Request for Information on Merger Enforcement

Public Comments of 23 State Attorneys General

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The Attorneys General of California, New York, Connecticut, Delaware, District of Columbia, Hawaii, Idaho, Illinois, Iowa, Maine, Maryland, Massachusetts, Michigan, Minnesota, Nevada, New Jersey, New Mexico, Oregon, Pennsylvania, Rhode Island, Utah, Washington, and Wisconsin submit the following Comments in response to the January 18, 2022 Request for Information on Merger Enforcement, issued by the Department of Justice and Federal Trade Commission. These Comments suggests ways to modernize federal merger guidelines (hereinafter "Guidelines") and protect competition. We offer our perspective on the status and direction of merger enforcement with respect to nine of the proposed questions:

- Potential and nascent competition (Question 7);
- Presumptions (Question 5);
- Digital markets – low and no marginal cost products (Question 11(c));
- Digital markets – competition for attention (Question 11(h));
- Special characteristics markets (Question 12);
- Nonprice effects (Question 2(a));
- Failing and flailing firms (Question 15);
- Private equity (Question 12(i)); and
- Remedies (Question 8).

The Guidelines have long and rightfully stood as influential authority on the development of antitrust law, important tools for federal and state antitrust enforcement, and critical guideposts for firms that are contemplating a merger. Because the courts respect federal enforcers' expertise, the Guidelines have framed how enforcers and other parties present their cases and have helped shape the evolution of antitrust law. Yet concerns mount that overly permissive merger enforcement may have led to over-concentration in many sectors, hindered the country's economic dynamism, entrepreneurialism, and innovation, and resulted in harm to consumers and competition itself.

We appreciate the invitation to comment on potential revisions to the Guidelines and have largely focused on areas where the current Guidelines are silent or should be updated to reflect sweeping economic changes or improved economic understanding. These suggested revisions could better arm federal and state enforcers to halt anticompetitive mergers in their "incipiency," as Congress intended. Moreover, thoughtful revisions to the Guidelines may dissuade parties from pursuing problematic mergers, while at the same time giving parties actionable guidance in pursuing mergers that are unlikely to be anticompetitive and may promote economic growth.

The first section examines acquisitions of potential and nascent competitors. Despite the anticompetitive harms that some of these mergers have enabled, they have become nearly impossible to challenge. We propose ways to facilitate challenges when appropriate.

In the second section, we address the substantial weakening of structural presumptions in recent decades. In it, we urge federal enforcers to adopt a modern and nuanced set of structural presumptions establishing that concentration exceeding certain thresholds reliably predicts that anticompetitive effects will flow from a transaction.

The third and fourth sections address the need for the Guidelines to better address the realities of digital markets, where many businesses harness vast amounts of consumer data, and market dynamics are frequently much different from those affecting traditional goods and services. The Guidelines should reflect a holistic understanding of how dominant firms, especially digital platforms, can harm competition by misusing mergers to accumulate ever more consumer data or dominate the market for consumer attention.

The fifth section discusses mergers that do not neatly fit within the traditional (but largely outdated) "horizontal or vertical" framework. We propose several presumptions, tools, and limiting principles to better identify the full range of potentially anticompetitive non-horizontal mergers.

Section six addresses how mergers may cause "nonprice" harms such as diminished innovation and lower quality. We propose tailored presumptions, closer consideration of nonprice effects, and a wider set of potential remedies.

In the seventh section, we discuss the Guidelines' current approaches to "failing" and "flailing firm" arguments. The Guidelines' current approach to the failing firm defense is adequate and does not require revision. As for so-called "flailing firm" or "weakened competitor" arguments, the Guidelines do not expressly lay out any parameters for the consideration of these claims, and no such parameters are needed.

In the eighth section, we propose that the Guidelines should specifically address private equity transactions. The structure and business model of private equity may result in harms to competition, such as accelerating consolidation and impairing acquired firms' ability to compete. We propose that federal enforcers evaluate the likelihood of these specific harms in private equity transactions; consider potential behavioral remedies to mitigate these harms, when appropriate; and closely scrutinize proposed divestitures to private equity buyers.

The last section encourages federal enforcers and the States to increase their collaboration in merger investigations right from the start. We propose an actionable framework when parties substantially change their divestiture or remedy proposals. We also propose that such changes trigger an extension of the merger review timeline.

State attorneys general play a crucial role in merger enforcement. The States can provide unique perspectives on how a merger will impact local markets and, where appropriate, craft protective remedies. We look forward to continued collaboration with federal enforcers to protect free competition, consumers, and our economies.

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POTENTIAL AND NASCENT COMPETITION

I. The Importance of Revising the Guidelines to Address Potential and Nascent Competition

As co-enforcers of the nation's antitrust laws, the State Attorneys General ("States") have unique perspectives, experiences, and interests in protecting their citizens from anticompetitive harms, including those arising from mergers involving potential and nascent competitors. The States are often the first stop for small businesses and local residents seeking to call attention to such harms.

Potential and nascent competitors are central to the nation's political, economic, and social well-being. But the current Guidelines and existing case law have fallen short in recognizing their importance. Dominant players have easily acquired start-ups and emerging businesses in recent years, demonstrating that recalibration of the Guidelines in this area is essential.

Revising the current Guidelines to address in greater detail mergers that implicate potential and nascent competition will promote improved antitrust enforcement, not only where the States join forces with their federal counterparts, but also when either group acts independently. Equally important, revised Guidelines can help frame how cases are presented in court and, as the courts respect federal enforcers' expertise, shape directions for the law to evolve to protect innovation and competition. Finally, revised Guidelines will help ensure that disruptive innovators can grow to challenge dominant firms.

A. The Difference Between Potential and Nascent Competitors

The terms "potential" and "nascent" competitor are increasingly used interchangeably. However, they refer to two different concepts.[1] A potential competitor is a firm that has not entered a market and does not currently compete with existing products, but either (a) is likely to do so in the future, or (b) could easily enter that market, if market conditions change.[2]

A nascent competitor is a firm that has a product in existence already, but that has not yet matured into a significant competitor, whether inside or outside of the relevant market.[3] The concept of nascent competition in United States antitrust law was largely developed by the D.C. Circuit in *Microsoft*.[4] Microsoft believed that Netscape's internet browser and Sun's Java programming language could emerge as threats to its Windows operating system monopoly.[5] While Netscape and Java were not in the relevant market, they were nascent competitors nonetheless because they "threatened to become viable substitutes for Windows," even though

[1] Andrew Elzinga, Nikhil Gupta, Margaret Kyle & Vivek Mani, *Economic Issues in Assessing Potential and Nascent Competition*, CPI ANTITRUST CHRON., at 16 (Feb. 2022), https://www.competitionpolicyinternational.com/antitrust-chronicle-economics-of-potential-competition/.
[2] *Id.*
[3] *Id*.
[4] *United States v. Microsoft Corp.*, 253 F.3d 34, 79 (D.C. Cir. 2001).
[5] *Id.* at 74-77.

they were not at the time "well-developed enough to serve as present substitutes." In the court's words, the "threat [was] only nascent."[6]

Both potential and nascent competition address competition that does not exist in the present. However, while potential competition involves forecasting entry and possible competitive effects, nascent competition involves forecasting the potential competitive constraint from an existing product on the relevant market in the future.[7] As such, the relevant facts for challenges involving potential competitors may differ from those involving nascent competitors.

The discussion that follows refers to potential competition but also applies to nascent competition unless otherwise noted.

B. Potential Competitor Acquisitions Implicate Several Federal Statutes

The acquisition of a potential competitor can violate Section 7 of the Clayton Act, Section 1 or 2 of the Sherman Act, and Section 5 of the FTC Act, though Section 7 tends to be most relevant. The Supreme Court has held that Section 7 bars "certain acquisitions of a market competitor by a noncompetitor . . . who threatens to . . . upset market conditions" to the detriment of competition.[8] In other words, acquisitions of potential competitors, including those outside of the relevant market, are covered by Section 7.[9] The Clayton's Act purpose to curb anticompetitive effects "in their incipiency" covers concerns regarding future effects on competition.[10] As the Supreme Court stated in *Brown Shoe*, in enacting the Clayton Act, Congress was concerned "with probabilities, not certainties."[11]

C. Potential Competition Recognized by the Supreme Court

The Supreme Court established in the early 1960s that mergers involving potential competitors can violate Section 7.[12] In *FTC v. Procter & Gamble*,[13] the defendant ("P&G"), a leading manufacturer of high-turnover household products, acquired Clorox, the leading bleach manufacturer. Although P&G did not produce bleach prior to its acquisition of Clorox, the Court held that the merger violated Section 7 because "the merger would seriously diminish potential competition by eliminating Procter as a potential entrant into the industry."[14] In coming to this conclusion, the Court stated:

> [A]ll mergers are within the reach of § 7, and all must be tested by the same standard . . . As noted by the Commission, this merger is neither horizontal, vertical, nor conglomerate . . . The anticompetitive effects with which this product extension

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[6] *Id*. at 54.
[7] Elzinga *et al.*, *supra* note 1, at 16.
[8] *United States v. Falstaff Brewing Corp.*, 410 U.S. 526, 531 (1973).
[9] *Fed. Trade Comm'n v. Procter & Gamble Co.*, 386 U.S. 568 (1967).
[10] *Brown Shoe Co. v. United States*, 370 U.S. 294, 317-18 (1962).
[11] *Id.* at 323.
[12] *See, e.g.*, *United States v. Penn-Olin Chem. Co.*, 378 U.S. 158 (1964); *United States v. El Paso Gas Co.*, 76 U.S. 651 (1964).
[13] *Procter & Gamble*, 386 U.S. at 570–71.
[14] *Id.* at 575.

> merger is fraught can easily be seen: (1) the substitution of the powerful acquiring firm for the smaller, but already dominant, firm may substantially reduce the competitive structure of the industry by raising entry barriers and by dissuading the smaller firms from aggressively competing; (2) the acquisition eliminates the potential competition of the acquiring firm.[15]

P&G stands today as an example of potential competition in a product extension merger. Subsequently, the Court expanded its potential competition analysis in a series of decisions.

In *Falstaff Brewing Corporation*,[16] Falstaff, the nation's fourth largest beer producer, sought to acquire Narragansett Brewing Co., the largest brewer in New England. Though Falstaff did not sell beer in New England, DOJ alleged that the acquisition violated Section 7 because Falstaff was a potential entrant in that market. Thus, the merger eliminated competition that could exist in the future. The district court rendered judgment for defendant and DOJ appealed. Ultimately, the Supreme Court remanded, holding that the district court "should have considered whether [Falstaff] was a potential competitor in the sense that its position on the edge of the market exerted a beneficial influence on the market's competitive conditions."[17]

In *Falstaff*, the Court described and approved the theory known as "perceived potential competition," where the perception of entry is a present competitive constraint.[18] Because the case was remanded to consider the question of perceived potential competition, the Supreme Court did not find it necessary to answer whether a merger should be barred under Section 7 even if the potential competitor had no present effect on competition—a theory often referred to as "actual potential competition."[19] Perceived potential competition refers to a non-market firm's *present* competitive effect, which arises because existing market participants perceive the firm as a potential entrant and thus able to discipline anticompetitive market conduct. By contrast, actual potential competition refers to the *future* procompetitive effects that could result from entry by a potential competitor.

In *Marine Bancorporation*, the Court distinguished actual from perceived potential competition. Marine Bancorporation and its parent, National Bank of Commerce ("NBC"), a large nationally chartered bank, together constituted the second largest bank in Washington State. NBC sought to acquire Washington Trust Bank, a medium-sized state-chartered bank with a 19 percent market share in Spokane. NBC had no offices in Spokane. DOJ sued to enjoin the merger, alleging NBC was an actual potential competitor and a perceived potential entrant.[20] The Supreme Court allowed the merger to proceed because "stringent barriers to entry" (extensive federal and state regulation of banks) eliminated other feasible methods of entry.[21]

In its analysis, the Court in *Marine Bancorporation* divided potential competition into two separate legal doctrines and outlined "preconditions" to Section 7 liability under each. Perceived

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[15] *Id*. at 577–78.
[16] *Falstaff*, 410 U.S. at 527–30.
[17] *Id.* at 526.
[18] *Tenneco, Inc. v. Fed. Trade Comm'n*, 689 F.2d 346, 351–52 (2d Cir. 1982).
[19] *Falstaff*, 410 U.S. at 537–38.
[20] *United States v. Marine Bancorp., Inc.*, 418 U.S. 602 (1974).
[21] *Id.* at 641–42.

potential competition requires proof that: (1) the market is substantially concentrated, (2) "the acquiring firm has the characteristics, capabilities, and economic incentive to render it a perceived potential de noto [sic] entrant" and (3) that "the acquiring firm's pre-merger presence on the fringe of the target market in fact tempered oligopolistic behavior on the part of existing participants in that market."[22] Actual potential competition requires proof that: (1) that the potential competitor had "feasible means for entering the . . . market" and (2) that "those means offer a substantial likelihood of ultimately producing deconcentration in the market or other significant procompetitive effects."[23]

Marine Bancorporation was the last Supreme Court ruling on a potential competition case. As such, the Supreme Court has never adopted actual potential competition as a Section 7 violation.[24]

D. Potential Competitor Acquisitions are Nearly Impossible to Challenge

The only fully litigated potential competitor case since the 1980s was lost by the FTC.[25] In *Steris*,[26] an actual potential competitor case, the FTC sought to enjoin Steris from acquiring its alleged potential competitor, Synergy. Steris and Synergy were the second and third largest sterilization companies in the world, respectively. Prior to the merger, the FTC alleged, Synergy had been planning to enter the U.S. market with an x-ray sterilization technology that could disrupt the market and compete with Steris' gamma sterilization. According to the FTC in *Steris*, the acquisition of an actual potential competitor violates Section 7 if "(1) the relevant market is highly concentrated, (2) the competitor "probably" would have entered the market, (3) its entry would have had pro-competitive effects, and (4) there are few other firms that can enter effectively."[27] The District Court held that the evidence did not support the FTC's claim that Synergy planned to enter the US market and denied to enjoin the merger.[28]

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[22] *Id.* at 624–25.
[23] *Id.* at 624–5, 633.
[24] *See, e.g.*, *Tenneco*, 689 F.2d at 352 ("The actual potential competition theory . . . has yet to receive sanction from the Supreme Court."); *Marine Bancorp.*, 418 U.S. at 638 ("Indeed, since the preconditions for that theory are not present, we do not reach it, and therefore we express no view on the appropriate resolution of the question reserved in Falstaff. We reiterate that this case concerns an industry in which new entry is extensively regulated by the State and Federal Governments."); PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW: AN ANALYSIS OF ANTITRUST PRINCIPLES AND THEIR APPLICATION ¶ 1128(d)(2) (4th and 5th eds. 2015-2021) ("The Marine Bancorporation situation was an unusual one.").
[25] Steven C. Salop, Potential Competition and Antitrust Analysis, Org. for Econ. Coop'n & Dev., Directorate for Fin. & Enter. Affairs, Competition Comm., Roundtable on the Concept of Potential Competition, at ¶ 24 (2021), https://one.oecd.org/document/DAF/COMP/WD(2021)37/en/pdf. The agencies have alleged the elimination of potential competition in complaints leading to settlements or abandonment. For example, in November 2020 DOJ sued to block Visa's planned acquisition of Plaid. DOJ alleged that Visa sought to buy Plaid as an "insurance policy to neutralize a threat" to its monopoly. Visa and Plaid ultimately abandoned the merger. *United States v. Visa Inc.*, No. 3:20-cv-07810, Compl., Dkt. No. 1 (N.D. Cal. Nov. 5, 2020). Also, the FTC and State Attorneys General have separately filed suits against Facebook alleging that it has engaged in a course of conduct with the aim of neutralizing and deterring competitive threats to its monopoly in personal social networking. The suits are ongoing as of this writing. *Fed. Trade Comm'n v. Facebook, Inc.*, No. 1:20-cv-3590-JEB (D.D.C.); *State of New York v. Facebook, Inc.*, No. 21-7078 (D.C. Cir.).
[26] *Fed. Trade Comm'n v. Steris Corp.*, 133 F. Supp. 3d 962, 966 (N.D. Ohio 2015).
[27] *Id.* at 966.
[28] *Id.* at 984.

Under the actual potential competition interpretation posited by *Marine Bancorporation* and *Steris*, the acquisition of a potential competitor is "nearly impossible to challenge, given the difficulty of establishing the but-for world with sufficient precision and certainty."[29] Revisions to the Guidelines, proposed below, could help lower that barrier.[30]

II. Proposed Changes in Standards and Approaches

The States propose nine new approaches (or clarifications) for the Guidelines that would strengthen enforcement in transactions involving potential competition:

1. The Guidelines should explicitly recognize that the actual potential competition doctrine can apply both where the acquired firm is the potential entrant into the acquiring firm's market, or where the acquiring firm is the potential entrant into the acquired firm's market.

   Steris is an example of the former scenario, while *Marine Bancorporation* is an example of the latter. The actual potential competitor case law has focused on a dominant acquirer as the potential entrant, but the doctrine embraces both scenarios.[31]

2. The Guidelines should make clear that the test the FTC advanced in *Steris* is not the only way to demonstrate that a merger involving a potential competitor violates the antitrust laws.

   The FTC's *Steris* proposal is one way to show a merger that eliminates a potential competitor violates Section 7, but it is not exclusive. For example, assessing uniqueness or the number of potential entrants can be informative but should not be dispositive.[32] Section 7 does not require that an acquiree be unique or one of the few firms that can enter for a merger to violate the law.[33]

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[29] C. Scott Hemphill & Tim Wu, *Nascent Competitors*, 168 U. PA. L. REV. 1879, 1894 (2020).

[30] The same barriers do not exist in other jurisdictions. For example, the merger between Farelogix and Sabre was challenged both by the United Kingdom's Competition and Markets Authority ("U.K. CMA") and the U.S. DOJ. Ultimately the merger was abandoned because the U.K. CMA decided to block the transaction; the DOJ challenged the transaction but lost. *United States v. Sabre Corp.*, No. 1:19-cv-01548-UNA, Compl., ECF No.1 (D. Del. Aug. 20, 2019); U.K. Competition & Mkts. Auth., Anticipated acquisition by Sabre Corporation of Farelogix Inc.: Final Report (Apr. 9, 2020), https://assets.publishing.service.gov.uk/media/5e8f17e4d3bf7f4120cb1881/Final_Report_-_Sabre_Farelogix.pdf.

[31] *Steris*, 133 F. Supp. 3d 962 (acquiree as potential competitor in acquirer's geographic market); *Marine Bancorp.*, 418 U.S. 602 (acquirer as potential competitor in acquiree's geographic market); *Falstaff*, 410 U.S. 526 (1973) (acquirer as potential competitor in acquiree's geographic market); *Alberta Gas Chems. Ltd. v. E.I. Du Pont de Nemours & Co.*, 826 F.2d 1235, 1254 (3d Cir. 1987) (Becker, J., dissenting) (actual potential competitor doctrine stated as "absent the acquisition, the acquiring firm would have entered the market in the near future").

[32] Mark Glick & Darren Bush, *Making the Potential Competition Doctrine Great Again*, CPI ANTITRUST CHRON. (Feb. 2022), at 38–39, https://www.competitionpolicyinternational.com/antitrust-chronicle-economics-of-potential-competition/.

[33] *United States v. H&R Block, Inc.*, 833 F. Supp. 2d 36, 79 (D.D.C. 2011).

3. The Guidelines should adopt a presumption that acquisitions of potential competitors by dominant firms are anticompetitive.

   Although the Guidelines would need to precisely define the applicable terms and thresholds, we support the general principle that a showing that (i) either merging party has market power, and (ii) that such power likely would be strengthened by the transaction, should be sufficient to establish a presumption of anticompetitive effect for transactions involving potential competitors.[34]

   Multiple commentators and existing case law support such a presumption.[35] For instance, in *Philadelphia National Bank*, the Supreme Court stated that the "intense congressional concern" relating to increasing concentration "warrants dispensing, in certain cases, with elaborate proof of market structure, market behavior or probable anticompetitive effects."[36] Phillip Areeda and Herbert Hovenkamp point out that mergers of potential competitors have "special significance when one of the firms is a monopolist."[37] This is because, as the Supreme Court has stated, where "concentration is already great, the importance of preventing even slight increases in concentration and so preserving the possibility of eventual deconcentration is correspondingly great."[38]

   Precise guidance for metrics and thresholds, as well as and clear definitions of key terms (e.g., "dominance," "incumbency," "market power," "monopoly," and "leading firm") are critical. For more detail on a proposed framework, please see the Presumptions Section, *infra*.

[34] U.K. Competition & Mkts. Auth., Merger Assessment Guidelines, § 5.15 at 42 (March 18, 2021), https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1051823/MAGs_for_publication_2021_--_.pdf (hereinafter "U.K. CMA Merger Guidelines") ("[W]here one merger firm has a strong position in the market and there are few significant potential competitors, even small increments in market power may give rise to competition concerns. Therefore, the acquisition by any such firm of a potential entrant may be concerning even if that potential entrant is expected to be small.").

[35] *See, e.g.*, Steven C. Salop & Fiona Scott Morton, *The 2010 HMGs Ten Years Later: Where Do We Go From Here?*, at 8 (2020), https://scholarship.law.georgetown.edu/facpub/2285, published at 58 REV. INDUS. ORG. 81 (2021) (proposing that HMGs apply anticompetitive presumption to acquisitions of small, nascent, or potential competitors by leading firms); JACQUES CRÉMER, YVES-ALEXANDRE DE MONTJOYE & HEIKE SCHWEITZER, EUR. COMM'N, DIRECTORATE-GEN. FOR COMPETITION, COMPETITION POLICY FOR THE DIGITAL ERA: FINAL REPORT, at 11 (2019), https://ec.europa.eu/competition/publications/reports/kd0419345enn.pdf ("notifying parties should bear the burden of showing that the adverse effects on competition are offset by merger-specific efficiences"); Tommaso Valletti, Après moi, le déluge! Tech giants in the digital age, at 5 (Dec. 5, 2018), https://ecp.crai.com/wp-content/uploads/2018/12/Tommaso-Valletti-2018.pdf ("for super-dominant firms, shift the burden of proof"); Massimo Motta & Martin Peitz, *How to deal with Big Tech mergers*, VOXEU (Feb. 11, 2020), https://voxeu.org/article/how-deal-big-tech-mergers ("If one of the merging parties has an entrenched dominant position, we argue that anti-competitive effects are likely to be present when the merger involves an actual or potential competitor and recommend a presumption of harm"); STAFF OF H. COMM. ON THE JUDICIARY, SUBCOMM. ON ANTITRUST, COMMERCIAL & ADMIN. LAW, 116TH CONG., INVESTIGATION OF COMPETITION IN DIGITAL MARKETS: MAJORITY STAFF REPORT AND RECOMMENDATIONS, at 387–88 (2020), https://judiciary.house.gov/uploadedfiles/competition_in_digital_markets.pdf?utm_campaign=4493-519 ("Subcommittee staff recommends that Congress consider shifting presumptions for future acquisitions by the dominant platforms") (hereinafter "HOUSE DIGITAL MARKETS STAFF REPORT").

[36] *United States v. Phila. Nat'l Bank*, 374 U.S. 321, 363 (1963).

[37] AREEDA & HOVENKAMP, *supra* note 24, ¶ 701(d).

[38] *United States v. Cont'l Can Co*., 378 U.S. 441, 461–462 (1964) (quoting *Phila. Nat'l Bank*, 374 U.S. at 365 n.42).

4. The Guidelines should adopt a dynamic competition analysis for potential competitors.[39]

The theory of dynamic competition traces its roots to Joseph Schumpeter, who cautioned against a constricted focus on static parameters: price and output competition.[40] According to Schumpeter, dynamic competition "acts not only when in being but also when it is merely an ever-present threat. It disciplines before it attacks."[41]

By recognizing that firms do not always compete for a share of the market simultaneously, dynamic competition best captures the potential loss of product and process innovation from a merger.[42] A dynamic competition analysis would expand the factual inquiry needed to assess the merging firm's innovation potential. It should consider not only (a) quantifiable data such as research and development investments, revenue streams, and valuation via conventional analyses, but also (b) qualitative firm management conditions, such as an entrepreneurial and risk-taking culture, employee skill sets, technological resources, and adaptability.[43]

Conversely, the Guidelines should acknowledge that the econometric tools traditionally used in merger analysis are likely to be of limited use in potential competition cases, because these firms tend to have no in-market sales or no sales at all. As such, numerical analyses, including probing price, output effects, diversion ratios, and HHIs will often be infeasible.[44] Moreover, these tools do not help predict how much future competition may exist without the merger. Instead, federal enforcers should place more weight on non-quantitative direct evidence, such as internal documents, before a merger was planned, from the merging parties and other market participants, stating their opinions on the direction of the industry and expansion plans.[45]

5. The Guidelines should also address which types of evidence are least probative.

Defendants often utilize self-serving testimony and unreliable post-deal documents. Ordinary course pre-merger business evidence should carry more weight, because mergers can drastically alter a firm's (and its executives') incentives. Many courts—including the Supreme Court—recognize that post-deal evidence can be "self-serving" and should be

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[39] *Id.* § 5, at 40; Org. for Econ. Coop'n & Dev., Directorate for Fin. & Enter. Affairs, Competition Comm., The Impact of Disruptive Innovation on Competition Law Enforcement: Executive Summary (2015), at 3, https://one.oecd.org/document/DAF/COMP/GF(2015)15/FINAL/en/pdf (recommending that competition authorities move towards dynamic competition analyses and away from static assessments).

[40] JOSEPH SCHUMPETER, CAPITALISM, SOCIALISM AND DEMOCRACY, at 83–84 (1942).

[41] *Id.* at 85.

[42] J. Gregory Sidak & David J. Teece, *Dynamic Competition in Antitrust Law*, 5 J. COMPETITION L. & ECON. 581, 620 (2009).

[43] U.K. CMA Merger Guidelines, *supra* note 34, §§ 2.28, 5.16 at 14, 42.

[44] Hemphill & Wu, *supra* note 29, at 1902 ("[F]orms of evidence typically used to build a prima facie case, such as evidence of higher prices, will not typically be available, given that a nascent competitor, by its nature, has not begun to fully compete at the time of acquisition.").

[45] Org. for Econ. Coop'n & Dev., Directorate for Fin. & Enter. Affairs, Competition Comm., The Concept of Potential Competition–Note by the United Kingdom, at 6 (June 10, 2021), https://one.oecd.org/document/DAF/COMP/WD(2021)34/en/pdf.

viewed with "skepticism." Courts have also acknowledged that evidence of future corporate intent can be shaped under the careful guidance of astute counsel.[46]

6. The Guidelines should adopt a longer timeframe to assess potential competitor mergers.

Merger enforcement under the Guidelines focuses almost exclusively on threats to competition in the short term. The current Guidelines[47] briefly address recent or potential entrants, recognizing that firms committed to entering the market in the "near future" are considered market participants, and describing "rapid entrants" as firms that "could very likely provide rapid supply responses . . . without significant sunk costs."[48] However, the Guidelines ignore that the possibility that acquisitions of firms planning to compete in current or future product markets, less rapidly, can also harm competition.[49] The Guidelines should expand their focus beyond threats to competition in the short term and put more weight on future competition.[50] Adopting a longer timeframe for analysis would enable the federal enforcers to analyze both the manifestation of more immediate harms and what future competitive constraints from potential competitors would look like.[51] The Nonprice effects Section, *infra*, sheds light on a how a focus on short term impact in merger analysis, including potential competitor mergers, may have long term adverse effects on innovation.

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[46] *See, e.g.*, *Marine Bancorp.*, 418 U.S. at 648 ("[T]he testimony of this vice president should not be given great weight. It is not only a speculative statement as to the failure of the Pacific National; it is also self-serving to the extent it keeps additional competitors out of the market."); *United States v. Siemens Corp*., 621 F.2d 499, 508 (2d Cir. 1980) ("[S]uch self-serving testimony by officials of the acquiring firm regarding its intentions must be viewed with skepticism."); *United States v. Phillips Petroleum Co*., 367 F. Supp. 1226, 1238 (C.D. Cal. 1973), *aff'd sub nom. Tidewater Oil Co. v. United States*, 418 U.S. 906 (1974) ("[I]mportantly, once the legal issues are known to astute corporate counsel, future facts as to corporate intent can be expected to be shaped under careful legal guidance to negate any inference that a corporation intended to enter any particular market which it later enters by merger.") (quoting J.F. Brodley, *Oligopoly Power Under the Sherman and Clayton Acts-From Economic Theory to Legal Policy*, 19 STAN. L. REV. 285, 357–58 (1967)); *Falstaff*, 410 U.S. at 568 (Marshall, J., dissenting) ("First, any statement of future intent will be inherently self-serving. A defendant in a § 7 case such as this wishes to enter the market by acquisition and its managers know that its ability to do so depends upon whether it can convince a court that it would not have entered de novo if entry by acquisition were prevented. It is thus strongly in management's interest to represent that it has no intention of entering de novo—a representation which is not subject to external verification and which is so speculative in nature that it could virtually never serve as the predicate for a perjury charge.").

[47] U.S. Dep't of Justice & U.S. Fed. Trade Comm'n, Horizontal Merger Guidelines § 5.1, at 15–16 (2010), https://www.justice.gov/sites/default/files/atr/legacy/2010/08/19/hmg-2010.pdf (hereinafter "2010 Horizontal Merger Guidelines") (emphasis added).

[48] *Id.* § 5.1.

[49] John E. Kwoka, *Non-Incumbent Competition: Mergers Involving Constraining and Prospective Competitors*, 52 CASE W. RES. L. REV. 173, 181–82 (2001).

[50] Herbert Hovenkamp, *Antitrust and Platform Monopoly*, 130 YALE L. J. 1952, 1978–79 (2021).

[51] Org. for Econ. Coop'n & Dev., Directorate for Fin. & Enter. Affairs, Competition Comm., The Concept of Potential Competition: OECD Competition Committee Discussion Paper at 35–36 (2021), https://www.oecd.org/daf/competition/the-concept-of-potential-competition-2021.pdf (hereinafter "OECD, The Concept of Potential Competition"). The United Kingdom has recently adopted a more flexible approach to timeframes. *See, e.g.*, Andrea Coscelli, U.K. Competition & Mkts. Auth., Competition in the digital age: reflecting on digital merger investigations (June 3, 2019), https://www.gov.uk/government/speeches/competition-in-the-digital-age-reflecting-on-digital-merger-investigations ("[T]he time-frame of 2 years typically used by us to assess the counterfactual may be somewhat limiting and should be extended, as even in the fast-moving digital world, becoming successful is likely to take somewhat longer.").

In general, meaningful assessments of market power need to be attentive to an estimated point in time for potential entry.[52] The Guidelines should include specific guidance on when a longer timeframe for merger analysis is warranted. As Hovenkamp has noted, determinations concerning the duration of the "foreseeable future" are "policy judgments, not the results of pure theory."[53] As such, the particularities of the market should determine the precise timeframe considered.[54]

A key question here is whether entry barriers are relatively permanent, or whether efficient alternatives can enter the market within a certain time. Another relevant factor is the dynamism of the relevant industry. When a merger brings a more mature firm together with a newer one, a short-run timeframe may not be sufficient to analyze the merger's effects. For example, a recent ex-post assessment of merger control decisions in the United Kingdom—including Facebook's acquisition of Instagram—concluded that a time frame of two years for future market developments—including entry—may be too limited. "[E]ven in the fast-moving digital landscape, becoming successful can take longer than two years."[55] As a result, the United Kingdom's updated Merger Assessment Guidelines state that the Competition and Markets Authority may consider a longer time period, depending on the nature of the market.[56]

Another issue for consideration is dynamic changes in competitive conditions, including both tangible characteristics (such as access to capital, research and development trajectory, and technological capability) and intangible characteristics (such as management philosophy and beliefs about future competitor and customer behavior).[57] With these characteristics in mind, a longer timeframe could be triggered when the merger's effects potentially include a decline in research and development or new product introduction. Establishing a set of factors in the Guidelines for extending review timeframes would provide enforcers and market participants clarity on when extended timeframes might apply, as well as the flexibility for enforcers to fully examine and identify longer-term competitive harms.

7. The Guidelines should remind federal enforcers and merging parties of the often-ignored second prong of Section 7.

Section 7 of the Clayton Act prohibits not only transactions whose effect "may be to substantially lessen competition," but also those that "tend to create a monopoly." As Assistant Attorney General Jonathan Kanter said, "The second prong— 'or tend to create

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[52] *See, e.g.*, Herbert Hovenkamp, *Exclusive Joint Ventures and Antitrust Policy*, 1995 COLUM. BUS. L. REV. 1, 80 (1995) (noting that "measures of market power are quite meaningless unless some estimate of duration can be attached to them.").
[53] *Id.*
[54] OECD, The Concept of Potential Competition, *supra* note 51, at 35.
[55] U.K. Competition & Mkts. Auth., Ex-post Assessment of Merger Control Decisions in Digital Markets at 21 (May 9, 2019), https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/803576/CMA_past_digital_mergers_GOV.UK_version.pdf.
[56] U.K. CMA Merger Guidelines, supra note 38, § 8.33 at 74.
[57] *See, e.g.*, Timothy F. Bresnahan, *Empirical Studies of Industries with Market Power*, in Richard Schmalensee and Robert D. Willig, eds., 2 HANDBOOK OF INDUSTRIAL ORGANIZATION 1011, 1023 (1989).

a monopoly'—has often been given less emphasis."[58] The Guidelines should remedy this problem by signaling that federal enforcers will fully enforce this second prong of Section 7. Moreover, the Guidelines should emphasize that the words "tend to" in the statute indicate that the burden of establishing future competitive harm under the Clayton Act is lower than for past and ongoing harm under the Sherman Act.

Section 7's incipiency standard is designed to prevent harm to competition. Accordingly, a merger that is likely to harm competition can be enjoined, even where it may be impossible to prove a Sherman Act Section 2 violation for the same conduct. For example, under a "tend to" analysis, a merger might violate Section 7 even where neither firm has monopoly power or the "dangerous probability" of attaining it—a key element of a Section 2 claim.[59] Invigorated enforcement of Section 7's second prong thus could prevent anticompetitive acquisitions of potential competitors in circumstances where a traditional "effects" approach would likely fall short.

8. Systematic or creeping acquisitions should be addressed by the Guidelines under both Section 7 of the Clayton Act and Section 2 of the Sherman Act.

Systematic or creeping acquisitions involve a firm that consecutively acquires multiple interrelated or complementary businesses, or potential competitors. Taken separately, these individual transactions may not meet the criteria for pre-merger notification or raise concerns regarding their potential to lessen competition. When considered together, however, they may substantially lessen competition.

Herbert Hovenkamp recently pointed out that "[t]he threat raised by systematic . . . acquisitions is more akin to an exclusionary practice . . . There is legal authority for treating mergers as exclusionary practices, but little recent enforcement history."[60] Systematic or creeping acquisitions have been observed to increase consolidation in multiple industries, including technology and healthcare. As Hovenkamp states, "Most of these acquisitions are not reasonably calculated to produce price increases or innovation reductions in the short run by facilitating collusion in the post-merger market. Their purpose, instead, is to prevent the eventual emergence of substantial rivals."[61]

Whether systematic or creeping acquisitions are challenged under Section 7, Section 2, or both, the Guidelines should make clear that systematic or creeping acquisitions should be evaluated together as a course of conduct, rather than analyzing each individual transaction

[58] U.S. Dep't of Justice, Press Release, Assistant Attorney General Jonathan Kanter of the Antitrust Division Delivers Remarks to the New York State Bar Association Antitrust Section (Jan. 24, 2022), https://www.justice.gov/opa/speech/assistant-attorney-general-jonathan-kanter-antitrust-division-delivers-remarks-new-york.

[59] *Cf. Brown Shoe*, 370 U.S. at 328–29 ("[T]he legislative history of s 7 indicates clearly that the tests for measuring the legality of any particular economic arrangement under the Clayton Act are to be less stringent than those used in applying the Sherman Act."); D. Bruce Hoffman, Dir., Bureau of Competition, U.S. Fed. Trade Comm'n, Antitrust in the Digital Economy: A Snapshot of FTC Issues, Remarks at GCR Live Antitrust in the Digital Economy (May 2019), https://www.ftc.gov/system/files/documents/public_statements/1522327/hoffman_-_gcr_live_san_francisco_2019_speech_5-22-19.pdf; Hemphill & Wu, supra note 29, at 1893–96.

[60] Hovenkamp, *supra* note 50, at 2041.

[61] *Id.*

in isolation.[62] As the Supreme Court held in *Continental Ore*, "plaintiffs should be given the full benefit of their proof without tightly compartmentalizing the various factual components and wiping the slate clean after scrutiny of each."[63] Moreover, the Guidelines should acknowledge that creeping acquisitions do not always creep in the same direction. Individually, services may offer different non-competing features to end-users. However, together the features can add to, and reinforce the utility of, the bundle of features of the merging firm's existing offering, thus increasing its market power and raising barriers to entry.[64] As a result, rivals would need to replicate more, rather than fewer, features in order to compete with the incumbent.

9. Entrenchment challenges to potential competitors should be expressly discussed in the Guidelines.

Mergers involving entrenchment increase market power by providing competitive advantages to the acquirer. Areeda has written, "Merger precedents have been concerned not only with combinations creating new power but also with those reinforcing present power . . . Section 7 [has a] prophylactic mandate."[65] The *P&G* Court recognized the dangers of entrenchment in holding that the acquisition would entrench Clorox because P&G could give the brand competitive advantages. As the Court stated, "Few firms would have the temerity to challenge a firm as solidly entrenched as Clorox."[66]

In *Wilson Sporting Goods*,[67] Wilson, the largest manufacturer and seller of sporting goods in the United States, sought to acquire Nissen, the leading manufacturer of gymnastics equipment. Even though Wilson did not manufacture or sell gymnastics equipment,[68] DOJ sued to enjoin the merger because it could facilitate entrenchment in three ways: (1) "it would entrench and possibly increase Nissen's already leading market position in gymnastic apparatus, while at the same time discouraging smaller competitors from aggressive competition with Nissen and deterring other companies from entering the market"; (2) "it would eliminate Wilson as an important potential entrant into the market . . . and end its role as a company on the fringe of the market"; and (3) "it would entrench

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[62] *Microsoft*, 253 F.3d at 50, 58; *United States v. Grinnell Corp*., 384 U.S. 563, 576 (1966) (monopolist violates Section 2 where it maintains its monopoly through combination of acquisitions that "eliminated any possibility of an outbreak of competition from the acquired firms.").

[63] *Continental Ore Co. v. Union Carbide & Carbon Corp.*, 370 U.S. 690, 699 (1962); *see also LePage's Inc. v. 3M*, 324 F.3d 141, 162 (3d Cir. 2003) (en banc) ("The relevant inquiry is the anticompetitive effect of [the defendant's] exclusionary practices considered together.); *City of Anaheim v. Southern Cal. Edison Co*., 955 F.2d 1373, 1376 (9th Cir. 1992) ("[I]t would not be proper to focus on specific individual acts of an accused monopolist while refusing to consider their overall combined effect.").

[64] Herbert J. Hovenkamp, *Digital Cluster Markets*, 2022 COLUM. BUS. L. REV (forthcoming 2022), https://scholarship.law.upenn.edu/cgi/viewcontent.cgi?article=3302&context=faculty_scholarship, at 15–16 (discusses Facebook's strategy of "buying up new innovators that were succeeding where Facebook failed").

[65] Philip Areeda, *Market Definition and Horizontal Restraints*, 52 ANTITRUST L.J. 553, 564 (1983).

[66] *Procter & Gamble*, 386 U.S. at 581.

[67] *United States v. Wilson Sporting Goods Co.*, 288 F. Supp. 543 (N.D. Ill. 1968).

[68] *Id.* at 546 ("Wilson does not manufacture or sell gymnastic equipment. It hopes to enter the market via this merger. Both the defendant companies, however, sell such items as gym mats, wainscotting, sweat suits, basketball backboards, volleyball equipment, and table tennis tables. These items concededly are relatively minor items for both Nissen and Wilson at this time, and Wilson does not manufacture most of them itself, but purchases them for resale.").

and increase Wilson's leading role in the sporting goods market and eliminate the actual and potential competition . . . Nissen might have mounted against Wilson."[69] The district court granted DOJ's request for a preliminary injunction because it found probable a lessening of competition in the market.[70] Ultimately, a consent decree barring the merger superseded the court's preliminary injunction.[71]

Recently the FTC advanced an entrenchment theory when it sued to block the proposed vertical acquisition of Aerojet, the last independent missile propulsion supplier, by Lockheed, the world's largest defense contractor. The FTC alleged that through the acquisition of Aerojet, "Lockheed would gain the ability to foreclose, raise costs for, or otherwise disadvantage, its prime contract rivals that rely on Aerojet's Critical Propulsion Technologies to compete effectively in the Relevant Markets."[72] Moreover, the FTC alleged that "[t]he effect of foreclosure by the combined firm following the acquisition would . . . only increase or entrench market concentration." The case was not ultimately litigated, as Lockheed terminated its plan to acquire Aerojet shortly after the FTC's complaint was filed.

Again, because Section 7 is designed to reach incipient anticompetitive effects, the Guidelines should recognize that a merger can violate the statute even if the merged firm's conduct may not be actionable under Section 2. In the context of potential competition, Section 7 "entrenchment" should not require either monopoly power or a dangerous probability to monopolize. It should, instead, operate more like the broader idea of leveraging economic power in one market in a way that confers actual or potential competitive advantage over rivals in another.[73]

III. Questions Presented and Proposed Responses

A. Absence of a Plan to Enter a Market is Not Dispositive

The Guidelines should not focus on a lack of evidence that a merging firm is contemplating entry into a market where the other firm competes. While plans to do so are certainly highly relevant, lack of such evidence should not be dispositive. A merger can pose a probable threat to competition in a market even if neither merging firm is intending to enter that market.[74]

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[69] *Id.* at 551.
[70] *Id.* at 556.
[71] *United States v. Wilson Sporting Goods Co.*, Final Judgment, 1968 Trade Cases ¶ 72,585 (CCH), 1968 WL 201065 (N.D. Ill. Oct. 28, 1968).
[72] *In the Matter of Lockheed Martin Corp.*, Dkt. No. 9405, Compl. (F.T.C. Jan. 25, 2022), ¶¶ 50, 53, at 10–11, https://www.ftc.gov/system/files/documents/cases/d09405lockheedaerojetp3complaintpublic.pdf.
[73] *Cf.* Sean P. Sullivan, *Anticompetitive Entrenchment*, 68 KAN. L. REV. 1133, 1144–45 (2020); *Procter & Gamble*, 386 U.S. at 576, 581; *Berkey Photo, Inc. v. Eastman Kodak Co*., 603 F.2d 263, 275 (2d Cir. 1979) ("It is clear that a firm may not employ its market position as a lever to create or attempt to create a monopoly in another market . . . That the competition in the leveraged market may not be destroyed but merely distorted does not make it more palatable.").
[74] *Falstaff*, 410 U.S. at 537.

For instance, potential competitor mergers can raise competitive concerns when one of the firms is a participant in a vertical or complementary product market. First, market participants may "perceive" a threat of entry by the firm in the adjacent market, disciplining anticompetitive market conduct regardless of whether a firm is intending or planning to enter the market.[75] Second, as Steven Salop has written, a potential competitor in an adjacent market that provides "additional competitive support to rivals of the acquiring firm" can exert procompetitive effects from the fringe of the market.[76] Increased competition can come through an alternative merger with a rival to the acquiring firm or through less permanent arrangements such as a supply or licensing agreement. As such, protecting the opportunity for a potential competitor to assist a rival to compete in the market can justify blocking a merger.

While likelihood of entry may be considered in potential competitor mergers, a low likelihood of entry should not be determinative, since "unequivocal proof" of a potential competitor's plans is "rarely available."[77] Likelihood of entry is a fact-intensive inquiry. Courts generally analyze the firm's capability, incentive, and intent to enter the relevant market.[78] Additional factors such as size, financial capabilities, prior history of acquisitions or de novo expansion, technological capabilities, management and marketing expertise, and whether entry was an attractive alternative can serve as evidence of capability and incentive.[79] The Guidelines could also utilize the concept of market proximity as another framework to evaluate the likelihood of potential entry: if two markets are similar in terms of production, marketing, technology, and transactional relationships, the resulting capabilities and incentives may make entry likely.[80] Evidence of intent can be found in the parties' pre-deal internal documents.[81]

With respect to acquirers with market power, the current Guidelines already recognize 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."[82] As a corollary to this point, the Guidelines should adopt a presumption that if either the acquirer or acquiree is dominant, the acquisition is anticompetitive, as discussed in Section II.A.3, *supra.* Moreover, the Presumptions Section, *infra*, proposes a framework towards a more nuanced set of presumptions for mergers generally.

B. Quantifying and Evaluating Potential Competition

As discussed in Section II.A.4, theories of dynamic competition would be helpful to quantify the importance of a potential competitor, particularly in markets where investment and innovation are part of the competitive process. For example, in pharmaceutical markets where firms are developing a drug or a mode of action or delivery, dynamic competition can be observed,

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[75] Salop, *supra* note 25, at ¶ 20; *Procter & Gamble*, 386 U.S. at 577–78.
[76] Salop, *supra* note 25, at ¶ 20; *Falstaff*, 410 U.S. at 532.
[77] *Marine Bancorp*., 418 U.S. at 624.
[78] *Falstaff*, 410 U.S. at 532–35; *Marine Bancorp*., 418 U.S. at 624; *Phillips Petroleum*, 367 F. Supp. at 1234–35, 1242.
[79] *Yamaha Motor Co. v. Fed. Trade Comm'n*, 657 F.2d 971, 978 (8th Cir. 1981).
[80] Joseph Brodley, *Potential Competition under the Merger Guidelines*, 71 CAL. L. REV. 376, 391–92 (1983).
[81] *Yamaha*, 657 F.2d at 978.
[82] 2010 Horizontal Merger Guidelines, *supra* note 47, § 5.3.

even though the potentially competing products do not have current sales.[83] If one of the firms is developing a particular drug targeting a certain disease, but is acquired by another firm working on a drug treating the same disease, the merged firms' incentives to continue investing in competing developments could be lost, reducing innovation and the benefits that flow to consumers from having competing drugs available for purchase.

Because traditional econometric tools are likely to be of limited use in potential competition cases, quantifying the importance of potential competitors is difficult. Therefore, the Guidelines should state that in such cases, federal enforcers will emphasize non-quantitative direct evidence. For example, pre-deal ordinary course documents concerning the motive for the acquisition or the intent behind it are likely to be more probative.[84] As the Supreme Court has stated, "knowledge of intent may help the court to interpret facts and predict consequences."[85] Evidence of intent may include an acquirer paying an anticompetitive premium, i.e., more than what the standard valuation tools would indicate is the target company's market value.[86] Moreover, a purchase price far higher than a target's revenues may also signal the elimination of a potential competitor.[87]

Evidence of a "killer acquisition" could also be probative. Killer acquisitions are not new to antitrust law.[88] For example, in *American Tobacco*,[89] the Supreme Court held that the company violated Section 2 of the Sherman Act by repeatedly spending millions of dollars in acquiring numerous plants, "not for the purpose of utilizing them, but in order to close them up and render them useless for the purposes of trade."[90] In *American Can*,[91] the Court held that the company violated Section 2 by buying plants and shutting most of them off or abandoning them thereafter.[92]

These decisions apply with equal force to potential competition. A potential competitor merger may empower the incumbent to not only discontinue the target firm's (or its own) innovation and preempt future competition, but also channel future industry innovation along a path that the incumbent prefers and can better control.[93] The State Attorneys General raised these concerns in their Section 2 and Section 7 litigation against Facebook.[94] But these concerns are not limited to digital markets. One study found that, conservatively, between 5.3% and 7.4% of U.S. pharmaceutical acquisitions in the authors' sample, some 46-63 per year, were "killer acquisitions,

[83] Norbert Maier & Kalle Kantanen, *Economics of Potential Competition*, CPI ANTITRUST CHRON., at 12 (Feb. 2022), https://www.competitionpolicyinternational.com/antitrust-chronicle-economics-of-potential-competition/.
[84] Hemphill & Wu, *supra* note 29, at 1903-04.
[85] *Bd. of Trade of Chi. v. United States*, 246 U.S. 231, 238 (1918).
[86] Maier & Kantanen, *supra* note 83, at 12-13.
[87] *Id.*
[88] Colleen Cunningham, Florian Ederer & Song Ma, *Killer Acquisitions*, 129 J. POL. ECON. 650 (2021).
[89] *United States v. Am. Tobacco Co.*, 221 U.S. 106, 182–83 (1911).
[90] *Id.* at 183.
[91] *United States v. Am. Can Co.*, 230 F. 859, 875 (D. Md. 1916), *appeal dismissed*, 256 U.S. 706 (1921).
[92] *Id.* at 875, 877 ("[T]here was no other conceivable reason, than the desire to suppress competition, for buying plants which it obviously would not pay to run, and at prices which in most cases far exceed the cost of fitting up, with brand new and up-to-date machinery, factories capable of turning out several if not many times as many cans . . . What was done . . . shows that the plants were bought, not for use, but to get them out of the market.").
[93] Cunningham et al., *supra* note 88, at 650.
[94] *State of New York v Facebook, Inc.*, No. 1:20-cv-03589-JEB, Compl., ECF No. 4 (D.D.C. Dec. 9, 2020).

reducing . . . development of . . . potentially competing products."[95] The Nonprice effects Section, *infra*, addresses killer acquisitions in the context of nonprice effects for mergers generally.

C. The Potential Competitor's Path of Evolution

As discussed in Section II.B, *supra*, the likelihood of entry by itself should not be outcome determinative in cases involving potential competitors. The potential evolution of a firm, however, can be assessed through its capability and incentive, for example by examining the merging firm's operations over time or market proximity.[96]

Section 7 deals in "probabilities."[97] But given the inherent difficulty of "proving" future events, the appropriate yardstick for what is probable should be informed by experience, the incentives a merger creates, and the potential for competitive harm. In particular, where one of the firms in a merger has market power, a plaintiff should not have to prove that competition but for the merger is "more likely than not."[98] As Scott Hemphill and Tim Wu have written concerning potential competitor acquisitions, "[e]ven a modest probability of a highly detrimental outcome is a large loss, in expected value terms, and ought to be avoided." [99] Adopting a "more likely than not" standard would weaken enforcement.[100]

As Hemphill and Wu argue, "[a]n incumbent with a high market share has a heightened incentive to suppress an entrant, given that it internalizes most or all of the benefits from doing so . . . ."[101] Accordingly, in mergers involving potential competition, there should be a flexible standard for satisfying the "substantial lessening of competition" or "tend to create a monopoly" elements of Section 7.[102] For either element, sufficient probability should vary depending on factors such as (1) the pre-merger market power of the individual merging entities and that of other market players, (2) the market's overall and trending concentration, (3) the presence of barriers to

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[95] Cunningham et al., *supra* note 88, at 654.
[96] Brodley, *supra* note 76, at 391–392.
[97] *Brown Shoe*, 370 U.S. at 323.
[98] *Id.* at 323 n.39 (quoting S. Rep. No. 1775, 81st Cong., 2d Sess. (1950)) ("The use of these words ('may be') means that the bill, if enacted, would not apply to the mere possibility but only to the reasonable probability of the prescribed (*sic*) effect . . . The words 'may be' have been in section 7 of the Clayton Act since 1914. The concept of reasonable probability conveyed by these words is a necessary element in any statute which seeks to arrest restraints of trade in their incipiency and before they develop into full-fledged restraints violative of the Sherman Act. A requirement of certainty and actuality of injury to competition is incompatible with any effort to supplement the Sherman Act by reaching incipient restraints."); *H&R Block*, 833 F. Supp. 2d at 49 (quoting *Hosp. Corp. of Am. v. FTC*, 807 F.2d 1381, 1389 (7th Cir. 1986) ("All that is necessary is that the merger create an appreciable danger of [anticompetitive] consequences in the future."); *United States v. AT&T Inc*., 310 F. Supp. 3d 161, 190, n.16 (D.D.C. 2018), *aff'd sub nom. United States v. AT&T, Inc*., 916 F.3d 1029 (D.C. Cir. 2019) (noting that "reasonable probability" or "appreciable danger" requires more than a "mere possibility" but less than a "more likely than not showing of harm.").
[99] Hemphill & Wu, *supra* note 29, at 1890.
[100] *Id.* at 1891 ("In the economic language of error costs, such an approach fails to manage costly 'false negatives' (harmful clearances) by setting a rule in which the frequency of false negatives may be low but their size [potential effect] is large.").
[101] Hemphill & Wu, *supra* note 29, at 1891–92; *see also Microsoft*, 253 F.3d at 79.
[102] Salop & Scott Morton, *supra* note 34, at 8 ("Absent legislation, the agencies can change enforcement policies but not the legal burdens in court. However, because the courts respect the agencies' expertise, the HMGs could have a role in influencing the law.").

entry and network effects, and (4) the role played by market complementarities.[103] This approach would realign merger enforcement with Congress's intent that Section 7 curb anticompetitive effects "in their incipiency."[104] Moreover, as discussed in Sections II.A.3 and II.B, *supra*, a presumption would shift the burden to the merging parties, who have superior access to the relevant information concerning the merger's potential anticompetitive effects and efficiencies stemming from the merger.[105]

Plaintiffs would first establish the industry structure and the market position of one or both of the merging parties (either through market shares or direct evidence). If these facts show that one of the merging parties is dominant or leading, the likelihood of a substantial lessening of competition—or in an appropriate case, tendency to monopoly—would be presumed to flow from the merger involving the potential competitor. The burden would then shift to defendants to prove that the merger does not violate either prong of Section 7. Defendants could, for example, put forth evidence that the potential competitor is not a likely entrant, that other firms have the same entry advantages, that the potential entrant is not likely to exert competitive constraints on the other firm now or in the future, that competition would benefit from the merger, and that investment and innovation are likely to increase rather than decrease as a result of the merger.[106] Taking all facts developed into account, a flexible reasonable probability standard, less than "more probable than not," would apply to determine whether there is a Section 7 violation.

In industries where technology and products evolve rapidly or unpredictably, the firms' internal documents, along with the views of industry participants and industry experts, are likely the most reliable sources for federal enforcers to understand the potential evolution of the market and the broader industry at large. Examples include ordinary course documents showing an incumbent's anticompetitive strategy which state that the rationale for the acquisition included eliminating a competitive threat or keeping an innovation (or innovative idea) out of the hands of another firm that might pose a competitive threat. A firm's broad pattern of acquiring potential competitors may also shed light into the intent behind its acquisitions. [107]

D. Accounting for Unexpected Competition

Competition from unexpected sources may be particularly relevant to dynamic markets, where "competition revolves around bringing new and innovative products" to a "growing and/or evolving" market.[108] The Guidelines should adopt the concept of dynamic competition discussed at Sections II.A.4 and II.B, *supra*; other enforcers have done so.[109] Doing so will facilitate the assessment of competitive harms caused by mergers that reduce incentives to invest in the development of new and innovative products. This approach allows enforcers to adopt a broader focus than one solely based on a future potential overlap.

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[103] *Id.*
[104] *Brown Shoe*, 370 U.S. at 317–18.
[105] Stigler Committee on Digital Platforms, Univ. of Chi., Booth Sch. of Bus., Stigler Ctr. for the Study of the Econ. & the State, Final Report, at 98 (2019), https://www.chicagobooth.edu/-/media/research/stigler/pdfs/digital-platforms---committee-report---stigler-center.pdf (hereinafter "Stigler Report").
[106] Glick & Bush, *supra* note 32, at 40.
[107] Hemphill & Wu, *supra* note 29, at 1903–04.
[108] U.K. CMA Merger Guidelines, *supra* note 38, § 5.17–24, at 43–45.
[109] *Id.*

In dynamic markets, firms that are not horizontal competitors today may become competitors in the future, due to investment and innovation. The fast-changing nature of dynamic markets poses heightened challenges in predicting future developments. Relevant factors include internal documents, similarities between characteristics of the products or services that are under development, and the views and expansion plans of market participants.[110] Examples of the types of investments or efforts a dynamic competitor might make include the development of new products, introducing "disruptive business models," and even "sacrificing short-run margins (or even operating at a loss) in order to attract users" or customers.[111]

E. Acquisitions Involving Potential Product Development

Transactions involving potential and nascent competitors should be presumed unlawful if either firm would likely develop its own competitive product absent the acquisition. As discussed in Section II.C, *supra*, if the firms are investing or planning to invest in developing similar products, a merger may remove their incentives to continue investing in these competing programs.[112] As such, the Guidelines should require that the merging firms show that developing a new product would not be feasible absent the merger.[113]

This rule accords with the general principle that all cognizable efficiencies must be merger-specific; they should not be readily attainable by other means or if the social cost of attaining them by other means is lower[114] Generally there is positive value to having more, rather than fewer competitors or economic actors. Competition through innovation is good for society.[115] This is reflected in the Congressional intent behind the 1950 amendments to Section 7, which sought to arrest trends toward increased concentration.[116] Such a rule would also ensure that merging parties explore alternatives to a merger that may be less injurious to competition, such as internal expansion, joint ventures, or licensing agreements.[117] It should be noted, however, that in some situations, joint ventures or other arrangements may result in a loss of competition, as discussed *infra* at the Special characteristic markets Section.

[110] *Id.*
[111] *Id.* § 5.16–17, at 42–43.
[112] AREEDA & HOVENKAMP, *supra* note 24, at ¶ 973.
[113] Org. for Econ. Coop'n & Dev., Directorate for Fin. & Enter. Affairs, Competition Comm., Start-ups, Killer Acquisitions and Merger Control—Background Note by the Secretariat (2020) at 33–34, https://www.oecd.org/daf/competition/start-ups-killer-acquisitions-and-merger-control-2020.pdf; *see also id.* at 27, 37 (merging firms may argue "the prospect of acquisitions creates incentives to innovate," however, this is not clear; some research shows dominant firms create "kill zones" through acquisitions of potential competitors (and other tactics), leading to reduced incentives to invest in startups).
[114] AREEDA & HOVENKAMP, *supra* note 24, at ¶ 973.
[115] *Id.*
[116] *Brown Shoe*, 370 U.S. at 315–18, 345.
[117] AREEDA & HOVENKAMP, *supra* note 24, at ¶ 973.

PRESUMPTIONS

I. The Long-Standing Use and Value of Structural Presumptions

For six decades,[118] courts have recognized that the likely competitive impact of a horizontal merger might be reasonably predicted by the structural characteristics of the relevant market. Structural analysis—the notion that the pre-merger concentration of a relevant market, taken together with the increase in market concentration occasioned by a particular transaction, provides a useful analytic framework for the evaluation of competition in the relevant market—is a valuable tool for effective merger enforcement. And the "structural presumption," or the use of structural analysis to determine that a merger that results in market concentration in excess of some threshold is presumptively illegal, is likewise a critical tool.

The Supreme Court's decision in *Philadelphia National Bank* set forth the rationale for the structural presumption and its attendant burden-shifting framework.[119] As the Court noted, "a merger which produces a firm controlling an undue percentage share of the relevant market, and results in a significant increase in the concentration of firms in that market is so inherently likely to lessen competition substantially that it must be enjoined in the absence of evidence clearly showing that the merger is not likely to have such anticompetitive effects."[120] There, the Court found that a merger resulting in a 30% combined market share presumptively substantially lessened competition. (The Court explicitly recognized that a combined share of less than 30% may still "threaten undue concentration," but declined to set a lower market share bound.[121]) The Court noted that the structural presumption "lightens the burden of proving illegality only with respect to mergers whose size makes them inherently suspect,"[122] and that it is rebuttable if the merging parties can show that the market share predictor does not comport with real-world evidence of likely competitive effect.

Use of the structural presumption introduced in *Philadelphia National Bank* is well rooted in empirical economic evidence indicating that pre-merger market shares are a predictor of competitive effects of a transaction. As noted by Herbert Hovenkamp and Carl Shapiro, "economic theory and a wide range of economic evidence support the conclusion that horizontal mergers that significantly increase market concentration are likely to lessen competition and harm consumers by raising prices, reducing output, or limiting product quality or innovation."[123] Work by economist Richard Schmalensee has shown that "seller concentration is positively related to the level of price."[124] John Kwoka's empirical work on the effects of consummated mergers shows

[118] *Phila. Nat'l Bank*, 374 U.S. 321.
[119] *Id*.
[120] *Id*. at 363.
[121] *Id*. at 364.
[122] *Id*. at 363.
[123] Herbert J. Hovenkamp & Carl Shapiro, *Horizontal Mergers, Market Structure, and Burdens of Proof*, 127 YALE L.J. 1996, 2006 (2018).
[124] Richard Schmalensee, *Inter-Industry Studies of Structure and Performance*, in 2 HANDBOOK OF INDUSTRIAL ORGANIZATION 951 (Richard Schmalensee & Robert D. Willig, eds. 1989).

that "market structure is a valid predictor of post-merger harm," and suggests utilization of stronger structural presumptions.[125]

Given the longstanding acceptance of structural inquiry as one mode of assessing the likely competitive impacts of a transaction in a market, and the empirically proven utility of the structural presumption, we would encourage federal enforcers to continue—and even expand—the use of structural presumptions. Because no two markets are competitively identical, we advocate for the adoption of multiple different ways of measuring market concentration, as well as a variety of different "triggering levels" for the invocation of a structural presumption based on the characteristics of the market. For example, some markets may have one or two "maverick" firms; acquisition of one of those mavericks by a competitor should be accorded more weight than acquisition of a non-maverick.[126] Or it may be the case that a firm operating in a relatively unconcentrated market for highly differentiated goods routinely acquires new, innovative entrants when the entrant has only a small share of the market. That pattern of acquisition, as well as the potential competitive effect of acquiring innovative entrants, should be given greater weight than, for example, a similar acquisition in a market for undifferentiated goods.[127] And firms may be able to exercise market power at a much lower market share in industry sectors with high levels of network effects or in industry sectors that are highly scalable.[128] Because industries vary greatly, structural presumptions should likewise be varied and tailored to an industry's unique characteristics.

As federal enforcers consider the use of structural presumptions, we urge them to avoid the historic bias toward "Type II" over "Type I" errors. "Type I" errors—where enforcement action is taken against a competitively benign merger—have been painted as far more dangerous than "Type II" errors, where enforcers fail to challenge an anticompetitive merger.[129] This preference for under-enforcement rests on the assumption that markets will naturally correct where enforcers fail to act, whereas the government will chill future procompetitive behavior if it challenges a competitively benign merger. Yet, after over thirty years, there is little empirical evidence supporting the over-enforcement theory, and mounting evidence that the hands-off approach has led merger policy astray.[130]

We emphasize that the existence of a structural presumption should not be taken to mean that transactions falling below the presumption thresholds are presumptively procompetitive or

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[125] John Kwoka, *The Structural Presumption and the Safe Harbor in Merger Review: False Positives, or Unwarranted Concerns?*, 81 ANTITRUST L.J. 837 (2017).

[126] *See* 2010 Horizontal Merger Guidelines, *supra* note 47, § 2.1.5, at 3–4, (discussing mavericks under heading of "Disruptive Role of a Merging Party").

[127] *See* HOUSE DIGITAL MARKETS STAFF REPORT, *supra* note 35, at 44 ("[S]erial acquisitions of nascent competitors by large technology firms have stifled competition and innovation.").

[128] *See* Hovenkamp & Shapiro, *supra* note 123, at 2007 ("In the presence of economies of scale, which are likely to exist in a concentrated market, a small incumbent firm or an entrant is unlikely to be as effective a competitor as a larger firm."). The same logic applies to network effects.

[129] Frank H. Easterbrook, *The Limits of Antitrust*, 63 TEX. L. REV. 1 (1984).

[130] *See e.g.*, Herbert Hovenkamp, *Antitrust Error Costs* 49 (Faculty Scholarship at Penn Law Nov. 29, 2021), https://scholarship.law.upenn.edu/cgi/viewcontent.cgi?article=3745&context=faculty_scholarship ("There is also considerable support for the conclusion that antitrust policy, but particularly merger policy, took a significant wrong turn in the mid-eighties.").

unproblematic. In other words, a presumption should not create a "safe harbor."[131] Transactions that do not trigger a structural presumption still merit holistic review, as even mergers in "unconcentrated" markets can sometimes result in price increases or other anticompetitive effects; overreliance on concentration alone leads to simplistic and stilted analyses.

In the next sections, we will summarize the history of Agency structural presumptions, and offer some specific suggestions regarding factors to consider when crafting flexible, dynamic structural presumptions for the next generation of antitrust.

II. Structural Presumptions Have Been Weakened Over Time

Structural presumptions are an important component of the Merger Guidelines and have been since their inception. In many ways, changes to the Guidelines' presumptions reflect the zeitgeist of the era.

The first iteration of the Guidelines, promulgated in 1968, outlined a two-step process for identifying presumptively anticompetitive mergers. First, the relevant market was categorized as "highly concentrated," "less highly concentrated," or "trending toward concentration." A market was deemed "highly concentrated" if the market shares of the four largest firms (the "four-firm concentration ratio") amounted to 75 percent or more.[132] A market was deemed "less highly concentrated" if the shares of the four largest firms amounted to less than 75 percent.[133] And a market was deemed "trending toward concentration" if the aggregate share of any grouping of the eight largest firms in the market had increased by seven percent or more in the prior ten years.[134] After categorization, the following table reflected whether the market shares triggered a presumption:

[131] Steven Salop makes a similar, though admittedly less categorical, proposal with respect to vertical mergers. *See* Salop, *supra* note 25, ¶ 21, at 7 ("Indeed, my own view is that such safe harbors also are inappropriate for evaluating acquisitions of established firms in vertically adjacent or complementary product mergers, except perhaps when both firms compete in unconcentrated markets. A safe harbor certainly should not be applied if only one of the markets is unconcentrated.").
[132] U.S. Dep't of Justice & U.S. Fed. Trade Comm'n, Merger Guidelines § 5 (1968), https://www.justice.gov/sites/default/files/atr/legacy/2007/07/11/11247.pdf.
[133] *Id.* at § 6.
[134] *Id.* at § 7.

<table>
<tr><th colspan="6">1968 Merger Guidelines Presumption Thresholds</th></tr>
<tr><th colspan="2">Highly Concentrated</th><th colspan="2">Less Highly Concentrated</th><th colspan="2">Trending Toward Concentration</th></tr>
<tr><th>Acquirer</th><th>Acquired</th><th>Acquirer</th><th>Acquired</th><th>Acquirer</th><th>Acquired</th></tr>
<tr><td>4%</td><td>4%+</td><td>5%</td><td>5%+</td><td rowspan="5">Top 8 firm</td><td rowspan="5">2%+</td></tr>
<tr><td rowspan="2">10%</td><td rowspan="2">2%+</td><td>10%</td><td>4%+</td></tr>
<tr><td>15%</td><td>3%+</td></tr>
<tr><td rowspan="2">15%+</td><td rowspan="2">1%+</td><td>20%</td><td>2%+</td></tr>
<tr><td>25%</td><td>1%+</td></tr>
</table>

Though the individual thresholds have changed over time, this two-step process is found in various iterations of the Guidelines. In 1982, market shares were swapped for the Herfindahl-Hirschman Index ("HHI")—the sum of the squares of the market shares of all firms in the relevant market.[135] A post-merger market was considered "unconcentrated" if its HHI was below 1,000, "moderately concentrated" if its HHI was between 1,000 and 1,800, and "highly concentrated" if its HHI was above 1,800.[136] The change in HHI (the "delta") was used to define the threshold for the creation of a presumption. Where a market was highly concentrated, a 50-point increase in the HHI created a presumption,[137] while a moderately concentrated market required a 100-point increase.[138] The 1982 Guidelines also included a "Leading Firm Proviso" which deemed acquisitions by firms with at least 35 percent market share of any firm with at least one percent market share, presumptively anticompetitive.[139] The following table summarizes the 1982 HHI thresholds:

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[135] U.S. Dep't of Justice & U.S. Fed. Trade Comm'n, Merger Guidelines § III(A) (1982), https://www.justice.gov/sites/default/files/atr/legacy/2007/07/11/11248.pdf.
[136] *Id.* at § III(A)(1).
[137] *Id.* at § III(A)(1)(c).
[138] *Id.* at § III(A)(1)(b).
[139] *Id.* at § III(A)(2).

1982 Merger Guidelines Presumption Thresholds		
Highly Concentrated (HHI ≥ 1,800)	Moderately Concentrated (1,800 > HHI ≥ 1,000)	Unconcentrated (HHI < 1,000)
50+ HHI delta	100+ HHI delta	N/A

The 1982 Guidelines loosened the scenarios under which a presumption would be triggered, as compared to the 1968 Guidelines. None of the combination thresholds in the 1968 Guidelines, for instance, would give rise to an anticompetitive presumption under the 1982 Guidelines. In a highly concentrated market, the combination of two firms with four percent market share would create an HHI delta of only 32, well below 1982's 50-point threshold. Similarly, in a moderately concentrated market, the combination of an acquirer with 20 percent market share and an acquired firm with two percent market share produces an HHI delta of just 80, still below the 1982 threshold.

The 1982 Guidelines shifted away from preventing concentration in its incipiency. While the 1968 Guidelines dedicated an entire category of presumptions to markets "trending toward concentration," the 1982 Guidelines focused solely on existing levels of concentration. And except for the Leading Firm Proviso, combinations in markets below a post-merger 1,000 HHI fell outside any 1982 structural presumption.[140] Underlying this change was a shift away from traditional thinking towards a view that placed a large amount of faith in efficiencies that were purportedly inherent to mergers. In 1982, the Guidelines did not admit so much, rejecting efficiencies as a justification for a presumptively anticompetitive merger.[141] Just two years later, the rationale became clear in the 1984 revision's language enabling purported efficiencies to redeem an otherwise presumptively anticompetitive merger.[142] And this was not the end of the pro-merger relaxations. In 1982, for efficiencies to *even be considered*, the evidence had to be "clear and convincing."[143] By the 1992 Guidelines, that speedbump had been removed; in that version, efficiencies only need be "cognizable," and the "clear and convincing" requirement is no longer present.[144]

The Guidelines' presumption criteria remained largely unchanged until 2010, when three changes were made: (1) the threshold levels for moderately concentrated and highly concentrated markets were bumped further up to 1,500 and 2,500 HHI respectively; (2) the required HHI deltas for challenging mergers was increased; and (3) certain mergers that would have previously been

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140 *See id.* at § III(A)(1)(a).
141 *Id.* at § V(A).
142 U.S. Dep't of Justice & U.S. Fed. Trade Comm'n, Merger Guidelines § 3.5 (1984), https://www.justice.gov/sites/default/files/atr/legacy/2007/07/11/11249.pdf (hereinafter "1984 Merger Guidelines").
143 *Id.*
144 U.S. Dep't of Justice & U.S. Fed. Trade Comm'n, Merger Guidelines § 4 (1992), https://www.justice.gov/sites/default/files/atr/legacy/2007/07/11/11250.pdf.

presumptively challenged, were deemed to now only "warrant scrutiny."[145] The following table summarizes the 2010 HHI thresholds:

2010 Merger Guidelines Presumption Thresholds		
Highly Concentrated (HHI ≥ 2,500)	Moderately Concentrated (2,500 > HHI ≥ 1,500)	Unconcentrated (HHI < 1,500)
100 – 200 HHI delta: Warrants Scrutiny 200+ HHI delta: Presumptively Anticompetitive	100+ HHI delta: Warrants Scrutiny	N/A

As an illustration, we apply iterations of the Guidelines to January 2022 U.S. auto sales.[146] The top six firms—Toyota, General Motors, Ford, Stellantis (owner of Chrysler and European brands), Honda, and Nissan—have market shares of 16, 14, 14, 13, 7, and 6 percent, respectively. Under the 1968 Merger Guidelines a merger between Honda and Nissan would be presumptively anticompetitive but would *not* generate a presumption under the 1982 or 2010 Guidelines. A merger between Stellantis and Honda would generate a presumption under the 1968 and 1982 Guidelines, but not under the 2010 presumptions. To be clear, under the current Guidelines, a merger that resulted in all of the following currently relevant U.S. brands living under one roof would *not* be presumptively anticompetitive: Acura, Alfa Romeo, Chrysler, Dodge, Fiat, Honda, Jeep, Maserati, and Ram; this does not even consider the brands that mostly operate abroad that likely have diminished incentive to enter the U.S. market.[147]

III. A Framework Towards a More Nuanced Set of Presumptions

The historical review above was designed to show how years of loosening have changed the antitrust enforcement landscape. Presumptions are important because they not only make enforcement efficient, but they also anchor practitioners, courts, and enforcers. However, it is important to recognize that the presumption only guides Agency enforcement priorities; it does not unilaterally change the applicable law, alleviate the need for agency enforcers to prove their cases before a factfinder, or alter the applicable standards of proof. That said, it seems that lax presumptions likely lead to under-enforcement. Thus, the triggers and thresholds for the presumptions should be strengthened.

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[145] 2010 Horizontal Merger Guidelines, *supra* note 47, § 5.3.
[146] Data provided by MarkLines. We make no representations with respect to its accuracy. MarkLines, USA-Automotive Sales volume, 2022, https://www.marklines.com/en/statistics/flash_sales/automotive-sales-in-usa-by-month (accessed March 1, 2022).
[147] This includes Citroen, DS, Lancia, Opel, Peugeot, and Vauxhall.

Past versions of the Guidelines have largely utilized what we will refer to as a "single-trigger" approach (i.e., looking to a single measure). We would encourage federal enforcers to adopt a more flexible approach that recognizes that market dynamics vary considerably. We propose that in addition to setting single-trigger thresholds, that the DOJ and FTC lay out a set of indicia which, when combined with other indicia, generate a presumption that competition is unlikely to work properly post-merger.

We identify three factors (size, market share, and HHI) that are typically relevant in an analysis of likely competitive impact, and thus are good candidates for use in single *and* double-trigger tests.

The first relevant factor is the size of the parties. While big is not necessarily bad, it is *always* relevant. Large firms are sophisticated, well-resourced, and benefit from economies of scale (even if just with respect to overhead). Sometimes this means they can bring innovations to market quickly and cheaply, but it also means they can dominate smaller, potentially more efficient, competitors. Federal enforcers should consider size thresholds at which deals are presumed to be anticompetitive.[148]

Second is the size of the relevant parties *within their* market (i.e., market share). Market shares reflect the understanding that large firms might still be weak within their markets, but also that small firms might be dominant within their markets. As with size, there are benefits that flow to firms with large market shares that alter the ability of competitors to constrain them. But the effect is not uniform across markets. Any adopted thresholds should consider the relevant competitive dynamics and whether the subject firms appear headed towards monopoly power.[149] One framework towards a more refined approach to market share is to consider thresholds that differ based on the importance of scale or network effects to the ability to compete in, or enter, the market.[150]

In setting a market share at which a presumption is triggered, we encourage federal enforcers to consider proposals that reflect recent developments in the law. While this is an area of debate, as discussed above, the 2010 Guidelines represent a high-water mark in the relaxation of presumption thresholds, and we believe that future presumption thresholds should be lower than those in the 2010 Guidelines. In order to tighten the presumption in a meaningful way, any market share presumption *must* be triggered at less than 50%.[151] How far below 50% is unclear, but we

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[148] Some in Congress are thinking in a similar vein. *See, e.g.*, Consolidation Prevention and Competition Promotion Act of 2021, S. 3267, 117th Cong. (2021), https://www.congress.gov/bill/117th-congress/senate-bill/3267/text (proposing two thresholds, one where acquisition results in acquiring more than $5 billion interest in target, and another where firm with more than $100 billion in assets acquires more than $50 million interest in target).

[149] We do not intend to draw any distinction between "monopoly" and "market" power.

[150] Scale is an appropriate basis to vary the threshold because it becomes more difficult for smaller firms to compete effectively where a competitor faces a cost structure that small competitors may have difficulty matching profitably. Therefore, the danger of negative competitive effects at modest levels of concentration is relatively larger than in markets without significant economies of scale.

[151] The 2010 Horizontal Merger Guidelines functionally have a 50% post-merger market share trigger baked into the HHI thresholds, with a very narrow safe harbor for acquisitions involving a part with less than 1% market share. Any

encourage federal enforcers to consider well-reasoned, longstanding Supreme Court precedent that suggests a 30% market share would be sufficient in some cases,[152] and the guidance of federal enforcers' European counterparts, which "in several cases considered mergers resulting in firms holding market shares between 40% and 50%, and in some cases below 40%, to lead to the creation or strengthening of a dominant position."[153] The European Commission also uses a 40% cutoff for finding that firms are unlikely to have a dominant position in its regulation concerning abuses of dominance.[154]

While there is no certainty that proposed legislation will pass, the two bills currently pending in Congress reflect a similar legislative trend towards tightening the presumption thresholds. S. 2039, sponsored by Senator Mike Lee of Utah, sets a 33% threshold for a rebuttable presumption, which is roughly in line with the proposal above.[155] It also sets a threshold for an irrebuttable presumption at 66%. S. 3267 aims to "establish simple, cost-effective decision rules that require the parties to certain acquisitions that either significantly increase concentration," in part by creating one test, of several, that hinges on a party to the transaction having a market share of 50 percent as an alternative to "otherwise ha[ving] significant market power."[156]

Third are the relevant HHIs and changes in HHIs as a result of the transactions. HHIs have limitations that should be appreciated.

1. HHIs are an artificial way to represent how the effect of an increase in one firm's market share varies based on the structure of the market (i.e., other firms' market shares).

2. The thresholds at which presumptions are triggered reflect preconceived, arguably outdated, notions of what concentration looks like. As discussed in detail above, the thresholds stem from older four-firm concentration limits that were further and further loosened. It is increasingly clear that a handful of competitors does not ensure competitive outcomes, and that when there are fewer competitors present, it becomes easier to increase prices, reduce output, reduce quality, or otherwise stifle innovation or consumer choice.

3. HHIs gloss over important competitive dynamics. HHIs do not account for economies of scale, network effects, or the competitive "status" of the acquirer or target.

To the extent that HHIs continue to be used, we propose two adjustments. The thresholds and deltas at which mergers are presumed to be anticompetitive should be returned to earlier, or

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combination of two firms that results in a firm of more than 50% market share will result in a post-merger HHI over 2,500 and a delta of over 200, the levels necessary to trigger a presumption, so long as the smaller firm has at least 2.1% market share. If the target has between 1-2.1% it would still "warrant scrutiny" under the 2010 Horizontal Merger Guidelines.

[152] *See Phila. Nat'l Bank*, 374 U.S. 321.

[153] Eur. Comm'n, Directorate-Gen. for Competition, Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings, 2004 O.J. (C31) 5, https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52004XC0205(02)&from=EN.

[154] Eur. Comm'n, Directorate-Gen. for Competition, Procedures in Article 102 Investigations, https://ec.europa.eu/competition-policy/antitrust/procedures/article-102-investigations_en (last visited Apr. 18, 2022).

[155] Tougher Enforcement Against Monopolists Act, S. 2039, 117th Cong. (2021), https://www.congress.gov/bill/117th-congress/senate-bill/2039/text.

[156] Consolidation Prevention and Competition Promotion Act of 2021, *supra* note 148.

even lower, levels.[157] Further, federal enforcers should provide examples of situations where they likely will not rely on HHIs (e.g., incumbent firm acquiring a disruptive entrant).[158] Alternatively, federal enforcers could apply alternative thresholds in some situations (e.g., a market with significant economies of scale or network effects, conditions where the market share may not reflect a firm's competitive significance).[159]

In addition to the three "single-triggers" above, federal enforcers should consider a multi-trigger approach where more modest levels of the single-trigger tests (i.e., that would not alone create a presumption), when combined with some number of the factors listed below, generate a presumption. Alternatively, federal enforcers could simply allow a showing of some number of the factors below to suffice. We propose that the list of relevant factors include[160]:

- existence of barriers to entry or expansion;[161]
- profit margins consistently above market-wide returns to capital that are not explained by a failure of the market to yet reach equilibrium;[162]
- reputation for poor quality that is likely to persist;[163]
- historical or current anticompetitive conduct;[164]

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[157] *See* Adil Abdela & Marshall Steinbaum, Roosevelt Inst., *The United States Has a Market Concentration Problem: Reviewing Concentration Estimates in Antitrust Markets, 2000-Present* (Sept. 2018), https://rooseveltinstitute.org/wp-content/uploads/2020/07/RI-US-market-concentration-problem-brief-201809.pdf ("[In 1982 the DOJ and the FTC] raised the level of market concentration that made it likely a merger would receive enforcement scrutiny. In 2010, the thresholds were raised even more. As a result, decades of lax merger review and antitrust enforcement gave way to rampant market power.").

[158] The logic here is consistent with the 1982 Guidelines' Leading Firm Proviso discussed above.

[159] *See* Hovenkamp & Shapiro, *supra* note 123, at 2007 ("In the presence of economies of scale, which are likely to exist in a concentrated market, a small incumbent firm or an entrant is unlikely to be as effective a competitor as a larger firm.").

[160] Some of these factors are not new to the merger guidelines. For instance, barriers to entry are discussed at some length in Section 9 of the 2010 Horizontal Merger Guidelines.

[161] These should include the importance of intellectual property, network effects, lack of excess supply or contestable demand, incumbent exclusivities, switching costs, high startup costs, the existing of a dominant incumbent, incumbent control over captive demand or supply, or existence of significant economies of scale with an incumbent at scale (i.e., kill zones). Evidence of recent, effective, entry should undermine claimed barriers to entry, but that entry must be sufficient to meaningfully compete with market leaders and require less than two years.

[162] The 2010 Horizontal Merger Guidelines correctly note that while margins are relevant to antitrust analyses, "high margins are not in themselves of antitrust concern." As part of the proposed double-trigger framework, margins would only be a cause for concern when combined with other indicia that post-merger competition is unlikely to function effectively. Perfectly competitive markets, the kind that lead to allocative efficiency, should result in zero" economic profits." As a result, where profit margins are consistently above market-wide returns to capital, competition is presumably already not working effectively, though that is not necessarily the result of anticompetitive conduct. Federal enforcers should articulate the conditions under which they would consider high margins a double-trigger factor.

[163] In competitive markets, poor quality competitors should presumably be driven out. This factor can be measured by failures to comply with professional or legal standards (e.g., being the subject of formal consumer complaints).

[164] Anticompetitive conduct only works in markets where the structure is not competitive to begin with; otherwise, customers and suppliers would defeat the attempt. The existence of such conduct indicates that market participants believe the conditions are ripe for the conduct to succeed (i.e., not competitive). See, e.g., Anne Bingham, Assistant Att'y Gen., U.S. Dep't of Justice, Antitrust Div., Address before the American Meat Institute, Antitrust Enforcement in the Meatpacking Industry (May 14, 1996), https://www.justice.gov/atr/speech/antitrust-enforcement-meat-packing-industry.

- customer perceptions of competitive closeness of merging parties;[165]
- likelihood of timely and sufficient entry by parties;[166]
- access to competitively sensitive data;[167]
- access to data;[168]
- the "status" of the parties;[169] and
- common ownership among industry participants.[170]

Presumptions must be sufficiently flexible to adapt to economic realities. If strengthened and implemented correctly, presumptions can be a tool to help enforcers identify problematic concentration in its incipiency. This is a better approach than having to address anticompetitive harms flowing from problematic concentration by attempting to unwind transactions after the fact. Further, presumptions can provide market participants with the clear guidance that they require.

DIGITAL MARKETS – LOW & NO MARGINAL COST PRODUCTS

I. Dominating Digital Markets

With few exceptions, antitrust enforcement in the United States has failed to confront the threat that dominant digital platforms pose to consumer welfare through the vast and ever-expanding collection, aggregation, and analysis of consumer data. After hundreds of acquisitions, a handful of companies now dominate the internet economy. Evidence mounts that their dominance is not purely the result of offering the best services at the lowest costs; instead, this dominance has been supported by unlawful, anticompetitive conduct that harms consumers. This section describes the unique qualities of digital platform markets and how the Guidelines should approach defining and assessing them.

II. The Difficulty in Defining Digital Platform Markets

Defining the relevant antitrust market(s) for digital platforms can be challenging. The complication stems from (A) consumers trading their data and attention for services that are nominally zero price; (B) availability of consumer data harvested for multiple uses, some known at the time of collection, but others unknown and developed later on, as well as continuously

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[165] Qualitative and quantitative measures of quality are appropriate. For instance, a record of customer complaints, or violations of legal or professional standards are indicia of poor quality. "Competitive closeness" should not be interpreted as requiring that the acquirer and target be next-best-substitutes.

[166] Entry enhances competition. Where an acquirer could credibly enter on its own (in lieu of purchasing the target), the acquisition eliminates potential entry by the acquirer and denies the market the benefit of that incremental competitor. See section regarding nascent and potential competition for a more complete discussion.

[167] If the merger would enable the parties to efficiently monitor competitors, downstream markets, or upstream markets, that may lessen competition.

[168] Increasingly mergers are driven by the ability to utilize certain data. Market participants recognize that data is valuable, and merger Guidelines should as well. Methods to analyze this factor are developing.

[169] Firms play different roles in their markets. Firms can be, for example, market leaders, market followers, mavericks, or disruptive startups. Acquisition of an aggressive, but small, competitor, may have an out-sized negative impact on competition. That said, there is a need to balance the likelihood that the acquirer can scale an innovative product more quickly post-acquisition than would otherwise be possible.

[170] Where there is common ownership among industry participants, incentives to compete are likely dampened, but certainly not enhanced.

evolving processes for data analysis; (C) multi-sidedness, i.e., the availability of platform features to multiple consumer and user groups; (D) significant network effects; (E) economies of both scale and scope, including a zero or near-zero marginal cost of distribution, and global distributional reach, again, at zero or near-zero cost; and (F) the availability of complementary features available in a virtually unlimited number of user-chosen combinations. Accordingly, an uncommonly probing enforcer review will often be needed to assess the effect of an acquisition on the platform's dominance or other position in its primary market(s). We address more specifically below several of these conditions.

A. Tackling Zero-Price Markets

Antitrust common law rests on a "goods and services for money" paradigm and has developed price-centric tests for market definition.[171] But these tests often break down when a digital platform provides zero-price services in return for users' personal data and attention to advertising.[172] These tests also do not fare well in industries with low marginal costs, high fixed costs, and data-driven economies of scale.[173] Accordingly, enforcers should bake consumer heuristics into their tests—realizing that status quo biases,[174] informational asymmetries,[175] and the "free effect"[176] may each impact consumer choice in ways not captured by price sensitivity tests. While "competition is only a click away," few consumers end up making that click. A variety of nonprice tools may be useful in accounting for these realities when determining the markets at issue in a proposed merger:

- Quantifying the value of consumer data and attention to support the argument that zero-price services *do* involve measurable bartered payment by the consumer in a defined market. This quantification would allow the application of the "Small but Significant Non-transitory Increase in Cost" test, or SSNIC.[177]

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[171] Examples include the SSNIP test, the Lerner Index for assessing market power, the Gross Upward Pricing Pressure Index (GUPPI) for calculating the likely price impact of a merger, and others. Russell Pittman, Dir. of Econ. Res., Antitrust Div., U.S. Dep't of Justice, Three Economists' Tools for Antitrust Analysis (U.S. Dep't of Justice Econ. Analysis Grp. Discussion Paper, Jan. 2017), https://www.justice.gov/atr/page/file/1404436/download.

[172] While the SSNIP, GUPPI, and others may help define positive price aspects of digital platform markets, such as advertising, the zero-price user markets confound these tests mathematically. Indeed, a five percent increase of $0 is $0. Moreover, behavioral economics has shown that consumers are predictably irrational when it comes to zero-price markets. For example, consumers overvalue zero-priced goods and hesitate to pay for services that were once zero-price. *See, e.g.*, Michal S. Gal & Daniel L. Rubinfeld, *The Hidden Costs of Free Goods: Implications for Antitrust Enforcement*, 80 ANTITRUST L.J. 521, 528–31 (2016) (summarizing research on "free effect"); Org. for Econ. Coop'n & Dev., Directorate for Fin. & Enter. Affairs, Competition Comm., Quality considerations in digital zero-price markets—Background note by the Secretariat 25–26 (Nov. 28, 2018), https://one.oecd.org/document/DAF/COMP(2018)14/en/pdf (same).

[173] *See* Herbert Hovenkamp, *Antitrust and Information Technologies*, 68 FLA L. REV. 419, 425–28 (2016) (discussing how Lerner Index and similar metrics lead to "false positives"—i.e., results erroneously indicating substantial market power—in context of digital goods with low marginal costs but high fixed costs).

[174] *See* MAURICE E. STUCKE & ALLEN P. GRUNES, BIG DATA AND COMPETITION POLICY 121 (2016).

[175] *Id.* at 58–60.

[176] *See* sources cited *supra* note 172.

[177] *See* John M. Newman, *Antitrust in Zero-Price Markets: Applications*, 94 WASH. U. L. REV. 49, 64–71 (2016).

- Define the market by focusing on the harm to consumers through degradation in quality, privacy, and innovation. This definition would allow the application of the Small but Significant Decrease in Quality test, or SSNDQ.[178]
- Define the market using qualitative factors and consumer choice.[179]

For non-horizontal mergers, enforcers would be wise to use other nonprice parameters to assess a vertical merger's unilateral effects on competition. For instance, enforcers can formulate tools analogous to the method economists already use to quantify upward pricing pressure.[180]

B. Tackling Multi-sidedness

A two-sided market creates value by bringing together two distinct groups of customers. In a digital economy, these markets include both transaction platforms and non-transaction platforms. While two-sided non-transaction platforms straddle two interrelated markets, two-sided transaction markets share a single market definition.[181] Mergers can affect both markets and each should be rigorously analyzed. Indeed, these two-sided platforms exhibit "indirect network effects," where "the value of the two-sided platform to one group of participants depends on how many members of a different group participate."[182]

III. Digital Platforms' Use of Acquisitions to Strengthen Market Power

The market power of dominant digital platforms is protected by barriers to entry that—while not unique to digital markets—are oftentimes far higher than in traditional industries. These barriers deter entry and result in unusually durable monopolies.[183] Dominant digital platforms have strengthened these already formidable barriers through acquisitions.

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[178] *Id.* at 69–72 (describing application of SSNDQ in *Qihoo 360 v. Tencent*, (2013) C3FJ4 (Sup. P. Ct. P.R.C. Oct. 8, 2014) (translation available at https://www.competitionpolicyinternational.com/assets/DecisionTranslation.pdf). The decline can also be an increase; Gal and Rubinfeld propose calling it "SSNIQ" instead. *See* Gal & Rubinfeld, *supra* note 172. "Natural experiments" can shed light on SSNDQ. For example, after Facebook acquired WhatsApp, WhatsApp's formerly robust privacy protections were allegedly severely degraded. How users reacted could help define WhatsApp's market, with the traditional caveats regarding awareness, quality valuation, and the "Cellophane fallacy."

[179] *See, e.g.*, Bundeskartellamt, Case B6-22/16, at ¶¶ 225, 241-57, 313, 332, *rev'd*, Oberlandesgericht [OLG] Düsseldorf, Aug. 26, 2019, VI-Kart 1/19 (V), *rev'd*, Bundesgerichthof [BGH], June 23, 2020, KVR 69/19 (qualitatively analyzing Facebook's business model and attendant network effects and finding Facebook was in social networking market based on users' perspective of functionality and purpose).

[180] *See* Keith Waehrer, Online Services and the Analysis of Competitive Merger Effects in Privacy Protections and Other Quality Dimensions (Jan. 12, 2016) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2701927 (advocating for enforcers to use formula for assessing downward quality pressure analogous to upward pricing pressure calculation for unilateral effects).

[181] Lapo Filistrucchi et al., *Market Definition in Two-Sided Markets: Theory and Practice*, 10 J. COMPETITION L. & ECON. 293 (2014).

[182] *Ohio v. Am. Express Co*., 138 S. Ct. 2274, 2280 (2018).

[183] "The markets where [digital platforms] operate exhibit several economic features that . . . appear together for the first time and push these markets towards monopolization by a single company. These features are: i) strong network effects . . . ; ii) strong economies of scale and scope . . . ; iii) marginal costs close to zero . . . ; iv) high and increasing returns to the use of data . . . ; and v) low distribution costs that allow for a global reach." Stigler Report, *supra* note 105, at 7.

An incumbent platform's acquisition of a complementary business degrades competition in two main ways. First, the incumbent can rapidly increase barriers to entry in its primary market by creating the necessity of successful multi-tiered entry.[184] If the acquisition is of a current or potential future entry point, the incumbent stifles competitive challenges.[185] Second, a dominant platform that plays a gatekeeper role can preference its acquired complementary service over competing services.[186] While consumers may benefit to some degree from seamless integration of the complementary service into the platform, the harms to competition in the incumbent's primary market and in the adjacent market are likely to outweigh such benefits. In digital markets, these barriers are heightened by data use and switching costs.

A. Data as a Barrier to Entry

Data-driven incumbent platforms use acquisitions to acquire unique sources of user data, which the incumbents commonly monetize through targeted advertising.[187] Increasing the "variety," or scope, of user data at its disposal can have a multiplier effect on the value of the incumbents' data-driven services.[188] Indeed, in these digital markets, it is especially true that "market values of incumbent firms greatly exceeding the replacement costs of their tangible assets may indicate that these firms have valuable intangible assets, which may be difficult or time-consuming for an entrant to replicate."[189] This data aggregation can create a variety of positive

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[184] *See* AREEDA & HOVENKAMP, *supra* note 24, ¶ 1011b (explaining that where a competitor must enter multiple markets simultaneously, high entry barriers in any one market will apply to combined market).

[185] In *Google/ITA*, Google sought to acquire the maker of QPX, "the leading independent airfare pricing and shopping system." In its complaint, the DOJ alleged, "the proposed merger will give Google the means and incentive to use its ownership of QPX to foreclose or disadvantage its prospective search rivals by degrading their access to QPX or denying them access to QPX altogether. As a result, the proposed merger is likely to result in reduced quality, variety, and innovation for consumers of comparative flight search services." *United States v. Google Inc.*, No. 1:11-cv-00688, Compl., 2011 WL 1338047, at ¶¶ 1–5 (D.D.C. Apr. 8, 2011). *See also Microsoft,* 253 F.3d at 71 (holding that Microsoft's exclusivity contracts with IAPs served to "keep usage of [rival browser Netscape] Navigator below the critical level necessary . . . to pose a real threat to Microsoft's monopoly.").

[186] For instance, the incumbent can raise rivals' costs in the adjacent market by charging fees or advertising costs that the incumbents' service does not pay, exempting itself from policies that make rival products less attractive, enhancing the inter-compatibility with the platform of its service respective to competitors' (or degrading that of competitors'), imposing contractual terms that make its service the "default" or far more prominent than competing services, creating technological restrictions that require use of the incumbent's service (sometimes while maintaining the appearance of competition by refraining from complete foreclosure), or making its service "zero-price" to the consumer. Once the adjacent service is integrated, it strengthens the incumbent's power in its primary market by necessitating multi-tiered entry and increasing consumer lock-in (discussed below).

[187] The assumption that "user data" is widely available and non-rivalrous is, in many cases, incorrect. Privacy laws and regulations often present obstacles to the free sale of personally identifying information. Even if such data is alienable, behavior by dominant digital platforms indicates that its direct sale is less profitable than its monetization through advertising. A dominant platform can aggregate disparate data sources to create rich user profiles from which it can glean a user's current desires or even anticipate his or her future ones. Nascent competitors that lack equivalent variety of data must sell their advertising at a lower price but are subject to high investment costs to offer an attractive user-facing service. This margin erosion can prevent nascent competitors from reaching minimum viable scale. The incumbent can thus eliminate competitive threats by acquiring and protecting unique data sources.

[188] For example, an advertisement based on an individual's demographic details, physical location, and purchase history is generally far more profitable than one based on demographic details alone.

[189] 2010 Horizontal Merger Guidelines, *supra* note 47, § 9.

feedback loops through (1) traditional network effects,[190] (2) network effects arising from the scale of data,[191] (3) network effects from the scope of data,[192] and (4) spillover effects from one side of a multi-sided platform to another side.[193]

These strong network effects can prevent new firms from entering the market or displacing incumbent firms—especially when combined "with other barriers such as restrictions on consumers or businesses easily switching services, network effects all but ensure not just market concentration but durable market power."[194] MIT visiting scholar and digital platform expert for the IRS, Geoff Parker, testified to the significant impact this has, explaining that one dominant platform "locked in users to its platform, making it difficult, if not impossible, for them to transfer their data to other social media platforms."[195] These effects are frequently underappreciated because large networks, tailored advertisements, and free products are often presumed to be welfare-maximizing rather than deleterious to competition.

Additionally, this significant data advantage empowers dominant platforms to identify and acquire nascent competitors earlier in their lifecycle.[196] Both antitrust experts and leading economists alike have highlighted the concern that "serial acquisitions of nascent competitors by large technology firms have stifled competition and innovation."[197] This serial acquisition strategy enables dominant firms to exploit their information advantages to acquire rapid-growth companies before they can threaten their market share.[198] Enforcers may not identify acquisitions as problematic at the time because of information asymmetries or because of market dynamics.

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[190] HOUSE DIGITAL MARKETS STAFF REPORT *supra* note 35, at 41 ("[S]ocial networks like Facebook exhibit powerful direct network effects because they become more valuable as more users engage with the network—no person wants to be on a social network without users.").

[191] When more people contribute data, a company's algorithms can better improve the quality of its product. When a company has a better-quality product, it attracts more people, who then contribute additional data. STUCKE & GRUNES, *supra* note 174, at 170.

[192] "[H]arnessing [a] variety of data across [a] platform [improves] the quality of its products or service" and "creates a positive feedback loop that attracts more users." *Id.* at 186.

[193] Online ads, for example, are more valuable "because they are more likely to be of interest to the consumers in question and thus more likely to successfully prompt them to purchase the item." U.K. Competition & Mkts. Auth., The Commercial Use of Consumer Data: Report on the CMA's Call for Information, ¶ 2.77 (June 2015), https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/435817/The_commercial_use_of_consumer_data.pdf. Multi-sided platform models crowd out equally efficient competitors that occupy only the zero-price side of the market. Because of the "free effect," consumers overvalue zero-price services. Therefore, non-platforms that compete in the now zero-price market cannot succeed merely by product improvement. As a result, the incumbent eliminates competition, and consumers are left with lower quality and variety. A competitor could choose to adopt the incumbent's business model and compete directly. But this is unlikely to succeed because of the network effects the incumbent enjoys and its ability to engage in exclusionary conduct. New merger Guidelines should expressly recognize this barrier to entry and limit mergers in zero-price markets accordingly.

[194] HOUSE DIGITAL MARKETS STAFF REPORT, *supra* note 35, at 41; Stigler Report, *supra* note 105, at 40. For a robust discussion of the way the variety, velocity, value, and volume of data can entrench market power, *see* STUCKE & GRUNES, *supra* note 174, at 200.

[195] Dorothy Atkins, *Facebook Users 'Exploded' By 2010, MIT Scholar Says at Trial*, LAW360 (Mar. 31, 2022), https://www.law360.com/articles/1479645/facebook-users-exploded-by-2010-mit-scholar-says-at-trial.

[196] *See* Potential and Nascent Competition, *supra*.

[197] HOUSE DIGITAL MARKETS STAFF REPORT, *supra* note 35, at 44; Stigler Report, *supra* note 105, at 47, 87.

[198] Maurice Stucke, *Should We Be Concerned about Data-Opolies?*, 2 GEO. L. TECH. REV. 275, 309 (2018) (discussing growing trend of "kill zone" tactics and related chilling effect on both "entrepreneurism and autonomy").

Historically, this is most likely to occur when a "dominant platform buys a nascent threat before it has fully developed into a rival."[199]

Indeed, the fact that federal enforcers "blocked none of the more than 600 acquisitions by dominant tech platforms" over the past decade and "took action against just one of them" suggests the need for the Guidelines to more seriously consider the competitive implications of data aggregation.[200] However, recent actions by the DOJ and FTC suggest that such a re-examination is happening;[201] the Guidelines should build on this trend by encompassing a more holistic understanding of how big data can be used to harm competition in digital markets.

B. Switching Costs as a Barrier to Entry

Dominant platforms can enhance their market power through acquisitions that make it more costly for users to switch to a competitor's products. Importantly, switching can be effectively prevented if the dominant platform (or any platform) makes it difficult, if not impossible, for users to move their critical personal data to another social media platform. This "lock-in effect" occurs when "switching costs are sufficiently high that users stay with an incumbent firm rather than switch to a firm whose product or service they would prefer."[202] High switching costs are an example of the lock-in effect.[203] The lock-in effect can also increase the power of traditional network effects by artificially preserving user scale and deterring future entry.[204] Acquisitions of complementary businesses are a common tool dominant platforms use to induce lock-in. For example, a consumer is more likely to replace a computer with one running the same proprietary operating system, if the consumer owns a smart watch, smart speaker, and mobile device that is compatible with that operating system. Even if the consumer prefers a rival computer operating system, the cost of switching includes the replacement cost of the peripherals or the lost utility of inter-compatibility. For example, a sufficiently powerful operating system publisher could increase lock-in, and stifle competition, by acquiring a manufacturer of smart

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[199] HOUSE DIGITAL MARKETS STAFF REPORT, *supra* note 35, at 44.
[200] *Id.* at 386.
[201] See the Department of Justice's October 2020 antitrust lawsuit against Google, *United States v. Google LLC*, No. 20-cv-03010, Compl., ECF No. 1 (D.D.C. Oct. 20, 2022), and its November 2020 challenge to Visa's acquisition of Plaid. *United States v. Visa Inc.*, No. 3:20-cv-07810, Compl., ECF No. 1 (N.D. Cal. Nov. 5, 2020).
[202] HOUSE DIGITAL MARKETS STAFF REPORT, *supra* note 35. In the long-term, lock-in tends to reduce competition and deter market entry. *See* STUCKE & GRUNES, *supra* note 174, at 159.
[203] In *United States v. Microsoft Corp.*, the D.C. Circuit noted that consumers face high switching costs that prevent them from switching from Microsoft Windows to the Mac OS. 253 F.3d at 52. As the Supreme Court noted in *Kodak*, high switching costs that lock in customers, combined with high information costs, can give a company leverage to exercise market power. *Eastman Kodak Co. v. Image Technical Servs., Inc.*, 504 U.S. 451, 477–78 (1991).
[204] *See* Spencer Weber Waller, *Antitrust and Social Networking*, 90 N.C. L. REV. 1771, 1789–92 (2012) ("The durability of [Facebook's] network effects is reinforced by the stickiness of the system. It is well documented how difficult it is to terminate a Facebook account . . . Facebook is sticky in another way that increases switching costs for users . . . [E]xporting information from Facebook to [other social networking] sites is not so simple."); Howard A. Shelanski, *Information, Innovation, and Competition Policy for the Internet*, 161 U. PENN. L. REV. 1663, 1683 (2013) ("Network effects can be reinforced when consumers face costs in switching from one product to a substitute . . . [To induce a "locked-in customer to switch], the competitor has to price more aggressively than it would have to if competing from a fresh start. Switching costs, therefore, can make market power more durable."). "Stickiness" may have a positive connotation indicating an element of voluntariness or engagement by the user, whereas "lock-in" connotes manipulation. *See* Ed Shelly, ChartMogul, *Lock-In vs. Stickiness in SaaS: Retaining Customers the Right Way* (July 26, 2019), https://chartmogul.com/blog/lockin-vs-stickiness-saas-retaining-customers/.

speakers. Feasibly, a sufficiently powerful incumbent could lower the purchase price of the target by degrading its inter-compatibility with the platform prior to the acquisition. After the acquisition, the incumbent could both (a) thwart competition in the smart speaker market by privileging its own devices; and (b) retain consumers in its primary market through lock-in, rather than by improving its core products. This raises rivals' costs of winning over those consumers.

Enforcers should keenly approach mergers in digital markets as a way for firms to build moats around their digital castles. By acquiring firms in the same market, upstream markets, and disparate markets, alike, monopolists may seek to accumulate data, lock-in users, and increase network effects.

DIGITAL MARKETS – COMPETITION FOR ATTENTION

Many digital platforms purport to provide their services and content free of charge. But these ostensibly "free" services deal in a different currency: attention. Digital platforms and service providers have created an approximately $7 trillion attention market[205] in which they provide content or services that consumers can use in exchange for their attention to advertisements. The Guidelines do not address attention markets directly. As a result, state and federal enforcers have lacked the tools to assess the anticompetitive effects of digital platform mergers and challenge them appropriately. Further, some courts have held that the absence of money-purchases renders these attention transactions "not a 'market' for purposes of antitrust law," precluding enforcement entirely.[206] We propose that the Guidelines encourage enforcers to consider the potential applicability of a toolkit of analytical approaches tailored to the merger of digital, attention-competing platforms.

In the competition for attention, digital platforms intersperse advertisements in their content, for which they can charge for the opportunity to expose consumers to advertisements. By bundling content and advertisements together, platforms force users to view ads while the users consume "free" content or services. In effect, consumers "pay" for digital content and service with the attention they spend on ads.[207] Thus, "free" is not actually free.[208]

In a competitive market, platforms will compete on the density of advertisements within that content (the attention "price" of consuming the content and/or using the service), the quality of their content (the value of the good "purchased" by end-users), and the price charged for advertising. But like in other highly consolidated markets, consolidation in attention-competition markets can harm consumers along these dimensions. Dominant firms can increase the amount of advertising embedded in content, which raises the attention cost consumers must pay. Innovation and quality of digital services may suffer, as lack of competition removes the incentive for firms

[205] David S. Evans, The Economics of Attention Markets, at 2 (2020) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3044858 (estimating 2019 market value of attention spent on digital platforms).

[206] *Kinderstart.com LLC v. Google, Inc.,* No. C06-2057JFRS, 2007 WL 831806, at *5 (N.D. Cal. Mar. 16, 2007); *see also id.* ("KinderStart cites no authority indicating that antitrust law concerns itself with competition in the provision of free services.").

[207] *See generally id.* at *7–9.

[208] *See, e.g.*, Scott Wallsten, Tech. Pol'y Inst., Competition Analysis in the Attention Economy: It's About Time (Feb. 5, 2020), https://techpolicyinstitute.org/publications/antitrust-and-competition/competition-analysis-in-the-attention-economy-its-about-time/.

to compete for consumers' attention by developing new and varied features. Finally, digital monopolists can increase the cash price of online advertising, which the advertisers may pass along to consumers.

Consequently, the Guidelines should address competition for—and payment of—attention directly. We propose that the Guidelines continue to focus on the competitive effects of a proposed merger,[209] but they should adopt a non-exhaustive toolkit of analyses. These analyses would incorporate the attention "price" (i.e., advertisement density for a "free" service), the quality and innovation impacts of a merger, and indirect money prices (as a proxy for attention). These approaches would inform the analysis of a merger's potential harm without requiring any single method. [210] The Guidelines must provide government enforcers the flexibility to assess mergers in a wide variety of digital markets. Regulators and firms should employ each approach in this toolkit *only* to the extent that approach assists in identifying anticompetitive effects of mergers.[211] These categories of tools encompass methods of defining markets and assessing consumer harm more directly.

I. Market Definition Approaches

Defining the market of an attention-competing firm provides one non-exclusive tool for assessing a proposed merger. We propose that the Guidelines suggest that, where potentially applicable and practical, enforcers give probing consideration to the potential use of at least three non-exclusive approaches to defining a market of attention-competing firms: (1) the Attentional Small but Significant and Non-Transitory Increase in Price ("A-SSNIP") test; (2) Small but Significant and Non-Transitory Decrease in Quality ("SSNDQ") test; and (3) a SSNIP test of the market for advertisements targeting consumers' attention (i.e., a SSNIP test of a proxy market).

A. A Test to Measure Attention Directly: Attentional-SSNIP

The Guidelines should include a merger review tool that measures attention directly—i.e., the cost or "price" of the otherwise free service. Professor's Tim Wu's A-SSNIP test exemplifies such a tool.[212] Unlike the traditional SSNIP test outlined in the 2010 Merger Guidelines (which measures the impact of an increase by a hypothetical monopolist in the cash price of its good or service),[213] the A-SSNIP assesses how an increase in "attention price" affects consumer

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[209] *See* 2010 Horizontal Merger Guidelines, *supra* note 47, § 4, at 7 ("Evidence of competitive effects can inform market definition, just as market definition can be informative regarding competitive effects."); Sarah Oxenham Allen et al., Market Definition in the Digital Economy: Considerations for How to Properly Identify Relevant Markets, at 1, in Am. Antitrust Inst., AAI Online Symposium: Technology and Market Definition (June 17, 2020), https://www.antitrustinstitute.org/wp-content/uploads/2020/06/Allen.pdf; *see also* Carl Shapiro, *The 2010 Horizontal Merger Guidelines: From Hedgehog to Fox in Forty Years*, 77 ANTITRUST L.J. 701, 707 (2010).

[210] *Id.*; *see also* Makan Delrahim, Assistant Att'y Gen., U.S. Dep't of Justice, Antitrust Div., Keynote Address at Silicon Flatirons Annual Technology Conference: "I'm Free": Platforms and Antitrust Enforcement in the Zero-Price Economy (Feb. 11, 2019), https://www.justice.gov/opa/speech/assistant-attorney-general-makan-delrahim-delivers-keynote-address-siliconflatirons.

[211] A proposed merger satisfying any individual method should not be taken as confirming or presuming the merger's legality.

[212] *See generally* Tim Wu, *Blind Spot*: *The Attention Economy and the Law*, 82 ANTITRUST L.J. 771 (2019).

[213] 2010 Horizontal Merger Guidelines, *supra* note 47, § 4.1.

behavior.[214] The A-SSNIP does so by "adding advertising to a product in a non-transitory fashion and determining whether that addition might make a significant number of consumers spend their time with a different product."[215]

Professor Wu asserts A-SSNIP would have assessed Google's acquisition of Waze more accurately:

> For the Google-Waze merger, the "online mobile mapping" market might have been the appropriate market; the hypothesis can be tested using an Attentional-SSNIP test. . . . The A-SSNIP would post a hypothetical monopolist who adds a 5-second advertisement before the mobile map and leaves it there for a year. If consumers accepted the delay, instead of switching to streaming video or other attentional options, then the market is correctly defined, and calculation of market shares would be in order.[216]

Drawing from our framework for modernizing structural presumptions, if this merger increased the "online mobile mapping" market's HHI sufficiently, it would have been presumptively anticompetitive.[217]

B. A Test to Measure Quality: SSNDQ

Where measuring attention cost directly is difficult, changes in quality may[218] be measured by a good's relative attention cost—i.e., the value of the good purchased with the same amount of attention.[219] This focus on quality aligns with the U.S. Supreme Court's view that "all elements of a bargain—quality, service, safety, and durability—and not just the immediate cost, are favorably affected by the free opportunity to select among alternative offers."[220] Accordingly, we propose that the Guidelines adopt a SSNDQ test consistent with Professors Gal and Rubinfeld's SSNIQ test.[221]

The test "examines switching once quality is reduced," using consumer behavior as "rough indicators about consumer preferences when quality changes."[222] This test traces the contours of a

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[214] Wu, *supra* note 212, at 797.
[215] *Id.* at 797–98. Much of the data required to empirically test the impact of additional advertisements on consumer switching resides with the merging parties and third-party marketing research firms. *See, e.g.*, Wallsten, *supra* note 208 (suggesting Nielsen and Comscore as examples). Regulators and merging companies alike would have—or could acquire—data sufficient to determine a merger's market definition and impact on consolidation.
[216] *Id.* at 777.
[217] *See* Presumptions, *supra*, Section IV; *see also* Wu, *supra* note 212, at 794 n.112; Wallsten, *supra* note 208 (applying the HHI to attention-competing markets).
[218] Notably, this approach may prove less instructive where marginal costs do not vary with quality. *See* Newman, *supra* note 177, at 71.
[219] *See* Gal & Rubinfeld, *supra* note 172, at 551–52.
[220] *Nat'l Soc'y of Prof'l Eng'rs v. United States*, 435 U.S. 679, 695 (1978).
[221] *See generally* Gal & Rubinfeld, *supra* note 172.
[222] *Id.* at 551.

market in which mergers "could result in reduced feature competition for attention."[223] The Guidelines should provide a non-exhaustive list of quality dimensions, including:

1. privacy protections for consumer data;
2. consumer control of data;
3. notice of data usage;
4. consumer choice – diversity of options;
5. reduction in frequently used features;
6. ease of consumers extricating themselves and their data from a platform; and
7. data portability across platforms.[224]

The SSNDQ could prevent mergers whose consummation did not impact price, or even the amount of attention consumers paid, but rather the value of the feature received in exchange.[225]

C. A Test to Measure Attention Indirectly: SSNIP of the Proxy Advertising Market

The Guidelines should clarify that the Supreme Court's decision in *Ohio v. American Express Co.* ("*Amex*") does not require definition of the related advertising market in assessing competition for attention.[226] But where regulators cannot determine the cost of a service purchased with attention, the Guidelines should encourage regulators to analyze related advertising markets as they proxy for the behavior of the relevant attention market.[227] Although the advertising markets are not dispositive in and of themselves, they serves as a rough proxy for the market for consumer attention (and they allow for the more-traditional SSNIP test).[228]

In *Amex*, the Court held that, "to accurately assess competition," the Court must "[e]valuat[e] both sides of a two-sided transaction platform."[229] But the Court defined two-sided transaction platforms as "those that facilitate a single, simultaneous transaction between participants."[230] Further, the Court concluded, the "key feature" of these platforms is that they "cannot make a sale unless both sides of the platform simultaneously agree to use their services."[231] Accordingly, "[t]ransaction platforms are thus better understood as 'suppl[ying] only one product'—transactions."[232]

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[223] See David S. Evans, *Attention to Rivalry Among Online Platforms and Its Implications for Antitrust Analysis*, 9 J. COMP. L. & ECON. 313 (2013).

[224] Nat'l Ass'n of Att'ys Gen., Federal Trade Commission Hearings on Competition and Consumer Protection in the 21st Century: Public Comments of 43 State Attorneys General, at 19–20 (June 11, 2019).

[225] For examples of the SSNDQ applied to digital platforms, see *Qihoo 360 v. Tencent*, (2013) C3FJ4 (Sup. P. Ct. P.R.C. Oct. 8, 2014); Case AT.40099, *Google Android*, 18/07/2018, ¶¶ 483–566.

[226] *See* Allen, *supra* note 209, at 3–4, 10 (discussing the limits on the applicability of *Amex*); Wu, *supra* note 212, at 118–19.

[227] *Cf.* David S. Evans, *Attention Platforms, the Value of Content, and Public Policy*, 54 R. INDUS. ORG. 775, 790 (2019) (market dominance in advertising market could lessen competition in related attention market).

[228] Gal & Rubinfeld, *supra* note 172, at 549–50.

[229] 138 S. Ct. at 2287.

[230] *Id.* at 2286.

[231] *Id.* at 2280.

[232] *Id.* at 2286 n.8 (second alteration in original) (quoting Benjamin Klein, et al., *Competition in Two–Sided Markets: The Antitrust Economics of Payment Card Interchange Fees*, 73 ANTITRUST L.J. 571, 580 (2006)).

Attention-competing services differ. Unlike the credit card platforms in *Amex*, "they do not exist for the sole purpose of facilitating simultaneous transactions."[233] Instead, consumers purchase a distinct service with their attention *and* often engage in conduct unrelated to any advertising transaction.[234] Platforms then process and bundle this attention, which advertisers have contracted to buy based on the users' profiles and the service or content consumed. These platforms "straddle two interrelated markets"—not a two-sided market.[235] And, to transact consumer attention, advertisers and platforms must price it. Thus, because the markets are interrelated, the behavior of advertisers in the proxy market may inform analysis of the consumer attention market.

* * *

These approaches build upon price-focused merger review and might help assess mergers of digital platforms competing for attention. These approaches are analogous to assessing changes in "cash" price. The A-SSNIP measures the price (in attention) a consumer is willing to pay for a given service (holding that service constant). The SSNDQ measures the same but holds the purchase price constant while varying the service a consumer receives for that price.[236] Where regulators cannot measure attention markets directly, related advertising markets may serve as suitable proxies.

II. Consideration of All Facets of Consumer Harm

"Market definition is not an end to itself"—it exists solely as an aid in determining a merger's potential harm to competition and consumers.[237] Thus, the Guidelines should encourage regulators and courts to consider any evidence of a merger resulting in increased costs for services[238] or quality harms. All or some of the preceding market definition approaches might provide guidance in this analysis, but the Guidelines should highlight other potentially helpful approaches. For instance, so-called "natural experiments"—e.g., relevant historical evidence of "increases or decreases in attention or information costs, decreases in quality, and competitive entry or exit"—should guide merger review.[239] Analogous mergers resulting in increased attention costs or decreased quality imply that the proposed merger would do the same. Further, as we commented above, the Guidelines should give significant weight to a merging company's internal documents regarding the effect of the merger.[240] Finally, the Guidelines should highlight that the

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[233] Tim Wu, *The* American Express *Opinion, the Rule of Reason, and Tech Platforms*, 7 J. ANTITRUST ENFORCEMENT 117, 118–19 (2019).
[234] *Id.*
[235] *See* Digital Markets – Low & No Cost Marginal Products, *supra*, Section II.B.
[236] Daniel Mandrescu, *The SSNIP Test and Zero-Pricing Strategies: Considerations for Online Platforms*, 2 EUR. COMP. & REG. L. REV. 244 (2018) (SSNDQ "is comparable to an increase of price from an economic perspective"").
[237] Delrahim, *supra* note 210; *see also* Allen, *supra* note 209, at 10 (quoting *id.*); *cf. Fed. Trade Comm'n v. Ind. Fed'n of Dentists*, 476 U.S. 447, 460−61 (1986) (holding that proof of anticompetitive effects "obviate[s] the need for an inquiry into market power").
[238] *See* Newman, *supra* note 177, at 72 ("[A] dominant firm may be more likely to increase information costs, attention costs, or both. . . .").
[239] *Id.* at 73.
[240] *See* Potential and Nascent Competition, *supra*, Sections II.B−D; *cf.* Wu, *supra* note 212, at 798 ("One might also examine documents internal to the companies . . .); Newman, *supra* note 177, at 73 ("Qualitative evidence of the inputs into a firm's decision making may also be valuable.").

types of harm common to mergers generally impact mergers of firms competing in attention markets.

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Our proposal would provide antitrust enforcers the necessary flexibility to regulate complex, evolving attention markets. And it would afford attention-market participants the clarity needed to plan potential mergers and better address potential anticompetitive outcomes of any contemplated mergers. By encouraging consideration of these approaches, the Guidelines would spur further development of these approaches and an assessment of their applicability and practicality. Ultimately, this process might facilitate the adoption of one or more of the approaches in a manner that would strike a balance between competing interests in merger review and bring much-needed reform to the regulation of attention-competing markets.

SPECIAL CHARACTERISTICS MARKETS

The Guidelines should identify the full range of non-horizontal mergers that may harm competition. This includes vertical mergers, partial mergers, and cross-market mergers. The Guidelines should also explicitly recognize that mergers may have both horizontal and vertical components.[241] Addressing the full range of non-horizontal mergers in the Guidelines is particularly important for healthcare markets where modern mergers frequently involve horizontal, vertical, and cross-market integrations.[242]

I. Vertical Mergers

A. Identification of the Underappreciated Anticompetitive Harms of Vertical Mergers.

The Guidelines should specifically address and provide guidance on vertical mergers. Vertical mergers are increasingly common - particularly in healthcare, through physician practice acquisitions by hospitals and insurer acquisitions of providers.[243] In fact, the percentage of primary care physicians and specialists in practices that are owned by hospitals has nearly doubled from 2010 to 2018.[244] While the traditional view has been that vertical integration is likely to be procompetitive, considerable research over the past decade has demonstrated that vertical mergers can be anticompetitive as in healthcare – leading to higher prices without corresponding improvements in quality or other efficiencies.[245] In addition, the healthcare sector is highly

[241] U.S. Dep't of Justice & U.S. Fed. Trade Comm'n, Vertical Merger Guidelines, § 1 (June 30, 2020) (hereinafter "2020 Vertical Merger Guidelines).
[242] Jamie S. King & Erin V. Fuse Brown, *The Anti-Competitive Potential of Cross-Market Mergers in Health Care*, 11 ST. LOUIS U. J. HEALTH L. & POL'Y 43, 45 (2018).
[243] *See, e.g.*, *Colorado v. UnitedHealth Grp. Inc.*, No. 2019-cv-031424, Compl. (El Paso County Dist. Ct. June 19, 2019) (addressing potential foreclosure in healthcare); *Commonwealth v. UPMC*, 208 A.3d 898 (Pa. 2019) (vertical conduct in healthcare).
[244] Thomas L. Greaney & Richard M. Scheffler, *The Proposed Vertical Merger Guidelines and Health Care: Little Guidance and Dubious Economics*, HEALTH AFFAIRS (Apr. 17, 2020), https://www.healthaffairs.org/do/10.1377/forefront.20200413.223050/full/.
[245] *Id*.

concentrated at every level and has high barriers to entry, making it particularly vulnerable to anticompetitive effects from vertical mergers.[246]

While the 2020 Vertical Merger Guidelines[247] ("VMG") identified some concerns, they did not identify the full range of harms that can result from vertical mergers—in particular, there was a lack of attention paid to the potential nonprice anticompetitive effects of vertical mergers.[248] The Guidelines should fully identify, to the extent possible, the universe of identifiable harms and provide guidance to enforcers and market participants through the adoption of rebuttable presumptions. In addition, the Guidelines should reject the presumption that the elimination of double marginalization is inherently efficient. Finally, the Guidelines should avoid adoption of a safe harbor based on market shares due to concerning trends of "stealth consolidation."

One of the anticompetitive harms that can result from vertical mergers is the risk of foreclosure. Foreclosure is the risk that one of the merging parties (either upstream or downstream) will block rivals from access to the other merging party or significantly increase the cost of such access.[249] For example, in healthcare, this can occur when a hospital acquires a large number of primary care physicians in a market, and then through control of those physicians, blocks referrals by those physicians to its competitor hospitals in the market.[250] This can result in disadvantages to competitor hospitals as they lose customers (patients) as it both reduces their revenue stream and weakens their bargaining position with insurers over the rates they will be paid. On the flip side, the acquiring hospital gains strength in its bargaining position due to increased patient volumes, allowing it to negotiate higher rates from insurers. If the competitor hospitals lose too much patient volume, it may eventually lead to exit from the market, again increasing the market power of the acquiring hospital. The market effects that result from foreclosure can also include reduced quality of care, restricted customer choice, and lessened innovation or a lessened likelihood of new entry.[251]

Another potential anticompetitive harm of vertical mergers is access to competitively sensitive information. As recognized in the 2020 VMG, vertical mergers can result in either upstream or downstream entities now having access to information about its rivals that was unavailable to it before as it now may also be acting as a seller or customer to that rival through its vertically integrated counterpart.[252] This can occur with respect to hospital and insurer mergers where the insurer may now have access to information about rates negotiated between the hospital and its rival insurers.

In addition to the two risks of foreclosure and information access recognized in the now-revoked 2020 VMG, vertical mergers can also lead to other harms. These include blocking nascent or potential competition by eliminating the most likely potential entrant, requiring would-be

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[246] *Id.*
[247] Now withdrawn by the Federal Trade Commission. *See* U.S. Fed. Trade Comm'n, Press Release, Federal Trade Commission Withdraws Vertical Merger Guidelines and Commentary (Sept. 15, 2021), https://www.ftc.gov/news-events/news/press-releases/2021/09/federal-trade-commission-withdraws-vertical-merger-guidelines-commentary.
[248] *Id.*
[249] *Id.*
[250] *Id.*
[251] *Id.*
[252] 2020 Vertical Merger Guidelines, *supra* note 241, at 10.

entrants to enter an upstream and downstream market simultaneously, and regulatory evasion by increasing prices on non-regulated product when bundled with a regulatory product.[253] The Guidelines should further consider recognizing that vertical mergers can present a risk of harm when there is an acquisition of an independent asset that is essential to competition in the market of the acquiring entity, such as in the FTC's recent challenge to the proposed vertical acquisition by Nvidia of one of the largest semiconductor chip technology companies, which would have provided Nvidia with control over an essential input to the products on which it competes.[254]

B. Employing Rebuttable Presumptions of Anticompetitive Harm

The 2020 VMG did not adopt any circumstances under which anticompetitive harm can be presumed.[255] By contrast, the Horizontal Merger Guidelines ("HMG") contain presumptions about when certain circumstances indicate that a proposed merger is presumed to harm competition due to the likelihood that it may raise competitive concerns.[256] The updated Guidelines should thus consider also adopting rebuttable presumptions for vertical mergers that are appropriate to apply in certain factual circumstances that research indicates is likely to yield harm to competition.[257] These presumptions, of course, should not be used to delimit all the ways by which vertical mergers can harm competition. Instead, they should be used to help bring clarity and efficiency to both enforcers and market participants by identifying scenarios in which competitive harm is likely.

A group of economists and academics proposed a set of five rebuttable presumptions in comments provided on the 2020 draft VMG, based upon the work of Professors Baker, Rose, Salop, and Scott Morton.[258] These presumptions would apply when at least one of the two markets (either upstream or downstream) is concentrated.

- Input Foreclosure Presumption: If the upstream merging firm in a concentrated market is a substantial supplier of a critical input to the competitors of the downstream-merging firm and a hypothetical decision by the merged entity to stop dealing with its downstream competitors would lead to a substantial diversion of business to the downstream merged firm. For example, in a vertical merger between a hospital and insurer, this could result in

[253] *See generally* Public Comments of 28 State Attorneys General on Draft Vertical Merger Guidelines, 4-8 (Feb. 26, 2020), https://www.justice.gov/atr/page/file/1258786/download (discussions of potential harms resulting from vertical mergers).

[254] *In the Matter of Nvidia Corp.*, Dkt. No. 9404, Compl. (F.T.C. Dec. 2, 2021), https://www.ftc.gov/system/files/documents/cases/d09404_part_3_complaint_public_version.pdf; *see also In the Matter of Lockheed Martin Corp.*, Compl., *supra* note 72 (challenging proposed vertical acquisition of last independent supplier of key missile inputs to weapons systems on which Lockheed competes); *Aspen Skiing Co.* v. *Aspen Highlands Skiing Corp.*, 472 U.S. 585, 607–08 (1985) (unilateral action by monopolist concerning independent assets removed competition from local market); *In the Matter of Negotiated Data Solutions LLC*, Dkt. No. C-4234, Decision & Order (F.T.C. Sept. 22, 2008), https://www.ftc.gov/sites/default/files/documents/cases/2008/09/080923ndsdo.pdf (finding that acquisition of patent essential to meet industry standards constituted unfair method of competition).

[255] *See generally* 2020 Vertical Merger Guidelines, *supra* note 241.

[256] 2010 Horizontal Merger Guidelines, *supra* note 47, § 5.3.

[257] *See* Jonathan B. Baker, Nancy L. Rose, Steven C. Salop & Fiona Scott Morton, *Five Principles for Vertical Merger Enforcement Policy*, 33 ANTITRUST 12, 16–17 (2019); Richard M. Scheffler et al., Comments on the Draft Vertical Merger Guidelines with Special Consideration to Health Care, 3–4 (Feb. 24, 2020), https://www.ftc.gov/system/files/attachments/798-draft-vertical-merger-guidelines/vmg20_scheffler_arnold_brown_et_al_comments.pdf.

[258] Baker et al. *supra* note 257.

the merged entity either excluding the merged hospital from participating in competing insurer's networks or raising the reimbursement rates that rival insurers must pay to include the merged provider in their networks.

- Customer Foreclosure Presumption: If a downstream merging firm is a substantial purchaser of the input and a decision to stop dealing with competitors of the upstream merging firms would lead to the exit, marginalization, or significantly higher variable costs of one or more of those competitors by diverting a substantial amount of business away from them. For example, this might occur when a hospital acquires a large number of local physician groups, and blocks referrals by those physician groups to other competitor hospitals.
- Elimination of Potential Entry Presumption: If either (or both) of the merging firms has a substantial probability of entering the other firm's concentrated market absent the merger.
- Dominant Platform Presumption: If a dominant platform acquires a firm with a substantial probability of entering into competition with it absent the merger, or if that dominant platform company acquires a competitor in an adjacent market.
- Two-tiered Entry Presumption: Post-merger a new entrant would have to enter both input and output markets if a substantial fraction of both input or output market is vertically integrated. For example, when reviewing a recent proposed change-in-control of a California non-profit hospital between a large hospital and a vertically integrated health system that was the dominant insurer in the region, economists found that such a merger was likely to result in a market in which any new entrant would need to also compete at both levels (insurer and hospital system) to effectively compete in the market.[259]

C. Application of the "Horizontal" Standard to Efficiency Claims and Discarding the Assumption Regarding Double Marginalization

The new Guidelines should require all efficiency claims to be evaluated under the same standards employed in the HMG and reject the notion that was adopted by the 2020 VMG that it can be inherently assumed that vertical mergers often benefit consumers through the elimination of double marginalization ("EDM").[260] EDM can occur when two vertically integrated firms merge that both independently charged a profit-maximizing margin on their products pre-merger. Once merged, the upstream firm now captures both profits, thus allowing a potential price reduction on the output product to be profitable when it may not have been pre-merger.

While efficiency benefits in a vertical merger can include EDM when the merged company sets the internal transfer price and the downstream price with a focus on joint profits instead of simply the profits of the separate businesses, presuming that a vertical merger will benefit competition is not warranted.[261] Claimed efficiencies, including EDM, must be cognizable, meaning that they must be verifiable, merger-specific, and not the product of an anticompetitive

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[259] Lisa Maiuro, Maiuro Health Care Consulting, An Evaluation of the Proposed Change in Control of St. Mary Medical Center, 121 (Nov. 11, 2021) https://oag.ca.gov/system/files/media/smmc-impact-report-2021-redacted.pdf (finding that because "the leading provider system in the area and the leading commercial insurer . . . [t]he would-be rival insurer may need to enter at both the provider and insurer levels of the supply chain in the . . . market. That would be costlier and riskier, and therefore less likely to occur, all else equal.").
[260] 2020 Vertical Merger Guidelines, *supra* note 241, at 2.
[261] Baker, *supra* note 257, at 13–15.

reduction in output or service. In addition, any cognizable efficiencies must be sufficient to reverse the competitive harms of the merger.

The 2020 VMG specifically rejected that EDM might not be merger specific if the parties could have theoretically achieved EDM without the merger if such a theoretical possibility is not reflected in documentary evidence.[262] This is contrary to the approach taken when evaluating efficiencies under the HMG and should not be a part of the new Guidelines. It is appropriate to consider whether EDM could have been achieved by the parties through another transaction short of a merger, such as through negotiation of a contract between two independent firms. For example, this might occur in a contract between a hospital and an insurer where an insurer receives a volume discount.

A merger also may not lead to EDM efficiencies if the downstream merging partner does not use the input produced by the upstream merging firm, e.g., because of incompatible technology. In the healthcare context, this might occur when a hospital acquires a physician group, but the two entities continue to use different electronic health records systems due to the differentiated nature of their practices. A recent study found that in almost half of vertically integrated firms there is no inter-firm input transfer; thus, one should not be presumed.[263]

Finally, benefits from EDM may be limited where the new entity loses profitable input sales by the merged upstream entity to now-competitor downstream third parties. This may limit the degree to which the merged firm actually lowers its inter-firm input transfer prices. For example, in the healthcare context, this may occur where a hospital merges with an insurer. As a greater proportion of the hospital's patients come from the merged insurer rather than rival insurers, the hospital will lose out on the profits from higher-paying insurers, and ultimately the merged entity may need to either raise prices to competitor-insurers or raise the price of insurance offered by the merged entity.

D. Not Employing a Safe Harbor Based on Market Shares

Last, the Guidelines should not employ the use of a safe harbor based on market shares due to rising concerns about the cumulative effects that may arise from a series of smaller vertical acquisitions—often referred to as "stealth consolidation."[264] This phenomenon is often observed in healthcare markets where hospital systems quietly acquire multiple small physician groups over time. Incremental acquisition of physician groups and outpatient clinics by hospitals systems can, over time, lock out competing hospital systems, leading to an increase in prices.[265] The 2020 VMG ultimately rejected the safe harbor proposed in the draft VMG, and the States recommend the updated Guidelines similarly do so.

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[262] 2020 Vertical Merger Guidelines, *supra* note 241, at 12.
[263] Baker, *supra* note 257, at 13.
[264] Greaney & Scheffler, *supra* note 244.
[265] *See, e.g.*, Nicolas Petris Ctr. on Health Care Mkts. & Consumer Welfare, Sch. of Pub. Health, Univ. of Cal., Berkeley, Consolidation in California's Health Care Market 2010-16: Impact on Prices and ACA Premiums, at 9, 16–26 (Mar. 26, 2018), https://petris.org/wp-content/uploads/2018/03/CA-Consolidation-Full-Report_03.26.18.pdf.

II. Partial Mergers

The key difference between a full merger and a partial merger is the level of control achieved by the acquiring firm as a result of the merger. In a full merger, the acquiring firm automatically gains control of the acquired entity.[266] In a partial merger, there must be a careful assessment of the degree of control conferred to the acquiring entity.[267] This assessment should look beyond solely the degree of ownership interest and include a fact-specific inquiry into the type and level of control conferred. This step is usually absent in a full-blown merger analysis, which assumes control. With respect to partial mergers, understanding the level of control conferred is an essential first step to analyzing both the competitive effects of a transaction and, secondly, any claimed efficiencies.[268] The greater the degree of control, the more a transaction should be treated as a full-blown merger. On the contrary, if there is a lack of control, it may be appropriate to either take this into account in the merger review (as discussed below with respect to the efficiencies analysis), or it may be more appropriate to apply the legal framework that applies to collaborations among competitors. It should be made clear, however, that a partial merger that does not result in a change of control can still lead to anticompetitive effects – but the analysis and framework may differ from than that of a full merger.

A. More Fully Identifying the Harms of Partial Mergers

While the current HMG address partial mergers, the updated Guidelines should more fully identify the anticompetitive effects that can result from partial mergers and provide more detailed guidance as to how to go about analyzing such mergers. Partial mergers are becoming increasingly common for several reasons. One reason is that it allows for firms to obtain some of the benefits of a merger, without having to give up their full independence.[269] Another is that firms may see it as a path toward less regulatory and legal scrutiny. This has been particularly true in healthcare where increased regulatory attention has led market participants to explore creative ways to affiliate and achieve results similar to a merger, without undertaking a full-blown merger. For hospitals, partial mergers or "affiliations" with physician groups may help increase a hospitals' referral base—leading to some of the foreclosure effects discussed above with respect to vertical mergers—but without the scrutiny that may come with a full merger. Partial mergers may also be viewed as a way to increase purchasing power or bargaining strength, without the other costs that come with a full-blown merger, such as taking on control and operation of another firm.

For example, in a case brought by the state of Washington, a large health system acquired the ambulatory surgical center and ancillary laboratory and imaging assets of a local physician

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[266] Steven C. Salop & Daniel P. O'Brien, *Competitive Effects of Partial Ownership: Financial Interest and Corporate Control*, 67 ANTITRUST 559, 562 (2000).
[267] *Id.*
[268] *See Washington v. Franciscan Health Sys.*, No. C17-5690-BHS, 2018 WL 3546802, at *6 (W.D. Wash. July 24, 2018) (denying summary judgment on grounds that fact-finding inquiry necessary to decide degree of economic integration and decision making conferred by transaction between physician group and hospital system; such determination will inform whether transaction should be treated as merger or agreement between separate entities more appropriately reviewed under Section 1 of Sherman Act).
[269] McGuireWoods LLC, Three Benefits of Bypassing a Merger and Choosing Looser Affiliations (Nov. 19, 2012), https://www.mcguirewoods.com/client-resources/Alerts/2012/11/3-Benefits-Bypassing-Merger-Choosing-Looser-Affiliations.

group, but only entered into a contractual affiliation with the physicians under which the physician group would join the health system's much higher payor contracts. Such a transaction, which was not a full-blown merger, was designed to maintain the independence of the physician group, increase referrals to the health system, and also increase the bargaining strength of the physicians. Because partial mergers can still raise many competitive issues, the Guidelines should provide a more detailed roadmap for how to analyze such mergers.

B. Expanding Pre-merger Notification Requirements

Arrangements that involve shared control or influence over a venture that do not exclusively involve a new product or service have garnered increased scrutiny in recent years. State and federal enforcers have recognized that hospital affiliations and certain joint ventures short of a full merger can result in a loss of competition.[270] Empirical research has shown the potential anticompetitive effects of these partial mergers.[271] Yet there is an information gap in detecting and halting anticompetitive transactions that may be structured to evade pre-merger notification requirements and regulatory review. In response to this gap, several states have enacted their own pre-transaction notification laws specifically for healthcare transactions that capture not just traditional full-blown mergers, but also partial mergers and affiliations.[272] The Guidelines should follow in the same vein to expand the robustness of the initial filing to include more in-depth analysis from the parties and disclosure of the potential ramifications of the proposed merger, thereby providing enforcers information to identify potentially anticompetitive mergers.

C. Addressing How the Degree of Change of Control in a Partial Merger May Impact the Analysis

The current HMG make clear that the Guidelines also apply to partial mergers—including minority positions. The Guidelines also recognize that "[w]hile partial mergers usually do not enable many of the types of efficiencies associated with mergers, federal enforcers consider whether a partial acquisition is likely to create cognizable efficiencies." The Guidelines should extend this to explain that a lack of full control can often mean that efficiencies are either not achievable or cannot be guaranteed as they may be in a full merger with assumed full control. Thus, an additional step of an efficiencies analysis in a partial merger should be an inquiry into whether or not the level of control necessary to achieve that efficiency has been conferred.

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[270] *See, e.g.*, *United States v. American Airlines Grp., Inc.*, No. 1:21-cv-11558, Compl., ECF No. 1 (D. Mass. Sept. 21, 2021); *United States v. Geisinger Health*, No. 4:20-cv-01383, Compl., ECF No. 1 (M.D. Pa. Aug. 5, 2020); Mauiro, *supra* note 259.

[271] Einer Elhauge, *The Causal Mechanisms of Horizontal Shareholding*, 82 OHIO ST. L.J. 3-4 (2021) (summarizing empirical studies).

[272] Barbar Sicalides, Daniel Anziska, Megan Morley & Dennie Zastrow, *State Enforcers Expanding Premerger and Antitrust Jurisdiction Over Health Care Transactions: Guidance for This Growing Trend*, ABA HEALTH ESOURCE (Dec. 15, 2020), https://www.americanbar.org/groups/health_law/publications/aba_health_esource/2020-2021/december-2020/sta-enf/ (summary of pre-transaction notification laws and bills in Connecticut, Washington, Colorado, and New York); *see also* Mass. Gen. Laws c. 6D, § 13 and 958 Mass. Code Regs. 7.00; Or. Rev. Stat. § 415.500 *et seq*. and Or. Admin. R. 409-070-0000 through 409-070-0085.

In partial mergers between hospitals and physician groups, efficiencies are only achievable to the extent that the acquiring hospital system has control over the physicians it is acquiring – such as through implementing full risk-sharing or population management incentives that affect utilization, and hence total cost of care, or even certain quality metrics (e.g., metrics involving sepsis or infection). And such control is only effective if there are actual consequences for the physicians if they fail to achieve such metrics or other efficiencies, such as a change in their compensation. As such, this should be a very fact-intensive inquiry. The agreements between the parties should be examined closely to determine if they indeed amount to a change of control. In a recent challenge to an affiliation between a hospital system and a physician group, during an oral ruling on a motion in limine to exclude evidence of alleged efficiencies, the Court noted that "[p]lans for further integration that are not based upon contractual obligations seem to be to be irrelevant. Any steps taken during the discovery period to further integrate the two medical business entities might be irrelevant, but the Court questions how probative they might be if, again, not required by transaction agreements such that they could be terminated, apparently, at any time." While the Court reserved its ruling on the motion, it noted that "such evidence appears problematic."[273]

D. Clarifying the Relationship Between the Guidelines and the Competitor Collaboration Guidelines

Last, it would be useful for federal enforcers to more clearly delineate in the Guidelines the relationship between the Guidelines and the Competitor Collaboration Guidelines. The current HMG do not reference the Competitor Collaboration Guidelines, leading one to perhaps erroneously assume that when reviewing a transaction, either the Horizontal Merger Guidelines or the Competitor Collaboration Guidelines apply, but not both. This is, of course, not the case as is recognized in the Competitor Collaboration Guidelines, which specifically provide that calculation of market shares as provided for under the Horizontal Merger Guidelines may be appropriate when evaluating a competitor collaboration under the rule of reason. Such clarity would be useful as there have been attempts to make the argument that application of the horizontal merger guidelines to competitor collaborations is inappropriate.[274]

However, the Competitor Collaboration Guidelines define a merger as a transaction that ends all competition between two firms. But often mergers may end competition for some aspects of the business between two firms, not all. In such a partial merger, application of principles from both the Guidelines and Competitor Collaboration Guidelines may be appropriate. They should not be viewed as mutually exclusive. For example, in a recent non-profit hospital transaction, a vertically integrated insurer-health system merged and acquired an interest in a competitor hospital that yielded effective control over the hospital.[275] In this transaction, competition may have ended between the two parties with respect to the provision of hospital services in that specific market, but competition remained for hospital services in other markets where both firms continued to

[273] *Franciscan Health*, 2018 WL 3546802, at *7.

[274] In the same challenge against the Franciscan Health System, the defense sought to exclude expert testimony regarding application of the horizontal merger Guidelines. In an oral ruling, the Court struck down such an argument, stating that it would "permit testimony and argument that would help it understand the degree of harm to competition that the rule of reason analysis considers . . . [and that t]he degree of harm to competition expected from a restraint of trade could be impacted by market concentration and market power as well as market share." *Id.* at *8–9.

[275] Mauiro, *supra* note 259.

operate. Competition further remained between the two firms with respect to their competing downstream physician groups in the same market as the merged hospital.

III. Cross-Market Mergers

A. Recognizing That Cross-Market Merger Cases May Be Brought Under Section 7.

Cross-market mergers refer to the acquisition of any firm that does not directly compete with the acquiring firm in the same geographic market.[276] In the healthcare context, this may look like the acquisition of a hospital by a hospital system in a geographic market in which the hospital system has no presence.[277] Recent research has demonstrated that cross-market mergers in healthcare can harm competition and raise prices under certain circumstances.[278] Because of this, the Guidelines should both recognize the potential harms of cross-market mergers and explicitly affirm that such cases may be brought under Section 7 of the Clayton Act.[279]

On its face, the language of Section 7 does not limit its applicability to mergers involving competitors in the same geographic market.[280] Rather, Section 7 asks whether a merger is likely to substantially limit competition based on past conduct, present facts, and economic modeling.[281] Thus, if past conduct, present facts, and economic modeling demonstrate that a cross-market merger is likely to harm competition, such a claim may be brought under Section 7.[282] It is important for the Guidelines to recognize this —particularly in the field of healthcare— as research has shown that cross-market mergers have led to significant price increases.[283]

B. Identifying Legal Bases to Challenge Anticompetitive Cross-Market Mergers

One theory under which cross-market mergers can harm competition is through anticompetitive tying.[284] The potential for anticompetitive tying in healthcare exists when a health system operates in multiple geographic markets and has a common customer (insurers or employers) that also operate in the same markets. When a health system acquires a hospital in a different geographic market, it can then attempt to negotiate with its customer (insurers or employers) on an all-or-nothing basis—meaning that the insurer must include all of the hospital system's facilities in its network or else the hospital system will refuse to contract. If a health system that attempts to do this has a "must have" hospital in just one of its markets—meaning the insurer could not have a marketable network without that hospital—then it can tie all of its other hospitals in other markets to that "must have" hospital and require the insurer to contract for them. This gives the hospital system significant market power and the ability to raise rates on hospitals

[276] Cross-market mergers may also refer to mergers in which the acquiring entity does not compete in the same product market as the acquired entity, but these are generally treated as vertical mergers, which are discussed above.
[277] King & Brown, *supra* note 242, at 45.
[278] *Id*. at 46.
[279] *Id*. at 57.
[280] Emilio E. Varanini, *Addressing the Red Queen Problem: A Proposal for Pursuing Antitrust Challenges to Cross-Market Mergers in Health Care Systems*, 83 ANTITRUST 2, 5–13 (2020).
[281] King & Brown, *supra* note 242, at 57.
[282] *Id*.
[283] Varanini, *supra* note 280, at 510–512.
[284] King & Brown, *supra* note 242, at 56.

even in geographic markets in which is does not have a dominant competitive position.[285] This theory was supported in a 2019 review by Federal Trade Commission economists Keith Brand and Ted Rosenbaum.[286] This theory was also the basis for a decision by the California Attorney General to impose conditions on a hospital affiliation due to the risk of anticompetitive cross-market effects resulting from that affiliation.[287]

Cross-market mergers pose a particular problem in healthcare due to the fact that large employers and insurance companies often serve as a common customer across multiple geographic markets within a single state. Employers want to purchase health insurance with a network that will serve all geographic market in which it has employees—which often may be multiple markets across a state. Thus, insurers who sell and market provider networks to employers are incentivized to build networks that contain sufficient providers in each geographic market.[288] Economic research has demonstrated that a health system increases its market power when it acquires additional facilities and providers, even when in different markets, and that this increase in market power results in increased healthcare prices.[289]

In addition to tying and common customer theories, the acquisition of an independent asset that is essential to competition could support a challenge under Section 7. Such a theory may be applicable where the merging parties do not operate in either the same product or geographic markets, but there has been a change in control of an independent asset essential to competition, such as a local community hospital with market power that nonetheless historically has charged low prices. Such a merger can still result in competitive harm as changes in control at a hospital (or other firm) can change the objections, information, or bargaining skills and sophistication of

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[285] *Id.*

[286] *See* Keith Brand & Ted Rosenbaum, *A Review of the Economic Literature on Cross-Market Mergers*, 82 ANTITRUST 533, 535–36, 545 (2019).

[287] *See, e.g.*, Cal. Office of the Att'y Gen., Attorney General's Conditions to Change in Control and Governance of Huntington Memorial Hospital and Approval of Affiliation Agreement by and between the Pasadena Hospital Association, the Collis P. and Howard Huntington Trust and Cedars-Sinai Health System (Dec. 4, 2020), Ex. 4 at 3–4, https://oag.ca.gov/sites/all/files/agweb/pdfs/charities/nonprofithosp/ag-decision-huntington-121020.pdf.

[288] King & Brown, *supra* note 242, at 58.

[289] *See* Leemore Dafny et al., *The Price Effects of Cross-Market Mergers: Theory and Evidence from the Hospital Industry*, 50 RAND J. OF ECON. 286 (2019) (finding that mergers between hospitals in different geographic regions within same state with common customers led to significant price increases of seven to ten percent compared with control hospitals that were not part of merger); Matthew S. Lewis & Kevin E. Pflum, *Hospital Systems and Bargaining Power: Evidence from Out-of-Market Acquisitions*, 48 RAND J. OF ECON. 579 (2017) (finding that prices at hospitals acquired by out-of-market systems increased by about 17% more than unacquired, stand-alone hospitals); *id.*, *Diagnosing Hospital System Bargaining Power in Managed Care Networks*, 7 AM. ECON. J.: ECON. POL'Y 243 (2015) (finding that cross-market provider acquisitions in some instances could lead to greater price increases and thus be more anticompetitive than even horizontal provider acquisitions involving direct competitors); Glenn A. Melnick & Katya Fonkych, *Hospital Prices Increase in California, Especially Among Hospitals in the Largest Multi-Hospital Systems*, 53 INQUIRY: J. OF HEALTH CARE ORG. PROVISION & FIN. 1 (2016) (finding that while many of the hospitals in California's largest systems do not substantially overlap with other system hospitals in terms of product and geographic markets, the hospitals in the large systems are able to achieve market power over prices beyond any local market advantage); Glenn A. Melnick, Katya Fonkych & Jack Zwanziger, *The California Competitive Model: How Has it Fared, and What's Next?*, 37 HEALTH AFFAIRS 1417 (2018) (reaffirming authors' 2016 findings of substantial price increases from growth of multicounty health care systems).

the parties' negotiating price.[290] Those changes can result in price increases regardless of whether the merging parties operate in the same, or distinct, markets.[291] This has been referred to as the "Change in Control" theory.[292] A change in control may lead to higher prices when the target entity is acquired by a large system that has bargaining sophistication,[293] is less risk-adverse due to its financial portfolio, or is less concerned or affected by local community backlash to higher prices.[294]

C. Providing Examples for How the Competitive Effects of a Cross-Market Merger May Be Measured

In addition to recognizing the legal theories that support a cross-market merger case, the Guidelines should also explore how the competitive effects of a cross-market merger may be empirically measured. A cross-market merger should be analyzed "based on the potential direct effect it might have on the value of the bundle of services offered by a hospital system to insurers for inclusion in their network."[295] Thus, economic analysis should focus on how to measure the "relative value of the target entity in the market (its market power) and then how much value it adds to the system given the other entities in the system, and the cumulative loss experienced by an insurer or employer from not having any of those entities in its network."[296]

One such model used in recent healthcare cases that may also be applicable to cross-market mergers is a "willingness to pay" analysis. Such an analysis looks at how much more a customer would be willing to pay to have access to the newly merged bundle of care as opposed to going to the next best alternative for care outside that bundle. In healthcare, this would be examined by looking at how much more a purchaser of health insurance would be willing to pay in terms of insurance premiums in order to keep a particular doctor or facility in network. This model has been used in a number of recent cases when evaluating increased bargaining leverage resulting from hospital or health system mergers by state and federal enforcers.[297] Data on insurer demand concerning multimarket provider networks may also allow economists to measure the effect of a cross-market merger on a targeted insurer.[298]

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[290] Gregory S. Vistnes, Competitive Effects Analysis of the Proposed Cedars-Sinai Health System/Huntington Memorial Hospital Affiliation, at 16–17 (Dec. 4, 2020) (on file with Health Care Rights & Access Section, Pub. Rights Div., Cal. Office of the Att'y Gen.).
[291] *Id.*
[292] *Id.*
[293] Lewis & Pflum, *Diagnosing Hospital System Bargaining Power in Managed Care Networks*, *supra* note 289.
[294] Vistnes, *supra* note 290, at 17.
[295] King & Brown, *supra* note 242, at 62.
[296] *Id.*
[297] *See, e.g.*, R.I. Office of the Att'y Gen., Decision Re: Hospital Conversions Act Initial Application of Rhode Island Academic Health Care System, Inc., et al. (Feb. 17, 2022), at 43, https://riag.ri.gov/press-releases/attorney-general-denies-application-merger-lifespan-and-care-new-england-health; Cal. Office of the Att'y Gen., Attorney General's Conditions to Change in Control and Governance of Huntington Memorial Hospital, *supra* note 287, at 24; *Fed. Trade Comm'n v. Advocate Health Care Network*, 841 F.3d 460, 476 (7th Cir. 2016); *Fed. Trade Comm'n v. Penn State Hershey Med. Ctr.*, 838 F.3d 327, 342, 353 (3d Cir. 2016); *ProMedica Health Sys., Inc. v. Fed. Trade Comm'n*, 749 F.3d 559, 567 (6th Cir. 2014); *Fed. Trade Comm'n v. OSF Health Care Sys.*, 852 F. Supp. 2d 1069, 1086 (N.D. Ill. 2012).
[298] Varanini, *supra* note 280, at 517.

D. Considering Adopting Limiting Principles for Cross-Market Merger Cases

Several limiting principles have been proposed by economists and academics that could be adopted by the Guidelines to provide clarity to market participants as to when it may be appropriate to bring a cross-market merger case. These limiting principles are aimed at identifying only those transactions that may be likely to have anticompetitive effects. First, cross-market merger challenges should be limited, for the time being, to mergers within the same state, as the current body of economic research finding anticompetitive effects from cross-market merger has thus far been limited to mergers occurring within the same state.[299] Second, there must be common customers or common insurers that span the markets served by the merging entities.[300] Finally, the entity should have market power in one or more markets prior to the acquisition.[301] There need not, and likely should not, be a market share threshold, but a cross-market merger where the acquiring entity does not have significant market share in either market is unlikely to affect its competitive position as there will remain alternatives in both markets for a common customer to choose from.[302]

NONPRICE EFFECTS

I. Mergers' Nonprice Effects Warrant Stronger Presumptions, Closer Consideration, and Wider Remedies

Mergers present more potential risks to competition and to the residents of our states than mere higher prices. While the 2010 Horizontal and 2020 Vertical Merger Guidelines acknowledge the potential of nonprice effects consequent to mergers,[303] the focus of previous Merger Guidelines and policy statements on price effects obscure the full scope of harms caused by consummated mergers. Permitting mergers with substantial nonprice effects on competition has observably led to increasingly concentrated industries and undermined our states' interests in protecting the safety, health, and fair economy of our states.

Courts and previous Guidelines have recognized nonprice effects which substantially lessen competition in areas such as innovation and quality.[304] The Horizontal Guidelines recognize market power can reduce product quality, product variety, service, and innovation.[305] For instance, when businesses withdraw products post-merger, the reduction in product variety is often due to the loss of competitive incentives attributable to the merger.[306] However, these nonprice harms should receive fuller recognition and wider scope in their application in the Guidelines going forward.

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[299] *Id*. at 522.
[300] King & Brown, *supra* note 242, at 66.
[301] *Id*.
[302] *Id*. at 67; Varanini, *supra* note 280, at 518.
[303] 2020 Vertical Merger Guidelines, *supra* note 241, § 4.a ("For example, a merger may increase the vertically integrated firm's incentive or ability to raise its rivals' costs by increasing the price or lowering the quality of the related product.").
[304] *See United States, v. Anthem Inc.*, 855 F.3d 345, 362 (D.C. Cir. 2017).
[305] 2010 Horizontal Merger Guidelines, *supra* note 47, § 1.
[306] *Id.* § 6.4.

Proper recognition of nonprice harms will continue to be undermined if those harms are not more robustly addressed. First, failure to more rigorously credit nonprice harms means that anticompetitive effects of mergers are not fully recognized. Second, the current neglect of these nonprice effects means that the efficiencies claimed by merging parties are given undue weight, as the merging parties need only claim those efficiencies off-set any measurable price effects. Rigorous analysis of these nonprice harms requires going beyond the quantitative models and analyses traditionally used to assess the effects of potential mergers on price. Rather, the direct impact of nonprice effects must be ascertained by distinct testimonial and expert evidence.

Additionally, a review of effects that focuses only on the effects of mergers on consumers, narrowly defined as retail purchases by homogenous end-purchasers, obscures the full scope of those effects. Consumers are just as harmed when innovation is squelched, access is reduced, services are lessened, and quality degraded. Nonprice effects should be eligible for the same presumptions as price effects in horizontal mergers. Market concentration presumptions as to the substantial lessening of competition are no less valid in instances where price is not the primary avenue of competition. Finally, these harms are no less valid nor less prevalent in the context of the non-horizontal mergers discussed herein.[307]

Based on this evidence and experience, the States first recommend that in concentrated markets with high barriers to entry where at least one of the merging parties has a history of limiting innovation by blocking or shuttering research of competitors providing products or services notably lacking in quality, durability, or safety, a presumption of nonprice harms should apply in pre-merger review. Second, we urge the DOJ and FTC to closely evaluate and fully consider these harms in every merger. When a risk of such harms is substantiated, federal enforcers may and should consider the full range of remedies that would be effective in fully restoring or preserving competition—including wider divestitures, break-up of firms, and universal compulsory patent licensing if necessary to remedy the harm. A more in-depth discussion of nonprice effects and remedies follows.

II. Capturing the Full Scope of Harm to Innovation

The current approach to analyzing the effect of mergers on innovation fails to capture fully the ability of dominant firms to reduce innovation. Narrow examinations of markets allow dominant firms to acquire additional intellectual property assets that can be used to foreclose innovation by competitors. Killer acquisitions of nascent competitors by dominant firms may outright end the development of new products and services. A focus on short-term impacts on innovations has also obscured mergers with horizontal and non-horizontal aspects in concentrated markets that may foreclose the research and development efforts of both nascent and mature competitors.

A. Mergers that Add to Vast IP Portfolios of Dominant Firms

Patents are temporary licenses to obtain monopoly profits, and carefully balancing their use to promote innovation without inordinate anticompetitive effects is a difficult and enduring problem in antitrust law. However, patents of one powerful competitor can inhibit innovation both

[307] See Special Characteristics Markets, *supra*.

in their own industry and other related industries that utilize either technologies plainly covered by the patents or technologies which may only dubiously be covered by the patents in question.[308]

For instance, following the breakup of AT&T and Bell Laboratories by federal enforcers and the compulsory licensing of its patent portfolio, at no cost to licensees, nationwide innovation increased markedly. Much of this innovation came from small firms that were previously stifled due to their lack of capital and inability to challenge or license the dominant firm's patent portfolio.[309] AT&T is but one instance where patent thickets impeded competition and innovation, causing deadweight loss in the general economies of our states, the national economy, and in particular, specific markets. Rather we as state enforcers see this issue replicated in several industries. The pharmaceutical sector is the most apparent example. Here, States have worked to ensure dominant brand-name firms do not use their large and suspect patent portfolios to induce pharmaceutical manufacturers to refrain from entering pharmaceutical markets and competing on price.[310]

For instance, when AbbVie was spun off from Abbott Laboratories, in 2013, it was an enterprise largely dependent on revenues from Humira, the world's best-selling drug. AbbVie leveraged Humira's high sales to bargain for better placement for other drugs on formularies. Instead of competing fairly, AbbVie used its monopoly in certain immunology markets to anchor its entire portfolio of products, which, but for monopoly leverage, would have had to compete in more crowded markets. Because the loss of Humira would represent a fatal blow to the nascent spinoff, AbbVie obtained at least 257 patents covering Humira, ensuring that generic competitors would have to fight patent litigation to launch a biosimilar alternative well into the 2030s.[311] Allowing firms to amass late patents of sometimes dubious quality that cover a monopoly product in the prescription drug market can create insurmountable barriers to entry, at least for a period of time. The accumulation of these patent thickets can be coupled by acquisitions to further hinder innovation.

When faced with the choice of how to diversify their business, considering the potential loss of the Humira monopoly, AbbVie deemed it more profitable to acquire and effectively eliminate a competitor to their own next-generation products, rather than invest further in their own research and development portfolio. During the FTC's review of the AbbVie-Allergan merger both Brazikumab from Allergan and Risankizumab (Skyrizi) from AbbVie were drugs competing largely with the same mechanism of action. Because AbbVie did not have any incentive to compete with itself, the FTC required it to divest Allergan's pipeline product. Yet, AbbVie was able to seek out a divestiture buyer who had previously divested the very same product due to a lack of interest in the therapeutic business market, because of AbbVie's own oppressive contracting practices that

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[308] Herbert J. Hovenkamp, *Antitrust and the Patent System: A Reexamination*, 76 OHIO ST. L.J. 467 (2015).
[309] Martin Watzinger et al., *How Antitrust Enforcement Can Spur Innovation: Bell Labs and the 1956 Consent Decree*, 12 AM. ECON. J.: ECON. POL'Y 328 (2020).
[310] For an example of states working alongside federal enforcers to ensure anticompetitive tactics cannot prevent generic competition in the pharmaceutical markets, *see New York ex rel. Schneiderman v. Actavis PLC*, 787 F.3d 638, 659 (2d Cir. 2015) (upholding state-obtained injunction to prevent manufacturer from impeding generic competition); *Fed. Trade Comm'n v. Actavis, Inc.*, 570 U.S. 136 (2013) (finding that patent settlements that delay generic entry do not preclude liability).
[311] Noah Higgins-Dunn, *The Top 15 Patent Expirations Coming This Decade*, FIERCEPHARMA (July 12, 2021), https://www.fiercepharma.com/special-report/humira-top-15-blockbuster-patent-expirations-coming-decade.

created high barriers of entry for competing products.[312] While AbbVie's Skyrizi was able to secure a record launch,[313] Allergan's competing product has languished in its acquirer's hands for over two years. It has never launched for the benefit of consumers or reached any new research milestones.[314]

Mergers should thus be presumed anticompetitive, based on effects on innovation, where a firm has either a dominant market share in the 30-50% range or higher (see discussion on Presumptions, *supra*) or an unusually large and enduring patent portfolio. Whether a patent portfolio is unusually large and enduring could be determined based on statistical studies in various industries as to the number of patents held on average, combined with prolonged and systematic efforts to extend the scope of patent protection based on minor modifications to the covered product or extended patent amendment activity.

Additionally, federal antitrust authorities should consider compulsory licensing of patents or development rights, or the spin-off of accompanying assets, to remedy harms to innovation. Particularly, because divestitures of pipeline product have an extremely high failure rate,[315] federal enforcers should consider granting compulsory licenses to any firm to complete development if divested pipeline products are not making consistent progress, as well as for legacy products that a firm ceases production of post-merger.

B. Effects of Concentrated Market Structure on Innovation

Concentrated markets, in combination with network effects, have raised the barriers of entry for new innovative entrants. Previous sections explain how acquiring and hoarding data could serve to entrench a monopolist.[316] In addition to user data, the acquisition of companies that possess licensing standards, platforms that process large amounts of data, or patents or inside knowledge of key technologies in industry-wide use has raised the barriers to entry in both the enterprise software and healthcare markets.

Recent transactions offer a glimpse of the competitive significance of the value placed on access to data sets, a firm's intellectual property policies, and overall valuation of platforms. For instance, leading chip system manufacturer Nvidia attempted to acquire an upstream provider of key industry technology, Arm, in 2021. In the semiconductor chip manufacturing market, a state of détente existed where Arm, a holder of a key technology that undergirds nearly all computer-

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[312] Letter from David A. Balto to Ian Conner, Dir., Bureau of Competition, U.S. Fed. Trade Comm'n (Feb. 18, 2020), https://b5dbfb83-9c74-47bd-bd60-30480423303a.filesusr.com/ugd/1859d0_68ca515ec90649b0bfe99d56eb368fec.pdf.

[313] Michael Christel, *Succession Plan: Skyrizi*, PHARMEXEC.COM (Sep. 13, 2020), https://www.pharmexec.com/view/succession-plan-skyrizi.

[314] Dissenting Statement of Commissioner Rohit Chopra, *In the Matter of AbbVie, Inc./Allergan plc*, Comm'n File No. 1910169 (May 5, 2020), https://www.ftc.gov/system/files/documents/public_statements/1574583/191-0169_dissenting_statement_of_commissioner_rohit_chopra_in_the_matter_of_abbvie-allergan_redacted.pdf.

[315] Charles McConnell, *Hoffman: FTC Won't Accept Pipeline Divestitures in Certain Mergers*, GLOBAL COMPETITION REV. (Feb. 5, 2018), https://globalcompetitionreview.com/hoffman-ftc-wont-accept-pipeline-divestitures-in-certain-mergers. *See also* D. Bruce Hoffman, Acting Dir., Bureau of Competition, U.S. Fed. Trade Comm'n, It Only Takes Two to Tango: Reflections on Six Months at the FTC (Feb. 2, 2018), https://www.ftc.gov/system/files/documents/public_statements/1318363/hoffman_gcr_live_feb_2018_final.pdf.

[316] *See* Digital Markets– Competition for Attention, *supra*, Section II.

based information processing, licensed that technology to all market participants at economically viable rates for all parties. Had the FTC not filed suit to block the transaction, Nvidia would have been the sole holder of Arm's patent portfolio.[317] By holding the preferred technology for the world's ecosystem of providing instructions to computer chips, Nvidia would have an insurmountable lead over nascent upstarts seeking to disrupt markets. The acquisition would have also further entrenched Nvidia's market power in the market for high-performance graphics cards.[318]

Examples of similarly dangerous transactions revolving around the acquisition of key technologies by a dominant player exist, engendering innovation and reducing competition. For instance, Nuance Communications' technology for speech recognition and patient data management is dominant in the healthcare market. Nuance's technology is used by 55% of physicians[319] and 77% of hospitals.[320] Already, this is an entrenched market and conservative by nature due to the risk of errors causing serious disability or even death. However, Nuance was acquired, in 2021, by another dominant provider of software for the healthcare space: Microsoft.[321] Microsoft's dominant Windows operating system is already used by 82% of the healthcare industry.[322] Following the merger, Microsoft's intention is to integrate and tie Nuance's software with its global Windows cloud ecosystem.[323]

Nascent competitors seeking to enter markets and transform industries can hardly make any headway against dominant products in different market segments that have been integrated and tied together, with the acquirers having every incentive to favor their products over those of rivals and nascent competitors. The scale of this concentration and vertical integration resulting from Microsoft's acquisition of Nuance makes the likelihood of customers switching from either Nuance or Microsoft to a nascent competitor highly unlikely. This dominant market position is exacerbated by the merged firm's ability to collect user data from multiple products, as Microsoft's cloud system will serve as an unrivaled source of user data concerning how customers utilize both Nuance's software and Microsoft's operating system and other cloud services. In fact, this merger raises similar concerns to those of Microsoft's control of the operating system market in the 1990s, which ultimately enabled it to illegally raise technical and practical barriers to entry for products

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[317] *In the Matter of Nvidia Corp.*, Compl., *supra* note 254.

[318] If the parties had not withdrawn the transaction subsequent to the FTC filing suit to block the merger, this may have been an excellent instance to resurrect the compulsory patent licensing conditions used in *Bell Labs. See* Watzinger et al., *supra* note 309.

[319] Susan Morse, *Microsoft doubles healthcare market with acquisition of Nuance*, HEALTHCARE FIN. NEWS (Mar. 20, 2020), https://www.healthcarefinancenews.com/news/microsoft-doubles-healthcare-market-acquisition-nuance.

[320] Nuance Communications, Inc., Healthcare AI Solutions and Services, https://www.nuance.com/healthcare.html (last visited Apr. 18, 2022).

[321] Morse, *supra* note 319.

[322] Jason Cohen, *While US Fights COVID-19, 83 Percent of Healthcare Systems Run Outdated Software*, PC MAGAZINE (Mar. 20, 2020) https://www.pcmag.com/news/while-us-fights-covid-19-83-of-healthcare-systems-run-outdated-software.

[323] Microsoft Corp., Press Release, Microsoft completes acquisition of Nuance, ushering in new era of outcomes-based AI (Mar. 4, 2022) https://news.microsoft.com/2022/03/04/microsoft-completes-acquisition-of-nuance-ushering-in-new-era-of-outcomes-based-ai/.

that competed with its own web browser software.[324] Ultimately, these effects stifled innovation and reduced consumer choice.[325]

Accordingly, federal antitrust authorities should consider whether presumptions based on market concentration should be applicable to data and key technology markets based on an acquirer or acquiree having substantial market power, e.g., 30-50% or more market share (see discussion of Presumptions, *supra*), and the existence of barriers to entry, particularly regarding vertical mergers.

1. A Presumption Against "Killer Acquisitions" by Dominant Firms

Many of the mergers which most clearly destroy innovation are the "killer acquisitions" described previously,[326] where a dominant firm acquires a nascent competitor and locks down their technology, shutters their independent business, or both. As these killer acquisitions are at least reasonably prevalent, entrench monopolists, and lead to significant nonprice effects, the States would urge the federal antitrust authorities to consider a presumption against acquisitions of nascent technologies by leading firms where those firms have a 30-50% or greater market share (see discussion of Presumptions, *supra*).

In innovation dependent industries, mergers often drive killer acquisitions of innovative, but smaller, firms. In the pharmaceutical industry, empirical research of acquisitions has found that between 5%-7.5% of mergers are "killer acquisitions," where a dominant firm with market power acquires a competing product in the early stages of research and then kills the product by never bringing it to market.[327] However, killer acquisitions need not involve a direct market overlap between the products of the acquiring firm and the products of the to-be-acquired firm. Rather, even when there is no direct competitive overlap between firms' on-market or in-development products, dominant firms have acquired such nascent products because they have the potential to erode market share. The reason being that nascent research could lead to a successor technology displacing or bypassing the need for an existing one altogether. For example: a

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[324] *Microsoft*, 253 F.3d 34.
[325] The State Attorneys General recognize that, in addition to being cleared by the United States Department of Justice, other global competition authorities have cleared the merger of Microsoft and Nuance, including the United Kingdom's Competition and Markets Authority on March 2nd, 2022 and the European Commission on December 21, 2021. *See* U.K. Competition & Mkts. Auth., Acquisition by Microsoft Corporation of Nuance Communications, Inc.: Decision on relevant merger situation and substantial lessening of competition (March 2, 2022), https://assets.publishing.service.gov.uk/media/6244608fd3bf7f32ac2b9425/Microsoft-Nuance_-_Decision_-_for_publication_.pdf; *see also* Eur. Comm'n, Directorate-Gen. for Competition, Press Release, Mergers: Commission approves acquisition of Nuance by Microsoft, European Commission (Dec. 21, 2021), https://ec.europa.eu/commission/presscorner/detail/en/ip_21_7067. However, the transaction did receive "deep scrutiny" in the United Kingdom, and a "closer look" in the EU. *See* Zacks Equity Res., Microsoft's (MSFT) Nuance Communications Deal Hits Roadblock, NASDAQ.COM (Dec. 14, 2021) https://www.nasdaq.com/articles/microsofts-msft-nuance-communications-deal-hits-roadblock. *See also* Andrea Park, *Microsoft's $19.7B Nuance buy hits a snag with EU antitrust probe*, FIERCEBIOTECH (Dec. 8, 2021), https://www.fiercebiotech.com/medtech/microsoft-s-19-7b-nuance-buy-hits-a-snag-eu-antitrust-probe.
[326] *See* Potential and Nascent Competition, *supra*, Section I.B.
[327] Cunningham et al., *supra* note 88, at 656 ("Using pharmaceutical industry data, we show that acquired drug projects are less likely to be developed when they overlap with the acquirer's existing product portfolio, especially when the acquirer's market power is large because of weak competition or distant patent expiration. Conservative estimates indicate that 5.3%–7.4% of acquisitions in our sample are killer acquisitions.").

treatment that could be applied in an earlier stage of a disease, or an injectable treatment could be replaced by oral medication.[328]

These killer acquisitions not only reduce innovation and potential consumer choice, but they also sunset alternatives that could lead to more competitive markets, a more productive economy, and better health and lives for consumers. Furthermore, by entrenching dominant or near-dominant monopolists, these killer acquisitions can be a harbinger of high prices and lower quality. The more alternatives can thrive and grow outside dominant brand-name products and the scope of their intellectual property protection, the more opportunities exist for monopolists to be forced ultimately to compete on price, quality, and choice.

While the most robust data of the negative nonprice effects of killer acquisitions exists in relation to the pharmaceutical industry, overly narrow merger analysis also permits killer acquisitions in the technology industry. As discussed previously,[329] none of the past 600 acquisitions by dominant tech platforms have been blocked. Google, for instance, has acquired numerous competing search products by purchasing up-and-coming firms. Under the current review system, Facebook (Meta) similarly maintained its prominence via a series of acquisitions of alternative social platforms or messaging apps.[330]

Empirical studies examining markets confirm that killer acquisitions, in addition to destroying specific innovations, collectively depress innovation more generally in the marketplaces where dominant firms operate. In the ideal innovative environment, capital would most efficiently flow to nascent competitors, with the potential to challenge monopoly profits obtained year after year by dominant firms. Instead, in the wake of a series of acquisitions, private investors become unwilling to stake money on firms they now view as being likely to be acquired by a dominant player before they become truly competitive.[331] In examining nearly three decades of digital acquisitions, the United States Senate heard testimony from investors specifically comparing a business too close to a dominant monopolist, such as Amazon, to Icarus flying "too close to the sun."[332] In pharmaceutical markets, dominant market players with existing product

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[328] In 2000, Questor held a monopoly over an adrenocorticotropic hormone drug called Acthar, the then-dominant treatment for rare epileptic diseases such as infantile spasms. Acthar was priced at roughly $40 a vial. In the mid-2000s, however, Novartis began developing Synacthen, a synthetic version of Acthar. In 2013, Questcor acquired the production rights for Synacthen and shut down development of the drug shortly thereafter. As a competitor to Acthar, Synacthen would have been a cheaper alternative that would have taken away significant market share from Questcor. Today, Acthar costs $39,000 a vial, which is a 97,000 percent increase in price over 19 years. Raksha Kopparam, Wash. Ctr. for Equitable Growth, Killer Acquisitions Lead to Decreased Innovation and Competition in the U.S. Prescription Drug Market (Sep. 25, 2019), https://equitablegrowth.org/killer-acquisitions-lead-to-decreased-innovation-and-competition-in-the-u-s-prescription-drug-market/. See also Org. for Econ. Coop'n & Dev., Start-ups, Killer Acquisitions and Merger Control–Background Note by the Secretariat, *supra* note 113, at 10 (discussing how Covidien, an established maker of expensive ventilators necessary to oxygenate patients such as those suffering from severe COVID-19, acquired nascent rival, Newport Medical Instruments, who held government contracts to produce new, cheaper, and more portable form of ventilator; after acquisition, no such ventilators were provided).
[329] *See* Digital Markets – Low & No Marginal Cost Products, *supra*, Section III.A.
[330] *See, e.g.*, *id.*; Nascent and Potential Competition, *supra*.
[331] Sai K. Kamepalli, Raghuram G. Rajan & Luigi Zingales, *Kill Zone*, at 5 (Feb. 16, 2021), https://ssrn.com/abstract=3555915.
[332] HOUSE DIGITAL MARKETS STAFF REPORT, *supra* note 35, at 49.

portfolios are most able to place new products on prescription drug formularies.[333] This gives dominant players an economic advantage in acquiring nascent competitors for the purpose of terminating their research, which occurs with some regularity in practice. These innovative, but smaller, firms face greater barriers to entry due to network effects and ultimately, often succumb to destructive acquisitions.

Based on the track record of dominant firms and our experience with divestiture remedies, the States reiterate our prior recommendation that a presumption against a dominant firm with 30-50% or more market share acquiring a company engaged in innovation with the potential for an impact in the same or a closely related industry.[334] Once these mergers are consummated, undoing the loss of innovation or of a nascent competitor may require extensive litigation and the expenditure of significant resources, or may simply be impossible.

2. Effects Analysis and Inadequate Remedies in Non-Horizontal Mergers

While many killer acquisitions are direct in nature, with the dominant firm acquiring the target firm, enforcers also observe less overt strategies in foreclosing nascent competitors. Recent mergers have left intact the ability of vertically integrated firms to foreclose on nascent competitors or, in the case of near monopolists, to reduce the incentives of even mature companies to invest in R&D and compete aggressively. In particular, the agricultural biotechnology and pharmaceutical sectors have grown more concentrated in the last two decades. Between acquisitions and four mega-mergers, four companies—Bayer, Syngenta, Corteva (Dow-DuPont), and BASF now account for over 68% of the total revenue in agricultural biotechnology markets.[335] Divestitures were required as part of these mergers to preserve innovation. However, the divesture buyers appear to have lacked sufficient incentives to compete. As detailed below, in the case of Monsanto-Bayer, the analysis failed to account for Monsanto's history of using its market power in complementary markets to foreclose potential rivals. And the ordered divestiture remedy was not properly assessed as to whether it could prevent such conduct in the future.

More specifically, prior to the merger, based on its market share alone, Monsanto allegedly would leverage its existing power in seed markets to restrict the use of competitor seed traits. One contractual provision prohibited smaller seed companies from combining Monsanto's genetic traits with seed traits controlled by its competitors without explicit written permission from Monsanto.[336] Other provisions tied rebates to companies filling 80 percent of their inventory with Monsanto products. The company also consistently tied purchase of its genetically modified seed to its RoundUp pesticide and used its intellectual property portfolio to repeatedly sue its customers for patent infringement.[337] Finally, Monsanto in conjunction with Bayer, BASF, Syngenta, and

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[333] David Balto, *Drug 'rebate walls' should be dismantled by the FTC's antitrust arm*, STAT (Dec. 4, 2018), https://www.statnews.com/2018/12/04/ftc-dismantle-drug-rebate-walls/.

[334] *See* Potential and Nascent Competition, *supra*, Section II.A.

[335] Lina Khan, *How Monsanto Outfoxed the Obama Administration*, SALON (Mar. 15, 2013), https://www.salon.com/2013/03/15/how_did_monsanto_outfox_the_obama_administration/.

[336] *Id.*

[337] Bethany Sumpter, *The Growing Monopoly in the Corn Seed Industry: Is It Time for the Government to Interfere?*, 8 TEX. A&M L. REV. 633 (2021) (discussing more than 1,000 lawsuits filed against farmers who allegedly violated licensing agreements or inadvertently used seeds containing Monsanto patented traits).

Corteva has repeatedly refused to cross-license genetic traits to smaller competitors, placing them at risk of patent litigation and liability.[338]

By the time of the merger, these practices meant that despite Bayer's entry into certain markets alongside Monsanto, Monsanto still possessed 49% and 50% shares in the soybean and corn seed markets, respectively. In the seed trait market, Monsanto had between 67% and 80% of the market for cotton seed traits and other seed genetic traits.[339] In contrast, BASF, the divestiture target, unlike Bayer, had no existing customer relationships or experience in the seed manufacturing and seed traits business.[340] While the divesture required Bayer to transfer its existing third-party agreements and customer information to BASF, these still represented significantly smaller shares of the relevant markets than Monsanto, whose market shares should have presumptively indicated market power. Given Monsanto's historical practices and Bayer's incentives to maintain Monsanto's market shares and revenue, it should have been self-evident that given the opportunity, Bayer would exclude BASF as an effective competitor by failing to provide the required support as part of the divestiture.

To elaborate, BASF's ability to bring R&D projects in the pipeline to market and effectively compete was premised on Bayer using its "best efforts" to help BASF get the necessary regulatory approvals for licenses, registrations, and permits required to use the divested assets and complicated approvals in multiple jurisdictions. [341] Despite the alleged need for BASF to become an independent competitor as soon as possible, the divestiture did not guarantee Bayer and BASF would enter into supply or other agreements reasonably necessary to allow BASF to effectively utilize the divested assets. Furthermore, Bayer was and is allowed to continue distributing BASF's products containing glufosinate ammonium and divested seed treatments. Considering BASF's lack of history in the U.S. markets, this divestiture arrangement created a huge incentive for the company not to injure its relationship with the merged entity and for the merged entity to fall short of providing its 'best efforts' to get a competitor to market.

Monsanto-Bayer is hardly alone. Mergers leading to market concentration continue to have negative innovation effects and remedies continue to inadequately address those effects. A wave of consolidation occurred in the agrochemical and biotechnology fields in the 1990s, leading to the four most active firms accounting for 80 percent of trials of new genetically modified seeds.[342] Subsequently, the number of firms conducting trials declined, and most non-government research efforts either slowed or were abandoned entirely. In addition to companies funding less research relative to their market size in consolidated markets, consolidation reduced the number of parallel research lines which are "critical to innovation in areas of uncertainty."[343] Today, companies like BASF and Corteva opt to combine their soybean R&D ventures rather than pursing independent

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[338] Peter Lee, *Innovation Consolidation*, 54 U.C. DAVIS L. REV. 967 (2020); see also Diana L. Moss, *Competition, Intellectual Property Rights, and Transgenic Seed*, 58 S. DAKOTA L. REV. 543 (2013).
[339] *United States v. Bayer AG*, No. 1:18-cv-01241, Competitive Impact Statement, ECF No. 3 (D.D.C. May 29, 2018).
[340] *Id.*
[341] *United States v. Bayer AG*, No. 1:18-cv-01241, Comments of the Attorneys General of California, Iowa, Massachusetts, Mississippi, and Oregon on the Proposed Final Judgment (D.D.C. May 29, 2018), https://www.justice.gov/file/1111006/download.
[342] Lee, *supra* note 338, at 1036.
[343] *Id.* at 1035.

lines of research.[344] Further, while requiring a number of limited patent divestitures, both the Dow-DuPont and Monsanto-Bayer mergers reduced the number of companies that could compete with both large patent portfolios and "quality patents," defined as patents that covered a large number of geographic markets and were cited in follow-on innovations.[345]

Here, too, market concentration and the aggregation of patents should lead to presumptions of anticompetitive effects and more effective remedies. And in that respect, innovation effects (and innovation markets) should be viewed more broadly. Consideration of the concentrated market structure involved in a merger, both merging companies' complete intellectual property portfolios, and the realistic probability of smaller competitors entering vertically integrated markets may reveal that post-merger overall incentives to innovate within the industry will decrease.[346] Consistent with enforcers' past practices, divestures should include widespread licensing of all intellectual property assets in a particular research portfolio.[347] But licensing should be combined with a complete divesture of a company's research & development capabilities, including employees and related assets, in order to prevent the loss of competition and to preserve innovation.[348]

III. Many Mergers Have Seen Quality Decrease, In Contrast to Their Promised and Unsubstantiated Quality Improvements.

The past several decades of consolidation have systematically degraded the quality of services and reduced resiliency across several industry sectors in our economy. Contrary to statements by proponents of relaxed restrictions on mergers, there is generally little to no evidence that post-merger, quality in products or services have increased.[349] Similarly with respect to

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[344] BASF Canada Agric. Sols., Press Release, Liberty 200 SN Herbicide named Preferred Glufosinate Partner with the Enlist Weed Control System (May 21, 2021), https://agriculture.basf.ca/east/en/company/news-room/liberty-200-sn-herbicide-named-preferred-glufosinate-partner-wit.html.

[345] Michaela Wilson, *Innovation Effects in Dow/DuPont: A Patent Analysis*, 64 ANTITRUST BULL. 54, 60, 72–73 (2019).

[346] Eur. Comm'n, Directorate-Gen. for Competition, Case M.7932, Dow/DuPont, Comm'n Decision, at 313–517 (Mar. 27, 2017), https://ec.europa.eu/competition/mergers/cases/decisions/ m7932_13668_3.pdf (analyzing overall innovation portfolio and constraints, market structure, and vertical integration of markets in addition to specific product markets); *see also In the Matter of Ciba-Geigy Ltd*., No. C-3725, Analysis of Proposed Consent Order to Aid Public Comment, at 4–5 (F.T.C. Dec. 17, 1996), https://www.ftc.gov/system/files/documents/cases/961217ciba analysis.pdf (analyzing market structure of gene therapy technology and the research and development of gene therapies markets in addition to product markets).

[347] *In the Matter of Ciba-Geigy Ltd*., *supra* note 346, Decision & Order, at 19–22 (F.T.C. Apr. 18, 1997) (requiring widespread licensing of gene therapy development tools and IP portfolio), https://www.ftc.gov/sites/default/files/documents/cases/1997/04/c3725.do.pdf; *In the Matter of Am. Home Product Corp*., C-3557, 119 F.T.C. 217, 236–37 (Feb. 15, 1995) (requiring licensing of early stage rotavirus research).

[348] Eur. Comm'n, Directorate-Gen. for Competition, Press Release, Commission Clears Merger Between Dow and DuPont Subject to Conditions (Mar. 27, 2017), https://ec.europa.eu/commission/presscorner/detail/en/IP_17_772 (requiring divesture of DuPont's global R&D organization, with the exception of a limited number of assets that support part of DuPont's pesticide business).

[349] John Kwoka & Shawn Kilpatrick, *Nonprice Effects of Mergers*, 63 ANTITRUST BULL. 169, 176–77 (2018); *see also* Nancy D. Beaulieu et al., *Changes in Quality of Care after Hospital Mergers*, 381 NEW ENG. J. MED. 51 (2020) (discussing modestly worse patient experiences and no significant changes in readmission or mortality rates in acquired hospitals post-merger).

vertical acquisitions, there is also no systematic evidence of enhanced quality.[350] This dearth of evidence suggests to us that that future enforcement efforts should be far more skeptical of any alleged procompetitive effects from increased quality that cannot be substantiated. To the contrary, increases in consolidation may substantially lessen competition and result in negative quality effects.

In the context of hospital markets, for example, acquired hospitals typically eliminate non-profitable lines of service.[351] Moreover, in the last decade, our experience with health provider acquisitions by private equity entities has strongly aligned with assessments that such mergers degrade quality of services. A later section discusses in more detail the full range of anticompetitive effects that private equity incentives may have in different industry sectors.[352] But, in California and other states, evidence of the impact of consolidation on quality has emerged most strongly in hospital, nursing home, and inpatient mental health facility acquisitions. Considering the patient populations at issue, this means that as consolidation has increased, quality has suffered in the services provided to our most vulnerable residents, including the elderly and individuals with substance use issues.

For example, Prospect Medical Holdings acquired seventeen hospitals in 17 states, including safety-net hospitals, which provide essential services to low-income residents.[353] Prospect Medical initially promised to improve quality of services. However, following their decade-long campaign of expansion, most of these facilities are more financially precarious, while providing fewer services. In Rhode Island, two of these safety-net hospitals possessed less than ten days of operating cash after financial transfers to both a real estate investment trust and to its private equity owners. The hospitals' liabilities net of assets went from $67 million to well over $1 billion.[354] Rather than competing rigorously on the quality of hospital services, the acquisitions reduced quality,[355] and the financial instability endangered the key provision of services, such as emergency behavioral health services and mental health and substance use services. This appears consistent across observations in the industry, where acquisitions are often financed by a leveraged

[350] Thomas G. Koch et al., *The Effects of Physician and Hospital Integration on Medicare Beneficiaries' Health Outcomes*, 103 REV. ECON. & STAT. 725 (2021); *see also* Marah N. Short & Vivian Ho, *Weighing the Effects of Vertical Integration Versus Market Concentration on Hospital Quality*, 77 MED. CARE & RES. REV. 538 (2020) (finding limited improvement on only 2 out of 29 quality measures post acquisition and decreased patient satisfaction strongly correlated with decreased competition).
[351] Cory Capp et al., *Antitrust Treatment of Nonprofits: Should Hospitals Receive Special Care?*, 15 ECON. INQUIRY 1183 (2020).
[352] *See* Private Equity, *infra.*
[353] R.I. Office of the Att'y Gen., Decision in Prospect Medical Holdings HCA Review: Roger Williams Medical Center and Our Lady of Fatima Hospital, at 3 (June 1, 2021), https://riag.ri.gov/sites/g/files/xkgbur496/files/documents/prospect_presentation.pdf.
[354] *Id.* at 15.
[355] Peter Elkind & Doris Burke, *Investors Extracted $400 Million From a Hospital Chain That Sometimes Couldn't Pay for Medical Supplies or Gas for Ambulances*, PROPUBLICA (Sept. 30, 2020), https://www.propublica.org/article/investors-extracted-400-million-from-a-hospital-chain-that-sometimes-couldnt-pay-for-medical-supplies-or-gas-for-ambulances ("The concerns are dire enough that on 14 occasions since 2010, Prospect facilities have been deemed by government inspectors to pose "immediate jeopardy" to their patients, a situation the U.S. Department of Health and Human Services defines as having caused, or is likely to cause, 'serious injury, harm, impairment or death.'").

buyout, subsequently face an increased risk of accumulating greater debt, and are finally acquired again within five to seven years.[356]

Evidence from consolidation in elder care, specifically dialysis services and nursing homes, illustrates how consolidations can degrade patient services. A study of dialysis centers acquired by Fresenius and DaVita found that post-acquisition, acquired facilities adopted practices from large chains, which degraded quality of care.[357] These reductions in quality are only compounded by the acquisition of physician provider groups by dominant firms in related markets. DaVita Medical Group is now owned by OptumCare, an arm of UnitedHealth Group. In addition to its quality issues, UnitedHealth's 80% market share in Medicare Advantage in some regions increases its incentive to contract exclusively with healthcare providers and foreclose on competing health plans.[358] These concerns have been confirmed throughout our ongoing experiences with for-profit nursing home chains, both before and during the pandemic.[359] Studies suggest in moderately and highly concentrated markets, private equity owners significantly reduce quality by reducing spending on staffing in low- and medium-competition markets. In the nursing home context, reductions in staffing are directly associated with reductions in quality of care.[360] Medicare or elderly patients at private equity backed nursing homes are ten percent more likely to die likely due to a combination of lower staffing levels and increased use of atypical antipsychotics.[361] In California, one of the most acquisitive nursing home chains, Brookdale Senior Living, artificially inflated its five-star quality ratings despite unlawfully discharging patients unsafely during the pandemic.[362]

These dangerous practices by acquirers are particularly alarming, given that similar private equity firms and other financial entities have begun to rapidly acquire substance use and mental health facilities. In California, one private investor-backed national chain was poised to acquire the only acute psychiatric hospital in a county; this facility served residents from numerous rural

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[356] Eileen Applebaum & Rosemary Batt, *Private Equity Buyouts in Healthcare: Who Wins, Who Loses?* (Inst. New Econ. Thinking, Working Paper No. 118, 2020), https://www.ineteconomics.org/uploads/papers/WP_118-Appelbaum-and-Batt-2-rb-Clean.pdf; *see also* RICHARD M. SCHEFFLER ET AL., AM. ANTITRUST INST., SOARING PRIVATE EQUITY INVESTMENT IN THE HEALTHCARE SECTOR: CONSOLIDATION ACCELERATED, COMPETITION UNDERMINED, AND PATIENTS AT RISK (May 8, 2021), https://www.antitrustinstitute.org/wp-content/uploads/2021/05/Private-Equity-I-Healthcare-Report-FINAL-1.pdf.

[356] Paul J. Elliason et al., *How Acquisitions Affect Firm Behavior and Performance: Evidence from the Dialysis Industry*, 135 Q. J. ECON. 221 (2020).

[356] *Colorado v. UnitedHealth*, Compl., *supra* note 243 (addressing potential foreclosure in healthcare).

[357] Elliason et al., *supra* note 356.

[358] *Colorado v. UnitedHealth*, Compl., *supra* note 243.

[359] Ashvin Ghandi, YoungJun Song & Prabhava Upadrashta, Private Equity, Consumers, and Competition: Evidence from the Nursing Home Industry (Mar. 22, 2022) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3626558.

[360] Charlene Herrington et al., *Appropriate Nurse Staffing Levels for U.S. Nursing Homes*, 13 HEALTH SERV. INSIGHTS (2020) (discussing relationship of higher staffing levels, increased resident quality of care, reduced re-hospitalizations, and reduced emergency room visits by nursing home residents), https://www.ncbi.nlm.nih.gov/pmc/articles/PMC7328494/.

[361] Atul Gupta et al., *Does Private Equity Investment in Healthcare Benefit Patients? Evidence from Nursing Homes* (Nat'l Bureau of Econ., Working Paper No. 28474, 2021), https://www.nber.org/papers/w28474.

[362] Compl., *People v. Brookdale Senior Living Inc.*, No. BCV-21-100539 (Cal. Super. Ct. Mar. 15, 2021), https://oag.ca.gov/system/files/attachments/press-docs/Brookdale%20Complaint.pdf.

counties and was one of the few providers of pediatric psychiatric services regionally.[363] Yet, post-merger, the merged entity along with another national chain, Universal Health Services, would have effectively created a duopoly.[364] At the same time, there were quality concerns tied to multiple incidents of sexual contact between minors at its other facility located in Northern California as well as failures of governance related to providing an insufficient number of supervising staff to remedy such concerns.[365] This combination of increased interest in acquisitions, more concentrated markets, and decreased quality is particularly concerning to the States as we work to expand treatment options in response to both the opioid epidemic and a growing mental health crisis among youth.

Consequently, our experience as States tells us enforcement efforts that focus on price effects to the exclusion of other evidence does a serious disservice to our most vulnerable residents. Fortunately, there are both qualitative and quantitative indicators of quality available to enforcement officials to properly weigh such potential harms in the future. For example, potential effects of lessened competition on quality can be evaluated by requesting quality and licensing records of all acquired and acquiring facilities from the parties, the Centers for Medicare & Medicaid Services, and state licensing bodies. For instance, during the review of the potential acquisition of an acute psychiatric hospital by an investor-backed chain, these records revealed a history of violating state and federal quality standards in over ten jurisdictions.[366] Allegations ranged from causing numerous patient deaths through neglect and poor infection control standards, serial instances of assault on patients and staff to 'boarding' patients to increase the revenue received from government and private payors for inpatient psychiatric care.[367] A presumption of a reduction in quality should apply to acquirers with noteworthy poor records of quality and safety, when their acquisitions also increase market concentration.

These experiences further suggest that enforcement efforts must consider a broader range of remedies to address such harms. In the most serious instances, where an acquiring firm has a history of violating state and federal standards and has failed to address these violations, this may merit blocking such a transaction. Short of a suit to block a transaction, we recognize many of these facilities provide essential services in our states, which are not easily replaced. Historically, state enforcers have imposed a range of conditions on both acquirers and acquired entities to address such effects. This includes requiring private equity sellers to set aside financial reserves to preserve the existing services provided and consequently, the competitiveness of the underlying facility asset in all relevant markets. California has also required enhanced monitoring of acquired facilities by state regulatory agencies, as well as reporting by stakeholders and parties to identify any degradation in services sooner rather than later. Additionally, empirics indicate that federal agencies have directly facilitated positive patient outcomes in industries, such as dialysis, when they have conditioned transactions on divestitures of overlapping facilities. We note here that a divestiture to a party incapable of or unwilling to operate a facility sustainably at the same level of

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[363] Richard M. Scheffler et. al., The Competitive and Quality Impact of the Proposed Acquisition of Adventist Health Vallejo by Acadia Healthcare 8–9, 13–14 (2021), https://oag.ca.gov/system/files/media/ahv-cqi.pdf.
[364] *Id.* at 30, tbl. 7.
[365] *Id.* at 35-37.
[366] *Id.* at 33-40 (describing violations in Ohio, Arizona, Florida, Washington, Texas amongst other states).
[367] *Id.*

quality is no effective remedy to quality concerns and in concentrated markets will ultimately lead to a similar loss in competition.[368]

Greater consideration of the full range of stakeholders in a merger may also reveal other avenues of investigation relevant to these nonprice effects. For instance, state legislative activity related to Pharmaceutical Benefit Managers (PBMs) has demonstrated that smaller firms vertically downstream in a market may be able to more clearly elaborate on the mechanisms of nonprice injuries likely to affect consumers in a downstream market than any other party. And enforcement actions related to nursing homes and other care facilities have shown that employees, small businesses, and government agencies may be able to identify potential effects on quality, which would remain unseen in an examination of data provided by the merging parties.

IV. Mergers of Intermediary Firms Have Blocked Competitors' Access to Markets, Harmed State Residents' Health, and Reduced Their Choices.

Similarly, control of market access in markets dominated by oligopolies and monopolies has ossified those markets, resulting in higher prices, less choice, and even the closure of smaller independent operations that are the lifeline for rural and underserved communities. Here, a presumption like, but broader than, a presumption against killer acquisitions should be employed, in which acquisitions should be presumed to be anticompetitive if they would have a tendency to reduce market access and involve a market dominated by an oligopoly or monopoly.

From the beginning, state and federal antitrust law has recognized that firms in concentrated markets with control over key arteries of commerce could use the threat of losing market access to ensure that downstream competitors complied with their demands. For instance, Ohio's judiciary, in 1891,[369] and later the U.S. Supreme Court, in 1911, ordered the dissolution of the Standard Oil trust. In these cases, Standard Oil was a key intermediary. It controlled access to markets through ownership of oil pipelines and monopolization of railroad contracts. This control was central to maintaining Standard Oil's illegal monopoly because Standard Oil's competitors could not get their product to market without railroads and pipelines. Consequently, Standard Oil's control of the key platform infrastructure of its industry created illegal barriers to entry, which maintained its monopoly and eliminated most competition in its market.

In the 21st century, mergers that create firms that can prevent products from even reaching consumers or downstream purchasers place our states' residents at risk of immense harm. This is especially apparent in healthcare. Over the past twenty years, the "Big Three" pharmacy benefit managers (PBMs) CVS, OptumRx, and Express Scripts have become increasingly horizontally and vertically integrated. Each entity has acquired one of the largest health payors in the nation. By acquiring other benefit managers, the Big Three have also ensured their oligopoly controls most of the pharmaceutical buyer market. This high degree of control over which drugs patients obtain, where, and at what price has enabled PBMs to overcharge state-sponsored health plans,

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[368] Thomas G. Wollmann, *How to Get Away with Merger: Stealth Consolidation and its Effects on US Healthcare* (Nat'l Bureau of Econ. Research, Working Paper No. 27274, 2021), https://www.nber.org/system/files/working—_papers/w27274/w27274.pdf.

[369] *State ex. rel. Attorney Gen. v. Standard Oil Co.*, 49 Ohio St. 137 (1891).

designed to provide care to our most vulnerable residents.[370] This market concentration and integration threatens to result in a situation similar to *Standard Oil*: payors that are not integrated into one of the Big Three PBMs are hobbled in selling plans; independent pharmacies can be disadvantaged, resulting in their closure at the expense of local communities; and patients can be restricted in their choice of medications at the risk of their health. With only three firms controlling 80% of the pipelines for drug distribution and reimbursement, unchecked merger activities by PBMs have resulted in a scenario where state enforcers and legislators must be constantly vigilant.[371]

In agricultural markets, which our residents depend on for access to safe and healthy food, powerful middlemen have restricted market access and caused smaller farms to shutter, in ways mirroring how *Standard Oil's* market access controls forced consolidation. For instance, due to artificially inflated buying power and restrictive contracts associated with selling chickens to a small number of chicken processors, a state of oligopsony has existed in this market for decades.[372] Restrictive contracts and market power on the side of processors has forced families to sell thousands of family farms in the state of Arkansas alone, doubling consolidation on the production side of the industry.[373] Even those farmers who try to opt out of using dominant processors and find processing for their produce on their own have minimal options. Large processing conglomerates own most of the supply chain, including the mills that process grain into feed, the hatcheries that produce broiler eggs and young breeding-stock chickens, the processing plants, and the plants that render and further process fats and other waste products.[374] Similar conditions hold true in many other agricultural markets, reducing residents' access to alternative food producers. Some producers attempt to opt-out of using consolidated food processors and distributors and see their production through to becoming a final retail product on their own. However, consolidation among the companies that control access to retail shelf space makes it unlikely that their products will ever reach consumers. For approximately 80% of American groceries, most retail sales are controlled by four or fewer firms.[375]

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[370] Barak Richman & Kevin Schulman, *Mergers Between Health Insurers and Pharmacy Benefit Managers Could be Bad for Your Health*, STAT (June 1, 2018), https://www.statnews.com/2018/06/01/mergers-health-insurers-pharmacy-benefit-managers/; Stacy Mitchell & Zach Freed, *How the FTC Protected the Market Power of Pharmacy Benefit Managers*, PROMARKET (Feb. 18, 2021), https://promarket.org/2021/02/19/ftc-market-power-pharmacy-benefit-managers/.

[371] Frier Levitt, LLC, Pharmacy Benefit Manager Exposé: How PBMs Adversely Impact Cancer Care While Profiting at the Expense of Patients, Providers, Employers, and Taxpayers, at 4 (Feb. 2022), https://communityoncology.org/wp-content/uploads/2022/02/COA_FL_PBM_Expose_2-2022.pdf.

[372] Tomislav Vukina & Porametr Leegomonchai, *Oligopsony Power, Asset Specificity, and Hold-up: Evidence from the Broiler Industry*, 88 AM. J. AGRIC. ECON., 589–605 (2006).

[373] Nina Lakhani, *"They Rake in Profits–Everyone Else Suffers": US Workers Lose Out as Big Chicken Gets Bigger*, GUARDIAN (Aug. 11, 2021), https://www.theguardian.com/environment/2021/aug/11/tyson-chicken-indsutry-arkansas-poultry-monopoly; Rebecca Boehm, Union of Concerned Scientists, Tyson Spells Trouble for Arkansas, fig. 4 (Aug. 11, 2021), https://www.ucsusa.org/resources/tyson-spells-trouble#read-online-content.

[374] James M. MacDonald, *Technology, Organization, and Financial Performance in US Broiler Production*, U.S. Dep't of Agric. Econ. Res. Serv., Econ. Info. Bull. No. 126 (June 2014), at 3–5.

[375] The consolidation runs deep: four firms or fewer controlled at least 50% of the market for 79% of the groceries. For almost a third of shopping items, the top firms controlled at least 75% of the market share. Nina Lakhani et al., *Revealed: The True Extent of America's Food Monopolies, and Who Pays the Price*, GUARDIAN (July 14, 2021), https://www.theguardian.com/environment/ng-interactive/2021/jul/14/food-monopoly-meals-profits-data-investigation.

While consolidation among food processing appears reminiscent of *Standard Oil*, conditions at many of these conglomerate food processors have begun to resemble health and safety conditions at the turn of the 20th century.[376] The largest meat processing conglomerates, Tyson and JBS had their workers contracting COVID-19 at a disproportionate rate compared to other food processors.[377] The physical injuries suffered by their workforces are also hugely disproportionate, with the fourth and sixth largest number of severe injuries across US employers, despite having relatively small workforces in comparison to other industries.[378] In numerous states, large meat processors used their size and influence to stonewall local public health departments throughout the pandemic, withholding data and refusing compliance with public health regulations.[379] At Tyson Foods, those same plant workers with depressed wages, minimal sick leave, and poor working conditions, likely due in part to the oligopsony caused by consolidation, are the very ones in charge of ensuring the majority of America's poultry supply is sanitary.[380]

In digital markets, intermediary monopolies also dominate access to information, restrict consumer choice, and inhibit competition; we are not the first to notice the parallel between the Internet coming largely into the hands of the few platforms and the railroad oligopolies of *Standard Oil*'s Gilded Age.[381] When one firm is the sole owner of the infrastructure necessary to bring firms' products to a particular market, their control over competition and consumer choice in that market can be near-absolute.

Consequently, we recommend that a merger be presumptively illegal if the acquirer has market power in a midstream, two-sided, or platform market and the acquisition would increase concentration in any of the markets served by that platform.[382] History and evidence demonstrate that such acquisitions have a natural tendency to restrain trade.

FAILING & FLAILING FIRMS

I. The Guidelines' Moderate Approach to the Failing Firm Defense Should Not Be Revised

The States are of the view that the Guidelines' approach to the failing firm defense is adequate and does not require revision. The Guidelines already take a moderate approach to the elements of the defense. Further dilution of the standard would weaken scrutiny of failing firm claims, even though both Agencies have recently indicated that they have serious concerns about credibility of these claims. As the Supreme Court has stated, the acceptance of a failing firm

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[376] *See, e.g.*, UPTON SINCLAIR, THE JUNGLE (1906), at 410 ("Preventable diseases kill off half our population. And even if science were allowed to try, it could do little, because the majority of human beings are not yet human beings at all, but simply machines for the creating of wealth for others.").

[377] Karen P. Stillerman, Union of Concerned Scientists, *4 Ways Tyson Foods Made 2020 Worse*, THE EQUATION (Dec. 21, 2020), https://blog.ucsusa.org/karen-perry-stillerman/4-ways-tyson-foods-made-2020-worse/.

[378] DEBBIE KERKOWITZ & HOOMAN HEDAYATI, NAT'L EMP. L. PROJECT, OSHA SEVERE INJURY DATA FROM 29 STATES (Apr. 2017), https://www.nelp.org/news-releases/osha-severe-injury-data-report/.

[379] Michael Grabell, *Emails Reveal Chaos as Meatpacking Companies Fought Health Agencies Over COVID-19 Outbreaks in Their Plants*, PROPUBLICA (June 12, 2020), https://www.propublica.org/article/emails-reveal-chaos-as-meatpacking-companies-fought-health-agencies-over-covid-19-outbreaks-in-their-plants.

[380] Boehm, *supra* note 373, at 10.

[381] Eben Moglen, *The Invisible Barbecue*, 97 COLUM. L. REV. 945 (1997).

[382] See Presumptions, *supra*.

defense is, at best, the "lesser of two evils"[383]—a determination that a transaction's threat to competition is outweighed by the likelihood that one of the merging parties will fail and its assets will exit the market. Thus, the standard for such defenses should remain difficult to meet.

The failing firm defense was first set forth by the Supreme Court in *International Shoe*, which held that the acquisition of a company "with resources so depleted and the prospect of rehabilitation so remote that it faced the grave probability of a business failure," where there was "no other prospective purchaser," did not violate Section 7 of the Clayton Act.[384] A decade later, the Court elaborated the failing firm defense in *Citizen Publishing* and held that "[t]he burden of proving that the conditions of the failing company doctrine have been satisfied is on those who seek refuge under it."[385] Since then, courts have taken varying approaches to the elements of the defense.

First, with respect to "the grave probability of a business failure," the Court in *Citizen Publishing* found that a firm could not establish a failing firm defense where there was no indication that its owners "were contemplating a liquidation" or sought to sell the firm, or that the firm was no longer a "significant threat" to its competitors.[386] Following suit, many courts applying this test require a showing that the firm is actually insolvent.[387] It is not enough for a firm to claim that its profits are declining or that it has incurred losses.[388]

Second, in *Citizen Publishing* the Court held that the failing firm defense "plainly cannot be applied in a merger or in any other case unless it is established that the company that acquires the failing company or brings it under dominion is the only available purchaser."[389] A few courts have simply restated or applied the "only available purchaser" language.[390] However, most courts hold that this requirement can be satisfied with a lesser showing: the firm must have "made a

[383] *United States v. Gen. Dynamics Corp.*, 415 U.S. 486, 507 (1974) (distinguishing failing firm defense from weakened competitor doctrine, discussed *infra*).
[384] *Int'l Shoe Co. v. Fed. Trade Comm'n*, 280 U.S. 291, 302–03 (1930).
[385] *Citizen Pub. Co. v. United States*, 394 U.S. 131, 138–39 (1940).
[386] *Id.* at 137–38.
[387] *See, e.g.*, *California v. Sutter Health Sys.*, 84 F. Supp. 2d 1057 (N.D. Cal.) ("The most important factor . . . is whether the firm is insolvent or on the brink of insolvency either in the bankruptcy sense, that the firm has no net worth, or in the equity sense, that the firm is unable to meet its debts as they come due."), *aff'd mem.*, 217 F.3d 846 (9th Cir. 2000); *United States v. MPM, Inc.*, 397 F. Supp. 78, 100 (D. Colo. 1975) (firm met "equity definition of 'insolvency'"); *United States v. G. Heileman Brewing Co.*, 345 F. Supp. 117, 122–23 (E.D. Mich. 1972) (firm failed to establish failing company defense because, *inter alia*, assets were "not depleted to the point of insolvency").
[388] *See, e.g.*, *United States v. Blue Bell, Inc.*, 395 F. Supp. 538, 550 (M.D. Tenn. 1975) (failing company defense not met by claims that acquired division had "unsatisfactory" earnings, and parent's intention to divest itself of allegedly failing division was "immaterial"); *Phillips Petroleum*, 367 F. Supp. at 1259–60 (firm that returned net income in five years prior to transaction could not establish failing company defense); *United States v. Pabst Brewing Co.*, 296 F. Supp. 994, 999–1000 (E.D. Wis. 1969).
[389] *Citizen Publishing*, 394 U.S. at 138.
[390] *See, e.g.*, *Golden Grain Macaroni Co. v. Fed. Trade Comm'n*, 472 F.2d 882, 887 (9th Cir. 1972) ("Merely proving that some or all of the most logical purchasers have declined to buy is not enough to prove that the challenged purchaser was the only prospective purchaser."); *Fed. Trade Comm'n v. Harbour Grp. Inv., L.P.*, Civ. A. No. 90-2525, 1990 WL 198819, at *3 (D.D.C. Nov. 19, 1990) ("The 'only' suggests that the burden on the defendant in proving compliance with this requirement is quite heavy.").

reasonable, good faith attempt to locate an alternative buyer" that would pose a less severe danger to competition.[391]

Third, the Court in *Citizen Publishing* added another element to the test in *International Shoe*: the firm's "prospects of reorganization" under the bankruptcy laws "would have had to be dim or nonexistent . . . ."[392] Two subsequent Supreme Court decisions did not include this element when articulating the test for a failing firm defense, albeit in dicta.[393] Relying on these decisions, a few district courts have concluded that an inability to reorganize in bankruptcy is not an element of the failing firm defense.[394] But the D.C. Circuit and the Sixth Circuit, along with other district courts, include it as a third element of the defense.[395]

The Guidelines incorporate all three elements of the failing firm defense but refrain from adopting the most demanding interpretations of them. For instance, under the "grave possibility of business failure" requirement, most courts require a showing of actual insolvency, but under the Guidelines, the allegedly failing firm just needs to show that it "would be unable to meet its financial obligations in the near future . . . ."[396] Likewise, a firm raising the defense need not show that the acquiring firm is the only available purchaser; it just needs to show that "it has made unsuccessful good-faith efforts to elicit reasonable alternative offers" that would keep its assets in the market while posing a lesser danger to competition. The Guidelines further specify that any offer to purchase the failing firm's assets for more than liquidation value (i.e., the highest value those assets could attain outside the relevant market) constitutes a reasonable alternative offer.[397] Finally, the 2010 revision of the Guidelines removed a separate, fourth element of the failing firm

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[391] *See, e.g.*, *Dr. Pepper/Seven-Up Cos., Inc. v. Fed. Trade Comm'n*, 991 F.2d 859, 865 (D.C. Cir. 1993) ("Third, the proponent of the acquisition] must demonstrate that there is no other viable alternative purchaser [by demonstrating] that it has made a reasonable, good faith attempt to locate an alternative buyer."); *United States v. Energy Sols., Inc.*, 265 F. Supp. 3d 415, 446 (D. Del. 2017) (merging parties failed to show that firm "made good faith efforts to elicit reasonable alternative offers that would pose a less severe danger to competition.").

[392] *Citizen Publishing*, 394 U.S. at 138.

[393] *See General Dynamics*, 415 U.S. at 507 ("A company invoking the defense has the burden of showing that its resources [were] so depleted and the prospect of rehabilitation so remote that it faced the grave probability of a business failure, and further that it tried and failed to merge with a company other than the acquiring one.") (internal quotation marks and citations omitted); *United States v. Greater Buffalo Press, Inc.*, 402 U.S. 549, 555 (1971) ("That test is met only if two requirements are satisfied: (1) that the resources of [the failing firm] were so depleted and the prospect of rehabilitation so remote that it faced the grave probability of a business failure, and (2) that there was no other prospective purchaser for it.") (internal quotation marks and citation omitted).

[394] *See, e.g.*, *United States v. Black & Decker Mfg. Co.*, 430 F. Supp. 729, 778 (D. Md. 1976) ("The weight of authority suggests that dim prospects for bankruptcy reorganization are not essential to successful assertion of the failing company defense."); *MPM*, 397 F. Supp. at 96 ("We conclude that a § 7 defendant need not be required to show that reorganization prospects under the Bankruptcy Act were dim or nonexistent in order to discharge its burden of proof as to the 'failing company' defense.").

[395] *See, e.g.*, *Dr. Pepper*, 991 F.2d at 865 (recognizing "no realistic prospect for a successful reorganization" as element of failing company doctrine); *United States Steel Corp. v. Fed. Trade Comm'n*, 426 F.2d 592, 608–09 (6th Cir. 1970) (requirement in *Citizen Publishing* that acquired company has "dim or nonexistent" prospects of reorganization in bankruptcy "has its origin in the ultimate facts material to *International Shoe*") (internal quotation marks omitted); *Phillips Petroleum*, 367 F. Supp. at 1259 (citing *Citizen Publishing* for requirement of dim prospects of reorganization in bankruptcy).

[396] 2010 Horizontal Merger Guidelines, *supra* note 47, § 11, at 32 (emphasis added).

[397] *Id.* at 32 & n.16.

defense: a showing that "absent the acquisition, the assets of the failing firm would exit the relevant market."[398]

By stepping back from the strictest formulations of the failing firm defense, the Guidelines take a moderate approach. The defense may still be difficult to satisfy, but it is not impossible to do so; enforcers have recognized failing firm arguments in decisions to clear recent transactions. For example, in 2016 the FTC approved the acquisition of Minnesota healthcare provider network St. Cloud Medical Group ("SCMG") by another such network, CentraCare Health, finding that SCMG's only line of credit was frozen, that physicians planned to leave the network if the transaction was not consummated, and that SCMG had mounted a good-faith multi-year search for an alternative purchaser that proved unsuccessful.[399]

Nevertheless, critics of the Guidelines' approach maintain that it sets too high of a burden for companies seeking to invoke the failing firm defense. For instance, some have contended that it is difficult to demonstrate, or even to predict, whether a company will be able to successfully reorganize under Chapter 11 of the Bankruptcy Act.[400] But the States are of the view that this requirement is necessary to account for the possibility addressed by the Supreme Court in *Citizen Publishing*: that a company which reorganizes under Chapter 11 may re-emerge as a strong competitor.[401] While conventional wisdom has it that most Chapter 11 cases fail, analysis of case statistics has revealed that the vast majority of debtors who meet the basic requirement of filing any plan of reorganization will successfully emerge from bankruptcy.[402] The justification for the failing firm defense is that clearance of an anticompetitive transaction is preferable to having a firm's assets exit the market completely. Therefore, it is reasonable for federal enforcers to require a showing that the allegedly troubled firm and its assets will not simply re-enter the market after a Chapter 11 reorganization.

Others have argued that the element of a good faith effort to seek reasonable alternative purchasers has been inconsistently applied and needs further elaboration.[403] But much of the

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[398] *Compare id.* at 32 with U.S. Dep't of Justice & U.S. Fed. Trade Comm'n, Horizontal Merger Guidelines § 5.1, at 29 (1997), https://www.justice.gov/sites/default/files/atr/legacy/2007/07/11/11251.pdf (hereinafter "1997 Horizontal Merger Guidelines").

[399] *In the Matter of CentraCare Health*, Dkt. No. C-4594, Compl. (F.T.C. Oct. 5, 2016), ¶¶ 37–38, at 7, https://www.ftc.gov/system/files/documents/cases/161006centracarecmpt.pdf.

[400] U.S. Fed. Trade Comm'n, Horizontal Merger Guidelines Review Project, Transcript of Workshop II, Dec. 8, 2009, 126:10–23 (comments of David S. Neill), https://www.ftc.gov/sites/default/files/documents/public_events/horizontal-merger-guidelines-review-project/091208transcript.pdf; *see also id.* 122:16–19 ("[T]he [G]uidelines requirement that you've got to demonstrate that you cannot successfully emerge from Chapter 11 is a very, very difficult burden to meet.") (comments of Katherine B. Forrest).

[401] *Citizen Publishing*, 394 U.S. at 138 ("Moreover, we know from the broad experience of the business community since 1930, the year when the *International Shoe* case was decided, that companies reorganized through receivership, or through Chapter X or Chapter XI of the Bankruptcy Act often emerged as strong competitive companies.").

[402] *See* Elizabeth Warren & Jay Lawrence Westbrook, *The Success of Chapter 11: A Challenge to the Critics*, 107 MICH. L. REV. 603, 606 (2009) ("Isolating those cases with a reasonable chance of success, as measured by the debtor's ability to advance a plan—any plan—of reorganization, we discovered that the success rate soars to more than seventy percent."); *id.* at 618 ("After all, the legal requirements for proposing a plan are minimal at best. Formally, a debtor needs little more than an explanation of how the business will deal with its creditors and the prospects for continuing the business.").

[403] *See, e.g.*, Norman A. Armstrong Jr. & Christopher C. Yook, *A Call for Greater Consistency in the Failing Firm Defense*, ANTITRUST SOURCE (Dec. 2017).

inconsistency arises from courts choosing to apply the "only available purchaser" language in *Citizen Publishing*, rather than the requirement of "unsuccessful good-faith efforts to elicit reasonable alternative offers"—already present in the Guidelines.[404]

More broadly, the States are of the view that criticisms of the Guidelines approach to the failing firm defense, however well intentioned, must be weighed against a fundamental problem with that defense: credibility. In our experience, failing firm arguments are prone to exaggeration, with merging parties making predictions of imminent failure that do not stand up to scrutiny. Recently, officials at both Agencies have expressed similar views. In 2020, Ian Conner, then director of the Bureau of Competition, warned merging parties to "think twice before making apocalyptic predictions of imminent failure during a merger investigation." Commenting that "candor before the agency" was "paramount," he noted that "it has been striking to see firms that were condemned as failing rise like a phoenix from the ashes once the proposed transaction was abandoned in light of our competition concerns," suggesting that "a serious effort to assess the standalone future of the company was not undertaken before representing that the failure of the merger would result in the imminent demise of that company." Counsel who repeatedly made such arguments in different transactions, Conner cautioned, were risking their own credibility.[405]

Similarly, former Assistant Attorney General Makan Delrahim pointed out in a 2020 speech that the failing firm defense "implicitly recognize[s] that companies may engage in mergers and acquisitions that do not rest on perfectly rational analyses and justifications." The defense "does not merely trust arguments that 'only a merger can save the company from failure'" because "such arguments may rest on faulty business judgment stemming from managers' cognitive biases." The exacting requirements of the defense "are designed to protect consumers from anticompetitive mergers, and they also attempt to ensure that antitrust analysis is not swayed by managers' faulty or irrational business judgment."[406]

Because of the issues discussed above, failing firm defenses should be subject to a high evidentiary standard. The States believe that the present statement of the failing firm defense in the Guidelines strikes the appropriate balance, taking a more moderate approach than some courts, yet still requiring ample evidence from merging parties that their transaction is, in fact, one of the rare instances where the defense actually applies.

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[404] Some commentators claim that federal enforcers have been inconsistent in their application of the "good faith efforts" requirement in the Guidelines. *See, e.g.*, *id.* at 6–7. However, suggestions that federal enforcers should remedy this problem by specifying the factors considered in determining whether a firm has made a "good faith effort"—*see id.* at 7–8—merely describe federal enforcers' current practices, and in the States' view, would not provide more certainty as to the outcomes of such fact-intensive inquiries.

[405] Ian Conner, Dir., Bureau of Competition, U.S. Fed. Trade Comm'n, On "Failing" Firms—and Miraculous Recoveries (May 27, 2020), https://www.ftc.gov/news-events/blogs/competition-matters/2020/05/failing-firms-miraculous-recoveries.

[406] Makan Delrahim, Assistant Att'y Gen., U.S. Dep't of Justice, Antitrust Div., Never Break the Chain: Pursuing Antifragility in Antitrust Enforcement, Remarks as Prepared for Delivery to Kellogg School of Management, Northwestern University Conference on Innovation of Economics (Aug. 27, 2020), https://www.justice.gov/opa/speech/assistant-attorney-general-makan-delrahim-delivers-remarks-thirteenth-annual-conference.

II. No Further Discussion of the Weakened Competitor Doctrine Should Be Added to the Guidelines

The Guidelines do not expressly lay out any parameters for the consideration of so-called "flailing firm" or "weakened competitor" arguments, and the States are of the view that no such parameters are needed. On the contrary, providing such guidance would only encourage merging parties to present such arguments, even though claims concerning a firm's financial or management difficulties are "readily exaggerated" and "generally rest on unwarranted assumptions."[407] Moreover, the highly fact-specific nature of the weakened competitor inquiry means that any guidelines of general application, across diverse markets and industries, would be of limited usefulness.

The modern weakened competitor doctrine under United States law has its origins in the Supreme Court's 1974 holding in *General Dynamics*. The Court found that because of recent changes in the coal industry, the acquired firm's lack of uncommitted coal reserves would eventually harm the company's ability to compete—even though it was not on the brink of failure at the time.[408] Significantly, the Court rejected the Government's argument that the merging parties were raising a "failing company" defense but failing to meet its requirements. Rather, the district court's findings "went to the heart of the Government's statistical prima facie case based on production figures," showing that the acquired firm "was a far less significant factor in the coal market than the Government contended, or the production statistics seemed to indicate."[409] Thus, *General Dynamics* set forth a limited weakened competitor doctrine that is analytically distinct from the failing firm defense currently contained in the Guidelines.

Since then, the lower courts have narrowly applied the weakened competitor doctrine as allowing defendants to "rebut the government's prima facie case by showing that the government's market share statistics overstate the acquired firm's ability to compete in the future and that, discounting the acquired firm's market share to take this into account, the merger would not substantially lessen competition."[410] However, the courts have, almost without exception, construed the doctrine narrowly and noted that it is disfavored, for multiple reasons:

1. Because firms raising a weakened competitor argument "are not in grave danger of failure"—in that case, they would be raising a failing company defense— "it is not certain that their weakness will cause a loss in market share beyond what has been suffered in the past, or that [such weakness] cannot be resolved through new financing or acquisition by other than a leading competitor."[411]

2. The weakened competitor doctrine "fails to account for the fact that financial difficulties not raising a significant threat of failure are typically remedied in a moderate length of

[407] AREEDA & HOVENKAMP, *supra* note 24, ¶ 963.
[408] *General Dynamics*, 415 U.S. at 499–503.
[409] *Id.* at 503.
[410] *Fed. Trade Comm'n v. Univ. Health, Inc.*, 938 F.2d 1206, 1221 (11th Cir. 1991).
[411] *Id.* (internal quotation marks omitted).

time, whereas a merger is a relatively permanent action that eliminates the potential for future competition between the merging parties."[412]

3. Approval of a merger due to weakened competitor arguments does nothing to address the ability of the merged firm to heighten barriers to entry: "The acquisition of a financially weak company in effect hands over its customers to the financially strong, thereby deterring competition by preventing others from acquiring those customers, making entry into the market more difficult."[413]

4. Proper application of the doctrine requires a "substantial showing that the acquired firm's weakness, which cannot be resolved by any competitive means, would cause that firm's market share to reduce to a level that would undermine the government's prima facie case."[414] In other words, the amount of evidence required for a weakened competitor argument should vary according to the strength of the prima facie case. If the government presents market shares, HHI values, or HHI increases demonstrating that the merger would result in highly concentrated markets (as discussed in Section 5.3 of the Guidelines), the defendant should face a high burden of showing that the acquired firm's weaknesses would cause the high market shares, HHI values, or HHI increases identified by the government to shrink to the point where the market could no longer be described as highly concentrated.[415]

For all these reasons, the Eleventh Circuit has stated that courts will credit weakened competitor arguments "only in rare cases . . . ."[416] Likewise, the Seventh Circuit has held that weakened competitor claims remain "probably the weakest ground of all for justifying a merger,"[417] the Ninth Circuit has held that "financial weakness does not in itself justify a merger,"[418] and the Sixth Circuit has called the weakened competitor justification "the Hail-Mary pass of presumptively doomed mergers . . . ."[419]

Accordingly, the Guidelines do not mention the flailing firm or weakened competitor doctrine by name, and do not set forth any standards, elements, or statistical thresholds for it.[420] Only two passages in the Guidelines refer to the doctrine:

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[412] *United States v. Aetna Inc.*, 240 F. Supp. 3d 1, 92 (D.D.C. 2017) (internal quotation marks omitted).
[413] *Kaiser Aluminum Chem. Corp. v. Fed. Trade Comm'n*, 652 F.2d 1324, 1339 (7th Cir. 1981).
[414] *Univ. Health*, 938 F.2d at 1221 (emphasis added).
[415] For example, in *United States v. Amax, Inc.*, the court found that as a matter of law, the merging parties failed to establish a weakened competitor defense because even if the Government's market share calculations were discounted as the defendants suggested, the industry was so "highly concentrated" that the result would still violate Section 7 of the Clayton Act. 402 F. Supp. 956, 972 (D. Conn. 1975).
[416] *Id.* at 1221.
[417] *Kaiser Aluminum*, 652 F.2d at 1339.
[418] *Fed. Trade Comm'n v. Warner Commc'ns*, 742 F.2d 1156, 1165 (9th Cir. 1984).
[419] *Promedica Health Sys.*, 749 F.3d at 572.
[420] *See, e.g.*, Bryan Koenig, *Enforcers Remain Worried about 'Flailing' Merger Arguments*, LAW360 (Feb. 10, 2021), https://www.law360.com/articles/1354352/enforcers-remain-worried-about-flailing-merger-arguments ("While federal merger guidelines lay out parameters to consider the so-called 'failing firm' defense . . . [Sarah Oxenham Allen, Counsel to the Assistant Attorney General and former Chair of the NAAG Antitrust Task Force] said there is no such recognition of the 'flailing' firm defense to help firms in less dire straits.").

1. In Section 11, on "Failure and Existing Assets," the Guidelines refer to the failing firm defense as "an extreme instance of the more general circumstance in which the competitive significance of one of the merging firms is declining . . . ."[421] This passage was added in the 2010 revision of the Guidelines.[422]

2. In Section 5.2, on "Market Shares," the Guidelines state that while market share and concentration data are based on historical evidence, "recent or ongoing changes in market conditions may indicate that the current market share of a particular firm either understates or overstates the firm's future competitive significance. Federal enforcers consider reasonably predictable effects of recent or ongoing changes in market conditions when calculating and interpreting market share data."[423] The substance of this passage was introduced in the 1984 revision of the Guidelines, though some of the original language was removed in subsequent versions.[424]

These passages indicate that federal enforcers consider weakened competitor arguments not as defenses to a presumptively unlawful merger, but rather as issues that inform the interpretation of the market share data that form the basis of the Government's prima facie case.[425] The States are of the view that this approach is consistent with the relevant cases, starting with *General Dynamics*, and enables federal enforcers to evaluate weakened competitor arguments with the flexibility and skepticism that they require. Such scrutiny does not inevitably result in federal enforcers rejecting weakened competitor arguments. For instance, the FTC approved Boeing's acquisition of McDonnell Douglas in 1997, largely on the basis of weakened competitor arguments.[426]

Nevertheless, even before the 2010 revision of the Guidelines, there were calls for "more guidance on flailing firm analysis."[427] More recently, some have claimed that there is a "high degree of uncertainty involved in trying to determine whether a merger involving a distressed firm should be cleared" and have encouraged the formal adoption of various approaches to provide clarity on this question.[428]

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[421] 2010 Horizontal Merger Guidelines, *supra* note 47, § 11, at 32.
[422] *Compare id.* with 1997 Horizontal Merger Guidelines, *supra* note 398, § 5.0, at 29.
[423] 2010 Horizontal Merger Guidelines, *supra* note 47, § 5.2, at 16–17.
[424] *Compare id.* with 1984 Merger Guidelines, *supra* note 142, § 3.22, at 16 & n.18.
[425] *Cf.* AREEDA & HOVENKAMP, *supra* note 24, ¶ 963c ("A much more acceptable alternative than accepting financial or management difficulties as a defense to a merger presumed to be anticompetitive is to consider such difficulties in calculating market share. This is essentially the approach taken in the government's Horizontal Merger Guidelines.").
[426] U.S. Fed. Trade Comm'n, Statement of Chairman Robert Pitofsky and Commissioners Janet D. Steiger, Roscoe B. Starek III and Christine A. Varney in the Matter of The Boeing Company/McDonnell Douglas Corp. (July 1, 1997), https://www.ftc.gov/legal-library/browse/cases-proceedings/public-statements/statement-chairman-robert-pitofsky-commissioners-janet-d-steiger-roscoe-b-starek-iii-christine.
[427] *See, e.g.*, Horizontal Merger Guidelines Review Project, Transcript of Workshop II, *supra* note 400400, at 121:15–16 (comments of Leslie C. Overton); *id.* at 122:15–16, 133:1–3 (flailing firms "certainly could be added to the guidelines . . . I do think it would be useful to make the *General Dynamics* factors more explicit in the guidelines.") (comments of Katherine B. Forrest).
[428] Ken Heyer, *Failing Firm Analysis and the Current Economic Downturn*, CPI ANTITRUST CHRON. at 6 (Sept. 2020), https://www.competitionpolicyinternational.com/wp-content/uploads/2020/09/AC-September-I.pdf.

The States are of the view that no further discussion of the weakened competitor doctrine should be added to the Guidelines. Additional guidelines would create a misleading impression of predictability and replicability, whereas the doctrine is highly fact-specific, and not susceptible to standards, elements, or thresholds that could apply broadly across the entire spectrum of industries and markets covered by the Guidelines. For an illustrative example, one need look no further than *General Dynamics* itself. While the transaction at issue involved a coal company with limited reserves, that fact alone was not sufficient for the Supreme Court to find that the company was a weakened competitor. Rather, the Court found that the coal industry as a whole had "entirely lost its largest single purchaser"—the railroads—after World War II, while facing "increasingly stiffer competition from oil and natural gas" for residential and industrial energy needs. Only the electric utility industry remained as "the mainstay of coal consumption," and utility companies generally bought coal through long-term supply contracts, shrinking the availability of coal available for short-term "spot" sales.[429] In this new environment, "a company's past ability to produce [was] of limited [competitive] significance" compared to its "its uncommitted reserves of recoverable coal" that it could promise to deliver in the future pursuant to such long-term contracts. The Court pointed out that under these conditions, a company with large supplies of coal not already contracted to other buyers would be better positioned than a company with small uncommitted reserves, "even though the latter may presently produce a greater tonnage of coal."[430]

In other words, the Court in *General Dynamics* found that changes in the coal industry's customer base and prevailing sales practices had created new market conditions, in which even present production or sales were poor indicators of future competitive strength. These factual findings underpinned the Court's holding that the Government's historically derived market shares would be inaccurate in predicting future market shares. One cannot abstract from *General Dynamics* or its progeny a rule that is divorced from these specific factual circumstances—such as a rule that the weakened competitor doctrine applies in all cases where competitors rely on exhaustible resources, and a firm is running low on those resources.

The States are also of the view that the credibility concerns accompanying the failing firm defense are even more serious with respect to weakened competitor arguments. As discussed *supra*, the failing firm defense requires a company to not only offer evidence regarding its present and future solvency and its ability to reorganize under Chapter 11, but also to undertake an affirmative course of action regarding searches for alternative purchasers. In contrast, weakened competitor claims involve highly fact-specific inquiries as to why the company's current performance may overstate its ability to compete in the future. Such inquiries depend on uncertain forecasts of variables such as financial health (including the ability to access credit), management, firm resources and capacity, and projected sales figures. As such, the weakened competitor inquiry is among the most speculative types of merger analysis, particularly vulnerable to exaggeration, bias, and unwarranted assumptions.

For instance, weakened competitor arguments often feature claims of financial difficulty, but these claims are necessarily short of actual insolvency; a firm that could allege actual insolvency would bring a failing firm defense. Thus, weakened competitors generally cannot point to readily observable indices of impending financial failure, such as defaulting on their obligations.

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[429] *General Dynamics*, 415 U.S. at 499–501.
[430] *Id.* at 501–02.

Instead, they allege that securing credit would be somehow difficult, or that certain investments would be both necessary and costly. As Professors Areeda and Hovenkamp point out, "it is not self-evident" that such problems will cause future declines that are worse than past performance, or that these problems cannot be addressed by alternative transactions less injurious to competition; "[n]or is there any obvious way of determining the extent of any probable decline."[431] This imprecision poses particular challenges under the weakened competitor doctrine, since—as discussed above—it requires a firm to show that its difficulties "would cause that firm's market share to reduce to a level that would undermine the government's prima facie case."[432] Finally, claims of financial difficulty not only entail speculative claims about a firm's future performance, but also assumptions about the general availability of credit in capital markets—yet another variable subject to imprecision and speculation.

The inherently imprecise nature of the weakened competitor doctrine gives merging parties an opportunity to present speculative arguments about their future prospects. This only exacerbates their tendency to rely on self-serving testimony from executives and unreliable documents created after planning for a transaction has begun—a problem that the States have noted in responses to other questions in the Agencies' Request for Information. These credibility issues underlie the frequent expressions of disfavor by courts presented with weakened competitor arguments. The near-silence of the Guidelines on the weakened competitor doctrine sends a welcome signal that the Agencies are of the same view.

If the Agencies conclude that some additional language pertaining to the weakened competitor doctrine should be added to the Guidelines, the States suggest that a footnote could be added to the existing sentence in Section 11 discussed above, which currently states that the failing firm defense is "is an extreme instance of the more general circumstance in which the competitive significance of one of the merging firms is declining . . . ."[433] The footnote could direct readers to the passage in Section 5.2, also discussed above, which currently states that the Agencies will consider any claims regarding declining competitive significance short of failure, as an argument that the "the current market share of a particular firm . . . overstates the firm's future competitive significance."[434] Such an addition would merely draw attention to the existing language in the Guidelines, which accurately encapsulates the weakened competitor doctrine as set forth in the caselaw. The footnote could also state that merging parties must present a substantial amount of evidence, including from documents created in the ordinary course of business, before the Agencies will consider the possibility that the acquired firm's current market share overstates its competitive significance to the point where it should be discounted enough to fall short of the benchmarks of a prima facie case. Alternatively, the Guidelines could simply delete the existing sentence in Section 11 describing the failing firm defense as "an extreme instance of the more general circumstance in which the competitive significance of one of the merging firms is declining," to avoid any confusion between the very different standards of the failing firm defense and the weakened competitor doctrine.

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[431] AREEDA & HOVENKAMP, *supra* note 24, ¶ 963a3.
[432] *Univ. Health*, 938 F.2d at 1221.
[433] 2010 Horizontal Merger Guidelines, *supra* note 47, § 11, at 32.
[434] *Id.* § 5.2, at 16–17.

PRIVATE EQUITY

Currently, the Guidelines are silent on the evaluation of private equity transactions. However, federal enforcers have recently signaled increased interest in the conduct of private equity and possible impacts on competition from acquisitions involving private equity. For instance, in a September 2021 letter to the FTC, Chair Lina M. Khan stated that "the growing role of private equity and other investment vehicles invites us to examine how these business models may distort ordinary incentives in ways that strip productive capacity and may facilitate unfair methods of competition and consumer protection violations."[435] Moreover, in 2020, the FTC proposed new pre-merger notification rules under the Hart-Scott-Rodino Act that would require a fund involved in a transaction to disclose further information about all other funds related to its ultimate parent.[436]

The States commend this focus on private equity. Many States have reviewed mergers involving private equity, particularly in the healthcare sector. Based on our experience with these transactions, we believe that closer scrutiny and oversight of private equity acquisitions are warranted. While we are cognizant of the fact that the Guidelines do not generally address the manner by which acquisitions are financed—publicly or privately—our view is that the Guidelines should specifically address private equity transactions, given the substantial increase in the number and dollar amount of such acquisitions in recent years, and concerns with how the structure and business model of private equity may result in harms to competition, such as increased consolidation and impairing an acquired firm's ability to compete. The States also suggest that when designing remedies for anticompetitive transactions involving private equity acquirers, federal enforcers should consider behavioral remedies specifically tailored to counteract certain incentives that are inherent to the fundamental structure of private equity investments.[437]

I. An Overview of the Private Equity Sector

A. Private Equity's Organization, Structure, and Compensation

The term "private equity" typically refers to pooled funds, largely from institutional investors (including pension funds and endowments) and very wealthy individuals, which are organized as partnerships with the investors as limited partners and the fund managers (from the

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[435] Letter from Chair Lina M. Khan to Commission Staff and Commissioners (Sept. 22, 2021), https://www.ftc.gov/system/files/documents/public_statements/1596664/agency_priorities_memo_from_chair_lina_m_khan_9-22-21.pdf.

[436] U.S. Fed. Trade Comm'n, Premerger Notification; Reporting and Waiting Period Requirements, 85 Fed. Reg. 77,053 (Dec. 1, 2020) (to be codified at 16 C.F.R. pts. 801–03).

[437] The States do not address here more traditional antitrust concerns with private equity, such as reporting issues under the Hart-Scott-Rodino Act, joint acquisitions by two or more private equity firms (so-called "club deals"), partial acquisitions of competing firms, or interlocking directorates under Section 8, as these have been discussed by commentators in detail and the States anticipate others filing comments relating to these concerns. *See, e.g.*, Kara Kuritz & Matthew Wheatley, *An Antitrust Roadmap for Private Equity Investment*, 34 ANTITRUST 70 (2020); Malika Levarlet, Leo Caseria & Ariel Yehezkel, *HSR and Antitrust Considerations for Private Equity Firms in M&A Transactions*, COMPETITION POL'Y INT'L ANTITRUST CHRON. (Jan. 22, 2018), https://www.competitionpolicyinternational.com/hsr-and-antitrust-considerations-for-private-equity-firms-in-ma-transactions/; James A. Keyte & Kenneth B. Schwartz, *Private Equity and Antitrust: A New Landscape*, 31 ANTITRUST 21 (2016).

private equity firms themselves) as general partners.[438] The fund managers are tasked with identifying suitable operating companies to add to a fund's portfolio, completing those acquisitions, and then making the fund's portfolio companies profitable within the limited lifespan of the fund, usually ten years, after which the fund expires and money is returned to the partners.[439]

A defining feature of private equity transactions—in contrast to other private investment vehicles such as venture capital and hedge funds—is that most private equity funds finance their acquisitions through debt supplied by banks and secured by the assets of the acquired company. Generally, 70-80% of the acquisition cost is financed through debt, secured by the acquired company and its assets, with the bulk of the remainder coming from the limited partners and only a smart part (usually 2% or less) provided by the general partners.[440]

Private equity managers are primarily compensated when an acquired company is resold (or "flipped"), with the general partners typically receiving around 20%.[441] And since the company's resale price is typically calculated as a multiple of the company's EBITDA (earnings before interest, taxes, dividends, and amortization), general partners' compensation is based mostly upon a portfolio company's EBITDA upon resale, rather than more long-term measures of a company's valuation.[442] In addition, the general partners are often compensated by fees from the limited partners and the company.[443]

B. Recent Growth in the Private Equity Sector

By design, the lack of transparency into private equity complicates evaluating either the magnitude or the effects of private equity acquisitions. Nonetheless, it appears that both the number of private equity acquisitions and the sheer amount of money managed by private equity firms have grown substantially over just the past few years. According to one estimate, global private equity volume in 2021 increased 111% compared to just the year before, with an estimated $1.2 trillion worth of deals.[444] Consequently, private equity is likely to have a substantial impact on competition in those areas and industries that it focuses on.

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[438] *See, e.g.*, THOMAS P. LEMKE ET AL., HEDGE FUNDS AND OTHER PRIVATE FUNDS: REGULATION AND COMPLIANCE § 13.1 (2021–2022 ed.).

[439] Peter N. Kaplan & Per Strömberg, *Leveraged Buyouts and Private Equity*, 23 J. ECON. PERSP. 1, 123–124 (2009).

[440] *Id.* at 124–26; H. KENT BAKER ET AL., PRIVATE EQUITY: OPPORTUNITIES AND RISKS 4 (2015); Paul Rogers, Tom Holland & Dan Haas, *Lessons From Private Equity Masters*, HARV. BUS. REV. (June 2002), https://hbr.org/2002/06/lessons-from-private-equity-masters ("PE firms rely heavily on debt financing. On average, about 60% of their assets are financed with debt, far more than the 40% that's typical for publicly traded companies.").

[441] Kaplan & Strömberg, *supra* note 439, at 124–125; SCHEFFLER ET AL., *supra* note 356, at 8; JAMES M. KOCIS ET AL., INSIDE PRIVATE EQUITY: THE PROFESSIONAL INVESTORS' HANDBOOK, at 22 (2009).

[442] SCHEFFLER ET AL., *supra* note 356, at 7; *see also* Appelbaum & Batt, *supra* note 356, at 12.

[443] Kaplan & Strömberg, *supra* note 439, at 123–124; SCHEFFLER ET AL., *supra* note 356, at 6.

[444] Steven A. Cohen, Karessa L. Cain & Alon B. Harish, Private Equity 2021 Year in Review and 2022 Outlook, Harv. L. Sch. F. on Corp. Governance (Feb. 9, 2022), https://corpgov.law.harvard.edu/2022/02/09/private-equity-2021-year-in-review-and-2022-outlook/ ("Global private equity transaction volume ended the year at approximately $1.2 trillion, representing approximately 20% of overall global M&A volume and an approximately 111% increase over 2020.").

II. Potential Harms to Competition

A. Impairment of Acquired Firms' Ability to Compete

The States are concerned that the structure and distinguishing features of private equity investments may encourage private equity firms to focus unduly on short-term revenue generation, rather than long-term investment in innovation, research, and development. This focus may impair an acquired company's ability to compete and could ultimately lead to its collapse.[445]

As an initial matter, the organization and compensation structure of private equity funds—with general partners who manage the funds having limited investment (less than 2%) but with substantial potential gains (20% of the resale amount)—raise concerns that they may be too risky an investment vehicle (as least for certain types of businesses). For example, the private equity model has been criticized as giving fund managers "perverse incentives that encourage short-termism and excessive risk taking," since fund managers have little to lose in a failed acquisition other than their initial payments (which can often be at least partially recovered by management fees obtained throughout the life of the fund).[446] Even supporters of private equity funds have acknowledged this risk (but believe it is exaggerated and outweighed by the benefits of private equity).[447]

As for structural concerns, private equity's reliance on high debt to fund its acquisitions raises concerns about the effect on the acquired debt-laden company. As discussed *supra*, private equity funds typically finance acquisitions with debt secured by the very company being acquired. Debt is thus at "the core" of the acquisition and private equity business model, because it "magnifies returns earned on successful private equity investments."[448] A typical result of this high debt is that the acquired company must generate substantial cash for interest payments on the loans

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[445] EILEEN APPELBAUM & ROSEMARY BATT, PRIVATE EQUITY AT WORK: WHEN WALL STREET MANAGES MAIN STREET 42 (2014); Bryce Covert, *The Demise of Toys "R" Us is a Warning*, THE ATLANTIC (July/August 2018) (quoting analyst at Forrestor that while Toys "R" Us was not in great shape at time of buyout, transaction "probably hastened their death"), https://www.theatlantic.com/magazine/archive/2018/07/toys-r-us-bankruptcy-private-equity/561758/.

[446] BAKER ET AL., *supra* note 440, at 11; SCHEFFLER ET AL., *supra* note 356, at 6. *See also* Sofia John & Minjie Zhang, *Information Asymmetries in Private Equity: Reporting Frequency, Endowments, and Governance*, 174 J. BUS. ETHICS 199, 200 (2021).

[447] Edith S. Hotchkiss, David C. Smith & Per Strömberg, Private Equity and the Resolution of Financial Distress, at 6 (Eur. Corp. Gov. Inst. – Fin. Working Paper No. 331/2012, July 7, 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1787446, published as 10 REV. CORP. FIN. STUD. 694 (Dec. 2021) ("One reason why PE fund managers may be compelled to employ excessive leverage has to do with the structure of their compensation contracts. In particular, the call option-like payoff of the general partner's profit share provides the PE fund manager with the extra incentive to invest in more risky investments because the manager's carried interest increases with large stock price increases, but has limited downside risk.") (internal quotation marks omitted); *but see* Ji-Woong Chung, Berk A. Sensoy, Lea Stern & Michael S. Weisbach, *Pay for performance from future fund flows: the case of private equity*, 25 REV. FIN. STUD. 3259, 3262 (2012) (contending that ability to raise funds in future is sufficient motivation for general partners to act prudently regardless of lack of personal stake in fund because "good performance in the current fund could lead to higher future incomes for GPs through an effect on expected future fund-raising.").

[448] APPELBAUM & BATT, *supra* note 445, at 47; *see also* SCHEFFLER ET AL., *supra* note 356, at 38.

taken out to finance its acquisition.[449] In addition to increased interest expense obligations, private equity funds will further increase their portfolio companies' operational expenses by charging them management fees.[450] It has been maintained that these efforts provide private equity firms with a powerful incentive to improve the performance of their portfolio companies.[451] However, when cash raised to pay down newly acquired debt is used to enhance investor returns rather than being reinvested in the company, the result may increase the company's risk of financial distress.

Private equity managers commonly embark on aggressive cost-cutting measures to raise the profits of their portfolio companies.[452] Cutting jobs at the acquired company is often the most outwardly visible of these measures; in 2021, a report found average job losses of 4.4% in the two years after a private equity buyout, relative to control companies.[453] Other routine measures to cut cost include changing suppliers or renegotiating or terminating certain contracts. Whatever the means, overly aggressive cost-cutting measures may hamstring a company's ability to operate, much less have sufficient resources to strengthen its product and service offerings in the face of competition or make long-term investments in innovation, research, and development.[454] However, the lack of transparency poses an obstacle to regulators' efforts to better understand these trends.[455]Another method used by private equity managers to increase an acquired company's

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[449] MICHAEL BRIGL ET AL., THE POWER OF BUY AND BUILD: HOW PRIVATE EQUITY FIRMS FUEL NEXT-LEVEL VALUE CREATION 2 (2016), https://www.bvkap.de/sites/default/files/study/bcg_power-of-buy-and-build-feb-2016.pdf; *see also* Elisa Kantor Perlman, *Risky Business: Applying the Failing Firm Defense in Private Equity Merger Reviews*, 34 ANTITRUST 38, 39 (2020); APPELBAUM & BATT, *supra* note 445, at 47.

[450] *See* Ludovic Phalippou, Christian Rauch & Marc P. Umber, Private Equity Portfolio Company Fees, at 1 (Univ. of Oxford, Said Bus. Sch. Working Paper, 2015), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2703354.

[451] Kaplan & Strömberg, *supra* note 439, at 131 ("Leverage creates pressure on managers not to waste money, because they must make interest and principal payments."); Rogers et al., *supra* note 440 ("PE firms rely heavily on debt financing . . . The high debt-to-equity ratio helps strengthen managers' focus, ensuring they view cash as a scarce resource and allocate capital accordingly."). *See also* Edward J. Janger, *Private Equity and Industries in Transition: Debt, Discharge & Sam Gerdano*, 71 SYRACUSE L. REV. 521, 522 (2021) ("The private equity story runs like this . . . market discipline is fueled by the leveraged buyout, where the purchasers pay for the firm with money borrowed by the firm itself. The idea is that the debt, secured by liens on the assets of the firm itself, will be repaid out of the income of the firm. This debt makes the managers 'hungry,' increasing the reward to equity if they succeed, and punishes them severely if they fail.").

[452] Bhuvy Abrol, Deepak Subramanian, Eric Overbey & Siddarth Kannan, Deloitte Consulting LLP, Private Equity: A New Era for Value Creation at 3, 5 (2020), https://www2.deloitte.com/content/dam/Deloitte/us/Documents/mergers-acqisitions/us-new-era-for-value-creation.pdf ("To try to compensate for an increasingly challenging environment, PE managers have faced pressure to pull known cost levers harder in an attempt to squeeze out greater cash flow. In some cases, this can lead to drastic cuts that damage a business . . . private equity funds need a value creation playbook that extends beyond traditional tactics such as short- or medium-term cost cutting.") (order of quotations reversed).

[453] Steven J. Davis et al., The (Heterogenous) Economic Effects of Private Equity Buyouts, at 16 (Becker Friedman Inst., Univ. of Chi., Working Paper No. 2019-122, 2021).

[454] *See, e.g.*, JOSH KOSMAN, THE BUYOUT OF AMERICA: HOW PRIVATE EQUITY WILL CAUSE THE NEXT GREAT CREDIT CRISIS 88 (2009) ("For an owner that doesn't care about building a sustainable business, one very effective way to boost profits in the short term is to starve a company of capital."); SCHEFFLER ET AL., *supra* note 356, at 53 (arguing weight of evidence on impact of PE investment in healthcare sector suggests they do more harm than good).

[455] *See, e.g.*, Paul Kiernan, *SEC Pushes for More Transparency From Private Companies*, WALL ST. J. (Jan. 10, 2022), https://www.wsj.com/articles/sec-pushes-for-more-transparency-from-private-companies-11641752489; Ken Pucker & Sakis Kotsantonis, *Private Equity Makes ESG Promises. But Their Impact Is Often Superficial*, INST. INVESTOR (June 29, 2020), https://www.institutionalinvestor.com/article/b1m8spzx5bp6g7/Private-Equity-Makes-ESG-Promises-But-Their-Impact-Is-Often-Superficial ("the opacity of ESG reporting by PE firms contrasts with the increasing transparency provided by many public companies").

short-term profits is the sale and lease-back of key assets, often real estate. This tends to leave the company paying expensive long-term leases, a significant financial burden. While the infusion of cash from the transaction could potentially outweigh the harm of having to pay an expensive long-term lease, e.g., if that cash were reinvested in the company or used to fund long-term strategic improvements, critics claim that too often, the proceeds are used to benefit the investors instead.[456]

As discussed *infra* Section III, examples from specific industries show that private equity's application of these strategies to increase short term-revenue and a higher resale value have impaired acquired companies' ability to effectively operate and compete. Such impacts would be particularly problematic in markets with few competitors or where the acquired company is an innovator or maverick.

B. Accelerating Consolidation

The acquisition strategies of private equity firms may also accelerate consolidation in a market and thereby result in increased concentration—a well-recognized concern under the Guidelines. For instance, commentators and enforcers have highlighted a recent trend of private equity firms engaging in "stealth consolidation" strategies of acquiring multiple smaller companies competing against each other, then combining the acquired companies in a direct or indirect consolidation or "roll up," for resale as a larger company with a greater market share, and thus, a higher valuation.[457] It should be noted that the accumulation or extraction of market power is not the only possible motivation for these "stealth consolidation" strategies of private equity firms. Firms may also engage in these tactics to obtain preference for certain financing and to increase the value of a portfolio company's EBITDA upon resale.[458]

Even so, stealth consolidation—no matter the motivation—presents a challenge to enforcers. Because the size of each individual acquisition is relatively small, many of these acquisitions fall beneath the reporting thresholds of the Hart-Scott-Rodino Act. Thus, these transactions—and the private equity firm's overall consolidation strategy—may be under the radar of antitrust enforcers (at least until resale of the combined company).[459] As for enforcement against roll-up transactions, some have taken the position that a roll-up of portfolio companies that are majority owned by the same private equity fund should not raise any concerns under Section 7

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[456] *See, e.g.*, *infra* Section IV.A (discussing Steward's acquisition of Caritas Health); SCHEFFLER ET AL., *supra* note 356, at 21, 33–34 (discussing recent examples); Appelbaum & Batt, *supra* note 442, at 25–27; STEPHANIE KREWSON-KELLY & R. BRAD THOMAS, THE INTELLIGENT REIT INVESTOR: HOW TO BUILD WEALTH WITH REAL ESTATE INVESTMENT TRUSTS 81 (2016).

[457] ERIN FUSE BROWN ET AL., PRIVATE EQUITY INVESTMENT AS A DIVINING ROD FOR MARKET FAILURE: POLICY RESPONSES TO HARMFUL PHYSICIAN PRACTICE ACQUISITIONS, at 7 (2021), https://www.brookings.edu/wp-content/uploads/2021/10/Private-Equity-Investment-As-A-Divining-Rod-For-Market-Failure-15.pdf; *see also* Jane M. Zhu & Daniel Polsky, *Private Equity and Physician Medical Practices–Navigating a Changing Ecosystem*, 384 NEW ENG. J. MED. 981, 982 (2021) (explaining that roll-up can create value for practice, but may also reduce competition); Covert, *supra* note 445 (noting that after Toys "R" US was acquired by private equity, it purchased other toy retailers including etoys.com and FAO Schwarz).

[458] BRIGL ET AL., *supra* note 449, at 3.

[459] U.S. Fed. Trade Comm'n, Statement of Commissioner Rohit Chopra Regarding Private Equity Roll-ups and the Hart-Scott Rodino Annual Report to Congress (July 8, 2020), https://www.ftc.gov/public-statements/2020/07/statement-commissioner-rohit-chopra-regarding-private-equity-roll-ups-hart.

because of the Supreme Court's decision in *Copperweld*,[460] although similar reasoning seems to have been adopted in only one reported case.[461]

Officials at the Agencies have stated that they recognize the difficulties involved; in July 2020, then-FTC Commissioner Rohit Chopra expressed his concerns about the "risk of loss of competition" and other "collateral consequences" caused by secretive, incremental "roll up" acquisitions by private equity firms.[462] The problem of stealth consolidation is particularly acute in the healthcare sector; in February 2020, FTC Commissioner Christine Wilson issued a statement, joined by Commissioner Chopra, calling for a Section 6(b) study on non-reportable transactions in the healthcare industry.[463] If adopted, the new pre-merger notification rules proposed in 2020, discussed *supra*, could provide the Agencies with information that would assist in the detection of stealth consolidation strategies while they are still in progress.

C. Outcomes of Private Equity Investments

Private equity funds typically justify the risk and heavy debt load they place on acquired companies by arguing that they are "rescuing" dying companies and providing the acumen, experience and discipline to turn these companies around.[464] While the States recognize that private equity firms can add value to their portfolio companies in some cases, we are skeptical that such claims have been sufficiently corroborated across the industry as a whole. For instance, based on the limited evidence available, it does not appear that private equity firms typically focus on failing or even highly distressed companies. Instead, private equity firms often acquire healthy yet possibly underperforming companies that meet certain criteria for investment: they generate a steady stream of cash, are undervalued, or have growth and exit potential.[465]

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[460] Keyte & Schwartz, *supra* note 437, at 22 ("a PE firm's decision to merge majority-owned entities should not be a Section 7 problem") (citing *Copperweld Corp. v. Indep. Tube Corp*., 467 U.S. 752 (1984)); Kuritz & Wheatley, *supra* note 437, at 74 (in transaction involving "reorganization or combination of majority-owned portfolio companies held by the same fund . . . *Copperweld* counsels that these reorganizations should not raise antitrust concerns because the reorganization or combination would represent the fund (i.e., the parent) restructuring itself as it sees fit.").

[461] *See, e.g.*, *Community Pubs., Inc. v. DR Partners*, 139 F.3d 1180, 1183 (8th Cir. 1998) ("[I]t was proper for the District Court to aggregate the interests of [two firms owned by the same family] for purposes of Section 7 analysis.") (citing *Copperweld*, 467 U.S. at 771).

[462] Chopra, *supra* note 459.

[463] U.S. Fed. Trade Comm'n, Statement of Commissioner Christine S. Wilson, Joined by Commissioner Rohit Chopra, Concerning Non-Reportable Hart-Scott-Rodino Act Filing 6(b) Orders (Feb. 11, 2020), https://www.ftc.gov/system/files/documents/public_statements/1566385/statement_by_commissioners_wilson_and_chopra_re_hsr_6b.pdf.

[464] *See, e.g.*, Shai Bernstein et al., Private Equity and Industry Performance (Nat'l Bureau of Econ. Res. Working Paper No. 15632, January 2010), http://www.nber.org/papers/w15632; BRIGL ET AL., *supra* note 449, at 5; Matt Negrin, *Swinging at Bain, Obama Ignores What Private Equity Is*, ABC NEWS (May 21, 2012), https://abcnews.go.com/Politics/OTUS/swinging-bain-obama-ignores-private-equity/story?id=16399013 ("The companies in which [private equity firms] invest are sometimes on the brink of failure to begin with, and are likely to go bankrupt without outside help. These risky investments often include making decisions like cutting costs and jobs.").

[465] APPELBAUM & BATT, *supra* note 445, at 43, 61; Covert, *supra* note 445 ("Private-equity firms enjoy the misperception that they swoop in and save struggling companies from the verge of ruin . . . That's the model followed by a few specialty firms, but it is far more common for private-equity firms to seek moderately successful targets where they see an opportunity to increase profit margins.")

Even with this focus on healthy companies, the track record of private equity appears to be mixed at best.[466] The States recognize that because of the prevailing lack of transparency in this industry, evaluating the outcomes of private equity acquisitions is much more complicated than estimating the numbers of funds and the volume of assets managed. Nevertheless, much of the analysis conducted to date suggests that private equity firms, on balance, have a negative impact on the companies that they acquire. For example, companies acquired by private equity funds have substantially higher amounts of debt than companies not run by private equity and are more financially distressed. Consequently, a significant share of companies that have filed for bankruptcy in recent years were currently or previously owned by private equity.[467] None of these analyses conclusively demonstrate that private equity was a significant cause of portfolio companies' financial distress or greater risk of bankruptcy. However, when combined with the incentives that encourage private equity firms to prioritize short-term cash flow over long-term investment (discussed *supra*), and the numerous examples of private equity acquisitions ending in failure (discussed *infra*), these results indicate that a more thorough evaluation of private equity and its effect on competition is warranted.

III. Industry-Specific Examples

A. Retail

Even before the COVID-19 pandemic, the retail industry had been struggling for some time. While diagnoses for these ills are legion—including poor management, inefficiencies, and fierce competition from companies like Amazon and Walmart—the facts indicate that private equity has played a role in the retail sector's plight.[468] Over two-thirds of retail firms filing for

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[466] *See, e.g.*, Ludovic Phalippou, An Inconvenient Fact: Private Returns & The Billionaire Factory, 3 (Univ. of Oxford, Said Bus. Sch. Working Paper, 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3623820 (PE fund returns about same as public equity indices since at least 2006); *but see* Michael Cembalest, JP Morgan Asset & Wealth Mgmt., Food Fight: An Update on Private Equity Performance vs. Public Equity Markets, 1 (2021), https://www.jpmorgan.com/wealth-management/wealth-partners/insights/food-fight-2021-private-equity-update ("Private equity is still outperforming public equity, but this outperformance is narrowing as all markets benefit from nonstop monetary and fiscal stimulus, and as private acquisition multiples rise[.]").

[467] Brian Ayash & Mahdi Rastad, Leveraged Buyouts and Financial Distress, at 13 (July 19, 2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3423290, published as 38 FIN. RESEARCH LETTERS 1 (2021) ("[T]he LBO firms are 18% more likely to go bankrupt than peer non-LBO firms. This is consistent with our earlier observation that the bankruptcy rate for the LBO sample is around 20% and for the control sample it is about 2%."); AMERICANS FOR FINANCIAL REFORM, DOUBLE EXPOSURE: RETAIL WORKERS NATIONWIDE HAMMERED BY THE COMBO CRISIS OF PANDEMIC AND PRIVATE EQUITY 2 (2020), https://ourfinancialsecurity.org/wp-content/uploads/2020/12/double-exposure-PE-retail-jobs-12-2020.pdf ("Before the pandemic, from 2015 to 2019, nearly two-thirds (62.5 percent) of retail chains that entered bankruptcy were owned by private equity firms."); Christa Hart & John Yozzo, FTI Consulting, Three Reasons Why Private Equity Might Want to Close the Door on Retailers (June 30, 2018), https://www.fticonsulting.com/insights/fti-journal/three-reasons-private-equity-might-want-close-door-retailers; Ben Unglesbee, *Which Private-Entity Retailers Are Still At Risk*, RETAIL DIVE (May 29, 2019), https://www.retaildive.com/news/which-private-equity-owned-retailers-are-still-at-risk/555363/ (evaluating over 125 private-entity companies since 2002).

[468] *See, e.g.*, Chuck Carroll & John Yozzi, *Private Equity Has a Retail Problem*, 37 AM. BANKR. INST. J. 46 (2018) (noting that in 2017 alone, prominent private equity-owned retailers Payless ShoeSource, Gymboree, Toys 'R Us, Rue21, and True Religion all filed for bankruptcy); *see also* Sapna Maheshwari & Vanessa Friedman, *The Pandemic Helped Topple Two Retailers. So Did Private Equity*, N.Y. TIMES (June 18, 2020), https://www.nytimes.com/2020/05/14/business/coronavirus-retail-bankruptcies-private-equity.html ("J. Crew and Neiman Marcus were each facing a

bankruptcy in 2016 and 2017 were backed by private equity.[469] In May 2019, nearly 75% of the retailers on Moody's list of "distressed" firms were owned private equity.[470] Another study concluded that over 70% of the largest retail chain bankruptcies since 2012 involved firms run by private equity funds.[471]

The high-profile bankruptcy of Toys "R" Us in 2017 raised awareness of private equity's role in retail's financial misfortunes; a Moody's retail analyst called it a "poster-child for what a leveraged buyout can do to a retailer."[472] The company was purchased in 2005 by the private equity firms of Bain Capital, KKR, and Vornado Realty, in a $6.6 billion leveraged buyout. Twelve years later, Toys "R" Us was liquidated in bankruptcy, even though it had sales of $11.1 billion in its final year.[473] Critics maintained that its private equity owners saddled the company with massive amounts of debt, further increased by its acquisitions of other retailers. The owners also imposed cost-cutting measures and asset sales that substantially impaired the company's ability to compete with larger and more efficient retailers like Amazon and Walmart, ultimately driving it into bankruptcy.[474]

The 2015 bankruptcy of grocery chain Haggen provides a cautionary lesson about private equity strategies. Haggen was a family run grocery chain of approximately 30 stores in the Northwest until it was acquired by a private equity firm (Comvest Partners) in 2011.[475] In December 2014, Haggen purchased 146 stores as part of an approved divestiture package from the acquisition of Safeway by Albertson's (itself owned by a private-equity firm, Cerberus Capital Management).[476] Haggen's aggressive expansion quickly failed, resulting in its bankruptcy filing

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host of issues before the coronavirus pandemic forced them to close their stores and eventually file for bankruptcy . . . [b]ut they also shared one increasingly problem for retailers in dire straights: an enormous debt burden[.]"); Soma Biswas, *Tops Markets Trustee Blame Morgan Stanley for Grocer's Bankruptcy*, WALL ST. J. (Feb. 13, 2020), https://www.wsj.com/articles/tops-markets-trustee-blames-morgan-stanley-for-grocers-bankruptcy-11581553545 ("Tops Markets, an upstate New York grocery chain, filed for bankruptcy . . . Since 2015, nine private equity-owned super market chains have filed for bankruptcy, struggling under excessive debt and growing competition from big box and online retailers."); Janger, *supra* note 451, at 523 ("The theory is that debt will provide capital, and leverage will provide incentives that will cause management to improve the firm. The apparent reality, at least from the retail cases, is that the investor purchases the firm, ostensibly to save it, using secured loans that minimize the risk of the lenders, but encumber the assets of the firm. The new owners sell assets to repay the acquisition loan as well as fees and dividends to themselves, and then they leave the creditors holding the bag. Framed this way, the private equity story looks more like a sucker's game, where management, the purchasers, and the lenders divide up the company's free assets and make money, while the employees and operating creditors are left holding the bag.").

[469] Hart & Yozzo, *supra* note 467.

[470] Unglesbee, *supra* note 467.

[471] BAKER ET AL., *supra* note 440, at 12.

[472] Unglesbee, *supra* note 467.

[473] BAKER ET AL., *supra* note 440, at 16.

[474] *Id*. *See also* Alicia McElhany, *Private Equity's Trail of Bankrupt Retailers*, INST. INVESTOR (May 26, 2017), https://www.institutionalinvestor.com/article/b15bvrspw3fq7q/private-equitys-trail-of-bankrupt-retailers ("Toys 'R' Us wasn't pushed into court because of terrible sales—it recorded nearly $1 billion in online sales in 2016. . . Rather, the company was struggling to pay down its staggering debt load—for which it could thank its 2005 leveraged buyout.").

[475] Angel Gonzalez, *Haggen's risky expansion largely bankrolled itself*, SEATTLE TIMES (October 29, 2015), https://www.seattletimes.com/business/retail/haggens-risky-expansion-largely-bankrolled-itself/.

[476] U.S. Fed. Trade Comm'n, Press Release, FTC Requires Albertsons and Safeway to Sell 168 Stores as a Condition of Merger (Jan. 27, 2015), https://www.ftc.gov/news-events/news/press-releases/2015/01/ftc-requires-albertsons-safeway-sell-168-stores-condition-merger.

in September 2015, closing or selling off over 160 stores.[477] Haggen has been able to survive after downsizing and retreating to its Northwestern origins, but thousands of employees lost their jobs and creditors lost tens of millions of dollars according to litigation and bankruptcy filings.[478] While Haggen's failure was ascribed to poor strategy and planning, it was also surmised that Haggen's sale-and-leaseback agreements for nearly 40 of the stores it acquired from Albertsons—valued at $300 million—provided nearly all the funding for the acquisition while burdening the stores with additional costs (further imperiling this risky endeavor).[479]

B. Healthcare

Private equity investment in healthcare has skyrocketed over the past 20 years, from $5 billion in 2000 to $124 billion in 2019 under one estimate.[480] Moreover, since private equity deals are typically highly leveraged (relying on secured debt), the total value of private equity deals in healthcare reaches much higher multiples; one commentator has offered conservative estimates of $41.5 billion in 2010 and $745 billion in 2019.[481] During this period, private equity firms operating in the healthcare industry have also shifted focus from hospital transactions to physician practice groups, as well as more specialized markets, including urgent care clinics, freestanding emergency departments, air ambulances, and specialty physician practices.[482] Many of these firms are acquired in smaller acquisitions as part of a stealth consolidation strategy, discussed *supra* Section II.B.[483]

Different approaches to stealth consolidation have been observed in the healthcare industry. One example is the acquisition and "roll-up" of smaller providers, discussed *supra*; another is the so-called "platform and add-on" approach, where the acquisition of a strong local or regional firm is followed by additional "bolt-on" or "tuck-in" acquisitions of its smaller competitors.[484] The States share the concerns raised by others as to the effects of these stealth consolidation efforts by private equity funds on competition as well as the availability and quality of healthcare.[485]

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[477] Robert Anglen, *Albertson's buys back stores feds forced it to sell*, AZCENTRAL (Nov. 25, 2015) (noting that 33 of Haggen stores were sold back to private-equity-owned Albertson's), https://www.azcentral.com/story/money/2015/11/25/albertsons-buys-back-stores-feds-forced-sell/76383234/.

[478] *Id. See also* Kevin Smith, *The Haggen grocery store situation explained: How it happened, where it's going*, SAN GABRIEL VALLEY TRIBUNE (Sept. 1, 2015), https://www.sgvtribune.com/2015/09/01/the-haggen-grocery-store-situation-explained-how-it-happened-where-its-going/.

[479] See Gonzalez, *supra* note 475 ("Haggen paid for most of the chain's risky West Coast expansion by quickly flipping some of the real estate it got from acquiring 146 stores from Albertsons and Safeway, according to securities filings, court documents and country records.").

[480] Eileen Appelbaum & Rosemary Batt, *Financialization in Healthcare: The Transformation of US Hospital Systems*, at 60 (Ctr. for Econ. Policy & Research Working Paper 2022-1), https://cepr.net/report/working-paper-financialization-in-health-care-the-transformation-of-us-hospital-systems/.

[481] SCHEFFLER ET AL., *supra* note 356, at 8–9.

[482] BROWN ET AL., *supra* note 457, at 3–4; Applebaum & Batt, *supra* note 480, at 74–75.

[483] Lovisa Gustafsson, Shanoor Seervai & David Blumenthal, *The Role of Private Equity in Driving Up Health Care Prices*, HARV. BUS. REV. (Oct. 29, 2019), https://hbr.org/2019/10/the-role-of-private-equity-in-driving-up-health-care-prices; SCHEFFLER ET AL., *supra* note 356, at 29, 38, 42; BROWN ET AL., *supra* note 457, at 7; Applebaum & Batt, *supra* note 480, at 74–78; Jane M. Zhu, Lynn M. Hua & Daniel Polsky, *Private Equity Acquisitions of Physician Medical Groups Across Specialties, 2013-2016*, 323 J. AM. MED. ASS'N 663 (2020).

[484] Chopra, *supra* note 459.

[485] See, e.g., *id.*; BROWN ET AL., *supra* note 457, at 6.

IV. State Attorneys General and Recent Private Equity Acquisitions

State Attorneys General are regularly called upon to review private equity transactions in the healthcare industry, often arising from regulatory oversight of that industry, or of non-profit organizations. This was this case in two relatively recent hospital acquisitions approved by the Attorneys General of Massachusetts and Rhode Island. While both acquisitions were allowed to proceed, Massachusetts expressed concern about the likelihood that Steward's community hospital-based, private equity-owned system would succeed, and Rhode Island expressed substantial concerns about the impact of the acquisition on competition and quality of care. Both states imposed conditions that addressed those concerns. While only time will tell whether these efforts were successful, the two transactions highlight certain complex issues presented when private equity acquires essential healthcare providers.

A. Steward Health and Caritas Christi Health (Massachusetts)

In 2010, Cerberus Capital Management's newly-formed Steward Health Care system sought to acquire the struggling six-hospital Caritas Christi Health Care system, based in Boston. Because Caritas was non-profit, the parties were required to seek approval from the Massachusetts Attorney General. Approval was granted subject to a number of conditions; Steward was required to preserve the jobs of approximately 12,000 Caritas employees, fully fund the pensions current and former Caritas employees, commit to no less than $400 million in capital improvements within four years; and agree not to close any hospitals in the system for a number of years, provided that certain financial metrics were met.[486]

Shortly afterward, Steward acquired four other community hospitals outside of Boston, and obtained hundreds of millions of dollars in debt secured by Steward's assets (including the Caritas Christi hospitals). It also engaged in an estimated $1.2 billion sale and lease-back deal with a real estate investment firm, which provided operating funds (and likely paid off Cerberus' investments), but also required the hospitals to pay expensive leases.[487] Nonetheless, Steward—now the largest private hospital operator in the country—continues to own and operate the Massachusetts facilities, though a 2019 report suggests that it is still highly leveraged and had negative operating and total margins the previous year.[488]

B. Prospect Medical Holdings (Rhode Island)

In 2020, the private-equity majority shareholder of Prospect Medical Holdings ("PMH"), which owned two struggling hospitals in Rhode Island (among others in numerous states), sought

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[486] *See Caritas Christi v. Coakley*, No. SJ-2010-453, Compl., Ex. M, Stmt. of Att'y Gen. as to the Caritas Christi Transaction (Mass. Oct. 14, 2010), https://www.mass.gov/doc/complaintexhibitmpdf/download?_ga=2.248748871.1735767894.1646337556-934371756.1646337556.

[487] Eileen Appelbaum, Ctr. for Econ. & Policy Research, Everyone Wondered How a Private Equity Firm Would Make Money in a Leveraged Buyout of a Struggling Non-Profit Hospital Chain—Now We Know, at 4–6 (Oct. 2016), https://cepr.net/images/stories/reports/steward-health-care-system-2016-09.pdf.

[488] Commonwealth of Mass., Ctr. for Health Info. & Analysis, Massachusetts Acute Hospital and Health System Financial Performance, FY 2018 (Sept. 2019), https://www.chiamass.gov/assets/Uploads/mass-hospital-financials/2018-annual-report/Acute-Hospital-Health-System-Financial-Performance-Report-FY2018.pdf.

to sell its controlling share of the company to Sam Lee (PMH's CEO) and David Topper (through his family trust) for $12 million plus the assumption of over $1 billion in debt. Together, Lee and Topper owned 40% of PMH before the sale. The parties were required to seek approval from the Rhode Island Office of the Attorney General. While the Attorney General approved the transaction, it imposed a number of conditions, including $80 million placed in escrow for hospital operating costs and paying off a loan; an additional $72 million in capital expenditures; a prohibition against sale or lease-back of the hospitals for five years, and after that only with approval by the Attorney General; a prohibition against liens, mortgages or other encumbrances on the hospitals without approval by the Attorney General; and a requirement that the hospitals must be "open and operational" for five years with no reduction of "essential health care services."[489]

The Attorney General called these conditions "unprecedented," but necessary to ensure the survival of the hospitals, which were "entirely dependent" on PHM.[490] The conditions were also justified by PMH's history of self-dealing, including the sale of key assets and saddling the hospitals with heavy debt burdens. For example, in 2018, PMH's board took out a $1 billion loan, with the hospitals as collateral, and used half of the loan to pay dividends to its investors. As a result, PMH—whose assets exceeded its liabilities by $67 million in 2017—ended up in 2020 with liabilities exceeding assets by nearly $1 billion.[491]

V. Recommendations for Addressing Private Equity in the Guidelines

The States are of the view that the Guidelines should take into account the foregoing concerns relating to private equity transactions, as follows:

1. The Guidelines should state that when federal enforcers evaluate acquisitions involving private equity, they will consider the likelihood of harms to competition specific to private equity transactions, such as impairing an acquired firm's ability to compete—or even potentially driving that firm to bankruptcy—through such measures as saddling the company with high debt burdens, selling key assets for short-term revenue, and cutting back on investments to cut costs and increase short-term profits.[492]

2. The Guidelines should state that federal enforcers will consider, when appropriate, behavioral remedies that would mitigate the potential competitive harms specific to private equity transactions. Such remedies could include prohibitions on and/or notice of further acquisitions and consolidation of acquired firms in "roll ups," requiring certain investments

[489] R.I. Office of the Att'y Gen., *In re Initial Application of Chamber Inc.; Ivy Holdings Inc.; Ivy Intermediate Holdings, Inc.; Prospect Medical Holdings, Inc.; Prospect East Holdings, Inc.; Prospect East Hospital Advisory Services, LLC; Prospect CharterCARE, LLC; Prospect CharterCARE SJHSRI, LLC; Prospect CharterCARE RWMC, LLC*, Decision, ¶¶ 22-34 (June 1, 2021), https://riag.ri.gov/sites/g/files/xkgbur496/files/documents/Prospect_Chamber_Ivy_AG_HCA_Decision.pdf.

[490] R.I. Office of the Att'y Gen., Press Release, Attorney General imposes unprecedented conditions on hospital ownership change to ensure future operations (June 1, 2021), https://riag.ri.gov/press-releases/attorney-general-imposes-unprecedented-conditions-hospital-ownership-change-ensure.

[491] R.I. Office of the Att'y Gen., Decision in Prospect Medical Holdings HCA Review, *supra* note 353, at 15, 18.

[492] A focus on less traditional competition harms is consistent with changes in federal enforcers' views over the years on other issues, e.g., privacy and competition in labor markets.

to ensure the acquired firm's ability to compete, and barring sale and lease-back transactions.

3. The Guidelines should state that when federal enforcers evaluate proposed divestitures to a private equity buyer, they may evaluate the private equity fund's incentives, and analyze what the buyer will do with the asset in the years before the fund expires. In particular, when the divested asset is a company (or part thereof), federal enforcers may evaluate whether the company is likely to remain a viable, standalone competitor by the time the fund expires. A relevant example, discussed *supra*, is Haggen's acquisition of grocery stores divested in connection with the merger of Safeway and Albertson's.

4. If the FTC's proposed rule concerning pre-merger disclosures under the Hart-Scott-Rodino Act by private equity fund associates is formally adopted, the Guidelines should set forth how federal enforcers will use this new information to inform their analysis of transactions involving private equity.[493]

REMEDIES

I. The Importance of Joint Enforcement

The State Attorneys General ("States") believe that overall enforcement and deterrence is strengthened when States have a seat at the negotiating table at the onset of an investigation. It is now common practice for federal enforcers to approach States once an investigation is completed and federal enforcers are poised to either block a transaction or settle with the parties. Federal enforcers involve States at this stage to further persuade parties to settle. While States understand this approach, States believe that engagement with federal enforcers should occur earlier and more often.

States are the proverbial boots on the ground and are uniquely positioned with intimate knowledge of local markets. States routinely recover remedies for the individuals they represent and are adept at crafting remedies to injured or would be injured parties. States' combined knowledge of local markets and expertise in consumer recovery, make them a valuable party to any settlement discussion.

States believe that increased collaboration with federal enforcers will lead to optimal remedies for consumers. Specifically, States are able to exact unique remedies in addition to the federal enforcer's remedies. States generally have antitrust laws that permit them to obtain broader remedies beyond what the Clayton Act and Section 5 of the FTC Act allow.[494]

[493] The States also suggest that private equity acquisitions may benefit from an FTC 6(b) study. See 15 U.S.C. § 46(b).

[494] Many states have antitrust laws that require them to protect the general welfare of a state's economy through antitrust enforcement. A number of states have also passed laws that expand their competitive impact review and enforcement authority, including California, Connecticut, Hawaii, Massachusetts, Nevada, New Hampshire, Oregon, Pennsylvania, and Washington.

II. The Benefits of Leveraging State-Specific Remedies

States pursue and obtain remedies aimed at alleviating anticompetitive pressures on local markets. Recently, both the Federal Trade Commission ("FTC") and the Utah Attorney General's Office ("UAGO") settled with DaVita/Total Renal Care, Inc. ("DaVita") concerning its purchase of the University of Utah's entire kidney dialysis business, which consisted of eighteen (18) clinics and other assets.[495] The settlement between the UAGO and DaVita expanded upon the settlement that the parties reached with the FTC. While the FTC's divestiture agreement included three clinics, the UAGO settlement included a fourth clinic in Northern Utah, subject to the same divestiture and monitoring provisions. An important addition to the UAGO's settlement was a provision that permits insurers to include individual clinics in rural areas even if the insurer does not elect to include other DaVita clinics in-network. The inclusion of the fourth clinic was important to the UAGO to preserve competition in the Northern Utah market for dialysis care.

States aim to preserve limited markets. In November 2020, the Department of Justice ("DOJ") and the New York Attorney General's Office ("NYAGO") approved the sale of Credit Karma to Intuit. As part of the approved transaction, both DOJ and NYAGO required Credit Karma to divest Credit Karma Tax ("CKT"), a free digital do-it-yourself ("DDIY") tax preparation product, to Square.[496] The NYAGO's settlement with the parties went a step further and required Square to keep CKT completely free for consumers.[497] This was an important remedy because the market for wholly free DDIY tax preparation products is sparse.

States are also able to obtain remedies that resolve both state and federal antitrust concerns. In Massachusetts, the AG and FTC investigated the proposed hospital merger between Beth Israel Deaconess Medical Center and Lahey Health System.[498] The Massachusetts AG settled with the parties and following the Massachusetts settlement, the FTC voted to close the investigation.[499] The FTC noted in its press release that the Massachusetts settlement contributed to its decision to close the investigation.[500] This is just one example where a State was able to impose remedies that alleviated the need for federal enforcers to seek remedies, but there are other examples.[501]

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[495] Utah Office of the Att'y Gen, Press Release, Settlement: Utah v. DaVita /Total Renal Care (Nov. 5, 2021), https://attorneygeneral.utah.gov/settlement-utah-v-davita-total-renal-care/.

[496] U.S. Dep't of Justice, Press Release, Justice Department Requires Divestiture of Credit Karma Tax for Intuit to Proceed with Acquisition of Credit Karma (Nov. 25, 2020), https://www.justice.gov/opa/pr/justice-department-requires-divestiture-credit-karma-tax-intuit-proceed-acquisition-credit; Assurance of Discontinuance, *In the Matter of Investigation by Letitia James, Attorney General of the State of New York, of Intuit Inc., and Credit Karma, Inc*., Assurance No. 20-079 (Nov. 25, 2020), https://ag.ny.gov/sites/default/files/2020.11.25_final.nyoag_.intuit_executed_1.pdf.

[497] *Id.*

[498] Mass. Office of the Att'y Gen, Press Release, AG Healey Reaches Settlement With Beth Israel, Lahey Health Over Proposed Merger (Nov. 29, 2018), https://www.mass.gov/news/ag-healey-reaches-settlement-with-beth-israel-lahey-health-over-proposed-merger; U.S. Fed. Trade Comm'n, Press Release, Statement of Federal Trade Commission Concerning Its Vote to Close the Investigation of a Proposed Transaction Combining Massachusetts Healthcare Providers (Nov. 29, 2018), https://www.ftc.gov/news-events/press-releases/2018/11/statement-federal-trade-commission-concerning-its-vote-close.

[499] *Id.*

[500] *Id.*

[501] Similarly, the California Attorney General's Office ("CAAGO") investigated the merger of Providence Group, Inc. and Plum Healthcare with the FTC. Following the investigation, only the CAAGO settled with the parties. Cal. Office

Lastly, it is worth noting that while partnering with federal enforcers, States occasionally recover non-competition related remedies that benefit the overall economies of their states. In such cases, States work with their federal partners to ensure that these types of remedies do not conflict with the federal enforcer's remedies.[502]

III. Strengthening the Procedural Approach for Merger Remedies

In addition to maximizing substantive remedies through joint enforcement, federal authorities should strengthen the procedural approach to formulating merger remedies. The comments described below seek to make the remedies review process more efficient while affording federal enforcers the time resources necessary to regulate effectively.

IV. Extending the Review Timeline for Certain Merger Remedy Proposals

The Guidelines should adopt a formal process and deadline for remedy proposals. One approach is to model the process after the timeline extension of the Hart-Scott-Rodino Antitrust Improvements Act of 1976: 15 U.S.C. § 18a, § 7A of the Clayton Act ("The Act"). Specifically, The Act provides that during the initial 30-day waiting period, the FTC or DOJ may, at its discretion, extend the timeline "for an additional period of not more than 30 days . . . after . . . [the federal agency] receives . . . all the information and documentary material required . . . . Such additional period may be further extended only by the United States district court, upon on application by the" federal agency. 15 U.S.C. § 18a(e)(2).

Similarly, the Guidelines could instruct the parties that their submission of a structural remedy proposal or a substantial change thereto triggers an additional 30-day extension of time for the federal enforcers to investigate the competitive effects of that remedy. This would deter "late-in-the-process" proposals after the FTC or DOJ has already expended significant investigatory resources – unless that change is worthy of further delaying the parties' ability to close their

of the Att'y Gen, Press Release, Attorney General Bonta Announces Steps to Safeguard Patient Care and Affordability in Providence-Plum Merger (Sept. 21, 2021), https://oag.ca.gov/news/press-releases/attorney-general-bonta-announces-steps-safeguard-patient-care-and-affordability.

[502] For example, in 2020, DOJ along with the attorneys general for the states of Arkansas, Colorado, Florida, Kansas, Louisiana, Nebraska, Ohio, Oklahoma, South Dakota, and Texas settled a merger challenge between T-Mobile and Sprint. U.S. Dep't of Justice, Press Release, Justice Department Settles with T-Mobile and Sprint in Their Proposed Merger by Requiring a Package of Divestitures to Dish (July 26, 2019), https://www.justice.gov/opa/pr/justice-department-settles-t-mobile-and-sprint-their-proposed-merger-requiring-package. The attorneys general for Colorado and Florida obtained separate settlements with remedies designed to benefit their constituents. In Colorado, one of the components to that settlement was a commitment from Dish to employ 2,000 people in the wireless industry in Colorado within three (3) years of the deal closing. Colo. Office of the Att'y Gen., Press Release, Attorney General's office secures 2,000 jobs, statewide 5G network deployment under agreements with Dish, T-Mobile (Oct. 21, 2019), https://coag.gov/press-releases/attorney-generals-office-secures-2000-jobs-statewide-5g-network-deployment-under-agreements-with-dish-t-mobile-10-21-19/. In Florida, as part of its merger agreement, T-Mobile agreed to double the number of available permanent back-up generators within Florida to at least 70 percent of sites within three (3) years of the closing date. Fla. Office of the Att'y Gen., Press Release, Attorney General Moody Joins DOJ in Supporting T-Mobile/Sprint Merger to Protect Consumers and Improve High-Speed Connectivity (Oct. 2, 2019), http://www.myfloridalegal.com/newsrel.nsf/newsreleases/8D89636E3BC4396185258487005DD3C6.

transaction (if approved). In the alternative, if such a delayed proposal is made, the federal enforcers have adequate opportunity to investigate before the decision-making window expires.

V. New Merger Guideline Language

For example, the Guidelines might provide that:

> "The Federal Trade Commission ("FTC") or the Assistant Attorney General ("AAG"), in its discretion, may extend the 30-day waiting period (or in the case of a cash tender offer, the 15-day waiting period) specified in 15 U.S.C. § 18a (b) (1) or the 30-day extension period specified in subsection (e) (2) for an additional period of 30 days (or in the case of a cash tender offer, 15 days) after the date on which the FTC or the AAG receives from any Person or Acquiring Person[503] a structural remedy proposal or a substantial change thereto. Such additional period may be further extended at the discretion of the FTC or the AAG."

VI. Existing Definition of "Substantial" in the Act

A "substantial change" to the proposed remedy that would trigger the additional 30-day period should be defined similarly to how "substantial" is used in existing subsections (e) (1) (B) (i) (II) and (g) (2) of The Act. Those subsections use "substantial" to define the standard of adequate compliance required for parties to satisfy the notification requirement or to satisfy a request for additional information during the waiting period.

The FTC and DOJ has an administrative process for determining if a party submission is not in "substantial" compliance. Staff prepares a deficiency letter for the section chief's signature that "specif[ies] the areas in which the submission is deficient" and, if the chief concurs, the letter will be issued to the parties.[504] The parties "may appeal" in a writing of ten (10) pages or fewer, including a concise explanation of the reasons why the party believes they are "substantially" compliant.[505] Someone from the federal authority who lacks direct responsibility over the pre-merger review will consider the matter, may request additional information within two (2) business days, and will render a decision on the appeal within three (3) business days after receipt of necessary information.[506]

Although there is a dearth of case law related to this administrative process and the meaning of "substantial" in this context, the federal government has given indications of their interpretation of "substantial." For example, the FTC brought a post-transaction case against a company after discovering substantial pre-merger noncompliance due to the company omitting documents related

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503 A "Person," as defined in The Act, is a person to whom a request is made under 15 U.S.C. § 18a (e) (1), which is a person required to file notification with respect to such acquisition under subsection (a) prior to the expiration of the waiting period specified in subsection (b) (1), or from any officer, director, partner, agent, or employee of such person. By contrast, an "Acquiring Person" takes the place of a "Person" in cases of a tender offer, and is defined in subsection (a).

504 U.S. Dep't of Justice, Antitrust Division Manual, ch. III, pt. D.2.j.iv (5th ed. 2018), https://web.archive.org/web/20220120085636/https://www.justice.gov/atr/file/761141/download.

505 *Id.*

506 *Id.*

to market share, competition, sales growth, and expansion.[507] The FTC has informally provided examples of "substantial" noncompliance, including "failing to provide accurate and complete [financial reporting] information."[508] The DOJ's Antitrust Division Manual characterizes a "substantial" noncompliance as one that is "significant."[509] And although not authoritative, at least one secondary authority writes that "substantial" compliance is partially an assessment of "good faith" conduct.[510]

VII. Proposed Definition of "Substantial" for the New Merger Guidelines

For purposes of the proposed merger guideline above, a "substantial change" to the proposed remedy that would trigger the additional 30-day period may include:

- Newly drafted language exceeding three (3) pages in length.
- New categories of terms not previously appearing, as opposed to changes to existing terms. For example, a newly drafted non-compete provision, as opposed to a proposed alteration to an existing non-compete provision.
- New or altered language requiring non-de minimis economic analyses by economists employed by enforcers.
- New or altered language regarding new or additional third-party involvement.
- Evidence exists that the remedy change is proposed in bad faith.

In addition, enforcers could use a similar administrative process as to the one they employ to determine whether a party is in "substantial" compliance, for determining whether a party has made a "substantial change" to the proposed remedy. The process will provide for internal checks and balances as well as providing the party an opportunity to respond to the determination.

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[507] William J. Baer, Director, Bureau of Competition, U.S. Fed. Trade Comm'n, Reflections on 20 Years of Merger Enforcement under the Hart-Scott-Rodino Act (Oct. 31, 1996), https://www.ftc.gov/public-statements/1996/10/reflections-20-years-merger-enforcement-under-hart-scott-rodino-act#N_91_; *United States v. Automatic Data Processing, Inc.*, Civ. No. 96-0606 (D.D.C., Apr. 10, 1996) (consent judgment).

[508] Premerger Notification Office Staff, Bureau of Competition, U.S. Fed. Trade Comm'n, Getting in Sync with HSR Timing Considerations (Aug. 31, 2017), https://www.ftc.gov/news-events/blogs/competition-matters/2017/08/getting-sync-hsr-timing-considerations.

[509] U.S. Dep't of Justice, Antitrust Division Manual, *supra* note 504, ch. III, pt. D.2.c.

[510] JULIAN O. VON KALINOWSKI ET AL., 1 ANTITRUST COUNSELING AND LITIGATION TECHNIQUES § 4.03 (2021).

Respectfully submitted,

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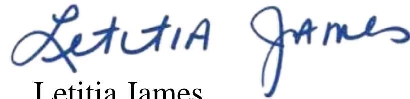
California Attorney General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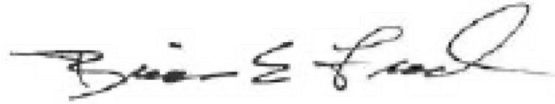
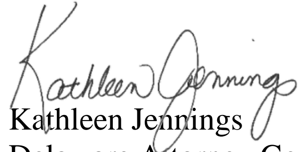
New York Attorney General

William Tong
Connecticut Attorney General


Brian E. Frosh
Maryland Attorney General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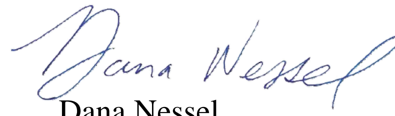
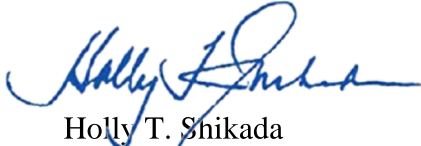
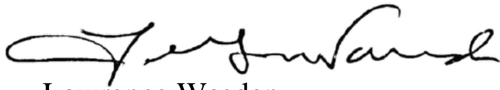
Karl A. Racine
District of Columbia Attorney General

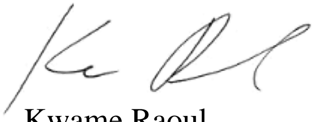

Dana Nessel
Michigan Attorney General


Holly T. Shikada
Hawaii Attorney General

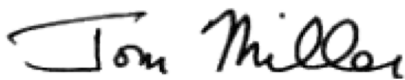
Keith Ellison
Minnesota Attorney General


Lawrence Wasden
Idaho Attorney General

Aaron D. Ford
Nevada Attorney General


Kwame Raoul
Illinois Attorney General

Matthew J. Platkin
New Jersey Acting Attorney General


Tom Miller
Iowa Attorney General

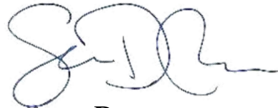
Hector Balderas
New Mexico Attorney General

Aaron M. Frey
Maine Attorney General

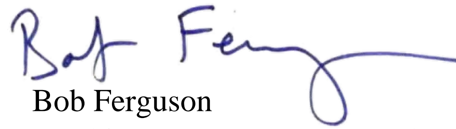
Ellen F. Rosenblum
Oregon Attorney General

Josh Shapiro
Pennsylvania Attorney General

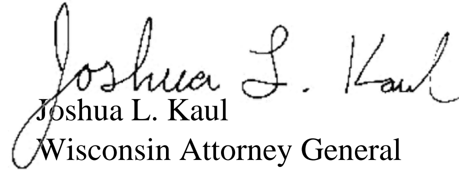
Peter Neronha
Rhode Island Attorney General



Sean Reyes
Utah Attorney General



Bob Ferguson
Washington Attorney General



Joshua L. Kaul
Wisconsin Attorney General