the requisite “reasonable probability” of anticompetitive harm necessary to prove a Section 7 violation
  - The Biden FTC is attempting to revive the entrenchment theory in its challenge to Amgen’s acquisition of Horizon Therapeutics<sup>1</sup>
    - The FTC alleges that the deal would allow Amgen to leverage its portfolio of blockbuster drugs to entrench the monopoly positions of Horizon medications used to treat two serious conditions, thyroid eye disease and chronic refractory gout
    - The FTC alleges that Amgen to use rebates on its existing blockbuster drugs to pressure insurance companies and pharmacy benefit managers (PBMs) into favoring Horizon’s two monopoly products, thereby reducing demand for alternative drugs and reducing the incentives of other drug companies to develop them.

<sup>1</sup> See [Complaint for a Temporary Restraining Order and Preliminary Injunction Pursuant to Section 13\(b\) of the Federal Trade Commission Act, FTC v. Amgen Inc.](#), No. 23-CV-3053 (N.D. Ill. filed May 16, 2023). We will follow this case in the course. If the opinion is issued in time, I plan to cover it in the last day of class.

# Untested theories

## ■ Background and observations

- These are theories included in the 2023 draft merger guidelines<sup>1</sup> are either—
  - Dormant from the 1960s and early 1970s and untested in modern antitrust law, *or*
  - Completely novel and untested
- Although announced in the 2023 draft merger guidelines, the agencies probably have had these theories in mind for the last two years without bringing any test cases
  - This suggests either—
    - Mergers that present strong factual predicates of these theories are rare, if not nonexistent, *or*
    - The agencies have identified mergers that present the requisite factual predicates, but are willing to allocate resources in pursuing cases to test their theories given their resource constraints and a large number of cases with higher enforcement priorities
- Moreover, it is doubtful that any of these theories will fare well in modern courts (especially the Supreme Court as currently constituted)

*We will defer examining these untested theories until later in the course*

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<sup>1</sup> U.S. Dep't of Justice & Fed. Trade Comm'n, [Draft Merger Guidelines](#) (July 19, 2023) (“2023 DMG”).



# Summary: Theories of anticompetitive harm

1. Coordinated effects/tacit coordination
2. Unilateral effects
3. Elimination of a maverick firm
4. Elimination of actual potential competition (and of nascent competition)
5. Elimination of perceived potential competition (never used)
6. Vertical theories
7. Modern entrenchment (dormant theory currently being tested)
8. Possible test cases

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# Synergies/Efficiencies

# Synergies/efficiencies

- Some definitions

- *Synergies* (a business term)

- Benefits to the company from the transaction that lower the combined firms' costs or increase its revenues

- *Efficiencies*

- The term used in antitrust analysis for synergies that benefit consumers

*Synergies are relevant to the antitrust analysis only to the extent they are passed on or otherwise benefit customers*

# Efficiencies

- Types of efficiencies potentially enabled by a merger
  1. Customer value-enhancing efficiencies
    - Make existing product better or cheaper, *or*
    - Create new products or product improvement better, cheaper, or faster
  2. Cost-saving efficiencies
    - Reductions in duplicative costs
    - Increases in the productive efficiency of the combined operation (e.g., through best practices, transfer of more efficient production technology)
  3. Anticompetitive synergies
    - Eliminate competition on price, quality, service, or innovation and so increase profits (horizontal theory of anticompetitive harm)
    - Create an incentive and ability to withhold important/ essential products or services used by competitors and so eliminate competition and increase price (vertical theory of anticompetitive harm)

# Efficiencies

- Examples of typically claimed efficiencies
  1. Lower costs of production, distribution, or marketing
    - Elimination of redundant or higher cost facilities, technologies, and personnel
    - Economies of scale or scope
  2. Complementary product lines
    - New or broader product offering desired by customers
    - Better integration between merging products further enhances customer value
  3. Accelerated R&D and product improvement
    - Greater combined R&D assets (researchers, patents, know-how)
    - Complementarities in R&D assets
    - Greater sales base over which to spread R&D costs
  4. Better service and product support
    - More sales representatives
    - More technical service support

# Efficiencies

- Efficiencies play two roles in an antitrust merger analysis
  1. They provide an explanation why the acquiring firm is pursuing the deal (and probably paying a significant premium) that does not depend on price increases to customers or other anticompetitive effects
  2. In some cases, efficiencies can tip the agencies into not challenging the deal
    - Where efficiencies exist in a problematic market, the procompetitive pressure resulting from the efficiencies can offset any anticompetitive pressure from the elimination of competition
    - Where efficiencies exist outside of the problematic market, the agencies can weigh very large efficiencies outside of the market against very small anticompetitive effects inside the market and exercise their prosecutorial discretion not to challenge the deal
      - As a matter of law, however, efficiencies outside of a relevant market cannot be weighed against anticompetitive effects inside the market

# Efficiencies

- To be credited by the investigating agency, synergies must be:<sup>1</sup>
  1. Merger-specific
    - That is, could not be accomplished in the absence of the merger
  2. Verifiable by sufficient evidence
  3. Would completely and immediately be sufficient to offset any anticompetitive tendencies of the merger
  4. Not be the result of an anticompetitive effect of the transaction
- Agency view
  - Efficiencies usually given very little weight in the Obama and, more surprisingly, the Trump administrations
  - This skeptical—even hostile—view of efficiencies has continued in the Biden administration

<sup>1</sup> U.S., Dep't of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines § 10 (rev. 2010).

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# Efficiencies

- Practice points
  - Efficiencies are very helpful in fashioning a procompetitive narrative
  - But agencies are (irrationally?) skeptical/hostile to the existence of efficiencies
  - Efficiencies will almost never outweigh prima facie evidence of an anticompetitive effect



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# Structuring the Defense

# Canonical structure of a complete defense

- The best way to assess the substantive risk is to develop the defense with the supporting evidence
- Canonical structure of the initial presentation of a complete defense
  1. The parties and the deal
    - Brief overview of the merging parties
    - Brief overview of the deal (including terms, timing, and conditions precedent)
  2. The deal rationale
    - Ideally, a rationale that both makes the deal in the profit-maximizing interest of the acquiring company's shareholders *and* in the interest of customers ("win-win")
      - In other words, the deal is procompetitive
    - Include any cost, cross-marketing, or product development deal synergies
  3. The market will not allow the deal to be anticompetitive
    - This is equivalent to saying that customers can protect themselves from harm if the merged firm sought to act anticompetitively

*The best defense is a good offense:*

*The transaction is affirmatively procompetitive, and the market would not allow the deal to be anticompetitive even if the combined firm tried*

# Some key questions

- All transactions
  - Why are the companies doing the deal? Is the business model behind the combination procompetitive or anticompetitive? How does the buyer expect to recoup any premium paid for the target?
  - Whatever the mechanism, will the combination likely result in increased prices to any identifiable group of customers?
    - The business people will know—you just have to get them to tell you the truth.
  - What cost savings or other synergies are expected from the deal? Is there persuasive evidence of likelihood, magnitude, and timing be presented to the investigating agency?
  - Will the deal enhance the ability of the combined company to create better products or services faster or otherwise improve consumer welfare in the short or long run?
  - What will the customers in the industry say about the deal if asked by the investigating agency?
  - Are there customers that will support the deal? If so, what is the reason for the support?
  - For customers that might complain, is there a way to neutralize their concerns (e.g., extend the term of their premerger contracts to provide additional protection against price increases)

# Some key questions

- All transactions (con't)
  - What do the company documents say—
    - About the reason for the deal?
    - About competition between the merging parties (including win-loss data)?
    - About the likely competitive effect of the deal?
    - About the premerger competitive landscape?
    - About the combined company's operation postmerger?
  - Does the company have good witnesses—
    - On the strategic rationale and synergies?
    - On each of the business lines likely to be investigated?
  - Same questions on documents and witnesses for the other merging party
  - If the investigating agency wants to challenge the deal, will it have customers that will testify against the deal at trial?
  - Are their competitors or other parties with the incentive and the wherewithal to work with the investigating agency to develop theories and evidence to challenge the deal?<sup>1</sup>

<sup>1</sup> Historically, the U.S. antitrust agencies give little credit to competitor testimony that a deal is anticompetitive. The idea is that an anticompetitive deal is likely to increase market prices and benefit competitors and that the real concern behind most competitor complaints is that the merged firm will become more efficient and procompetitively win business away from the complaining competitor. That said, the agencies are always willing to enlist competitors to help them better understand the market, gain access to industry customers, and generally develop evidence.

# Some key questions

## ■ Horizontal transactions

- Are the merging companies strong and close competitors with one another?
- How many other effective competitors does each merging party have?
- Do customers “play” the merging parties off one another to get better prices or other deal terms?
- In bidding situations, do the merging firms frequently bid against one another? How many other bids do they usually face? Do they frequently find themselves competing against one another in the “best and final” round of bidding?
- Are the conditions in the marketplace conducive to direct oligopolistic coordination on price?
  - If not, is there another mechanism for oligopolistic coordination (e.g., coordinated capacity reductions)?
- Is the target firm a “maverick” and engage in disruptive market conduct (such as aggressive discounting)?

# Some key questions

## ■ Nonhorizontal transactions

### □ Potential competition

- Is either of the merging parties a potential entrant into a market in which the other company is an actual competitor?
- If so—
  - Is the target market highly concentrated?
  - Is the target market performing more or less competitively or is it performing noncompetitively? (The merging party that is the actual competitor will know)
  - How likely is it that in the absence of the transaction the potential entrant merging party would in fact enter the market and in what scale and in what time frame?
  - Are their other firms equally likely to enter into the market on the same or greater scale and in the same or less time as the potential entrant merging party?
  - What would the effect of this entry be on the performance of the target market?

### □ Nascent competition

- Is either of the merging parties a monopolist or near-monopolist in some relevant market?
- If so, does the other merging party have or is developing a technology that has the theoretical potential—in the hands of either the developer or a third-part acquirer/licensee—to significantly undermine the dominant firm's position in the relevant market?

# Some key questions

## ■ Nonhorizontal transactions

### □ Vertical foreclosure

- Does one of the merging firms supply an important input or distribution/retail channel to the other merging firm?
- If so,
  - Could competitors in practice protect themselves from harm in the event of foreclosure or higher input prices (or lower downstream prices) from the combined firm by either (a) dealing with other firms in the market, or (b) vertically integrating into the input or downstream market?

### □ Vertical information conduits

- As a result of the transaction, will one merging party gain greater access to competitively sensitive information of its competitors?

### □ Modern entrenchment

- Would an acquisition further entrench a monopolist in some space?
- If so, would the monopolist create the acquired firm's product de novo if it was prohibited from making the acquisition (even if the monopolist has no current plans to do so)
- NB: This is a novel theory being advanced by the Biden administration<sup>1</sup>

<sup>1</sup> This appears to be the theory underlying the FTC's challenge to Meta's acquisition Within Limited, Inc. the idea is that Meta's acquisition of Within with its uniquely popular virtual reality-dedicated fitness app Supernatural would entrench Meta in the virtual reality space and that Meta, if blocked from acquiring Within, would create its own virtual fitness app even though it has no current plans to do so. See [Complaint for a Temporary Restraining Order and Preliminary Injunction Pursuant to Section 13\(b\) of the Federal Trade Commission Act, FTC v. Meta Platforms, Inc.](#), No. 3:22-cv-04325 (N.D. Cal. filed July 27, 2022)