Class 21 slides

14. Elimination of Potential Competition

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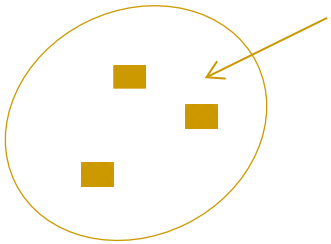
Three potential competition theories

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

Actual potential competition

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



Actual potential entrant

Theory: Entry would deconcentrate an oligopolistically performing market and make it more competitive

Actual potential competition

- The idea
  - Acceptance by courts
    - The Supreme Court has reserved judgment on the elimination of actual potential competition[1]
      - When these cases were decided, the Court has not yet developed the view that the proper test of the effect of a merger on competition was to compare the market outcomes going forward with and without the merger
      - The prevailing view was whether the acquisition reduced postmerger competition compared to premerger competition
    - Lower courts, the FTC, and the 2023 DOJ Merger Guidelines "recognize" the elimination of actual potential competition as an actionable anticompetitive harm under Section 7
      - Most courts accept the theory assuming its validity
      - A final decision of the theory's validity has not been necessary since not modern litigated case has found the elements of the theory satisfied on the merits
      - But it is clear from reading the opinions that the lower courts think the theory should be cognizable and would so hold if the merits favored the plaintiff
      - Courts should recognize the theory—and presumably the Supreme Court will if and when presented with the question—given the modern test of competitive effects

[1] *See* United States v. Marine Bancorporation, Inc., 418 U.S. 602, 625, 639 (1974); United States v. Falstaff Brewing Corp., 410 U.S. 526, 537-38 (1973).

Actual potential competition

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

Different courts may articulate the elements somewhat differently, but they all can be unpacked into these five elements

Actual potential competition

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

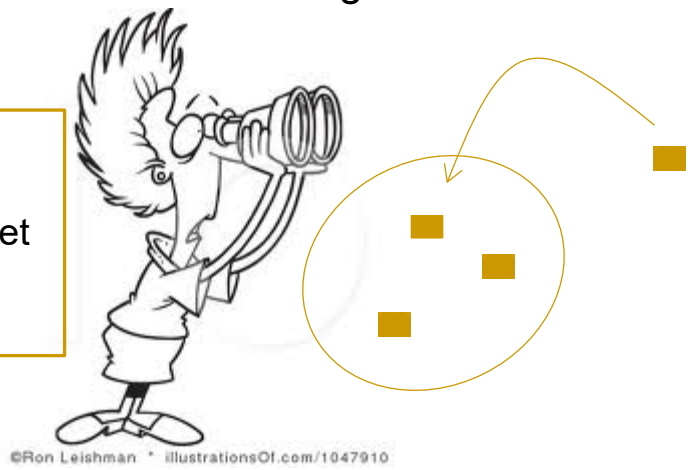
    the agencies will accept the divestiture of entry-related assets

- The practice
  - Although modern courts have not found for the government under this theory, the agencies have used the theory to obtain divesture consent decrees when—
    1. The alleged target market is highly concentrated,
    2. There are few if any other similar or better situated actual potential entrants, *and*
    3. Entry by the putative actual potential entrant is almost certain in the immediate future

Perceived potential competition

- The idea
  - Incumbents firm fear the perceived potential entrant will enter the market and hence have moderate their prices ("limit pricing") to discourage that firm from actually entering
  - An acquisition by an incumbent firm of the perceived potential entrant eliminates the threat of entry and incumbent firms no longer have an incentive to moderate prices

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



Perceived potential entrant (waiting "in the wings")

- Theory recognized by the Supreme Court
  - The Supreme Court has recognized the elimination of perceived potential competition as a valid theory of anticompetitive harm
  - Ironically, the agencies have used the theory rarely (if at all)—even in consent decrees—since 1980 since it is almost impossible to show that incumbent firms have engaged in limit pricing to discourage entry

Perceived potential competition

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

Perceived potential competition

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

Potential expander cases

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

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

- Technically, the agencies may try these cases as horizontal acquisitions since the acquirer did have a "toehold" position in the relevant market. The agencies then argue that given the acquirer's interest in expanding into the market, the acquirer's small current market share significantly understates its future competitive significance in the absence of the acquisition
- Acquirers defend by showing that de novo entry is not in their profit-maximizing interest and that they are neither an actual potential entrant or a "potential expander" in the absence of the acquisition
- The agencies did not fare well in these cases, and they have not brought one since the 1980s on this theory[1]

[1] *See, e.g.*, Complaint, *In re* BASF Wyandotte Corp., 100 F.T.C. 261, 263 (Apr. 5, 1979) (alleging that BASF, with a 2% share of sales of organic pigments in the United States, was a potential expander, and therefore that its pending acquisition of Chemetron's Pigment Division, with a share of 9.2% in the U.S. sale of organic pigments, violated Section 7), *dismissed*, *id*. at 264 (no appeal to the Commission taken).

A final note

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

Mylan/Perrigo

Mylan/Perrigo (2015)

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

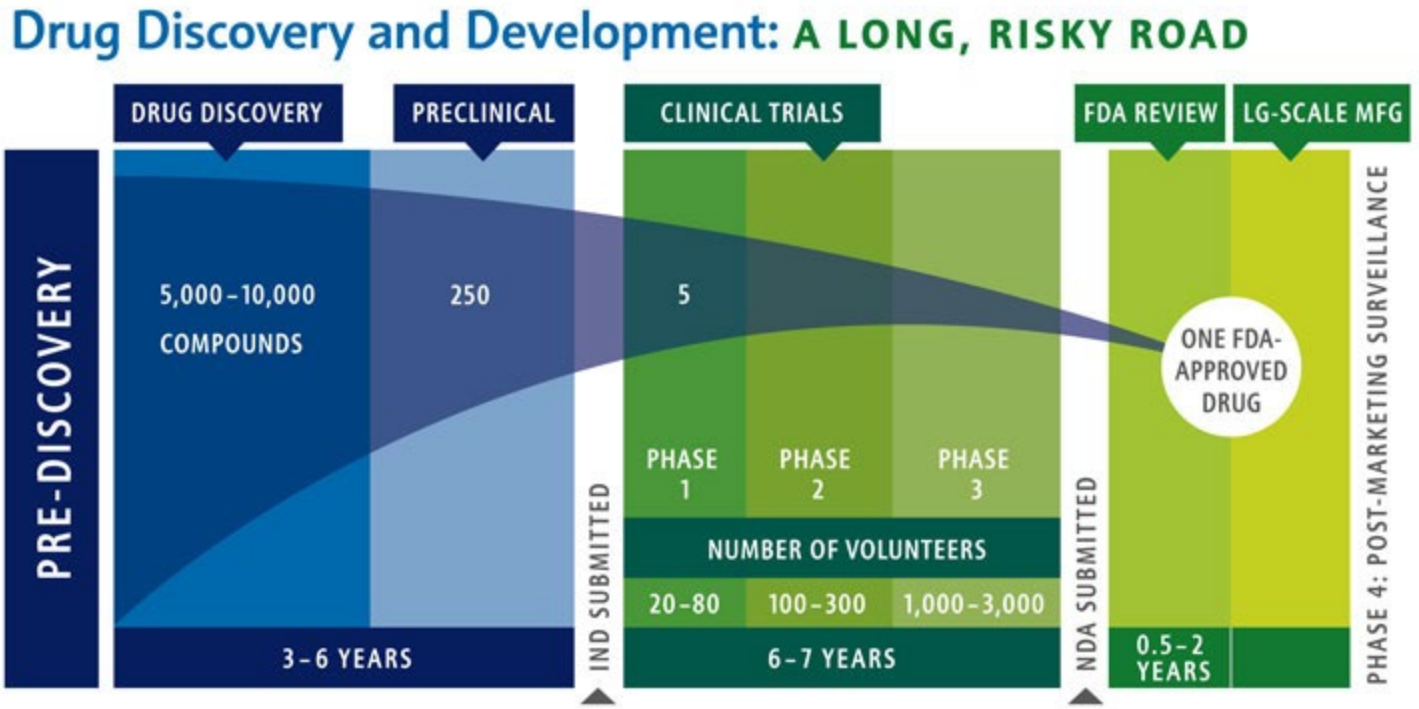
Mylan/Perrigo (2015)

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

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

Mylan/Perrigo (2015)

- New drug approval process



Source: Pharmaceutical Research and Manufacturers of America

Mylan/Perrigo (2015)

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

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

Mylan/Perrigo (2015)

- FTC challenges by stage of product development
  - Goes to the question of whether there will be actual entry in the absence of the acquisition
  - Mylan/Perrigo (2015)—Approved ANDA[1]
    - Mylan ordered to divest all rights, title and interest in and to all assets related to the United States in the four Mylan existing overlapping products and the three Mylan ANDA-approved products to Alvogen Group, Inc., an experienced generic pharmaceutical company
  - Hikma/Custopharm (2022) —Approved ANDA
    - Custopharm, a US-based generic sterile injectables company, ordered to transfer Custopharm's assets related to its development of the corticosteroid drug triamcinolone acetonide (TCA) to Long Grove Pharmaceuticals, LLC, another portfolio company owned by Water Street Healthcare Partners (the seller) that was not part of the acquisition
    - Long Grove ordered to operate and maintain Custopharm's TCA assets for four years
    - FTC may appoint a monitor to report on the companies' compliance with the order's requirements

[1] Once the FDA has approved an Abbreviated New Drug Application (ANDA) by a generic manufacturer showing that its drug is bioequivalent to a fully approved drug, the applicant may manufacture and market the generic drug product without conducting clinical trials.

Mylan/Perrigo (2015)

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

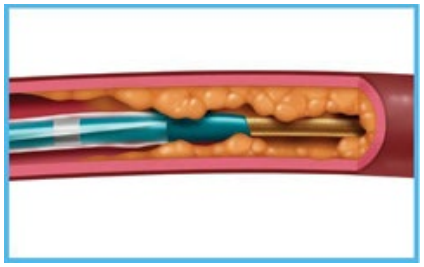
Medtronic/Covidien (2014)

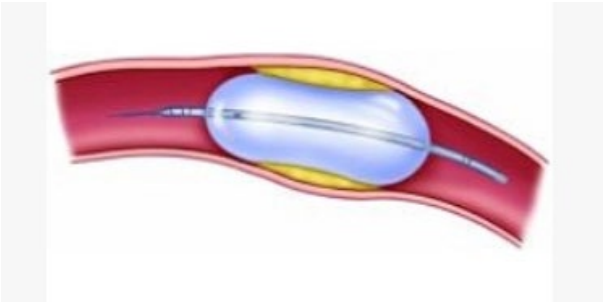
Medtronic/Covidien (2014)

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

Medtronic/Covidien (2014)

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





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

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

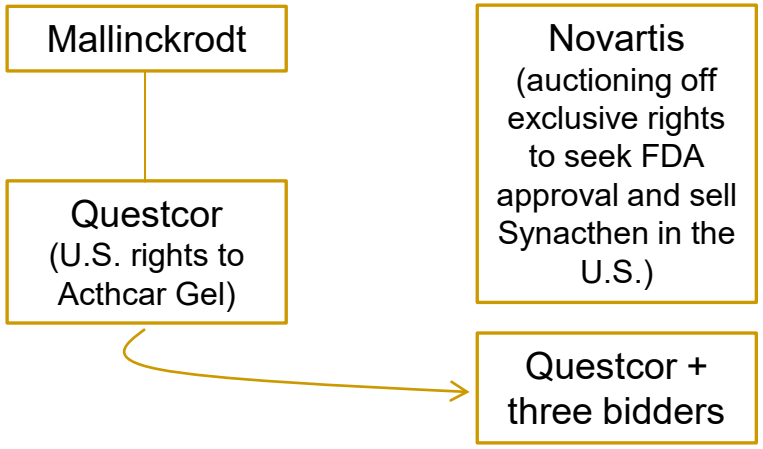
Mallinckrodt/Novartis AG (2017)

Mallinckrodt/Novartis AG (2017)

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

Mallinckrodt/Novartis AG (2017)

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



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

Mallinckrodt/Novartis AG (2017)

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

Steris/Synergy Health (2015)

Steris/Synergy Health (2015)

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

Steris/Synergy Health (2015)

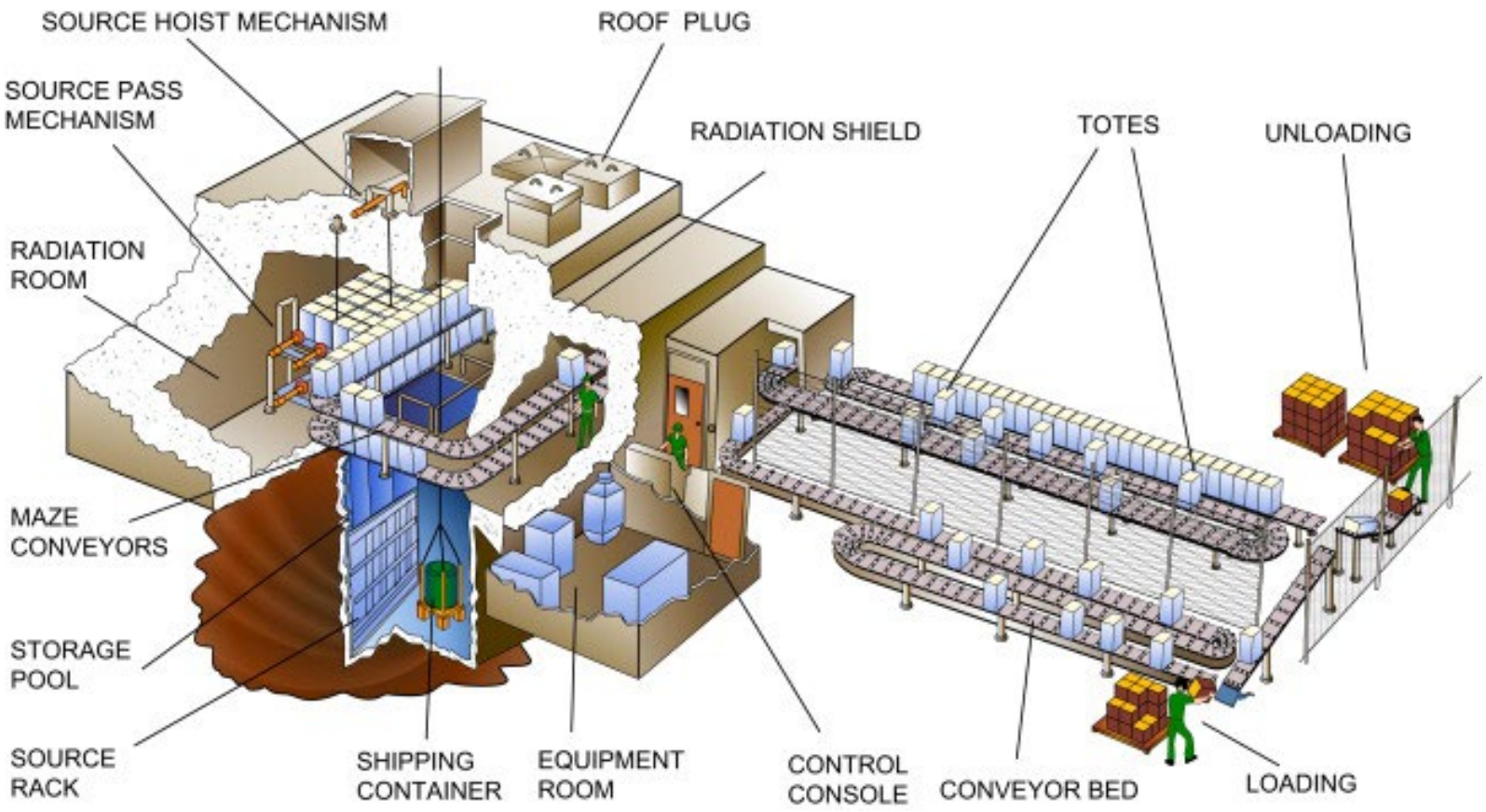
- Three primary methods of contract sterilization used in the U.S.
  1. Gamma sterilization
     - Sterilizes by exposing products to photons from radioactive isotope Cobalt–60
     - Good penetration complete even at high densities
     - Compatible with most materials
     - Only viable option for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

Steris/Synergy Health (2015)

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

Steris/Synergy Health (2015)

Gamma Irradiation Services Plant

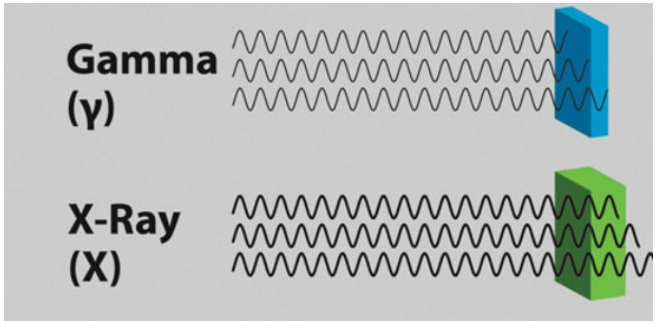


Steris/Synergy Health (2015)

Gamma Irradiation Services Plant

Steris/Synergy Health (2015)

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



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

Steris/Synergy Health (2015)

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

Steris/Synergy Health (2015)

- District court
  - Following a three-day evidentiary hearing, the court denied the FTC's request for a preliminary injunction
  - Assumed the elimination of actual potential competition is a cognizable theory

Elements

1. Highly concentrated market
2. Alleged potential entrant "probably" would have entered the market
3. Such entry would have had procompetitive effects
4. Few if any other firms could enter the market effectively

NB: This test differs somewhat from the test we developed since it lacks a timing element on SynergyHealth's entry but for the acquisition (but not important given the court's findings)

  - *Court*:
    - Prior to the hearing, the Court directed the parties to focus their attention on the second element of the actual potential competition theory (likelihood of entry)
    - After the hearing, found that the FTC failed to show that Synergy probably would have entered the U.S. but for the transaction
      - A failure in *Baker Hughes* Step 3
      - The FTC probably made out a prima facie case and so satisfied Step 1
      - But the merging parties introduced evidence in Step 2 that put the element in issue
      - The Court resolved the issue in Step 3 finding the preponderance of the evidence favored rejection

Steris/Synergy Health (2015)

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

Steris/Synergy Health (2015)

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

Eliminating “Nascent” Competition

"Nascent competitors"

- An emerging concern beginning 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"

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

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 the specific effects of a particular acquisition[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]
- WDC: A possible reinterpretation
  - Under the case law, Section 7's incipiency standard looks just to the *likelihood* of harm to competition
    - *Conventional (defense) wisdom*: The acquisition of a nascent competitor does not violate Section 7 because the likelihood of anticompetitive harm is speculative and hence not "reasonably probable"
  - *Argument*: But from a consumer welfare perspective, reasonableness should be interpreted in terms of the *expected value* of the harm, not just likelihood
    - So a low probability of anticompetitive harm should be "reasonable "within the meaning of the incipiency standard if the magnitude of the harm, should it occur, is high enough
    - This interpretation could reach nascent competitor acquisitions, if the foregone competitive benefit of entry, should it occur, is sufficiently high
    - An expected value analysis also should consider any offsetting procompetitive benefits of the acquisition

[1] 15 U.S.C. § 18.

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

The legislative solution

- Other proponents see a judicial extension of Section 2 law to cover acquisitions of nascent competitors by dominant firms as unlikely 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).

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 company be?
  2. How much of a threat is required to be of competitive concern?
  3. How big does the threat have to be?
  4. How unique does the threat have to be?
  5. How likely does the threat need to be?
  6. How quickly must the threat be likely to materialize into real-world competition in the absence of the dominant firm's acquisition?
  7. What kind of defenses, if any, are available to a dominant firm acquiring a nascent competitor?
     - What if the acquiring dominant firm can prove that significant consumer welfare benefits will result from the acquisition?
     - There is a subsidiary question of which party should bear the burden of proof (production or persuasion) on any defenses

Some questions

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

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

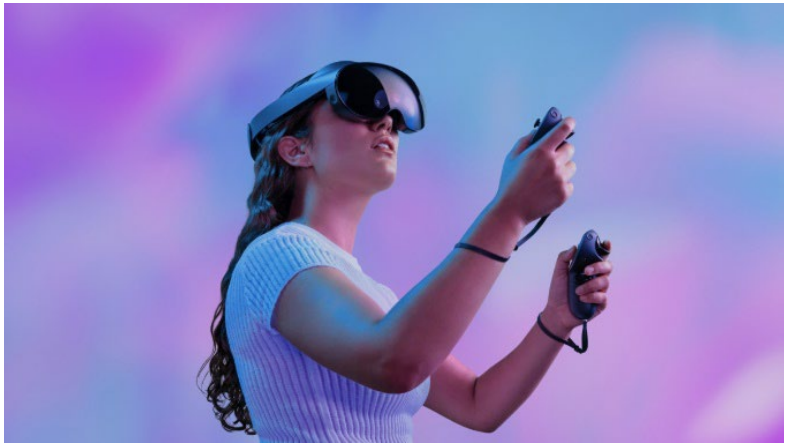
Meta/Within

Meta/Within

- The deal
  - Meta for acquire Within Unlimited
    - Announced November 1, 2021
    - Reportedly for around $400 million—Not publicly announced

Meta/Within

- *The buyer*: Meta
  - Formerly known as Facebook
  - The leading developer of virtual reality ("VR") devices and apps through its Reality Labs division
    - Since 2017, has invested $36 billion in Reality Labs
      - For an operating loss of $30.7 billion
    - Leading hardware product: Oculus Quest VR headset
      - Flagship product: Meta Quest Pro ($1499)
    - Leading software product: Beat Saber
      - A VR rhythm game where the user slashes the beats of adrenaline-pumping music as they fly towards you, surrounded by a futuristic world



Meta/Within

- *The target*: Within Unlimited
  - A privately held virtual and augmented reality company started in 2014
  - Flagship product: *Supernatural*, a VR subscription fitness service
    - The leading VR fitness app (monthly subscription: $18.99)
    - Offers over 800 fully immersive VR workouts, each set to music and located in a virtual setting such as the Galapagos Islands and the Great Wall of China

The Section 13(b) action

- The FTC's original complaint
  - July 22, 2022: 3-2 vote to challenge the transaction
  - Section 13(b) complaint filed in the Northern District of California
  - Claims
    1. Elimination of Meta as an actual potential entrant
    2. Elimination of Meta as a perceived potential entrant
    3. Elimination of horizontal competition between Within's Supernatural and Meta's Beat Saber
- The amended complaint
  - Filed October 7, 2022
  - Dropped horizontal competition claim

The District Court

- Tried in the District Court of the Northern District of California
  - Judge Edward J. Davila
    - Appointed by President Obama
    - Assumed office: March 3, 2011
    - Assigned case: July 22. 2022

    - Seven-day evidentiary hearing

The decision

- 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—
      1. Industry or public recognition of VR dedicated fitness apps as a distinct submarket
      2. 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)
      3. Distinct customers (here, a younger male demographic) and distinct prices
  - HMT: Not important that the HMT analysis by the FTC's economic expert was faulty
    - *Rule*: A relevant product market need not be proved through the HMT and that the *Brown Shoe* factors alone can suffice

The decision

- Elimination of actual potential competition
  1. Court: Accepted the elimination of actual potential competition as a theory of anticompetitive harm under Section 7
     - Rejected 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
       - Rejected defendants' argument that the FTC was required to prove oligopolistic, interdependent, or parallel behavior as part of the FTC's prima facie case
     - Rather, required defendants to show that the market was in fact "genuinely competitive" in rebuttal
       - 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
         a. Market nascency (all firms in the market entered within the last five years)
         b. Volatility of market shares
         c. Recent new entry (a doubling of VR dedicated fitness apps)
         d. Low barriers to entry
     - WDC: The best way to think about this is that the court employed a *rebuttable presumption* that a highly concentrated market operates anticompetitively
       - *Query*: What should be the burden of proof on the merging parties on rebuttal: production or persuasion?

The decision

- 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]
          - Rejected 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—
          i. "Available feasible means" (ability)
          ii. Incentive

[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.

The decision

- 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
     b. Available feasible means
        - Court relied on *objective* evidence
          - *Standard*: Would a reasonable firm in Meta's position have the available feasible means of entering the market?
        - Here, the court found—
          - Meta has the financial and VR personnel resources to enter the market de novo
          - BUT lacks—
            a. "the capability to create fitness and workout content, a necessity for any fitness product or market," *and*
            b. "the necessary studio production capabilities to create and film VR workouts"
        - *Rule*: Simply having the resources to buy the necessary inputs is not enough
          - WDC: What more does is needed? What is the limiting principle?

The decision

- 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
        - *Query*: Why did "inconclusive" evidence of subjective intent cause the FTC's case to fail?

The decision

- Elimination of perceived potential competition
  1. Court: Theory requires—
     1. A concentrated market premerger
     2. Possession of the 'characteristics, capabilities, and economic incentive to render it a perceived potential de novo entrant'; *and*
     3. 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
     - The question posed
       - The question here is whether firms in the target relevant market—here, VR dedicated fitness apps—*perceive* the merging firm as an entrant ready to jump into the market if the market becomes less competitive and more profitable
     - 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
       - Court: What the firm was thinking of doing but not disclosing publicly (the subjective evidence) is irrelevant to the perceived potential competition theory—too unreliable
         - Within biased in favor of the deal
         - Other firms may have a self-interest in defeating the deal

The decision

- Elimination of perceived potential competition
  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 concurrently with the decision to deny the preliminary injunction[1]
  4. Conclusion
     - Court: Perceived potential competition theory failed for lack of sufficient evidence of either required element that—
       - Meta was a perceived potential entrant, *or*
       - There was a direct effect of Meta's presence on the behavior of firms in the relevant market, leading in a more competitive market

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

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).