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MERGER CONTROL IN DYNAMIC MARKETS – Contribution from the United States

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Merger Control in Dynamic Markets

- Contribution from the United States –

1. Introduction

1. In the United States, courts and antitrust enforcers regularly confront mergers in dynamic industries, such as those involving high-technology goods and services. Such mergers are reviewed according to the same basic framework that guides merger analysis in any other industry. Section 7 of the Clayton Act prohibits mergers whose effect "may be substantially to lessen competition, or to tend to create a monopoly."[1] Under this standard, the Antitrust Division of the U.S. Department of Justice (DOJ) and the Federal Trade Commission (FTC) (together, the Agencies) seek not only to stop imminent anticompetitive effects, but to be forward-looking and stop potential restraints on competition "in their incipiency."[2] Other provisions of the antitrust laws may also apply to such mergers, such as Section 2 of the Sherman Act, which prohibits monopolization, attempted monopolization, and conspiracy to monopolize.[3]

2. The Agencies take a careful, fact-based approach to assessing the competitive effects of any merger, focusing on the particular economic characteristics and dynamics of the markets affected by the transaction. To that end, the Agencies conduct thorough factual investigations, including economic analysis, review of relevant documents, and interviews with the parties, customers, and competitors. Throughout this process, the Agencies recognize that market conditions and industry structure can be highly dynamic: accordingly, the staff of the Agencies avoid relying solely on static metrics. For example, current market shares may overstate or understate future competitive significance of industry participants, particularly in industries where innovation and new product development are key elements of competition.

3. The Agencies consider both price and non-price competitive effects in their analyses. For example, in dynamic industries, firms often compete on the basis of innovation and new product development. The 2010 Horizontal Merger Guidelines, which provide the framework for the Agencies' analysis, recognize the importance of these dimensions of competition.[4]

4. In dynamic industries and markets, the Agencies recognize that it is particularly important to evaluate the effects of a merger on future competition. Current U.S. antitrust law recognizes that firms can be significant competitors even if they are not both currently producing substitute products or services, where there is reason to believe that the firms could or would offer such substitutes in the future. And this implies, for example, that

[1] 15 U.S.C. Section 18.

[2] *Brown Shoe v. United States*, 370 U.S. 294, 323 (1962).

[3] 15 U.S.C. Section 2.

[4] Horizontal Merger Guidelines, §6.4 Innovation and Product Variety, U.S. Dep't of Justice and Fed. Trade Comm'n (Aug. 2010), *available at* http://www.justice.gov/atr/public/guidelines/hmg-2010.html.

mergers in dynamic industries can raise "potential competition" concerns where a firm buys a company that is planning to, or would likely have the ability and incentive to, enter its market to compete directly (or when there is evidence that the acquiring firm is likely to enter the target's market).

5. In dynamic industries and markets, the Agencies also recognize that competition from new, innovative, and disruptive entrants—including those with unusual business models—may be highly significant to competition and consumers, and that the elimination of such competition may cause significant harm. In appropriate cases, accordingly, the Agencies often evaluate whether a merger may lessen competition by eliminating a "maverick" firm, *i.e.*, a firm that plays a disruptive role in the market to the benefit of customers. For example, if one of the merging firms has a strong incumbency position, or participates in a small oligopoly of strong firms, and the other merging firm threatens to disrupt market conditions with a new technology or business model, their merger can result in a substantial lessening of competition.[5] This may be the case even if the maverick player is a relatively new entrant or has only a modest market share.

6. The Agencies also recognize that dynamic markets are sometimes distinguished by fast-paced, innovative, and valuable product or service improvements, as rivals improve their offerings to satisfy the demands of consumers. When parties can show that a merger will significantly improve the ability and incentive of competitors to offer such benefits to consumers, the Agencies will take such efficiencies into account during merger analysis.

7. In appropriate cases, mergers in dynamic industries may be cleared subject to remedies that are tailored to address price and non-price potential harm, including harm to innovation. Generally speaking, the Agencies prefer structural remedies—*e.g.*, divestiture of a business unit—over behavioral remedies. This may be especially important in dynamic industries, when there is a risk that behavioral remedies could constrain a firm's behavior in ways that will impede its ability to respond efficiently to changing market conditions in the interests of consumers.

8. In the following sections, this paper provides some illustrative examples of recent DOJ and FTC experience analyzing mergers in dynamic markets.

2. DOJ Experience Assessing Mergers in Dynamic Industries

2.1. Remedies to Preserve Innovation Competition

9. In several recent cases the DOJ has imposed merger remedies to maintain innovation competition. For example, in May 2018, the Division took action to preserve innovation competition in agricultural product markets as a resolution in the Bayer/Monsanto transaction. The originally proposed Bayer/Monsanto transaction would have resulted in reduced competition in 17 distinct agricultural product markets, and would have significantly affected innovation in agriculture. Absent the merger, Bayer and Monsanto competed in offering "integrated solutions"—combinations of seeds, traits, and crop protection products—that combined innovations in various parts of the agricultural sector. Court filings quoted company documents that revealed their rivalry drove investment in developing new products.

[5] Id. at §2.1.5.

10. The DOJ's remedy was its largest ever negotiated merger divestiture, valued at $9 billion, intended to preserve competition in existing and developing product markets. The divestiture package included certain intellectual property and research capabilities, including "pipeline" R&D projects, to support innovation competition. This innovation-focused remedy ensures that the divestiture buyer, BASF, will continue the legacy of R&D that Bayer had before it.

11. The Thales/Gemalto merger raised similar issues around preserving innovation competition in dynamic markets. Thales and Gemalto are the world's leading providers of General Purpose Hardware Security Modules, which secure encryption processing and key management. Such devices are frequently included as components of complex encryption solutions to safeguard sensitive data, and have been undergoing fast-paced innovation.

12. The Division's remedy required Thales to divest, as a viable ongoing business, its General Purpose Hardware Security Module business. The Division designed the divestiture to preserve the incentive and ability to innovate. For example, it requires divestiture of certain intellectual property and research capabilities for products under development. As in Bayer/Monsanto, this divestiture ensures that the structure of the market post-transaction will promote the race to innovate in this high-tech industry.

2.2. Vertical Merger Enforcement in a Dynamic Industry

13. A recent example of a vertical merger in a dynamic industry challenged by the Department of Justice is AT&T, Inc.'s acquisition of Time Warner Inc., which raised concerns regarding AT&T's ability to raise its rivals' costs and stifle innovation. The DOJ concluded that significant harm would flow from allowing AT&T—a large video distributor—to acquire content critical to existing competitors and innovators. In particular, AT&T could raise rivals costs and weaken new innovators in video by withholding or limiting the terms of access for the valuable Time Warner content it sought to acquire. Following protracted court proceedings, an appeals court ultimately permitted the merger to proceed based on certain factual findings made in the lower courts.[6]

14. Various "virtual MVPDs," which deliver television over the internet, have disruptively entered the pay TV industry in recent years. AT&T is the largest legacy pay television distributor in the United States through its ownership of DirecTV, its legacy U-Verse service, and its virtual MVPD AT&T TV Now (formerly DirecTV Now). At the time DOJ filed its complaint, AT&T had around 25 million video subscribers, out of around 94 million pay TV subscribers overall in the United States. Time Warner is a major programmer, owning several traditional television networks (including TNT, TBS, CNN, and Cartoon Network) through its Turner Broadcasting division, as well as the HBO and Cinemax premium networks operated by its HBO division.[7] The Turner networks are among the most highly rated television networks in the United States and are included in most pay TV packages offered by MVPDs. HBO is widely recognized as the leading premium network in the U.S. Given the importance of their content, Time Warner's networks were an important input to innovators disrupting AT&T's traditional video distribution business model.

[6] United States v. AT&T, Inc., 916 F.3d 1029 (D.C. Cir. 2019).

[7] Traditional television networks are often referred to as "basic cable networks", because they are included in "basic" video bundles. Premium channels such as HBO, in contrast, require an additional paid subscription.

15. DOJ argued that the merger would give AT&T an opportunity to blunt the competition DirecTV (and other MVPDs) face from new forms of video distribution, in particular from virtual MVPDs that distribute linear television online. DOJ presented evidence that after the merger, AT&T could use several strategies to impede these competitors. One potential strategy was the withholding of Time Warner content by AT&T, potentially in concert with Comcast – the other major vertically integrated MVPD in the United States – withholding its NBCU content. Another strategy was insisting on licensing Time Warner's networks only as a large bundle. This would frustrate the virtual MVPDs' efforts to offer a cheaper alternative to MVPDs by selling "skinny bundles" rather than the hundreds of channels in most MVPD packages. Unfortunately, the district court ruled in favor of the defendants based on specific factual findings.

16. In its decision on appeal, the D.C. Circuit noted that the district court "undoubtedly made some problematic statements, which the government identifies and this court cannot ignore;" nevertheless, the Court ultimately held that the district court did not commit clear error in deciding that the evidence was insufficient to show that the proposed merger was likely to substantially reduce competition.[8] Notably, the appellate court credited the viability of DOJ's innovation theory for vertical merger enforcement, stating that "vertical mergers can create harms beyond higher prices for consumers, including decreased product quality and reduced innovation."[9]

3. FTC's Experience Assessing Mergers in Dynamic Industries

3.1. FTC Merger Cases involving Potential Competitors

17. As noted above, a merger may substantially lessen competition in violation of Section 7 if the merger would eliminate a likely entrant.[10] In *United States v. Falstaff Brewing Corp.*, the Supreme Court emphasized that Section 7 prohibits "certain acquisitions of a market competitor by a noncompetitor," such as a merger involving a new entrant "who threatens to . . . upset market conditions," to the detriment of competition.[11] Likewise, the Horizontal Merger Guidelines explain that a merger between an incumbent and a potential entrant can raise significant competitive concerns: "The lessening of competition resulting from such a merger is more likely to be substantial, the larger is the market share of the incumbent, the greater is the competitive significance of the potential entrant, and the greater is the competitive threat posed by this potential entrant relative to others."[12] As in any merger investigation, the type and extent of evidence needed to determine whether a firm is a potential competitor will vary with the circumstances.

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[8] Id. at 1038.

[9] Id. at 1045.

[10] See Statement of the Commission, "Competition in Digital Technology Markets: Examining Acquisitions of Nascent and Potential Competitors by Digital Platforms," before the U.S. Senate Committee on the Judiciary, Subcommittee on Antitrust, Competition Policy, and Consumer Rights, (Sept. 24, 2019), https://www.ftc.gov/system/files/documents/public_statements/1545208/p180101_testimony_-_acquisitions_of_nascent_or_potential_competitors_by_digital_platforms.pdf.

[11] 410 U.S. 526, 531 (1973) (citing *FTC v. Procter & Gamble Co.,* 386 U.S. 568, 578- 80 (1967)).

[12] HMG § 5.3.

18. In a number of cases in pharmaceutical markets, the FTC has identified and protected potential competition by requiring relief when a firm with a product on the market intended to acquire another firm with a product in development that would likely provide important competition with the on-market product.[13] In such cases, the FTC has had particular regard to the Food and Drug Administration's approval process, which provides a degree of transparency and predictability as to the timing of potential entry of a new drug. The Commission has also developed considerable experience of its own predicting competitive effects, including the effects of entry, in pharmaceutical markets.[14]

19. Proving a loss of potential competition from any individual transaction is a case-specific, fact-intensive exercise, and in certain cases it can be challenging. For example, in a recent proceeding that relied on a theory of potential competition, the court held that the Commission had failed to carry its burden when challenging a merger between two firms providing contract sterilization services to health care product manufacturers. The FTC sought a preliminary injunction to prevent the merger (pending an administrative trial) of Steris Corporation, one of only two companies providing sterilization services to medical device firms in the United States, and Synergy Health plc, a British company with plans to expand into the United States with a new, and potentially superior, sterilization technology. Synergy had advanced plans to enter, such as securing physical locations for its plant and contracting for the required equipment. But Synergy officials testified at trial that they likely would not have followed through with those entry plans, and the court concluded that the evidentiary record was insufficient to conclude that the entry was "probable."[15]

20. While some potential competition cases (like the Steris case) involve an established incumbent and an incoming rival, other cases involve a transaction between two incoming competitors, neither of which is yet established in the relevant market. The Commission will be equally vigilant in protecting potential competition in cases of this type. And where a merger of this kind may reduce competition by bringing separate competitive efforts under common control, the Commission may in appropriate circumstances require a divestiture of one of the products under development. In other cases, however, the Commission may determine that the merger is beneficial on balance (for example, because successful entry is more likely to result from an integrated effort than from two separate attempts).

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[13] *See* Fed. Trade Comm'n, *Overview of Action in Pharmaceutical Products and Distribution* (August 2018), list of cases included in Potential Competition Mergers, at 60-67 and Innovation Market Mergers at 67-68: https://www.ftc.gov/system/files/attachments/competition-policy-guidance/overview_pharma_august_2018.pdf.

[14] Fed. Trade Comm'n, *Authorized Generic Drugs: Short-Term Effects and Long-Term Impact* ii-iii (2011), http://www.ftc.gov/sites/default/files/documents/reports/authorized-generic-drugs-short-term-effects-and-long-term-impact-report-federal-trade-commission/authorized-generic-drugs-short-term-effects-and-long-term-impact-report-federal-trade-commission.pdf (the first generic competitor's product is typically offered at a 20 to 30 percent discount to the brand product); Fed. Trade Comm., *Pay-For-Delay: How Drug Company Pay-offs Cost Consumers Billions* 8 (2010), http://www.ftc.gov/sites/default/files/documents/reports/pay-delay-how-drug-company-pay-offs-cost-consumers-billions-federal-trade-commission-staff-study/100112payfordelayrpt.pdf (subsequent generic entry creates greater price competition, with discounts of 85 percent or more off the price of the brand name drug).

[15] *FTC v. Steris Corp.,* 133 F. Supp. 3d 962 (N.D. Ohio 2015). The Commission later dismissed its administrative complaint. *In re Steris Corp., and Synergy Health PLC*., Dkt. No. 9365 (May 29, 2015).

21. The Commission has applied a similar analysis—including outside the pharmaceutical context—where the merging firms are two of a small number of likely entrants into a future market. For example, in the 2013 merger involving Nielsen and Arbitron, both companies were developing cross-platform measurement services to measure viewership across TV, the Internet, and other platforms. Both firms had developed plans, invested money, and reached out to customers to begin marketing beta versions of those products. Customers believed that Nielsen and Arbitron would compete, and that the two companies were best positioned to develop a new cross-platform measurement product. Based on these independent efforts, customers believed that Nielsen and Arbitron eventually would compete directly to provide national syndicated cross-platform measurement services. The Commission concluded that each company could be considered a likely future entrant, and that the elimination of the future offering of one would likely result in a lessening of competition.

3.2. FTC Cases Involving Mergers that Eliminate a Disruptive Competitor

22. When evaluating mergers in dynamic markets, the FTC closely scrutinizes mergers in which an industry leader seeks to acquire an up-and-coming competitor that is, or is likely in the future to be, changing customer expectations and gaining sales. For example, last year, the FTC challenged the merger of market leader CDK Global, and far-smaller competitor, Auto/Mate.[16] According to the complaint, the transaction would have reduced competition in the already-concentrated market for specialized platform business software used by U.S. franchise automotive dealers, known as dealer management systems. Auto/Mate competed with CDK and other larger franchise dealer management system providers and won business by offering lower prices, flexible contract terms, low fees for third-party apps participating on the platform, free software upgrades and training, and high quality customer service. Auto/Mate's outsized impact on existing platforms indicated that the merger would dampen competition from a key emerging rival.

23. In some dynamic markets, the parties' products or services may involve the supply of certain forms of data: in those markets, too, the FTC will watch closely for the elimination of particularly significant or disruptive competitors. For example, in 2014 the Commission moved to block Verisk Analytics, Inc.'s proposed acquisition of EagleView, alleging that the proposed transaction would result in a virtual monopoly in the U.S. market for rooftop aerial measurement products used by insurers to estimate repair costs for property damage claims.[17] Before the merger, EagleView was the leading provider of rooftop aerial measurement products that relied on its proprietary software to analyze aerial images. Verisk provided the leading software platform used by insurers to process roof damage claims, and had recently entered into direct competition with EagleView by developing its own library of high-resolution aerial images. Other firms were only distant competitors. The Commission alleged that the elimination of competition between the firms—competition that was becoming increasingly significant—would likely lead to higher prices and reduced incentives to innovate. After the Commission voted to challenge the acquisition, the companies abandoned their deal.

[16] *In re CDK Global*, Dkt. 9382 (complaint filed Mar. 20, 2018). Shortly after the FTC issued its complaint, the parties abandoned their proposed transaction.

[17] FTC Press Release, "*FTC Challenges Verisk Analytic, Inc.'s Proposed Acquisition of EagleView Technology Corporation*," (Dec. 16, 2014), https://www.ftc.gov/news-events/press-releases/2014/12/ftc-challengesverisk-analytics-incs-proposed-acquisition.

24. Finally, the FTC recognizes that potential competition may exist—and should be protected through the merger control process—even when a potential entrant faces regulatory hurdles on the path to entry. For example, in 2009, the Commission authorized litigation to block Thoratec Corporation's proposed $282 million acquisition of rival medical device maker HeartWare International, Inc. The Commission charged that the transaction would substantially reduce competition in the U.S. market for left ventricular assist devices ("LVADs"), a life-sustaining treatment for patients with advanced heart failure. HeartWare was engaged in clinical trials for what many considered to be a superior device. Although the path to regulatory approval of these devices is challenging, there was ample evidence that HeartWare's device was the most likely future competitor to Thoratec's device. The few other companies developing LVADs were significantly behind HeartWare in their clinical trials and were unlikely to reach the market as soon as, or be as competitive as, HeartWare's device.[18] The Commission filed a complaint to block the transaction, alleging that no other firm could replace the current and future competition eliminated by the merger.[19] The parties abandoned the transaction in the face of the Commission's challenge.

[18] *In the Matter of Thoratec Corp. and HeartWare Int'l., Inc.,* Dkt. 9339 (July 30, 2009).

[19] FTC Press Release, *FTC Challenges Thoratec's Proposed Acquisition of HeartWare Int'l*., (July 30, 2009), http://www.ftc.gov/news-events/press-releases/2009/07/ftc-challenges-thoratecs-proposed-acquisition-heartware. The parties abandoned the transaction in the face of the Commission challenge.