14. Potential Competition Mergers

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Topics

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

Eliminating Potential Competition

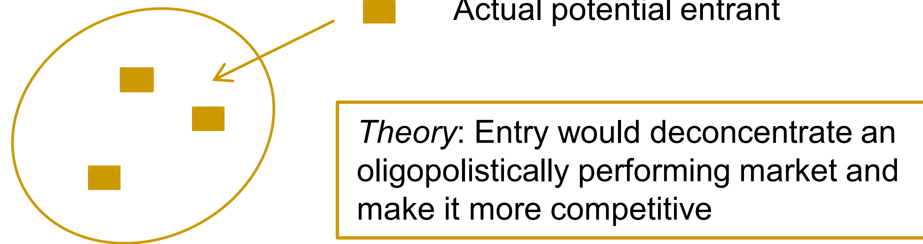
Two potential competition theories

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



- NB: The actual potential entrant may be either:
  - The target (the typical case), or
  - The acquiring firm

Actual potential competition

- *Marine Bancorp*[1]
  - Without deciding on its viability, the Supreme Court observed that the actual potential competition doctrine:

> proscribe( ) a market extension merger solely on the ground that such a merger eliminates the prospect for long-term deconcentration of an oligopolistic market that in theory might result if the acquiring firm were forbidden to enter except through a de novo undertaking or through the acquisition of a small existing entrant (a so-called foothold or toehold acquisition).[2]

- The Second Circuit described the doctrine:

> The theory of the (actual potential competition) doctrine is that competition in the market would be enhanced by the addition of the new competitor and therefore the elimination of such a potential competitor would substantially lessen competition within the meaning of § 7.[3]

[1] United States v. Marine Bancorporation, Inc., 418 U.S. 602, 625 (1974).
[2] *Id*. at 625.
[3] United States v. Siemens Corp., 621 F.2d 499, 504 (2d Cir. 1980)

Actual potential competition

- Acceptance by courts
  - Not yet approved by the Supreme Court
    - The Supreme Court has reserved judgment on the elimination of actual potential competition as a viable theory under Section 7[1]
    - *WDC*: Almost surely, the reason the Supreme Court reserved the question was the contemporary interpretation of Section 7's anticompetitive effects requirement
      - Section 7 prohibited mergers the effect of which that "may be to substantially lessen competition"[2]
      - In the 1970s, the contemporary interpretation of this language was to compare competition before and after the merger
        - As a result, the actual competition doctrine was questionable because the merger eliminated the prospect of a future postmerger *improvement* in competition and no event would result in *less* competition postmerger compared to premerger
      - In the modern interpretation, courts compare competition on a *going-forward basis* with and without the acquisition, so that the anticompetitive effect element is satisfied if there is a reasonable probability that competition in the market with the acquisition would be less than competition without the acquisition.
        - As a result, an acquisition that satisfies the elements of the actual potential competition doctrine violates Section 7 and is a viable theory of anticompetitive harm

[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).
[2] Clayton Act § 7, Pub. L. No. 81-899, 64 Stat. 1125 (Dec. 29, 1950) (Section 7 under the Celler-Kefauver Act before amendments beginning in 1980; current version at 15 U.S.C. § 7).

Actual potential competition

- Acceptance by courts (con't)
  - 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[1]
    - Low success rates
      - Of the circuit courts, only the Eighth Circuit has found the plaintiff met its burden of proof, upholding the FTC order after an administrative trial that a joint venture eliminated an actual and potential competitor from the market for outboard motors[2]
  - But agencies have used the actual potential competition doctrine to obtain consent decrees when—
    1. The market is highly concentrated, *and*
    2. Entry by the actual potential entrant is almost certain in the immediate future

[1] *See, e.g.*, Yamaha Motor Co. v. FTC, 657 F.2d 971 (8th Cir. 1981); United States v. Siemens Corp., 621 F.2d 499 (2d Cir. 1980); FTC v. Atl. Richfield Co., 549 F.2d 289 (4th Cir. 1977); FTC v. Meta Platforms Inc., No. 5:22-CV-04325-EJD, 2023 WL 2346238, at *21 (N.D. Cal. Feb. 3, 2023); United States v. Phillips Petroleum Co., 367 F. Supp. 1226 (C.D. Cal. 1973), *aff'd sub nom.* Tidewater Oil Co. v. United States, 418 U.S. 906 (1974), *and aff'd*, 418 U.S. 906 (1974); Altria Group, Inc., No. 9393, 2022 WL 622476 (F.T.C. Feb. 23, 2022) (initial decision); B.A.T. Industries, No. 9135, 1984 WL 565384 (Dec. 17, 1984) *see also* FTC v. Steris Corp., 133 F. Supp. 3d 962, 966 (N.D. Ohio 2015) ("[T]he FTC has clearly endorsed this theory by filing this case, and the administrative law judge will be employing it during the proceeding.... Accordingly, in deciding the likelihood of success on the merits, the Court will assume the validity of this doctrine.").
[2] Yamaha Motor Co., Ltd. v. FTC, 657 F.2d 971 (8th Cir. 1981).

Actual potential competition

- Elements of the actual potential competition theory of harm
  1. Non-competitiveness
  2. Uniqueness
  3. "Available, feasible means" of procompetitive entry
  4. Incentive
  5. The actual potential entrant must have a reasonable likelihood of entry into the relevant market in the near future with a procompetitive effect

- Two important notes
  1. Not all of these elements are specifically identified as such in the case law but are inherent in the precedent and the underlying economic theory
  2. Proof: Observations/predictions
     - The first four elements are *observable* at the time of the acquisition and therefore require affirmative proof
     - The fifth element requires a prediction of:
       - The fact of entry
       - The timing of entry
       - The effect of entry on competitive conditions in the relevant market

The following slides unpack these elements

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:

       > [T]he doctrine comes into play only where there are dominant participants in the target market engaging in interdependent or parallel behavior and with the capacity effectively to determine price and total output of goods or services.[1]

     - If the market is operating competitively, new entry cannot improve the market's competitive performance
     - In the typical case where the actual potential entrant is the target, the market of concern is the market in which the buyer operates
       - This is the market that putatively would be more competitive if, absent the acquisition, the potential entrant actually entered the market)
       - In some cases, the potential entrant may be the buyer, in which case the market of interest is the market in which the target (the incumbent firm) operates[1]

[1] United States v. Marine Bancorporation, Inc., 418 U.S. 602, 631 (1974);
[2] For an example, see FTC v. Meta Platforms Inc., No. 5:22-CV-04325-EJD, 2023 WL 2346238 (N.D. Cal. Feb. 3, 2023) (where the FTC alleged that in the absence of the acquisition, Meta, the acquiring firm, would probably enter the VR dedicated fitness app market of the target Within Limited).

Actual potential competition

- Elements of the actual potential competition theory of harm
  1. Non-competitiveness (con't)
     - Proof[1]
       - A prime facie case of non-competitiveness can be made out by evidence of sufficiently high concentration ratios
         - Modern courts use the HHI
         - "Sufficiently high" is not well-defined by the case law, but it is likely that most courts would accept 2500 of the Merger Guidelines s the threshold
       - If the plaintiff makes out a prima facie case, the burden shifts to the merging parties to show that the concentration ratios does not accurately depict the economics characteristics of the relevant market
         - At least one modern court has held that *Marine Bancorp* puts the burden of persuasion on the merging parties[2]
           - *WDC*: As a matter of modern antitrust jurisprudence following the *Baker Hughes* three-step burden-shifting approach, the per burden on the merging parties should be one of production; the ultimate burden of proving non-competitiveness should rest with the plaintiffs
         - At least one court has rejected multiple new entry and likely future entrants as evidence sufficient to rebut a prima facie case based on concentration ratios in the absence of a showing that this entry deconcentrated the market[3]

[1] *See Marine Bancorporation*, 418 U.S. at 631; *accord*, *Meta Platforms*, 2023 WL 2346238, at *17.
[2] *Meta Platforms*, 2023 WL 2346238, at *18-*19.
[3] *Id*. at *20 ("Although the 'introduction of new firms and fluid condition of market entry and exit can indicate competitive behavior,' the bottom line is that these new entrants have not significantly deconcentrated the market, nor do they suggest a trend towards such deconcentration.") (quoting United States v. Black & Decker Mfg. Co., 430 F. Supp. 729, 751 (D. Md. 1976)).

Actual potential competition

- Elements of the actual potential competition theory of harm
  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 "available feasible means for entering the market other than by acquiring the [target company]"[1]
     - 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,
         - the incumbent firm's financial, engineering and other capabilities required to enter the market de novo, *and*
         - whether any barriers to entry into the market are so high as to be preclusive
       - For a toehold acquisition to qualify as an "available, feasible means" of procompetitive entry:
         - toehold firms must exist in the target market, which if acquired would provide a viable avenue to developing a significant market presence; and
         - such firms must be available for acquisition, presumably on objectively reasonable terms
       - Demonstrating an "available, feasible means" of entry is an element of the plaintiff's prima facie case[2]
     - Proof of "available, feasible means" of procompetitive entry is an element of the plaintiff's prima facie case and cannot be presumed solely on the basis of the incumbent firm's resources and motivation to enter[3]

[1] *Marine Bancorporation*, 418 U.S. at 633; accord *Meta Platforms*, 2023 WL 2346238, at *20.
[2] *Meta Platforms*, 2023 WL 2346238, at *20.
[3] *See id.* at *27 ("To the extent the FTC implies that—based solely on the objective evidence of Meta's resources and its excitement for VR fitness—it would have inevitably found and implemented some unspecified means to enter the market, the Court finds such a theory to be impermissibly speculative.").

Actual potential competition

- Elements of the actual potential competition theory of harm
  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[1]
     - 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
     - Objective factors to consider
       - The profitability of participating in the relevant market[2]
         - For entry in the near future, current profitability is likely to be a good proxy for future profitability unless the market is changing rapidly (as in the case, for example, in some high tech markets)[3]

[1] For cases requiring that the actual potential entrant be likely to enter in the "near future" absent the acquisiton, see Tenneco, Inc. v. FTC, 689 F.2d 346, 352 (2d Cir. 1982); United States v. Siemens Corp., 621 F.2d 499, 505 (2d Cir. 1980); BOC Int'l, Ltd. v. FTC, 557 F.2d 24, 29 (2d Cir. 1977).
[2] FTC v. Meta Platforms Inc., No. 5:22-CV-04325-EJD, 2023 WL 2346238, at *25 (N.D. Cal. Feb. 3, 2023) ("The profitability of the relevant market is unsurprisingly a relevant incentive that many courts consider.").
[3] *Id.*

Actual potential competition

- Elements of the actual potential competition theory of harm
  5. Entry by the actual potential entrant must have a reasonable likelihood of a procompetitive effect in the near future
     - Assuming it occurred, entry by the actual potential entrant must have a "substantial likelihood of ultimately producing deconcentration of that market or other significant procompetitive effects"[1]
       - *WDC*: In modern antitrust jurisprudence, a "substantial likelihood" should be read as a "reasonable probability"[2]
         - The Fifth Circuit has held that the "reasonable probability" standard "signifies that an event has a better than fifty percent chance of occurring [with a] 'reasonable' probability represent[ing] an even greater likelihood of the event's occurrence."[2]

[1] *Marine Bancorporation*, 418 U.S. at 633; accord *Meta Platforms*, 2023 WL 2346238, at *20.
For courts adopting a "reasonable probability" standard, see Mercantile Texas Corp. v. Bd. of Governors of Fed. Rsrv. Sys., 638 F.2d 1255, 1268 (5th Cir. 1981); BOC Int'l, Ltd. v. FTC, 557 F.2d 24, 28–29 (2d Cir. 1977); FTC v. Meta Platforms Inc., No. 5:22-CV-04325-EJD, 2023 WL 2346238, at *21-*22 (N.D. Cal. Feb. 3, 2023); *see also* United States v. Siemens Corp., 621 F.2d 499, 506 (2d Cir. 1980) (holding that "there must, for purposes of determining whether such relief is appropriate, be at least a "reasonable probability" that the acquiring firm would enter the market, and preferably clear proof that entry would occur") (internal citations omitted).
[2] *Mercantile Texas*, 638 F.2d at 1268-69; *accord Meta Platforms*, 2023 WL 2346238, at *21-*22.

Actual potential competition

- Elements of the actual potential competition theory of harm
  5. Entry by the actual potential entrant must have a reasonable likelihood of a procompetitive effect in the near future
     - *Near future*: As a corollary to the reasonable probability requirement , courts have held that entry must be in the “near future” and that “eventual entry” makes the test one of “ephemeral possibilities”[3]

[1] BOC Int'l, Ltd. v. FTC, 557 F.2d 24, 28–29 (2d Cir. 1977) (“Thus the FTC was correct in using a 'reasonable probability' test here, but its accompanying reference to 'eventual entry' makes the overall FTC test, we believe, one based largely on 'ephemeral possibilities.'”) (footnote omitted); *see* Tenneco, Inc. v. FTC., 689 F.2d 346, 352 (2d Cir. 1982); United States v. Siemens Corp., 621 F.2d 499, 505 (2d Cir. 1980); *Meta Platforms*, 2023 WL 2346238, at *27; Altria Group, No. 9393, 2022 WL 622476, at *70 (F.T.C. Feb. 23, 2023) (Initial Decision).

Actual potential competition

- Elements of the actual potential competition theory of harm
  5. Entry by the actual potential entrant must have a reasonable likelihood of a procompetitive effect in the near future
     - The Fifth Circuit has a slightly different take on the "near future" requirement:

> The Board made no finding as to when Mercantile would actually enter either of the two markets. Mercantile urges that we adopt the Second Circuit's rule that independent entry must be shown likely to occur in the near future. *See Siemens*, 621 F.2d at 505; BOC International, 557 F.2d at 29. We agree that, as petitioner argued in *BOC International*, the "degree of uncertainty in any economic prediction becomes unacceptably high as it is projected further and further into the future." 557 F.2d at 29.. While concurring with the Second Circuit that a time limit is desirable to limit speculation, we believe that the time limit should be more directly related to the predication being made.
>
> The amount of time needed for successful entry is relevant only if entry will be so delayed that the structure of the market will have changed by the time Mercantile actually enters. If the market has deconcentrated, Mercantile's pro-competitive efforts will no longer be required by the Clayton Act standard. At some point in the future, the degree of concentration in the market becomes so inherently unpredictable that the entire predictive enterprise should be abandoned out of fairness to the outsider firm. Accordingly, the Board should determine at what point Mercantile would be likely to enter the market. If Mercantile can enter either market within two or three years, we assume (absent contrary evidence) that each market will remain sufficiently concentrated so that Mercantile's procompetitive efforts are legally required. If Mercantile will not enter until much later, then the Board should assess the volatility of the two markets to determine the fairness of predicting whether they will still be concentrated at the time when Mercantile is likely to enter. A market's structure may or may not be predictable for five years; after that point, only the most stagnant market will support the extrapolation of previous data. As a heavily regulated industry, banking would not seem a likely candidate for the seer; regulatory change can quickly alter the structure of the market.[1]

[1] Mercantile Texas Corp. v. Bd. of Governors of Fed. Rsrv. Sys., 638 F.2d 1255, 1271-72 (5th Cir. 1981) (footnotes omitted).

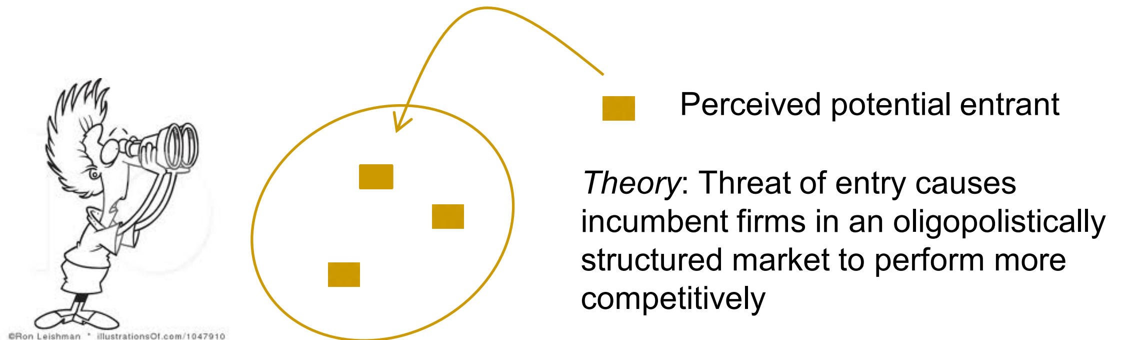
Actual potential competition

- 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), Actavis, Inc., No. C-4414 (F.T.C. issued Sept. 27, 2013) (settled by consent order).
[2] Decision & Order, 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[1]
    - 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.



[1] United States v. Falstaff Brewing Corp., 410 U.S. 526, 531-37 (1973); United States v. Marine Bancorporation, 418 U.S. 602, 624-25 (1974).

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

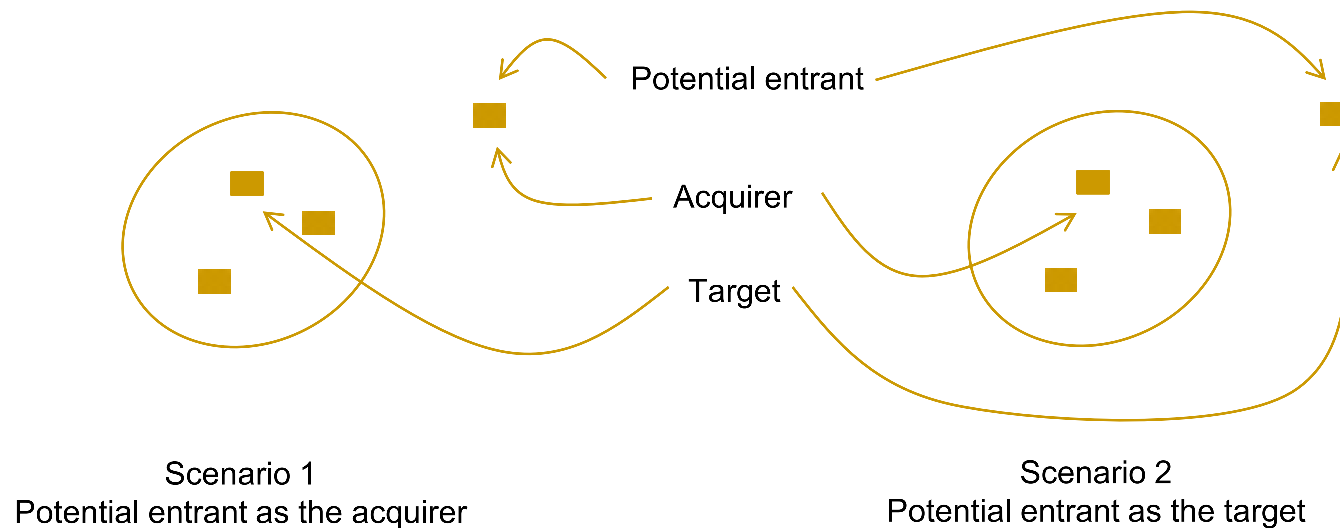
- Elements of the perceived potential competition theory of harm
  3. Perception as a likely potential entrant
     - Incumbent firms must perceive the firm as a likely potential entrant
     - Objective evidence of the incumbent firm's capabilities and incentives to enter the relevant market are probative of the perception of the firm as a likely potential entrant[1]
  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[1]
  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

- Notes
  1. Again, not all of these elements are specifically identified as such in the case law but are inherent in the precedent and the underlying economic theory

[1] FTC v. Meta Platforms Inc., No. 5:22-CV-04325-EJD, 2023 WL 2346238, at *31 (N.D. Cal. Feb. 3, 2023).
[2] *Id*. at *32 ("Accordingly, the FTC must produce some evidence—direct or circumstantial—that Meta's presence had a direct effect on the firms in the relevant market.").

Elimination of potential competition

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



Scenario 1
Potential entrant as the acquirer

Scenario 2
Potential entrant as the target

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:
    1. 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
    2. 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)
    - 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?

Some questions

2. How much of a "nascent competitor" 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 probative here
       - But companies should quickly adjust to minimize the creation of this evidence
       - Or the company could just be a "paranoid monopolist" and see threats where no threats exist
     - 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
       - BUT target companies may create documents indicating the future possibility that they may compete with the acquiring company, not because they would but rather to increase the perceived value of eliminating this competitive threat to the acquiring company
         - Plaid may have done this with Citibank
     - 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

Postscript: Meta/Within

- The background
  - Challenged Meta's proposed acquisition of privately-owned Within Limited, Inc., the maker of the popular virtual reality-dedicated fitness app Supernatural
    - Acquisition price: Reportedly $400 million (not publicly disclosed)
  - Meta
    - Has an 80% share of VR headsets
    - Was investing heavily in the VR space
    - Offers VR apps developed by third parties in its Quest Store (a VR app store)
    - Develops its own VR apps (in part through acquired VR app studios)
    - Funds development of VR apps by other parties
    - Acquired Beat Saber, VR rhythm game that is the most popular VR app of all time, in 2019
  - Within Limited
    - *Key product*: Supernatural, a VR *dedicated* fitness app available through the Quest Store, which has more than an 80% share of revenue among existing VR dedicated fitness apps

Postscript: Meta/Within

- The amended complaint (filed October 7, 2022)
  - Alleged that the acquisition would eliminate actual and perceived potential competition in the relevant market for VR dedicated fitness apps
  - Did 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, alleged 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 alleged—
    - "[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—Am. Compl. ¶ 6), *and*
    - a "wings" effect, including on Within (perceived potential competition—Am. Compl. ¶¶ 11, 106, 111-116 (all redacted)).

- 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 (Orig. Compl. ¶ 12)
    - *WDC*: 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

Postscript: Meta/Within

- The Section 13(b) proceeding
  - Northern District of California
    - Filed July 27, 2022
    - Two theories of anticompetitive harm
      - Elimination of actual potential competition
      - Elimination of perceived potential competition
    - Assigned to Judge Edward J. Davila
    - Seven-day evidentiary hearing
    - Decided January 31, 2023—FTC petition for a preliminary injunction denied[1]

[1] FTC v. Meta Platforms Inc., No. 5:22-CV-04325-EJD, 2023 WL 2346238 (N.D. Cal. Feb. 3, 2023).

Postscript: Meta/Within

- The Section 13(b) proceeding
  - Market definition
    - Conclusions
      - Rejected defendants' argument for a larger market including—
        - Non-dedicated fitness VR app, *and*
        - Non-VR connected fitness products and services
      - Accepted FTC's alleged market of a national market for VR dedicated fitness apps
    - *Brown Shoe* analysis
      - While VR dedicated fitness apps compete for consumers with other types of exercise products and apps, the evidence showed that VR dedicated fitness apps are a distinct economic submarket
      - Used *Brown Shoe* "practical indicia," namely—
        - Industry or public recognition of VR dedicated fitness apps as a distinct submarket
        - Several "peculiar characteristics and uses" that distinguish VR dedicated fitness apps from "both other VR apps and non-VR fitness offerings," including—
          - Specifically marketed for fitness (e.g., trainer-led workouts, trackable progress)
          - Provides a VR experience by transporting the user to a virtual 360-degree environment for the workout, being fully portable and taking up little space)
          - Fully portable (unlike large exercise machines like stationary bikes)
        - Distinct customers (here, a younger male demographic) and distinct prices
    - HMT
      - Not important that the court rejected the HMT analysis by the FTC's economic expert as faulty
        - *Rule*: A relevant product market need not be proved through the HMT and that the *Brown Shoe* factors alone sufficed

Postscript: Meta/Within

- The Section 13(b) proceeding
  - Elimination of actual potential competition
    1. Court: Accepts the elimination of actual potential competition as a theory of anticompetitive harm under Section 7
       - Rejects defendants' argument that the theory was not viable because it had never been endorsed by the Supreme Court
    2. Court: Theory requires a concentrated market premerger
       - Here, FTC satisfied its burden by presenting evidence of that the market shares of firms in the markets resulted in market concentration "well above" the thresholds in the 2010 Horizontal Merger Guidelines
       - Rebuttal required defendants to show that the market was in fact "genuinely competitive"
         - Rejected defendants' argument that the FTC was required to plead oligopolistic, interdependent, or parallel behavior as part of the FTC's prima facie case
         - Court: Inclined to find the following defendant's rebuttal evidence insufficient, but did not have to decide since the FTC failed to make out a prima face case of other required elements of the theory
           - Market nascency (all firms in the market entered within the last five years)
           - Volatility of market shares
           - Recent new entry (a doubling of VR dedicated fitness apps)
           - Low barriers to entry

Postscript: Meta/Within

- The Section 13(b) proceeding
  - Elimination of actual potential competition
    3. Court: Theory requires that there be a reasonable probability that Meta would have entered the VR dedicated fitness app market de novo if it was not able to acquire Within
       a. *Reasonable probability standard*:
          - Requires that the plaintiff make a prima facie case of a "a likelihood [of entry by the alleged actual potential entrant] noticeably greater than fifty percent"[1]
            - Rejects defendants' proposed "clear proof" standard
              - Standard adopted by the FTC in B.A.T. Indus., No. 9135, 1984 WL 565384, at *10 (F.T.C. Dec. 17, 1984)
          - Looks to—
            - "Available feasible means" (ability)
            - Incentive
       b. *Available feasible means*. Here, the court found—
          - Meta has the financial and VR personnel resources to enter the market de novo
          - BUT lacks—
            - "the capability to create fitness and workout content, a necessity for any fitness product or market," *and*
            - "the necessary studio production capabilities to create and film VR workouts"

[1] *Meta Platforms*, 2023 WL 2346238, at *21-*22 (adopting reasonable probability interpretation of Mercantile Texas Corp. v. Bd. of Governors of Fed. Rsrv. Sys., 638 F.2d 1255, 1268-69 (5th Cir. 1981). *See supra* slide 15.

Postscript: Meta/Within

- The Section 13(b) proceeding
  - Elimination of actual potential competition (con't)
    3. Court: Theory requires that there be a reasonable probability that Meta would have entered the VR dedicated fitness app market de novo if it was not able to acquire Within
       c. *Incentive*. Here, the court found the record "inconclusive"
          - *Objective evidence:*
            - There were "certainly some incentives for Meta to enter the market de novo, such as a deeper integration between the VR fitness hardware and software, but ""it is not clear that Meta's readily apparent excitement about fitness as a core VR use case would necessarily translate to an intent to build its own dedicated fitness app market if it could enter by acquisition."
          - *Subjective evidence*: "[T]he subjective evidence indicates that Meta was subjectively interested in entering the VR dedicated fitness app market itself, either for hardware development or defensive market purposes."
            - NB: The court gave little weight to the testimony of executives and relied more on statements in the company's regular course of business documents
            - Compare to Steris/Synergy Health, where the district court gave significant weight to party testimony at trial
       d. Conclusion
          - Actual potential competition theory fails here for lack of "available feasible means"
          - *WDC*: Having the resources to obtain the necessary resources—as Meta surely did—is not enough in the absence of sufficient evidence of the company's subjective intent to use those resources

Postscript: Meta/Within

- The Section 13(b) proceeding
  - Elimination of perceived potential competition
    1. Court: Theory requires—
       a. A concentrated market premerger
       b. Possession of the 'characteristics, capabilities, and economic incentive to render it a perceived potential de novo entrant'; *and*
       c. A "premerger presence on the fringe of the target market in fact tempered oligopolistic behavior on the part of existing participants in that market"
    2. Characteristics, capabilities, and economic incentive to render Meta a perceived potential entrant
       - Court: "[T]he objective evidence in the record is insufficient to support a finding that it was 'reasonably probable' Meta would enter the relevant market"
         - NB: Note the limitation to the *objective evidence*—that is, the evidence that incumbent firms in the relevant market could perceive and fact upon
         - What the firm was thinking of doing but not disclosing publicly (the subjective evidence) is irrelevant to the perceived potential competition theory
    3. Tempering effect on incumbent firms in the relevant market
       - Court: The FTC failed to adduce sufficient evidence—direct or circumstantial—to make a prima facie showing that Meta's presence had a direct effect on tempering anticompetitive conduct by firms in the relevant market
       - Note: The court found that the allegation that Within was "concerned about making any moves that would hurt its ability to compete against Meta as a potential entrant" and providing an example was sufficient to satisfy the FTC's pleading burden and denied the defendants' motion to dismiss[1]

Remember, Within is by far the largest firm in the relevant market

[1] *Meta Platforms*, 2023 WL 2346238, at *21.

Postscript: Meta/Within

- The Section 13(b) proceeding
  - Elimination of perceived potential competition
    4. Conclusion
       - Court: Perceived potential competition theory failed for lack of sufficient evidence of either characteristics of Meta as a perceived potential entrant or of a direct effect on the behavior of firms in the relevant market

Postscript: Meta/Within

- Subsequent developments
  - February 6, 2023: The FTC announced it would not appeal the district court's decision[1]
  - February 8, 2023: Meta closes Within Limited acquisition[2]
  - February 24, 2023: The FTC dismissed the administrative complaint[3]

[1] *U.S. FTC Will Not Appeal Decision Allowing Meta To Purchase VR Content Maker Within*, Reuters.com (Feb. 6, 2023). Interesting, the FTC did not issue a press release or otherwise note its decision to dismiss on the FTC's web site.
[2] Jason Rubin, VP of Play, *Within Joins Meta*, Meta Quest Blog (Feb. 8, 2023).
[3] Order Returning Matter to Adjudication and Dismissing Complaint, Meta Platforms, Inc., No. 9411 (F.T.C. Feb. 24, 2023).