Merger Analysis Going Forward
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Editor’s Note: Getting Mergers Right

BY MICHAEL A. LINDSAY

They argue, created efficiencies that reduced costs, resulted in new features, and enabled a more seamless customer experience. They also describe Senator Elizabeth Warren and Senator Amy Klobuchar’s proposed antitrust legislation and what they believe would be the chilling effects that this legislation might have on the entire ecosystem of the technology sector.

Third, John Harkrider reviews three attempted acquisitions in the tech space that the United Kingdom’s Competition and Markets Authority (CMA) reviewed. Two transactions were abandoned, and the third is under review, but all three involved a larger tech firm’s acquisition of a smaller tech company. He explores the breadth of CMA’s jurisdictional claims (all three transactions involved U.S. companies) and the degree of convergence between the CMA and U.S. enforcement agencies. (Fayne and Foreman discuss U.S. enforcers’ challenges to two of these transactions.)

Benjamin Bradshaw and Scott Schaeffer discuss the debate over common ownership of competing firms through institutional investors. They take no position on whether this kind of common ownership has anticompetitive effects, but they provide a useful guide to the key issues—and some key background facts—in this ongoing debate.

Some institutional investments are led by private equity firms, and like any other investor, PE firms want to make successful investments. Sometimes, however, PE investments do not work out, and the PE firm tries to invoke the “failing firm” defense to sell a company to a strategic buyer. Elisa Kantor Perlman reviews the basic principles behind this defense and their specific application to PE owners. She concludes that the existing rules are sufficient to address the complexities that PE ownership can entail—and that the investment objectives of a PE firm and other stakeholders are not relevant to the legality of a proposed sale to a strategic buyer and do not excuse a PE owner from satisfying the “failing firm” requirements.

Mark Botti, Nicholas Hill, Sheridan Rogers, and Mathis Wagner discuss what they see as an important development in the banking world that should play a key role in analyzing bank mergers (although it has not yet done so): the emergence of virtual banks, where depositors do not typically have access to a physical branch and instead conduct transactions electronically. At least from a retail banking perspective, they argue that this development should have significant

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implications for measuring the degree of bank concentration in merger analysis.

Despite today’s neo-populist movement in antitrust, economic analysis remains critically important. One key concept in assessing vertical mergers is the effect on eliminating double marginalization (EDM). John Kwoka and Margaret Slade help non-economists to understand what double marginalization is and why anyone would care about its elimination. They agree that at least some vertical mergers require close scrutiny, and they caution that the calculation of EDM is often simplistic and flawed, and that its treatment as the principal source of efficiency can be misplaced. Kwoka and Slade also explore ambiguous EDM effects in vertical mergers outside of the common analytical paradigms.

Antitrust counselors can better assess antitrust risks and advise their clients if the enforcement process is transparent. Anna Lyle-Smythe and Lucy Chambers offer a comparison of the relative degrees of merger enforcement (and other antitrust enforcement) in the European Union, China, and the United States. (Readers interested in transparency should also read Harkrider’s article, which discusses transparency of the UK merger review process.) Lyle-Smith and Chambers describe the merger review processes as they existed before the COVID-19 pandemic. Competition agencies around the world have announced temporary measures (such as elimination of in-person meetings) that may affect relative transparency until the public health situation normalizes.

What happens when, despite the best efforts of antitrust counselors to get it right, a deal fails on antitrust grounds? Most parties will have agreed on antitrust risk allocation in their transaction documents. Karen Kazmerzak, James Lowe, and Joseph Coniglio discuss the kinds of risk allocations available to the parties, but more interestingly, they also discuss litigation over the meaning of these various risk allocations in transactions that failed to close. Any antitrust counselor who reviews antitrust risk allocation provisions would benefit from reading this article.

Continuing our tradition of direct engagement with competition officials, Associate Editor Vanessa Turner interviewed Margrethe Vestager, who, in addition to her service as the European Commission’s Commissioner for Competition, has now taken on a second EC role as Executive Vice President for a Europe Fit for the Digital Age. This wide-ranging interview includes some topics that merger counselors will want to note, particularly Vestager’s comments about potentially reviewing the Commission’s Notice on the definition of relevant market.

Finally, William Kolasky concludes his three-part series on antitrust in the Warren Court. Although none of the four cases he discusses were merger cases, he does discern a more general lesson from the Warren Court’s antitrust jurisprudence. Kolasky acknowledges that several recent reviews of merger retrospectives have raised serious questions about whether our merger policy has become too relaxed. He urges that we take these studies seriously but that we also learn from the Warren Court experience so that we do not over-correct.

Whether you are an enforcer, a counselor, or a judge, we hope that the articles in this issue help you get mergers right.
The Draft Vertical Merger Guidelines: A Modern Approach, But Gaps and Questions Remain

By James Keyte

The Long Awaited — and anxiously anticipated — Draft Vertical Merger Guidelines (VMG) were released by the U.S. Federal Trade Commission and U.S. Department of Justice on January 10, 2020, and they indeed appear to reflect what the Agencies are doing in practice when assessing proposed vertical mergers. But whether they offer the requisite thoroughness and clarity to provide reliable guidance to the legal and business community is another matter (although, as of this writing, public comments were not yet due). It is also interesting that two of the FTC Commissioners abstained from endorsing the VMG, apparently not viewing them as aggressive or clear enough.

Set forth below is a brief description (and some observations) addressing what is in the VMG and what is not. At a minimum, we now have a much better understanding of what the Agencies have been doing when assessing proposed vertical mergers, even if the judicial arena may impose additional or different standards in an actual Clayton Act Section 7 litigation.

What Is in the Draft VMG

Abandoning Traditional Vertical Merger Analyses in Favor of Assessing Rivals’ Access to “Related Products”

Perhaps the newest revelation in the VMG is that the Agencies are not necessarily looking for market structures in which the merging parties have traditional market power in two vertically related markets. Instead, in Section 2, the new focus (though clearly being used for years) centers on identifying one or more “related products” (“a product or service in the relevant market . . . to which access by the merged firm’s rivals affects competition”) — and then determining whether the merger will affect that access in a way that harms rivals and potentially (or presumably) consumers. A related product can be in the form of “inputs,” “means of distribution” or “access to a set of customers,” or presumably any other asset or resource a rival may “need” or desire in order to compete effectively.

The Analysis of Market Structure Takes a Back Seat to a 20% Safe Harbor (of Sorts)

The VMG begin, with the title “Market Participants, Market Shares and Market Concentration,” (Section 3), seemingly preparing the reader for a discussion of multi-level market power and its asserted ills and risks. Not so. Consistent with the new focus on rival access to “related products,” the VMG make clear that the Agencies consider these traditional concepts and measures to be much less relevant to the analysis than in the past. Specifically, while the VMG recount that the Agencies “normally” identify one or more relevant markets, the purpose appears to be only for assessing the “competitive significance of related products” — e.g., as stated in Section 3, “[T]he share of output in a relevant market that uses related products,” which in turn informs to the extent of potential foreclosure in a more traditional relevant market.

Relatedly, the quasi-20 percent safe harbor in the VMG requires an assessment of both the merged firm’s percentage of the relevant market that may be harmed and the percentage of the “related product” controlled by one of the merging parties. (Interestingly, there is no requisite assessment of the structure of the market for the related product itself.) As the VMG explain in Section 3, the Agencies are unlikely to challenge a vertical merger where the parties to the merger have a share in the relevant market of less than 20 percent, and the related product is used in less than 20 percent of the relevant market. Moreover, even with this assessment, the safe harbor may not apply for new or rapidly growing products or market shares.

A Commitment to Raising Rivals’ Costs (RRC) Theories and Modeling

The most predictable and practical conformation in the VMG is the explanation that RRC is the primary unilateral effects theory of both Agencies in vertical merger analysis. (Section 5.) In essence, the theory and related economic literature did not exist for the 1984 Non-Horizontal Merger Guidelines, and in that sense it is an important acknowledgment that this is what the Agencies are now...
using, as the DOJ did in AT&T/Time Warner. As explained in the VMG, a vertical merger may “diminish competition by allowing the merged firm to profitably weaken or remove the competition constraint from one or more of its actual or potential rivals in the relevant market, by changing the terms of those rivals’ access to one or more related products.” This, the VMG explain, can be in the form of higher prices (or lower quality) for “related products” or a complete refusal to supply.

The VMG also make clear that the Agencies are dedicated to the use of modeling RRC (including netting out the elimination of double marginalization), although the VMG note that the Agencies would not treat modeling results as “conclusive.” The VMG then highlight a few of the RRC theories typically considered, including (1) causing rivals to lose sales and, in turn, deterring innovation, entry or expansion, affecting access to finance or charging higher prices; (2) causing incremental “diversion” to the merger firm, post-merger; and (3) creating a cushion, through that diversion, to make foreclosure or RRC profitable, post-merger. (Section 5.) The Agencies would consider these theories as long as the resulting effects are not “de minimis” (which is not defined).

Fencing in the “Elimination of Double Marginalization” (EDM) Credit from AT&T/Time Warner

The DOJ’s economic expert in AT&T/Time Warner essentially gave the parties an upfront efficiencies credit—and quantified it for them—based on the standard economic proposition that a vertical merger typically (if not invariably) eliminates the cost of having to pay, pre-merger, the margin markup of the other firm.

The VMG not only reject any presumption (theoretical or otherwise) that the elimination of double marginalization is an efficiency in a vertical deal, in Section 6 they place the burden on the parties to “identify and demonstrate how the merger eliminates double marginalization.” Further, the VMG explain the various conditions under which the Agencies will not accept an EDM assertion, including the presence of incompatible technologies, already aligned incentives (through pre-existing contracts), and incentives to increase prices, for example, based on potential increased demand for upstream inputs. In short, the VMG put the parties on notice that EDM will no longer be a credit at the outset of a case and must be fought for like an affirmative defense.

What Is Not in the Draft VMG

Perhaps because it is an opening draft for comment, the VMG are equally notable for what is not detailed or addressed as for what is. Specifically, while the VMG explain what the Agencies are doing in some detail for an RRC unilateral effects analysis, they do little to provide an overall analytical framework, a thorough discussion of burdens of proof or, importantly, to describe the marketplace conditions under which they would have no concern, independent of the 20 percent quasi-safe harbor. Nor do they address the important issue of remedies.

What Happened to the Role of Market Structure and Competitive Dynamics?

Unlike the 1984 Guidelines, the VMG say little, if anything, about market structure (or marketplace dynamics) and its analytical role in assessing vertical mergers. This is troubling in two respects.

First, the VMG do not expressly (or implicitly) recognize that a vertical merger does not inherently alter the market structure to “eliminate” a competitor as occurs with a horizontal merger. This was critical in AT&T/Time Warner, as the court highlighted that there is no “structural presumption” of potential anticompetitive effects in a vertical deal and, as a result, the government must start from scratch in attempting to prove a substantial lessening of competition in a relevant market.

Second, the VMG reference market definition, but then relegate its role. Unlike the 1984 Guidelines—and what little case law exists—the VMG do not require defining markets and assessing market power for both the upstream and downstream markets. Instead, it appears that market definition is only needed to provide context for assessing RRC or foreclosure of access to a “related product” and the 20 percent quasi-safe harbor. And, as noted, there is no analysis of market structure for the related product itself—e.g., whether there are ready demand substitutes for the related product and whether entry or repositioning is easy for that product.

This leaves the VMG with an arguably untested RRC theory and model, as long as a party has a 20 percent share in the alleged market being harmed and in which the merged firm also controls 20 percent of the related product. And that sounds a lot like the exact theory offered and rejected by the court in AT&T/Time Warner (albeit primarily based on the deficiency of the model, although the decision also reflects a great concern about the DOJ’s static market analysis).

One could fairly point out, then, that the VMG do not conform easily to the current state of the law, including the teachings of Fruehauf Corp. v. FTC, which, even back then, had a detailed discussion of what part of the market remains accessible to rivals, under what conditions, and how that relates to overall effects.

Connecting RRC to Enduring, Incremental Market Power

One of the more troubling aspects of the VMG is that they never explain how the Agencies connect a theory of RRC
with a “substantial lessening of competition” in a relevant market. Moreover, we know that Clayton Act Section 7 contemplates an incremental and enduring market-wide effect for there to be a real risk to competition and consumers. Absent that, the Agencies would effectively be protecting rivals from mere changes in vertical bargaining positions—hardly what Section 7 envisioned and clearly a problematic theory of enforcement after AT&T/Time Warner.

Even the EU’s 2004 non-horizontal merger guidelines require as much. For example, in addition to a careful assessment of the extent of foreclosure and incentives and ability to carry out an RRC or foreclosure strategy, the EU guidelines detail when and why there is not likely to be an “overall likely impact on effective competition,” including the assessment of the ability of rivals to switch to other resources, the presence of buyer power, or repositioning and entry. U.S. antitrust law, however, is even more demanding in requiring evidence of market-wide harm than the EU.

### When Does Modeling Not Work?

Given the prominence that modeling plays in the VMG we might have expected some guidance on what the Agencies view as reliable modeling and what they view as not reliable. This was a key aspect of the AT&T/Time Warner litigation, where the court spent pages explaining what it saw as right or wrong in the econometric modeling undertaken by the government. It would be useful, then, for the VMG to highlight for practitioners the Agencies’ position on what makes for a relevant and robust model, whether for RRC or more sophisticated structural models that assess the interaction among all demand and supply agents in the actual and “but-for” worlds. As it is, parties are left to imagine or discern what and how the Agencies may be modeling in any particular vertical merger, leaving any difference or disagreements for litigation. This is not a recipe for predictability.

### The Subject of Remedies Cannot Be Ignored

Finally, one could suppose that remedies should not be the subject of “guidance” or that the principles in the DOJ’s existing Remedies Guidelines should suffice. Yet, as a practical matter, companies in years past have routinely made an array of deals (private and with Agency consent) that resolved Agency concern in vertical mergers. Moreover, in light of AT&T/Time Warner, one would think that the Agencies might address the practice of a party-driven “fix-it-first” or, more problematically, “fix-it-during” litigation proposals, if not simply to provide constructive notice to the parties (and courts) well in advance of any future litigation.

### Stay Tuned

In sum, there is a real question here of completeness, whether the Agencies intended a minimalist approach as the framework itself or, instead, offered a mere opening salvo. But, in recent years, there has been an enormous amount written on what these guidelines should (or should not) contain and so much more certainly could have been addressed. For his part, for example, Professor Steven Salop is likely to see a need both to expand the types of competitive risks involved (including through use of vertical GUPPI analysis) as well as in assessing the potential procompetitive benefits.

In the meantime, it will be interesting to watch the comments flow in and see what translates into concrete changes. Even then, there inevitably will be new Section 7 vertical merger litigations that lead to a more complete and predictable framework and set of principles for assessing vertical mergers. In the end, of course, courts are the ultimate authors of “guidelines,” but that may still take some time to unfold.

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2 While the VMG address potential coordinated effects, there is not much new there; instead, the VMG primary focus is on unilateral effects.
5 See id. at 1032.
6 In addition to AT&T/Time Warner, see, e.g., Fruehauf Corp. v. FTC, 603 F.2d 345 (2d Cir. 1979).
8 Fruehauf, 603 F.2d at 353.
To Catch a Killer:
Could Enhanced Premerger Screening for “Killer Acquisitions” Hurt Competition?

BY KELLY FAYNE AND KATE FOREMAN

In early 2019, Colleen Cunningham, Florian Ederer, and Song Ma released a much-discussed paper hypothesizing the existence of a phenomenon in which pharmaceutical companies acquire other pharmaceutical companies, not in an effort to bring the targets’ drugs to market, but to prevent them from doing so.\(^1\) According to Cunningham et al., “Incumbents acquire firms with overlapping drug projects and . . . these acquired drugs are less likely to be developed, particularly when they overlap with the acquirer’s product portfolio and when the acquirer has strong incentives to protect his existing market power.”\(^2\) The authors label this type of transaction a “killer acquisition.”

Canny branding for the theory formerly described as “the acquisition of a nascent or potential competitor” in order to neutralize that competitor hit the antitrust world at exactly the right moment. With the efficacy of existing merger control regimes in question, and broader popular and political angst about the tech industry simmering, the “killer acquisition” moniker found its way into antitrust discourse (and the Twitterverse). For example, one tweeter wrote, “Nobel prize winner #JeanTirole quotes only one article during his speech at @EU_Commission @EU_Competition conference . . . the @Yale article. . . on ‘killeracquisitions.’”\(^3\) The topic has also made it into U.S. Senate hearings, the antitrust conference circuit, and speeches by the Antitrust Division Assistant Attorney General and FTC leadership.

There is room for debate and certainly for additional empirical research to assess the merits of this theory and its applicability to proposed transactions. However, if we assume (for the sake of argument) that killer acquisitions—or, more formally, destructive acquisitions of nascent or potential competitors—occur more often than is socially optimal, then is increased premerger scrutiny the policy response best suited to preserve competition and innovation? We conclude that it may not be, and that enhanced scrutiny could indeed entrench larger, well-capitalized firms while making it more costly and riskier for smaller firms to innovate and compete.

The Killer Acquisition Theory
Cunningham et al. provide an empirical examination of the pharmaceutical industry. In particular, the authors use pharmaceutical industry data on acquired drug projects and measure whether a drug project is more or less likely to be developed based on whether the target’s project overlaps with the acquirer’s product portfolio and whether the acquirer faces strong competition or approaching patent expiration. The authors conclude that “about 6% of acquisitions in our sample are killer acquisitions.”\(^4\) In addition, the authors also express concern that “killer acquisitions appear to routinely avoid regulatory scrutiny by acquiring entrepreneurial ventures at transaction values below the HSR review thresholds.”\(^5\)

Although the influential paper was written about the pharmaceutical industry, the concept has been more widely applied, particularly to the technology sector, motivating cries to break up “Big Tech.” For example, the U.S. Senate Judiciary Committee held hearings in September 2019 on “Examining Acquisitions of Nascent or Potential Competitors by Digital Platforms.”\(^6\) At the hearings, Bruce Hoffman, then Director of the FTC Bureau of Competition, spoke for the FTC and argued that “current law [including the Clayton Act, Sherman Act, and FTC Act] provides the Commission with several potential avenues to counter anticompetitive conduct by large technology firms to thwart nascent and potential threats by acquisition or other means,” citing sev-
eral recent cases, including CDK/AutoMate, Verisk/Eagle-View, Thoratec/Heartware, and Nielsen/Arbitron. In a speech in June 2019 on “Antitrust Enforcement and Digital Gatekeepers,” Assistant Attorney General Makan Delrahim also indicated that the Antitrust Division is on the lookout for “the potential for mischief” of acquisitions that have “the purpose and effect . . . to block potential competitors, protect a monopoly, or otherwise harm competition by reducing consumer choice, increasing prices, diminishing or slowing innovation, or reducing quality.”

True to its word, the DOJ challenged Sabre’s acquisition of Farelogix in August 2019 on the grounds that it was “a dominant firm’s attempt to eliminate a disruptive competitor after years of trying to stamp it out.” The DOJ’s complaint details allegations that Farelogix developed and commercialized a technology for airline booking services that made it harder for Sabre to compete, citing colorful deal documents (e.g., describing Farelogix as one airline’s “Trojan horse to f*** us”). The FTC followed suit in December 2019 by suing to block Illumina, which the FTC estimated as having a 90 percent share of a next-generation DNA sequencing market, from acquiring Pacific Biosciences (PacBio), which was estimated to have a 2 percent to 3 percent share. The FTC alleged that “[t]he Acquisition, if consummated, would eliminate the nascent competitive threat that an independently owned PacBio poses to Illumina’s monopoly power.”

Notwithstanding the DOJ’s and FTC’s actual and promised enforcement against transactions that might fit the killer acquisition archetype, critics argue that U.S. enforcement is not rigorous enough. At the Senate hearing on acquisitions by digital platforms, Diana Moss, President of the American Antitrust Institute, cited data showing high rates of acquisition activity for large tech platforms and argued that the FTC and DOJ have a weak record of merger enforcement in digital technology markets, in part because “digital market firms may purposely and strategically pursue deals that are not HSR-reportable.” In a report published by the Chicago Booth Stigler Center for the Study of the Economy and the State, the authors argued, the behavior that may be of greatest concern to the many policymakers studying powerful digital businesses is their acquisition of potential competitors. These acquisitions often fall below the value threshold under which the buyer would need to notify competition authorities in advance of the deal. As a consequence, authorities have little or no ability to assess whether a given deal is procompetitive or harmful to competition before it closes.

In an article published in the American Economic Review: Insights, Thomas Wollmann also argues that an abrupt increase in HSR reporting thresholds in 2001 corresponded with an increase in mergers between competitors, what he calls “stealth consolidation.” And in a critique of the current level of merger enforcement in the digital space, Professor Carl Shapiro of the Haas School of Business at the University of California, Berkeley, suggests that articles by Cunningham et al. and Wollmann “provide[] worrisome evidence about mergers taking place just below the threshold.”

**Enhanced Premerger Scrutiny?**

The Chicago Stigler Report proposes several potential solutions to address concerns about nonreportable acquisitions of potential or nascent competitors, one of which is to require notification and preclearance “for any acquisition by a business designated as having bottleneck power.” The argument is that “[w]hen network effects are strong, a digital business with bottleneck power will likely only have very small competitors. Therefore, even small transactions can neutralize an important potential competitor that is poised to grow.” Others have proposed alternative measures. For example, U.S. Senator Elizabeth Warren is reported to be working on legislation that would ban mergers in which one company has annual revenue of more than $40 billion. Yet others have argued for shifts in the burden of proof, requiring the parties in certain high-tech deals to prove the pro-competitive benefits of the transactions, rather than applying current antitrust law, which places the burden of proof on the government.

Outside the United States, moves to enhance premerger reporting have gained traction. In 2017, Germany amended the German Act Against Restraints of Competition to require companies to report transactions with high deal values even if target revenues are below €5 million. Andreas Mundt, President of the German Federal Cartel Office, explained in a 2017 interview, “It is not unusual in the digital economy for important companies to start with a very low turnover,” and stated that the new notification threshold “could enable the Bundeskartellamt to look at such important deals.” Austria made a similar amendment to its merger notification thresholds. The Australian Competition and Consumer Commission (ACCC) is considering following suit. Australia has a voluntary merger notification regime where notification is recommended on the basis of the market share the parties will have as a result of the transaction. However, the ACCC signaled in its July 2019 Digital Platforms Inquiry Report:

> [T]he mergers framework in Australia should be updated to make it clearer that [factors such as acquisition of potential competitors by the dominant firms and economies of scope created by control of data sets] should be taken into account in assessing whether an acquisition has the effect or likely effect of substantially lessening competition.

Similarly, the March 2019 report Unlocking Digital Competition, commissioned by the UK government, recommends that “digital companies identified as having a strategic market status ought to make the CMA aware of every intended acquisition.” Finally, the EC report Competition Policy for the Digital Era considers “whether the current regime of EU merger control needs to be adjusted to better address concerns relating, inter alia, to the early elimination
of potential rivals.” While the report finds that “it is too early to change the EUMR’s jurisdictional thresholds,” it recommends continued study and consideration of whether an amendment to the thresholds may be justified in the future.

Motivating Innovation
As the Cunningham et al. paper acknowledges, acquisitions of innovative targets in the early stages of development by established firms can be procompetitive. This is partly because “firms who are better at exploiting technologies acquire innovative targets to realize synergies, effectively enabling specialization and subsequently increasing innovation and overall welfare.” Accordingly, if we align our thinking with the economic theory and begin with the viewpoint that firms are motivated to maximize profits, then we can begin to look at the motivation for acquisitions from a more balanced perspective. There are, of course, many potential procompetitive motivations for a small firm to be acquired and for an established firm to acquire a startup.

Motivations for Being Acquired. There are many reasons why a smaller firm might seek to be acquired. The Silicon Valley Bank (SVB) conducts an annual survey of startups. The results of the latest survey are published in the SVB’s US Startup Outlook 2019. The survey comprises 1,377 respondent companies, the majority of which were privately owned, small (fewer than 25 employees), young (less than five years old), in the technology sector in the United States and had less than $25 million in revenue. Over half were expecting their next sources of funding to come from venture capital. When asked what the long-term goals for their companies were, 50 percent answered that they were looking at being acquired and 15 percent said they did not know, “underscoring the difficulty of planning an exit amid increased market volatility.” Thus, the promise of being acquired might be spurring innovation and incentivizing startups that otherwise would not have been born. Indeed, as Cunningham et al. point out, “[i]t is possible that the presence of an acquisition channel also has a positive effect on welfare if the prospect of entrepreneurial exit through acquisition (by an incumbent) spurs ex-ante innovation.”

Why would a startup want to be acquired instead of taking a chance at the potentially more lucrative route of an IPO? Aiming for an IPO can be challenging: 2019 was supposed to be a banner year for IPOs, with many companies looking to the stock market to make a splash. But the year proved not to live up to the hype, with newly public companies suffering losses and other would-be public companies reassessing their plans to go public. A New York Times article dubbed 2019’s public offerings the “I.P.O. Fizzle.” Indeed, at the end of 2019 only 24 percent of 2019’s public offerings were expected to have positive incomes in 2020. When Lyft made its initial public offering in March 2019, its shares opened at $87, and as of January 24, 2020, shares were trading at $48. Uber made its initial public offering in May 2019, with shares opening at $42, and as of January 24, 2020 (even pre-COVID-19 related declines), shares were trading at $37. This was despite the fact that Uber was the tech startup that had the highest level of equity funding ($15 billion) in the United States from 2014 to 2019. Pinterest and Slack Technologies have met similar fates. Airbnb decided to delay its IPO. WeWork put its IPO on hold since hitting a rocky path with its troubled leader, and its valuation has plummeted. There are some recent success stories, such as Zoom Video Communications, which went public in April 2019, with a share price of $65; as of January 24, 2020, shares were trading at $75. However, if it is this difficult for well-known, well-established startups to go public, it is no wonder many startups are looking to be acquired rather than trying to strike it rich by going public.

The probability of a startup carrying out an IPO has dropped significantly in recent years. The number of IPOs in the United States has declined from 486 in 1999 to 159 in 2019. Besides planning toward acquisition as an exit strategy, firms might want to be acquired if they come up against the constraints that often face small innovative firms. For example, startups often face limits on the venture capital they can raise and the timing of when that capital comes in. Without cash on hand, it is hard to attract a competent workforce—offering a share in the venture can only go so far. As small firms get bigger, they also run into more regulation. For example, tipping from 49 to 50 employees sets off HR-related compliance requirements. Smaller firms also run into limitations on their legal resources and ability to comply with other regulations, such as the EU General Data Protection Regulation and the recently enacted California Consumer Privacy Act. Thus, using its small size and agility to get started and then selling itself to a larger firm to launch or grow can make a lot of sense for a small firm.

Motivations for Acquiring. The data on R&D spending seems to suggest that Big Tech companies are not acquiring competitors so that they can refrain from innovating. In 2017, the top spenders on R&D were Amazon.com at about $22 billion per year, Alphabet at about $17 billion, followed closely by Samsung Electronics, Volkswagen, Microsoft, Huawei, Intel, and Apple. Trailing them are a handful of pharmaceutical companies, such as Roche, Johnson & Johnson, Merck, and Novartis. While internal spending on R&D is an excellent means to innovation, outsourcing innovation can also be a winning strategy for large companies. Smaller companies are more agile, and each can try something different, show at least the promise of proof of concept, and then be acquired by an established firm to let the technology take flight. Thus, the large firms can let the smaller firms compete for winning ideas and then the large firms can acquire the winners and launch the technology in a way that would have been difficult for the smaller firm to do alone.
Companies in areas like the life sciences space face their own set of challenges that can be mitigated by consolidation. For example, pharmaceutical companies benefit greatly from economies of scale and scope. Economies of scale help streamline operations and reduce overhead. Economies of scope help manage risk and fund R&D by entering new therapeutic categories or broadening geographic reach to build larger portfolios and stronger pipelines. Businesses with high risk, such as pharmaceutical companies, often find it easier to finance their R&D via equity, rather than debt, which requires a stable cash flow. This is especially true for the payoffs from R&D, which in life sciences are skewed to later years, after much of the R&D spending, clinical trials, and approval process has taken place. Moreover, the probability of advancing from one milestone to the next (e.g., clinical trial phases) is highly uncertain, and the costs can be prohibitive for a small firm. According to one estimate, only about 12 percent of drugs make it from Phase I of clinical trials through Phases II and III, through FDA approval, all the way to market. On average, this process costs approximately $2.6 billion (including capitalization costs) and takes approximately eight years. Whether this process will get even trickier with more biologics and gene therapies coming on board remains to be seen.

The Costs of Premerger Review (and Who Bears Them)

In addition to the more obvious costs, such as legal bills and filing fees, premerger review creates other costs for the merging parties, including costs that arise from uncertainty about whether the deal will ultimately close intact (i.e., with no remedies), how long approval will take, the magnitude of the injury to the business in the time between signing and closing of the merger (e.g., if employees leave in the face of job uncertainty), and other opportunity costs (e.g., forgone financing or passed-up acquisition offers). While the parties are free to allocate the burden of those costs between themselves in the merger agreement (e.g., with a breakup fee), the ability of a target to decrease its own costs may be limited by its bargaining power when negotiating with a relatively large potential acquirer.

There are multiple factors that can increase the potential costs of premerger review. While the most obvious is whether the deal itself presents antitrust questions that will require additional scrutiny (e.g., a merger of close competitors, unhelpful deal rationale documents, angry customers), another factor is whether there is premerger review at all. As numerous critics of the current antitrust merger review regime have observed, transactions that are not subject to HSR review may close without waiting for an antitrust investigation to complete. Those critics frequently imply that deals that are not subject to review could be detrimental to competition, innovation, and consumers. However, it is important to remember that the FTC and DOJ can open a Section 7 investigation at any time, including after a transaction has closed. Indeed, they have done this several times in recent history, including with Axon Enterprise/VieVu, Otto Bock/FIH Group, and Parker-Hannifin/CLARCOR. Further, the investigative delay of a procompetitive transaction may actually cause harm to competition, innovation, and consumers, contrary to the intent of premerger review.

In his paper on “Stealth Consolidation,” Wollmann argues that the increased likelihood of detection from HSR review is an important deterrent in preventing anticompetitive mergers. However, this ignores the important cost-shifting effect of a premerger enforcement regime. Premerger review allocates the risk and associated costs of an antitrust investigation on both of the merging parties. Postmerger review, on the other hand, allocates the risk and associated cost entirely to the acquirer. Moreover, when it comes to potential “killer acquisitions,” the costs of being blocked during premerger review may disproportionally fall on the target because the paradigmatic targets are smaller, more capital-constrained startups with unproven technologies.

As Assistant Attorney General Makan Delrahim has recognized, even though the Antitrust Division issues second requests in less than 1 percent of reported transactions, “[t]hat 1%, however, is expensive . . . [and] resource intensive.” A 2014 survey of antitrust practitioners reported a median cost of second request compliance of $4.2 million, with a reported range of $2 million to $9 million. This same survey reported, on average, production of documents from 26 document custodians, typically employees of the merging parties.

So how are these costs paid? The acquirer can usually absorb these costs with little trouble. The target likely faces more cashflow constraints. Startups go through several phases of raising capital. The first is seed funding. In this round, startups typically raise between $1.1 million and $5.6 million, and this stage lasts around three years. Before moving to the next phase, Series A (which fewer than 10 percent of seed-funded startups reach), an increasing number of startups (82 percent in 2018) are already generating revenue. In Series A, a startup can expect to reach between $10.5 million and $15.7 million in funding, and by the time they reach Series B, they are raising around $25 million to $32 million, on average. Therefore, a $2 million to $9 million premerger review bill could eat up a significant amount of cash for a firm that is in a race to make it to the next round of financing.

Apart from the monetary costs, there are also time costs to consider. A merger review that takes six months uses up the
valuable resources of the startup’s already overtaxed human capital. Whether or not a startup could survive long enough to get more funding is also an important question. Rounds of financing are typically years apart. A firm that is living from round to round may simply be unsure that it could have enough cash on hand to stay afloat during a multi-month merger review process, particularly if there is uncertainty at the end of that process. The existential risk of extended merger review may be particularly untenable for a startup subject to (as startups often are) interim operating covenants that both prohibit bringing on more investors and require the startup to maintain the value of the business.

**Following the Money (and Moneymakers)**

Ideas, skilled labor, and capital are critical inputs for startup success. If enhanced premerger review for smaller transactions means that more ultimately benign acquisitions of startups are subject to an augmented risk of premerger scrutiny, the implications for startup formation and funding should be factored into the policy analysis. Additional risk of intensive premerger scrutiny raises the costs associated with acquisition as an exit option. While this could mean fewer startups are acquired (potentially reducing the number of killer acquisitions), it also means the expected rewards of starting, working at, and funding a startup are reduced. This could be particularly costly if, as Cunningham et al.’s paper suggests, “killer acquisitions” occur at a relatively low rate.

The importance of financing to startups cannot be overstated. Many of these firms do not expect to see substantial revenue or turn a profit for years. Startups need cash to fund their operations in the meantime. This cash flow often comes from venture capitalists, who must invest time in due diligence before tying up their funds in illiquid assets for several years prior to seeing returns on their investments. If the potential of being acquired as an exit strategy is seriously threatened, the venture capitalists will factor this increased risk into their calculus and perhaps invest elsewhere. If the potential returns to startup formation diminish, larger tech firms with proven success may be a more attractive investment vehicle.

Reduced access to financing (and to the promise of a big payday upon being acquired) may also affect how people with great ideas monetize those ideas. Instead of taking a short-term risk on starting a company that may one day be acquired, the safer bet for a would-be entrepreneur may simply be to use her intelligence and skills at a job at an established tech company.

It may not only be entrepreneurs who are affected, but their skilled workforces, as well. In the 2019 SVB Survey, over 80 percent of respondents answered that they were looking to increase their workforce in 2019. When asked how challenging it is to find skilled workers, 91 percent of respondents replied that it was somewhat or extremely challenging. The positions that most need filling are in “product development/R&D, sales and technical positions.” Moreover, when asked what are the most important public policy issues affecting their companies, 63 percent of respondents answered “access to talent.” This answer ranked number one, above healthcare costs, cybersecurity, consumer privacy, and other answers. With the much-anticipated banner year of IPOs not materializing in 2019, startup employees are finding that pay cuts and long hours are less worthwhile if there is no IPO producing substantial stock payouts. Making payday-by-acquisition more difficult could further deter an otherwise willing startup employee. If long hours and low pay are paired with little promise of a future reward, the best tech talent may find that established tech firms are the best places to invest their talent.

**Promoting Innovation**

As with most issues at the intersection of antitrust and innovation, policy questions about acquisitions of nascent and potential competitors present a number of complications. It is critical, however, to address those questions with an eye to what the ultimate goal of any policy change would be. If the objective is to protect and promote innovation, we should be cautious about any solution that puts increased burdens on the entrepreneurs who we hope will drive that innovation. Proposals to change or enhance premerger scrutiny of acquisitions involving smaller tech startups may indeed subject more anticompetitive deals to review and could even result in more anticompetitive deals being blocked before closing. The counterweight, however, is that such a move will inevitably subject more startups to higher costs and higher risks associated with antitrust merger review. The implications could be significant if the returns to investing capital, talent, and time into startups (and the resulting innovation) are diminished as a result.

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2 Cunningham et al., supra note 1, at 41.

3 Roderick Nieuwmeyer (@Nieuwmeyer), TWITTER (Jan. 17, 2019, 8:22 AM), https://twitter.com/Nieuwmeyer/status/108589013304638580. Concurences tweeted, “The first panel «Killer acquisitions: Should they be prevented?» has ended. It was moderated by Mike Cowie (@cowiem, @dechertllp) and Clemens York (@dechertllp). #GlobalMerger19 #KillerAcquisitions @dechertllp @News_CRA @FrontierEcon.]” Concurences (@CompetitionLaw), TWITTER (Dec. 6, 2019, 3:40 AM), https://twitter.com/CompetitionLaw/status/1202870356383583852.

4 Cunningham et al., supra note 1, Abstract.

5 Id. at 42.
ANTI-MERGER SENTIMENT IS EVERYWHERE. But it particularly targets a narrow corridor from San Jose to Seattle that houses many of the world’s largest technology companies. From politicians to academics to the popular media to antitrust agencies, rarely a day goes by without some call to increase antitrust scrutiny over the technology sector.

Much of the anti-merger sentiment has focused on acquisitions of nascent technologies by large firms. Many of these firms rose to prominence, in part, through the successful integration of nascent technologies into their platforms, such as Facebook, Inc.’s acquisition of Instagram Inc. and Google Inc.’s acquisition of YouTube, Inc. But antitrust interventionists have argued that some of these transactions were anticompetitive on the basis that those nascent technologies could have challenged the alleged dominance of the superstar tech firms if they were not acquired. Many interventionists are now revisiting this acquisitive era with sharp criticism for the alleged permissiveness of the antitrust agencies and calls to increase merger scrutiny.

However, the antitrust agencies must operate within the confines of the law. And as many practitioners recognize, an effects-based antitrust regime poses significant evidentiary burdens for challenging acquisitions of nascent competitors because the competitive impact of these types of transactions are, by their very nature, highly speculative. In the United States, this has prompted debate among interventionists on two parallel paths: (a) proposals to increase enforcement within existing law; and (b) proposals to change the law.

Many antitrust practitioners and academics recommend that enforcers follow the first path. The Federal Trade Commission has been particularly active in this area, establishing the Technology Enforcement Division to reportedly investigate nascent competitor acquisitions, including consummated ones. In addition, the FTC’s Office of Policy Planning sponsored several workshops on this subject and most recently issued orders under Section 6(b) of the FTC Act to require five large tech companies—Microsoft, Google, Apple, Amazon, and Facebook—to produce information relating to smaller acquisitions that fell below the Hart-Scott-Rodino (HSR) threshold over the past ten years.1 And the FTC recently challenged Illumina Inc.’s proposed acquisition of Pacific Biosciences of California, Inc. under a nascent competitor theory, which the parties abandoned soon thereafter. The Department of Justice also recently held its own workshop on the subject2 and challenged Sabre Corporation’s proposed acquisition of Farelogix Inc., which involves the purchase of nascent travel software by a long-time incumbent provider. Finally, leading academics have formulated a variety of proposals to increase merger enforcement under existing law.3

Legislators, on the other hand, are well-down the second path. Concerns over the rise of “big tech” are bipartisan, frequently fueled by populist sentiment on both sides of the aisle.4 Most prominently, Senators Elizabeth Warren and Amy Klobuchar put forward detailed legislative proposals that would fundamentally change U.S. merger law. Senator Warren’s proposal, which she released as part of her presidential campaign, would break up “platform utilities”—which includes some of most prominent technology companies in the world. The proposal would also implicitly prohibit any future acquisitions of adjacent technologies that could be integrated into a platform. Senator Klobuchar’s proposal, which is reflected in a pending Senate bill, does not break up existing companies, but would place onto the merging parties the burden of proving a negative—that their acquisitions are not anticompetitive. Unlike Warren’s proposal, Klobuchar’s proposal is not industry specific and, as we will show, would place at risk more than 70 percent of total deal value within the United States.5

From the industry perspective, the first path is cause for heightened awareness. The second path is cause for alarm. Many antitrust practitioners and economists in the United States have an instinctual reaction that antitrust overreach chills competition and innovation. They may argue about the techniques of the scalpel, but there is a strong argument that it is a better instrument than a bludgeon. However, calls to turn our effects-based antitrust system over to an explicit anti-merger regime indicate that the tech industry needs to work harder to make the case that effects-based merger control strikes the right enforcement balance.
Part of this case should come through a better articulation of efficiencies, within the broader merger policy debate, that arise from the integration of nascent technologies into an established technology company. The efficiencies are numerous, starting with product integration, which is the lifeblood of the technology industry. The integration of new technologies (from the acquired firm) into a broader portfolio or platform (from the acquiring firm) tends to reduce costs, drive new features, and enable a more seamless customer experience, offering a “one-stop shop.” And these benefits are usually merger-specific because, even if two firms were collaborating independently prior to the merger, the level of co-design and co-optimizations will significantly increase post-merger as incentives align more closely. Other efficiencies arise simply from resource allocation. A start-up company may have a great idea but little ability to scale. The acquiring firm often provides a sales force, back-office support, and engineers who can expand the acquired firm’s nascent technology to the acquired firm’s existing customer base.

These procompetitive effects need to be taken into account to achieve the right balance in merger policy. Antimerger legislation that does not consider these scenarios threatens to chill efficiency-enhancing transactions with minimal benefit of preserving nascent competition.

There is also a quantitative case to be made through data. These data show a vibrant start-up ecosystem, funded by venture capital, and dependent on acquisitions, or “exits,” by established technology firms. As discussed above, these exits generate significant efficiencies for the acquiring firm. But they also generate returns to the investing venture capital firms, which are then reinvested back into the start-up ecosystem, driving more innovation and consumer benefit. Despite popular claims of a “start-up slump,” our data show that investment activity has been steadily growing over the past decade and is currently thriving. Furthermore, as one recent study by Professors Gordon Phillips and Alexei Zhdanov found, this VC investment activity is strongly correlated with opportunities for M&A exits and negatively correlated with anti-merger laws. Our analyses below are consistent with those findings.

### Enforcement Challenges Under the Clayton Act

Section 7 of the Clayton Act prohibits mergers that may substantially lessen competition or tend to create a monopoly. For mergers between competing market participants, the agencies are well versed in applying the Horizontal Merger Guidelines, and the quantitative tools they prescribe, to predict a merger’s likely competitive effects. Technology mergers often increase the degree of difficulty in this analysis due to uncertainties in defining technology markets and capturing the impact of dynamic competition. Still, the agencies have been successful in either blocking or obtaining remedies in a number of recent mergers between established competitors in the tech sector.

However, when the acquired firm is not a fully-fledged competitor, but could be, the analysis is more challenging. The acquired firm might be considered a “potential competitor,” which is distinguished from an “actual competitor” in that the firm is not yet in the relevant market but is considered “likely” to enter. The concept of a “nascent competitor” is related but somewhat different. A nascent competitor does not have to be in the relevant market, but it would possess a product or technology that has the potential to mature into a significant competitor. While the term “nascent competitor” is not explicitly referenced in the Merger Guidelines, Section 2.1.5 captures the potential harm from this type of acquisition, stating that, “if one of the merging firms has a strong incumbency position and the other merging firm threatens to disrupt market conditions with a new technology or business model, their merger can involve the loss of actual or potential competition.” These concerns are consistent with the incipiency doctrine underlying the Clayton Act, which is reflected in the Supreme Court’s decision in Brown Shoe Co. v. United States.

Most agency precedent involves challenges to acquisitions of potential competitors. A large number of these cases involve pharmaceutical markets and were resolved by consent decrees because merging pharmaceutical companies are often willing to resolve agency concerns through divestiture when the discrete product overlap in question is relatively small compared to the overall deal value. Pharmaceutical cases also have relatively transparent and defined paths to market in later-stage development through publication of clinical trials or regulatory filings. Thus, their applicability to the technology sector is limited at best.

In the technology sector, the FTC challenged acquisitions of nascent technology companies in CDK Global, Inc. & AutoMate, Inc., Verisk Analytics, Inc. & EagleView Technology Corp., and most recently in Illumina, Inc. & Pacific Biosciences of California, Inc. However, in all four cases, the parties abandoned their transactions prior to trial. As noted above, the Department of Justice is currently challenging Sabre’s proposed acquisition of Farelogix under a nascent competition theory. The case went to trial earlier this year and is now awaiting the judge’s ruling at the time of publication.

Because of this limited litigation profile, agency enforcement history can mask the evidentiary challenges in proving a nascent or potential competitor case in court. In fact, FTC v. Steris Corp. is the only potential competition case litigated to a decision in the past 40 years. There, the merging parties prevailed because the FTC could not prove that the target “probably” would have entered the relevant market within a reasonable period of time. The acquiring firm, Steris, was one of only two providers of contact sterilization services in the United States. The acquired firm, Synergy Health PLC, originally planned to enter the U.S. market by importing an alternative sterilization technology it marketed in Europe. However, it reversed course and abandoned its entry plans while the deal was pending. The FTC argued Synergy only...
did so to evade antitrust enforcement of its transaction, but the court found that Steris’s decision not to enter was independent of the transaction and, instead, was based on legitimate business considerations, including lack of customer support, regulatory hurdles, and cost overruns.

In our view, the rationale of Steris should apply to a nascent competitor acquisition brought under Section 7 of the Clayton Act. The challenging agency therefore would need to show the nascent competitor “probably” would have emerged to substantially impact competition with the acquiring firm but for the acquisition. Given the inherently uncertain trajectory of nascent technologies, the challenge of proving this element may explain the lack of cases, despite the increased volume of calls to step up enforcement. For example, former FTC Commissioner Maureen Olhausen recently commented that the Steris case “shows the evidentiary difficulty of bringing these types of cases.”

Section 2 Solution?

In light of the evidentiary hurdles in challenging nascent competitor acquisitions under Section 7 of the Clayton Act, some commentators have suggested applying a monopolization theory under Section 2 of the Sherman Act as an alternative framework. The foundation for this framework dates back to the work of Professor Phillip Areeda, whose analysis was adopted by one of the seminal monopolization cases of our time, United States v. Microsoft Corp.

In Microsoft, the D.C. Circuit found that Microsoft violated Section 2 by foreclosing competition from middleware software (Netscape Navigator and Java) through anticompetitive product design changes and customer agreements. These middleware providers were not fully-fledged competitors, but rather were considered a nascent threat to Microsoft’s Windows operating system monopoly. The D.C. Circuit set forth a three-part test designed to assess and, if necessary, balance the anticompetitive effects and procompetitive justifications of Microsoft’s conduct. But the court never actually applied this test, as it found multiple instances in which Microsoft’s conduct was facially anticompetitive by placing roadblocks in front of middleware software providers through product design changes and customer contracts. Thus, unlike agency practice in the merger context, the court never attempted to balance the harms of Microsoft’s alleged conduct with its purported benefits.

The court also rejected Microsoft’s lack-of-causation argument. Microsoft argued that the DOJ failed to establish a causal link between Microsoft’s conduct and the maintenance of its monopoly because Netscape and Java were only nascent rivals and may not have been able to successfully compete against Windows even in the absence of Microsoft’s anticompetitive conduct. However, the court reasoned that the DOJ did not need to show a causal link because “it would be inimical to the purpose of the Sherman Act to allow monopolists free reign to squash nascent, albeit unproven, competitors at will—particularly in industries marked by rapid technological advance and frequent paradigm shifts.” Thus, unlike in a merger case, the government did not need to predict Netscape and Java’s emergence as a viable competitor to Microsoft in a hypothetical “but-for” world.

The FTC applied the Microsoft rationale to the merger context in two health-care industry transactions—FTC v. Mallinckrodt ARD, Inc. and Illumina. In the Mallinckrodt case, the FTC obtained $100 million in disgorgement by challenging an allegedly anticompetitive acquisition of a nascent pharmaceutical product under a monopolization theory. The FTC alleged that Mallinckrodt’s subsidiary, Questcor Pharmaceuticals, Inc., acquired a product from Novartis AG called Synacthen, which was a near-duplicate of Mallinckrodt’s dominant product, Acthar Gel. Synacthen was approved outside the United States, but not in the U.S., when Novartis commenced an auction for the U.S. rights. Questcor allegedly saw limited value in acquiring Synacthen because “any therapeutic indication that Questcor pursued with Synacthen could have been pursued with Achtar.” However, once Novartis began the auction, Questcor allegedly acquired the product as a defensive move to prevent another bidder from trying to develop the drug and launch it in the United States to challenge Questcor’s monopoly. Unlike the losing bidders that followed a normal diligence process and developed plans to compete against Achtar Gel, Questcor “had only inchoate plans for Synacthen and conducted limited due diligence” before outbidding its rivals. This allegedly showed that Questcor acquired Synacthen to limit competition.

In the wake of its consent decree, the FTC published commentary that the Mallinckrodt case was significant because it showed that acquisitions of nascent competitors can be challenged even without alleging that the target product “was ‘likely’ to clear all regulatory and other hurdles to reaching the market.” Even though the FTC did not mention the Steris case, the commentary appears to be a reaction to that case, which came down in the prior year. The Commission viewed its approach as consistent with the Microsoft decision concerning the “elimination of nascent threats” to competition. Thus, the Commission concluded: “Section 2 can be an important tool in the antitrust arsenal and may be particularly relevant to protecting competition in the pharmaceutical space, where defendants often argue that FDA approval is so complex, difficult, costly, and time-consuming that plaintiffs cannot demonstrate ‘likely’ entry.”

After Mallinckrodt, a number of commentators, including a former FTC Commissioner, called on the antitrust agencies to extend this Section 2 theory to the tech sector. In addition, Bruce Hoffman, former Director of the FTC’s Bureau of Competition, argued that the attraction of this approach is a reduced standard for causation compared to Section 7 of the Clayton Act. But Hoffman recognized that use of Section 2 would also require proof of monopoly power, which “generally... means a market share in the 70 to 80
percent range, usually coupled with some evidence of durability and entry barriers.”

The FTC further developed its Section 2 theory in its recent challenge to the Illumina/Pacific Biosciences transaction, which the parties then abandoned. According to the complaint, Illumina was a monopolist in DNA sequencing (with more than 90 percent market share) that sought to acquire Pacific Biosciences—a small but growing rival (with 2–3 percent market share). Although Pacific Biosciences’s sequencing technology differed from Illumina’s technology, the FTC alleged that Pacific Bioscience had been taking business from Illumina and that Illumina viewed Pacific Biosciences as a competitive threat. Thus, the FTC brought its complaint under Section 2 of the Sherman Act (and Section 7 of the Clayton Act), alleging that the transaction “will substantially lessen competition and further insulate Illumina’s monopoly from PacBio’s increasing competitive threat.”

While the FTC recognized that there were a number of other smaller rivals to the merging parties, it alleged they had limited customer acceptance or future prospects due, in part, to Illumina’s extensive patent portfolio.

The Mallinckrodt and Illumina cases indicate that Section 2 may be increasingly applied to acquisitions of smaller rivals by a dominant firm. However, their applicability to the tech sector remains in question and should by no means be considered a panacea for regulators to avoid a detailed, fact-intensive inquiry into the likely effects of an acquisition. Any Section 2 merger challenge would still require proof of monopoly power and anticompetitive conduct that was not outweighed by efficiencies. The Mallinckrodt complaint did not recognize any cognizable efficiency argument, as the FTC alleged that the transaction was entirely defensive. In the Illumina complaint, the parties’ efficiency defense was at least recognized, but the FTC alleged that any efficiencies were not merger-specific. These arguments are not so easily disposed of in technology cases, particularly those in which the acquired technology is complementary to the acquired firm’s platform and can benefit from product integration. Even if the agencies could show that the acquired technology was a nascent rival to the platform, the Microsoft case holds that these efficiency arguments would still need to be addressed and weighed against alleged anticompetitive effects.

**Legislators Push the Boundaries**

For many antitrust practitioners, the burden borne by the agencies to prove that an acquisition is unlawful is an important attribute of a system designed to strike the right balance in approving procompetitive transactions while blocking anticompetitive ones. But for tech interventionists, it’s a bug. The charge is led by Senators Klobuchar and Warren, who have put forward detailed legislative proposals that would result in significant changes to U.S. merger law. Those proposals are supported, in part, by growing academic and media commentary calling for more stringent merger enforcement within existing law. We address a few of these proposals, ranging from incremental to sweeping.

The incremental approach is illustrated by a number of proposals put forward by leading academics to strengthen merger enforcement under existing law. Professor Tim Wu outlined the framework for a novel market for “attention,” which would presumably convert acquisitions of adjacent (and thus complementary) technologies by digital software platforms into horizontal overlaps. Professor John Kwoka has argued that agencies should reverse their current effects-based approach in favor of a structural presumption that would rigidly restrict mergers that result in a certain level of market share concentration. Even though this would involve a departure from current agency practice, there would be significant legal flexibility to do so under the Supreme Court case, *United States v. Philadelphia National Bank*. That case created a presumption of illegality for mergers resulting in a significant increase in concentration—a presumption that can only be rebutted by evidence clearly showing that the merger is not likely to have anticompetitive effects. As antitrust practitioners know, this remains the standard under which mergers are litigated.

However, for acquisitions of potential competitors or nascent competitors, it is unlikely that creative market definitions or reliance on a structural presumption would alleviate the agencies’ evidentiary burdens. As discussed above, the agencies still need to prove that the emergence of the target firm in the absence of the transaction (for Section 7 cases) or an act of monopolization that is not outweighed by efficiencies (for Section 2 cases).

Senator Klobuchar’s bill, the Consolidation Prevention and Competition Promotion Act of 2019, could change this landscape. As the ranking Democratic member of the Senate Judiciary Subcommittee on Antitrust, Competition Policy, and Consumer Rights, Klobuchar has repeatedly put forward legislation to strengthen antitrust enforcement during her Senate tenure.

The Klobuchar bill begins by broadly reducing the standard for all mergers from “substantially” lessens competition to “materially” lessens competition. Furthermore, it defines a special category of “mega mergers,” in which the burden of proof shifts to the merging companies to show that their combination does not “materially” lessen competition. “Mega mergers” are defined to include mergers that are (1) greater than $5 billion in value or (2) involve a party with assets, net annual sales, or market capitalization greater than $100 billion engaging in a transaction valued at greater than $50 million. As we discuss below, this mega merger category is likely to have a significant chilling effect on merger activity. For any company valued at greater than $100 billion, it would both expand the HSR size-of-the-transaction threshold (currently at $94 million) and require the company to prove the merger did not harm competition. At the time of publication, there were approximately 150 companies valued at greater than $100 billion listed in publicly traded stock exchanges.
Senator Klobuchar’s proposal to shift the evidentiary burdens to the merging parties has been supported by academic interventionists in the United States and Europe. It was also part of the recommendation in the “Competition Policy for the Digital Era” report put out in April 2019 by a panel of advisors to the European Commission. European Commission Executive Vice President Margrethe Vestager is reportedly considering whether to implement this proposal.

Senator Warren’s proposal goes significantly further than Senator Klobuchar’s. While it has not been incorporated into any proposed legislation, Warren’s proposal would fundamentally change the organization of the entire technology industry in one fell swoop and effectively prohibit future acquisitions for many prominent companies.

The lynchpin of Senator Warren’s proposal is to stringently regulate what she labels “platform utilities.” A “platform utility” is broadly defined as any company that operates a public online marketplace, exchange, or platform for connecting third parties. A platform utility with annual revenues of $25 billion or more must “structurally separate” or, in layman’s term, be broken up. After breakup, the company would also be required to meet a standard of fair, reasonable, and nondiscriminatory (FRAND) dealing with users of its platform. A platform utility with revenues below the $25 billion threshold (between $90 million and $25 billion) would remain intact but would be required to meet the same FRAND standard.

Under the Warren proposal, leading software platforms would need to divest the multitude of in-house products they sell (or offer for free) on their platforms. To call this disruptive is a gross understatement. Warren’s proposal also specifically calls for the unwinding of recent large mergers she views as anticompetitive, including Amazon.com, Inc./Whole Foods Markets Inc., Facebook/Instagram, and Google/Waze Limited. Going forward, these companies, among others, would be effectively prohibited from entering into future acquisitions in adjacent markets. Besides the efficiency losses described above, this abrupt restructuring of the U.S. tech industry would place U.S. companies at a disadvantage in competing against other equally large international companies, namely in China, which would continue to operate integrated software platforms.

Senator Warren’s proposal has been met with criticism, even among those considered antitrust interventionists. Diana Moss, President of the American Antitrust Institute, recently questioned the appropriateness of breakup proposals targeted at the digital technology sector, noting that these “blunt breakup remedies” rely on assumptions that often conflict with the “procedural and exacting nature of antitrust.” Moss also questioned the appropriateness of defining arbitrary threshold criteria for mandated restructuring.

This sentiment was recently echoed by Executive Vice President Vestager, who opined that “[w]e don’t have a problem that big where breaking up could be the solution.” Consistent with existing U.S. law, Vestager believes divestitures are only appropriate when “illegal behavior” is found.

Senator Klobuchar’s proposal is less severe than Warren’s, but it would still dramatically alter U.S. merger enforcement and likely chill future acquisitions by large technology firms. While her proposal would not prohibit transactions like Senator Warren’s, it would still result in more deals being notified and, at a minimum, lower the standard of proof. For the approximately 150 companies valued at more than $100 billion, the Klobuchar proposal would create a special category of antitrust enforcement where the acquirer would have to prove a negative—that its acquisition was not anticompetitive. This burden-shifting framework would also apply to any transaction valued at more than $5 billion, no matter the size of the parties.

The Start-up “Bump”

Very few voters are likely to shed a tear on behalf of large companies if their ability to acquire start-ups is limited. But from a policy perspective, any proposed changes in the law must also take into account their impact on a vibrant start-up ecosystem, which is built on the ability to sell to established firms. Even if one is skeptical about merger efficiencies, policymakers must consider how a radical shift in merger policy would threaten the health of the start-up ecosystem.

The foundation of the start-up ecosystem is venture capital financing. Venture financing is one of the riskiest investments in the world, through which financiers “seed” the creation of new businesses, often based on nothing more than an idea. The technology industry was built on venture capital, as firms like Apple and Facebook owe their existence to a select few “angel” investors who saw financial opportunity in a founder’s dream. But for every one of those, these are multitudes of firms like Theranos Inc., Juicero Inc., and Airware (incorporated as Unmanned Innovation, Inc.) that burned through millions of dollars in financing and went out of existence. One study estimated the failure rate of VC funding to be 75 percent on average.

What incentivizes venture capitalists to take this high-degree of risk? Like any investment avenue, it is the reward. In the VC industry, that reward is well defined: exiting in a reasonable timeframe through an acquisition or initial public offering. The prospect of an exit—earning a high return in a relatively short timeframe—is the primary driver of almost all venture capital financing. As any viewer of the television show Shark Tank knows, the most often asked question by the VC “sharks” is, “How will I get my money back?” But this exit is only temporary. The VC industry often seeks to reinvest its earnings back into the start-up ecosystem—driving more innovation and competition. In fact, many venture capital firms have grown from small start-up firms themselves to significant vehicles for profit and return. Softbank Group Corp.’s Vision Fund, now managing an estimated $100 billion, has recently dominated the start-up world. Other newly established funds such as Sequoia Capital Operations LLC and Tiger Management Corp. have valua-
tions that exceed $1 billion. According to Crunchbase, there were more than 2,700 VC firms globally, and 1,800 in the United States, as of 2019.49 These funds have more than $400 billion in venture capital assets under management.50

Corporate venture capital (CVC) is also a significant driver of start-up activity, as CVCs now participate in more than 50 percent of total VC deal value.51 Intel Capital, which is owned by Intel Corp., was founded in 1991 and has been credited as a pioneer in this area. Since that time, Intel Capital has invested more than $12 billion in more than 1,500 companies in 57 countries worldwide. Of those companies, 670 have either gone public or been acquired.52 Many other companies, such as Google, Microsoft, and Salesforce.com, Inc., have followed Intel’s lead in this area, leading to a vibrant competitive environment for investment opportunities among corporations and independent VC firms alike.

Data confirm the vibrancy of the venture capital ecosystem. For example, the publication Pitchbook tracks all VC funding worldwide, across industry sectors. According to Pitchbook, VC activity reached all-time high levels of investment in 2018, which was closely followed by an equally impressive level of investment in 2019. Figure 1 shows that from 2006 to 2018, venture capital deal values have been steadily rising, reaching a peak of $140.2 billion in 2018. Deal activity maintained its high levels in 2019, with a total investment of $136.5 billion. As one VC publication commented, these high levels of investment in the industry appear to be “the new normal.”53

Venture capital funding is also extremely diffuse, defying any notion that most funding funnels to “unicorns” (private firms valued more than $1 billion). As Figure 2 shows, in the United States in 2019, venture capital firms funded a total of 10,777 deals—nearly double the number of deals (5,444) in 2010. The majority of these deals are small, with more than half falling below $5 million in value. Large lump sum investments are less common in venture capital: less than 600 venture capital deals in 2019 were valued over $50 million.

Our analysis is consistent with a recent assessment of 2018 Pitchbook data from Hal Varian, the Chief Economist at Google and Emeritus Professor at the University of California, Berkeley. His analysis shows that first-time venture financing increased by nearly $4 billion in 2018 compared with 2017.54 Varian’s study contradicts a slightly older study by economists Kevin Caves and Hal Singer that showed a decline in VC funding as of 2017. The Caves-Singer study indicated a temporary downturn in an otherwise generally upward trend of VC funding, but it relied on older data that did not account for increased investment in 2018.55

When it comes time to exit, IPOs grab all the headlines. However, IPO markets are extremely volatile, as shown by recent disappointments in IPOs from Uber Technologies Inc., Lyft, Inc., and The We Co. They are also driven by unicorns and are generally inhospitable to smaller firms, which lack the requisite size or scale to operate as a standalone public company.

For many smaller companies, exit through acquisition is the lifeblood of VC financing. Many start-ups seek to ultimately partner with larger companies with more resources, rather than become fully-fledged companies themselves. In return, these large firms obtain valuable talent and technology that could be difficult to obtain organically. This ecosystem depends on a robust and efficient M&A environment.

Data confirm that exits through acquisition are significantly more common than IPOs. Varian calculated that there have been about twice as many successful acquisitions as IPOs in the United States since 1990.56 Our own data show that acquisitions remain the most popular exit for VC-backed start-ups. In 2019, 71 percent of venture capital exits were through acquisitions, while only 9 percent were through IPOs (and the remaining 20 percent of exits were through buyouts). Though a large proportion of deal value (80 percent) was concentrated in VC-backed IPOs, this trend is expected to slow given that exits in 2019 were primarily driven by unicorns capitalizing on strong market conditions. For many VC-backed companies, acquisitions remain the only exit option.

Based on these data, it is hard to argue that start-up activity is stifled by allegedly anticompetitive acquisitions in the
technology. The opposite is true. However, a counter-narrative has emerged from antitrust interventionists that attempts to connect a “start-up slump” to lax antitrust enforcement, including merger enforcement. For example, the subcommittee on which Senator Klobuchar is the minority ranking member and Senator Lee is the Chairman, recently held a hearing on Competition in Digital Technology Markets, in part to highlight Klobuchar’s proposed legislation. In that hearing, Senator Klobuchar claimed the United States was at a “record low” number of start-ups in decades, a statistic that she attributed to the rise of monopolization in the tech industry. Similarly, Senator Warren’s rationale for her proposal is that “weak antitrust enforcement has led to a dramatic reduction in competition an innovation in the tech sector” such that “venture capitalists are now hesitant to fund new start-ups.”

The claims by Senators Klobuchar and Warren appear to be based on analyses of U.S. Census Bureau data showing a decline in start-up activity over the past decade. However, Census data is not a relevant metric for an antitrust policy debate because it is widely over-inclusive. Under the Census definition, a “firm” is simply “a business organization consisting of one or more domestic establishments that were specified under common ownership or control.” And “start-ups” includes any “firm” with an age of zero. Therefore, “start-ups” can include any business, such as a local restaurant or retail store. Indeed, in 2015, there were 414,000 start-ups identified by the Census data, which is more than 22 times the number of venture capital transactions in 2018.

There could be many reasons for the decline in self-financed entrepreneurship in this country, but it is disingenuous to draw a connection between Census data and the technology industry, where start-up activity relies primarily on venture capital. So long as venture capitalists are incentivized to finance start-up activity at scale, disruptive competition will remain alive and well. Just ask taxi operators or makers of compact discs, video rentals, or print magazines, all of whom have been disrupted by VC-funded technology start-ups.

Others make the more subtle argument that VC activity has declined in the areas that require direct competition with an allegedly dominant software platform. The data we reviewed are not sufficiently detailed to address this claim, but even if it were true, it would be an unremarkable trend, consistent with any maturing industry. It is likely that if one tracked trends in automobiles, airlines, and consumer appliances, one would see a drop-off in start-up activity as those industries matured. This is the natural lifecycle of any investment activity as growth opportunities dry up and consolidation occurs. The key distinguishing factor in technology, though, is that start-up activity continues at a breakneck pace—it has just shifted to emerging growth areas such artificial intelligence, autonomous driving, blockchain, Internet of Things (IoT), and 5G technology where the markets have yet to fully form.

An Analysis of Potential Effects from Proposed Legislation

The increasing calls to restrict M&A activity in the technology sector take this vibrant start-up ecosystem for granted. They also reflect a misunderstanding of what drives investment activity in new technology. A casual observer of the popular debate over technology mergers might infer that M&A is driven by a desire to protect a dominant position and ward off threats. In reality, many technology investments are driven by growth opportunities.

Technology investments also require significant capital expenditure and present high failure rates. These risks are rivaled only by the pharmaceutical industry, which is experiencing its own heightened scrutiny over the supposed prevalence of “killer acquisitions”—a moniker given to acquisitions like the one in Mallinckrodt that are allegedly designed to kill off innovative threats to a pharmaceutical monopoly.

In both the pharmaceutical and tech industries, there is a delicate balance in maintaining the functioning of the start-up ecosystem (with biotech companies serving as the prime example of pharmaceutical start-ups)—as profits slated for investment could easily be shifted to dividends and stock buybacks.

Senator Warren’s proposal, if enacted, would significantly chill M&A activity in the technology industry overnight. Many companies at risk of being classified as a platform utility would immediately reassess their ability to acquire companies in adjacent markets—even if they were confident about their procompetitive integration plans, the lack of horizontal competition, and the existence of sufficient rivals to counteract their abilities and incentives to foreclose. In short, Warren’s proposal provides no leeway to the agencies in assessing competitive effects for a potentially broadly defined category of transactions.

Senator Klobuchar’s proposal is less radical, but it would also have chilling effects on merger activity both within and outside the technology industry. The primary threat posed by this legislation is prolonging merger reviews that present no competitive concern. The technology industry moves extremely fast, and winners and losers in nascent technologies are often determined by who gets to market first. Thus, extended reviews could significantly undermine the business case for a transaction, as integration plans must be shelved until antitrust approval is received.

Review times have been increasing in the current heightened enforcement environment, which may already be having a chilling effect on merger activity. Klobuchar’s proposal would likely exacerbate this problem. At a minimum, more transactions will need to be notified under her proposal as the HSR threshold would be lowered from $94 million to $50 million for acquisitions by firms valued at more than $100 billion. And a burden-shifting framework would substantially lengthen review times, as companies would struggle to provide enough information to skeptical antitrust authorities, yielding the threat of a merger challenge without the burden of proof.
Senator Klobuchar’s proposal would also create significant uncertainty about how this new evidentiary power would be wielded, depending on the leadership of the antitrust agencies. Klobuchar’s proposal essentially establishes a category of mergers that are presumptively illegal unless the merging parties can prove they are not. That is a powerful tool that has the potential to be misused by an enforcement authority, particularly for vertical and conglomerate transactions that are likely to generate significant efficiencies without any cognizable horizontal overlaps.

To provide some illustration of the impact of Senator Klobuchar’s burden-shifting proposal, we return to the data. When analyzing 362 transactions announced in 2019 with values greater than $50 million, 54, or roughly 15 percent, would have been affected by Klobuchar’s burden-shifting framework. Of these 53 transactions, 44 were greater than $5 billion in value and 10 were below the $5 billion threshold. Although Klobuchar’s proposal may affect only a minority of total deals, this framework would have a large impact when assessing total economic value of the transactions. In 2019, Klobuchar’s proposal would affect a staggering 72 percent of the total transaction value of the acquisitions announced in the United States in 2019 with values greater than $50 million. In other words, this proposal would have placed approximately $756 billion of deal value at risk in 2019.

It is notable that, even though Senator Klobuchar’s proposal is driven by concerns about technology mergers, many other industries would be impacted. While 20 percent of these acquisitions were made by technology firms, 20 percent of acquirers were in healthcare, 15 percent were in consumer goods and services, and 7 percent were in financial services. These figures indicate that Senator Klobuchar’s legislation would have a broad impact beyond technology firms.

Conclusion
Ask any antitrust practitioner what draws him or her to the field and you will probably hear some variant of an answer about the appeal of diving deep into the workings of an industry. Deep industry expertise is a prerequisite to understanding the likely competitive effects of an antitrust case. The FTC’s establishment of its Technology Enforcement Division is consistent with that reality, as are similar task forces in other countries. If the criticism is that merger enforcement has been too permissive in a certain industry, a natural response is to devote more resources to understanding, and ultimately proving, the competitive impact of transactions in that industry. Despite the evidentiary challenges posed by the Steris case, the recent Illumina and Sabre cases indicate that the agencies believe they can prove nascent competitor acquisition cases in court.

The proposals from Senators Warren and Klobuchar, and under consideration in Europe, reflect skepticism about the agencies’ ability to execute this mission. Warren’s proposal is an outright rejection of an effects-based system. Klobuchar’s proposal relieves the agencies of their obligation to prove a case. The latter may seem like a minor adjustment in merger policy, but it would upend years of antitrust enforcement based on the principle that companies can freely enter into transactions unless a complainant (either an agency or private party) can prove they are anticompetitive. In considering whether this type of significant shift in U.S. merger law is warranted for the technology sector, policymakers must consider the potential chilling effects on merger efficiencies and the technology start-up ecosystem, as well as spillover effects to other industries.

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4 See e.g., Statement of Senator Richard Blumenthal (D) on FTC Inquiry into Big Tech Consolidation Acquisition Strategies (Feb. 11, 2020) (“The last time the FTC came before Congress, I asked why they weren’t scrutinizing and blocking Big Tech acquisitions of potential competitors. I am glad to see the FTC finally heeding that call—but introspection and studies are not an excuse for continued enforcement inaction.”); Senator Josh Hawley (R), Overhauling the Federal Trade Commission (Feb. 10, 2020) (“Google and Facebook have acquired hundreds of companies in the last two decades, yet the FTC never once intervened to try to block any of these acquisitions.”), https://www.hawley.senate.gov/sites/default/files/2020/02/Hawley-FTC-Overhaul_0.pdf.
5 As discussed infra, this value was calculated based on an analysis of Deal Point Data, which covers all mergers announced in 2019 with deal values over $50 million. Senator Klobuchar’s bill proposes shifting the burden of proof for all mergers (1) that are greater than $5 billion in value or (2) involve a party with assets, net annual sales, or market capitalization greater than $100 billion engaging in a transaction valued at greater than $50 million.

See Horizontal Merger Guidelines, supra note 8.

Brown Shoe Co. v. United States, 370 U.S. 294, 317–18 (1962) (during “rising tide of economic concentration, [Congress wanted mergers to be blocked] at a time when the trend to a lessening of competition in a line of commerce was still in its incipiency . . . . [Congress wanted to] brake this force at its outset and before it gathered momentum.”).


Sokol, supra note 6, at 7–8.


Id. at 58–59.

Id. at 79 (citing PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 651c, at 78).


Id. ¶¶ 7–8.

Id. ¶ 51.

Id. ¶¶ 47–48.


Id.


See Kwoka, supra note 3.


Emily Craig, Vestager Considers Shifting Burden of Proof for Big Tech, GLOBAL COMPETITION REV. (Oct. 31, 2019).

Elizabeth Warren, Here’s How We Can Break Up Big Tech (May 8, 2019), https://medium.com/@teamwarren/heres-how-we-can-break-up-big-tech-9ad9de0da324c.


See Varian, supra note 48.


See Varian, supra note 48.


Warren, supra note 45.


Mike Swift, VCs May Help Antitrust Regulators Peer into the ‘But-For’ World of Big Tech Acquisitions, MLLEX MARKET INSIGHT (Feb. 14, 2020).

Id. (quoting Patricia Nakache from venture capital firm Trinity Ventures, who explained that “[o]ne reason driverless cars and cryptocurrency have seen such ‘mini gold rushes’ of investment . . . . is that there is no dominant company in those areas of technology.”).


The UK Competition and Markets Authority: Outlier or Canary in the Coal Mine?

BY JOHN D. HARKRIDER

The UK Competition and Markets Authority’s (CMA) investigations into three recent technology mergers involving U.S. companies—Illumina/PacBio, Sabre/Farelogix, and Thermo Fisher/Roper—have drawn attention from antitrust practitioners on both sides of the Atlantic.1 Two of the mergers were abandoned before a final CMA decision and the other is still pending final CMA review and facing a litigation challenge in the United States. These cases are interesting both because they involve tech companies acquiring smaller rivals and because they indicate the CMA’s willingness to challenge transactions between U.S. companies where the UK has a relatively limited connection.

In all of these cases, the CMA publicly expressed a concern about the deals in advance of the Federal Trade Commission or Department of Justice. This may give the impression that the CMA is more aggressive than U.S. regulators. In reality, the procedural rules of the CMA—namely its requirement to publish a decision to move to Phase 2 relatively early in the merger review process—cause it to take public positions in advance of other regulators. But this does not necessarily mean that the CMA is taking more aggressive positions than other regulators. Indeed, the U.S. agencies ultimately sued to block both Illumina/PacBio and Sabre/Farelogix.

Even if the CMA is not a regulatory outlier, careful consideration of CMA merger review is useful to antitrust practitioners for a number of reasons:

- First, because the CMA is quite transparent as to the evidence it collects and its analysis of that evidence, it is possible to gain considerable insight into how the CMA and potentially other regulators process market feedback, especially when customer reactions to the deal are mixed.2
- Second, because filing with the CMA is voluntary, the decision on whether to include the CMA as a closing condition plays a prominent role in merger negotiations as the CMA typically permits parties to close into a hold separate, especially when the transaction is in Phase 1.3
- Third, because it will be challenging to litigate a merger with the FTC or DOJ knowing that, even if one prevails, it will still be necessary to obtain clearance from the CMA. This means that CMA review potentially removes a very important, and in many respects foundational, component of American antitrust review—namely, independent de novo judicial review of merger decisions by the FTC or DOJ. While this may be a reasonable byproduct of parallel review where a regulator has a strong jurisdictional claim to review a merger—such as where a merger has an EC dimension—it seems less appropriate under principles of comity and fairness where the merger’s connection to a non-U.S. regulator is more tenuous.

I review the CMA’s investigations of these transactions below, with a particular focus on jurisdiction, the views of third parties, and the extent of coordination and convergence with U.S. agencies.

Illumina/PacBio

On November 1, 2018, Illumina, Inc. and Pacific Biosciences of California, Inc. signed an agreement for Illumina to acquire PacBio for approximately $1.2 billion.4 Illumina and PacBio are both “global suppliers of DNA sequencing systems” and associated peripherals to universities, laboratories, and research institutes.5 Illumina manufactures and sells short read DNA sequencing systems.6 PacBio manufactures and sells native long read DNA sequencing systems, which are materially more expensive than short read systems.7 The CMA announced the launch of its merger inquiry on April 17, 2019, and issued its Phase 1 decision on June 18, 2019.8

In its Phase 1 decision, the CMA found that the merger should be referred to Phase 2 because it may result in a substantial lessening of competition (SLC) within UK markets, driven by horizontal unilateral effects related to “the supply of [next generation] DNA sequencing [(NGS)] systems worldwide.”9 The CMA combined short and long read systems into a single market because “the majority of third party submissions, industry reports and many of the Parties’ internal documents, all indicated a material (and increasing)
Because the CMA’s process is transparent, we can see that the CMA is willing to block deals even when customer reaction is decidedly mixed.

[competitive] overlap between the . . . technologies for at least some use cases.”

The CMA pointed to the parties’ very high combined share (projected at 90–100 percent in the UK and 80–90 percent worldwide) in NGS systems as “prima facie raising competition concerns.” It acknowledged that Illumina’s existing market position accounted for the vast majority of the parties’ combined share, but found that PacBio’s current share failed to capture its competitive significance following the launch of its (faster and less costly) sequencing system a few months earlier. The CMA further found high barriers to market entry and expansion, also noting that alternative suppliers had relatively low market penetration compared to Illumina and less developed offerings than PacBio.

The CMA referred the merger investigation to Phase 2 on June 27, 2019, and issued its Provisional Findings on October 24, 2019. In its Phase 2 Provisional Findings, the CMA found that the merger would result in a SLC due to horizontal competition concerns in the market for the supply of NGS systems in the UK. The CMA cited customer evidence that short and long read sequencing systems “are currently substitutable for at least some projects,” with customers noting “areas where long read sequencing had already displaced short read sequencing in their work.” The CMA also pointed to evidence from the parties’ internal documents, customers, and competitors that the parties would compete more closely in the future because of improvements to PacBio’s technology.

On November 13, 2019, the parties responded to the CMA’s notice of possible remedies with a remedies offer, which Illumina revised on November 20, 2019. The CMA’s Remedies Working Paper provisionally concluded that prohibition of the merger would be “the least onerous effective remedy and [that it was] not disproportionate to the SLC and its adverse effects.”

Jurisdiction. The CMA found jurisdiction to review the merger between the two U.S. companies on the basis of the share of supply test set out in section 23 of the 2002 Enterprise Act. Significantly, “the share of supply test is not an economic assessment [and] . . . the group of goods or services to which the jurisdictional test is applied need not amount to a relevant economic market . . . .” This gives the CMA significant flexibility to find that the share of supply test is met even when there are significant disputes on the issue of market definition. The transaction failed to meet the alternative ground for jurisdiction—the turnover test—as PacBio’s UK turnover did not exceed £70 million.

Of some note, the parties did not contest jurisdiction in their merger notice, noting that the share of supply test was met. They conceded that even though they were “not active on the same product market, they [were] both suppliers of sequencing systems” in the UK, with a combined share of more than 25 percent, although PacBio’s share in the UK was “de minimis.”

Third-Party Views of the Merger. Because the CMA’s process is transparent, we can see that the CMA is willing to block deals even when customer reaction is decidedly mixed. For example, the parties noted:

The CMA states that “roughly half of the customers we spoke to said that short read and long read are currently substitutable for at least some projects.” This is simply not true. . . . of the 21 customers interviewed by the CMA for whom call notes were provided to the Parties’ counsels, 15, i.e., more than 70%, clearly stated that short read and native long read systems are not interchangeable for any project, application, or use case.

The CMA’s decision acknowledged that “most customers . . . felt that PacBio’s offering would improve under Illumina.” Some customers, however, expressed concerns to the CMA about the merger, including that “Illumina could ‘slow down’ development of PacBio’s technology, fail to develop PacBio’s technology fully, or be slow to release new technology.” Others “had mixed views [of the merger] as they felt that there may be a loss of competition, but that Illumina may be well-placed to develop PacBio’s technology.” Several third parties also submitted responses to the CMA’s Phase 1 Decision to Refer and Phase 2 Provisional Findings. One third party commented that the CMA’s view that short read and native long read technologies can be used interchangeably is “definitely not my experience or the experience of anyone in my extensive network.”

The parties commissioned third party DeciBio to conduct a customer survey, which they submitted to the CMA as “evidence that short read and long read technologies are not interchangeable for any [of 41 identified] ‘use case[s].’” The CMA did not “place material weight on the survey in [the] provisional assessment, highlighting that, in its view, the quotes the parties shared did not reflect the nuance of the interview notes.” The CMA further stated that there were methodological issues with the survey, including that the aim of the survey was leading and the response rate was low (5 percent) and potentially not representative. In addition, the CMA noted that it was not contacted prior to the survey being conducted and had therefore been unable to comment on the survey’s methodology.

Coordination and Convergence with the United States? Until December 2019, the CMA was the only regulator who had taken a position on the transaction, and a number of commentators found that the CMA’s conclusions seemed unusually broad. But on December 17, 2019, the FTC authorized an action to block the transaction, making it clear that the CMA was not alone in its concerns.
Notably, the FTC complaint alleged not only a violation of Section 7 but also that Illumina had violated Section 2 of the Sherman Act by seeking unlawfully to maintain its NGS monopoly power by eliminating the nascent threat posed by PacBio. The complaint described Illumina as a monopolist in the NGS systems market with a U.S. market share exceeding 90 percent. According to the FTC Statement, “When a monopolist buys a potential rival, it can harm competition. These deals help monopolists maintain power. That’s why we’re challenging this acquisition.”

On January 2, 2020, the parties announced that they had terminated the merger agreement, “considering the lengthy regulatory approval process the transaction ha[d] already been subject to and continued uncertainty of the ultimate outcome.” Upon the parties’ abandonment of the merger, the CMA noted that it had been closely cooperating with the FTC throughout the regulators’ respective investigations.

**Sabre/Farelogix**

On November 14, 2018, Sabre GLBL Inc., a subsidiary of Sabre Corp., a technology and software provider to the global travel industry, announced its intent to acquire Farelogix, Inc., an airline technology solutions supplier, for approximately $360 million. Sabre distributes airline content to travel agents through its global distribution system (GDS), which aggregates flight pricing, availability, and other information from airlines and other third parties. “Farelogix supplies these services through a product that allows airlines to connect to travel agents directly.” Farelogix was instrumental in developing an XML messaging protocol called New Distribution Capability (NDC) that allowed airlines to provide travel agencies with real time delivery of personalized ancillary offers for travelers, such as club access, wi-fi, and extra legroom. When Farelogix implemented NDC, the airlines’ fares typically were not compared against rivals. Sabre and other GDSs also offered NDC capabilities, but unlike Farelogix, the GDS implementation of NDC typically compared one airline’s fares and ancillaries against competing airlines.

Sabre claimed that the deal would drive faster innovation in the highly competitive airline IT space. “The CMA’s mergers intelligence function identified [the] transaction as warranting an investigation,” and it announced the launch of its merger inquiry on June 21, 2019. The transaction was referred to Phase 2 on September 2, 2019.

In its Phase 1 decision, the CMA wrote that it believed that the merger may result in a SLC in the supply of services that facilitate the indirect distribution of airline content worldwide and the supply of non-core Passenger Service System (PSS) merchandising modules. The CMA’s Issues Statement provided that its inquiry at Phase 2 would focus on these areas and noted that its theories of harm centered on “the removal of Farelogix as a current and/or growing competitive threat to other providers, as well as an independent innovator in the industry.”

The CMA further noted that it would consider with respect to both theories of harm whether the merger would lead to “[h]igher prices and/or worse terms for airlines; and/or [s]lower rates of innovation and product development[,] [and] reduced product range or quality (compared to the situation without the merger).”

Responding to the CMA’s Issues Statement, the parties argued that the CMA mischaracterized the markets’ competitive conditions “by overestimating the Parties’ current and future development capabilities” and underweighting the innovative potential of an increasing number of competitors, including Amadeus and Travelport, among others. Sabre and Farelogix emphasized the transaction’s negligible increase in combined share and cited product descriptions and bidding data to show that the parties did not currently compete with one another at any significant level. Finally, they pointed to internal documents, industry participant statements, and economic data to argue that there was no realistic prospect of Farelogix achieving sufficient scale so that it could replace Sabre’s GDS services to any significant degree; that Farelogix is a complement rather than a potential substitute to market GDSs; and that therefore the CMA had no basis on which to find the merger anticompetitive.

As of the middle of January 2020, the CMA has not yet released its Phase 2 Provisional Findings. The transaction is pending and the review period has been extended to April 12, 2020.

**Jurisdiction.** Sabre and Farelogix are both U.S. companies. Farelogix has no revenues in the UK. The parties took the position that the CMA’s share of supply test had not been met—the only potential avenue for jurisdiction given the turnover test was not met—and the CMA therefore had no jurisdiction over the merger. At Phase 1, however, the CMA provisionally found that “it is or may be the case” that the test would be met based on (1) the share of “supply of services to British Airways that facilitate the indirect distribution of airline content,” and (2) “the Parties’ supply of services that facilitate the indirect distribution of airline content to travel agents in the UK.” With respect to the latter, the CMA considered that “because travel agents’ views (including those of UK travel agents) on the Parties’ products will ultimately affect the success of such products, the Parties in practice compete to distribute content to travel agents (including UK travel agents).”

The parties argued that it was “inappropriate for the CMA to determine whether the share of supply test is met based on the Parties’ proportion of sales to a single airline customer” and that Farelogix did not have any travel agent customers in the UK. The CMA justified its approach, noting that:

Within this context, the CMA will have regard to any reasonable description of a set of goods or services to determine whether the share of supply test is met . . . . [T]he CMA has a wide discretion in describing the relevant goods or services and . . . in applying the share of supply test, the CMA may have regard to value, cost, price, quantity, capacity, number
of workers employed and any other criterion in determining whether the 25% threshold is met. . . . [T]he share of supply test is not an economic assessment of the type used in the CMA’s substantive assessment and need not amount to a relevant economic market. 57

The CMA’s Issues Statement provided that it would consider the question of jurisdiction in the Phase 2 inquiry.58 In their response to the Issues Statement, the parties pushed back strongly on the initial determination, describing the CMA’s application of the share of supply test in this case as “wrong in law, arbitrary and irrational.”59 Commentators have noted the CMA’s “assertive” and “unusual” approach to jurisdiction.

Third Party Views of the Merger. The CMA’s Phase 1 decision acknowledged that “third parties[’] . . . views on the [potential] impact of the Merger on the supply of non-core PSS merchandising modules were mixed.”60 It explained that “some airlines did not have concerns regarding the . . . Merger on non-core PSS solutions and considered that there would be sufficient other providers left to constrain the merged entity.”61 Still, “Others expressed concerns regarding the impact of the Merger if Sabre were to stop making Farelogix’s merchandising solution available on a PSS-agnostic basis . . . or were to stifle Farelogix’s capabilities more generally.”62

Based on the CMA’s summary of third-party feedback, it appeared that views were similarly mixed on the impact of the merger on the supply of services that facilitate the indirect distribution of airline content were similarly mixed. The CMA noted that “a few airline IT services providers thought that non-GDS suppliers would be able to provide an effective constraint on the Parties post-Merger and that Farelogix did not have a ‘unique innovative capability.’”63 On the other hand, several airlines expressed doubts about whether the non-GDS suppliers could replicate the competitive constraint on the merged entity that is currently exercised by Farelogix on Sabre.64 Half of the travel agents consulted by the CMA considered the parties to compete closely or moderately and half considered them to compete weakly or not at all.65

Most travel agents believed that the merger would allow for at-scale NDC technology distribution through Sabre’s GDS, satisfying travel agents’ expressed “interest in consuming NDC content through their existing GDS[s],” and “some airlines considered that the additional funding provided to Farelogix by Sabre could benefit innovation. Several third parties raised concerns regarding the removal of Farelogix as an independent competitor on innovation generally.”66 However, the CMA also noted that “[m]ost airline and service providers raised concerns that, post-Merger, the Parties would slow down NDC implementation and/or cease implementing NDC innovations after an initial minimum integration.”67

While the CMA has not published its Phase 2 Provisional Findings as of this writing, Amadeus, a “strong competitor to both Parties” and one of the three largest GDSs in the global market,68 submitted a public response to the CMA’s Issues Statement that is notable in its criticism of the regulator. Indeed, in its response, Amadeus argued that “[t]he Issues Statement contains fundamental errors of fact in respect of the innovation and technology landscape, including with respect to the role of Amadeus”69 and noted that Amadeus did not recognize the CMA’s characterization of Farelogix “as an important innovator and significant disruptive force[.]”70

Coordination and Convergence with the United States? Again, the CMA in its Phase 1 decision was the first regulator to formally express detailed concerns about the deal. But on August 20, 2019, the DOJ sued to block the acquisition,71 alleging that the transaction would allow Sabre to “eliminate a disruptive competitor.”72 These concerns echoed those raised by the CMA. A bench trial began on January 27 in the U.S. District Court for the District of Delaware and the parties were awaiting a ruling as of the date of this writing.73

Thermo Fisher/Roper

On April 24, 2018, Thermo Fisher Scientific, Inc., a manufacturer of transmission electron microscopes (TEMs), agreed to acquire Gatan from Roper Technologies, Inc. for $925 million.74 Gatan manufactures peripherals for use with microscopes, including direct detection cameras (DD cameras) and filters for use with TEMs, and supplies them to Thermo Fisher and other TEM manufacturers. Thermo Fisher also manufactures DD cameras solely for use with its own TEMs.75

The CMA announced it was opening a Phase 1 investigation into the merger of the two U.S. companies on October 24, 2018, and referred the investigation to Phase 2 on January 7, 2019.76 In its Phase 1 decision, the CMA found that the merger gave rise to a “realistic prospect of a [SLC]” due to vertical effects, arising from the merged entity foreclosing the supply of Gatan peripherals to Thermo Fisher’s TEM competitors.77 The CMA indicated that “[t]he effect of this foreclosure would be to enhance Thermo Fisher’s market position in TEMs, where it is already very strong, reducing its incentive to innovate, increasing prices and reducing service and quality for customers.”78

Its Phase 1 decision was also concerned with a SLC as a result of horizontal unilateral effects in the supply of DD cameras for use with TEMs worldwide.79 The CMA found that the merged entity would “have a high combined share in the supply of DD cameras ([70–80]%, including Thermo Fisher’s self-supply), with only one other supplier of DD cameras remaining after the Merger,” noting “post-Merger[,] the Parties may have less incentive to innovate.”80

The CMA published its Provisional Findings on April 17, 2019.81 These included findings that the transaction may result in a SLC in the market for the sale of DD cameras and in the market for the sale of filters, and in foreclosure and information sharing in the supply of Gatan peripherals to TEM suppliers.82 The CMA noted that Thermo Fisher and Gatan were the two largest suppliers of DD cameras, looking
to evidence from internal documents and third parties which “show[ed] that the Parties [were] close competitors.” The CMA found that the competition between the parties had driven quality improvements benefiting Thermo Fisher and non-Thermo Fisher TEM users.

The parties argued that the merger—integrating a system supplier with a component supplier—would broaden their customer base and unlock important benefits for customers and scientific research, including increased and faster innovation than achievable absent the merger and less expensive and more user-friendly microscopes. They insisted that the deal would “allow more customers in the UK and globally to access [TEMs] to support their scientific research.” The parties described Gatan as “a supplier to Thermo Fisher rather than a significant competitor,” noting that there was very limited horizontal competition between the parties. They also argued that there could be no ensuing vertical effects of the deal because Thermo Fisher had already negotiated long-term supply agreements with its rivals that used Gatan peripherals, leaving “no scope for input foreclosure.”

On May 7, 2019, Thermo Fisher responded to the CMA’s Provisional Findings with a remedy proposal, including a divestment of Thermo Fisher’s DD camera business to a third party in the form of a technology license and a vertical divestment of Thermo Fisher’s DD camera business to a third party in the form of a technology license and a vertical remedy package. The parties argued that the proposal addressed the CMA’s provisional SLC findings while maintaining important customer benefits that would result from the merger. On June 10, 2019, however, the parties abandoned the deal.

**Jurisdiction.** As with Illumina/PacBio and Sabre/Farelolisys, Thermo Fisher/Roper failed to meet the CMA’s turnover test for UK jurisdiction. The CMA again found jurisdiction over the merger on the basis of the share of supply test.

The parties’ initial submission at Phase 2 highlighted the transaction’s “limited UK nexus:”

Both Thermo Fisher and Gatan are companies based in the US and the TEM market is global in geographic scope. Gatan’s other TEM customers (JEOL and Hitachi) are both based in Japan. Gatan’s annual UK turnover is only [REDACTED] and the Transaction is only caught by UK merger control on the basis of the share of supply test if Thermo Fisher’s internal (captive) sales of DD cameras are taken into account.

**Efficiencies.** While there is no final decision—since the parties abandoned the deal before one was issued—the Provisional Findings’ treatment of the efficiencies proffered by the parties is instructive.

The CMA’s Merger Assessment Guidelines provide that “[e]fficiencies arising from [a] merger may enhance rivalry, with the result that the merger does not give rise to an SLC.” The parties argued that the merger would lead to customers benefiting from a number of efficiencies, including: (1) lower TEM prices for consumers, due to elimination of double-marginalization (EDM); (2) better products (as a result of better integration of peripherals) and reductions in the total costs of ownership (TCO) for Gatan filter users; (3) improved customer maintenance and support; (4) greater variety of products available to customers (due to product repositioning and improved product choice); and (5) sales expansion because Thermo Fisher would be able to offer cheaper and more accessible microscopes.

The CMA wrote that the parties’ cited efficiencies were not “timely, likely and sufficient to prevent an SLC” and also that some lacked evidentiary support that they were merger-specific. It also concluded that Thermo Fisher lacked “strong incentives to pass-on price reductions or quality improvements to end-customers” and had in fact a stronger incentive to improve its customer maintenance absent the merger. Further, in the CMA’s view, there was insufficient evidence submitted by the parties to demonstrate that the merger would result in a substantial expansion of TEM sales.

The parties argued to the CMA that, post-merger, Thermo Fisher’s acquisition of peripherals from Gatan at cost would lead to cost savings that the company would pass through to customers as lower prices. The parties’ economists argued that the “reasonably conservative” standard result of EDM in a merger is that a monopolist facing linear demand will pass through 50% of cost reductions.

The CMA nevertheless rejected the parties’ assertion of EDM, noting that “Thermo Fisher [lacked] . . . a strong incentive to pass through a large share of cost savings to end-customers.” The CMA pointed to a lack of sufficient evidence from Thermo Fisher’s business plans of such an incentive and highlighted Thermo Fisher’s high market share in important downstream customer segments, high barriers to entry, and the lack of customer price sensitivity in the supply of TEMs. In the CMA’s view, all of this evidence suggested that Thermo Fisher had “limited incentive to pass through a substantial portion of cost savings.”

Third Party Views of the Merger. The parties submitted to the CMA a customer survey as evidence that “the benefits identified by the Parties . . . would be valued by customers.” The customer survey was conducted by a third party, DJS Research. The CMA, however, criticized the survey for its small sample size, labeling its findings as “too limited to draw any broad conclusions regarding the set of potential TEM customers.” In assessing customer views of the merger, the CMA acknowledged that while “[there was] evidence that end-customers would value an integrated service and maintenance offering,” some customers expressed concerns about the deal.

**Coordination and Convergence with the United States?** Many believed that the CMA’s position in this case was out of step with the FTC, with one commentator reporting that “[it was] striking . . . that US regulators waved the deal through in June 2018 without any concerns.” But it is not clear that is actually what happened. Indeed, the FTC does not actually “clear” deals, and there may be situations where the FTC allows the HSR period to expire because the parties are unable to close. This could occur, for instance,
where the parties have not yet obtained clearance in another jurisdiction.

Is the CMA out of Step with Other Regulators?
While the CMA is viewed as a tough regulator that has led the charge in investigating a number of high-profile transactions, that perception may simply result from an expedited procedural timetable and publication obligation that causes the CMA to state its conclusions in advance of other regulators in many cases. Indeed, there is no evidence in any of the three deals profiled in this article that the positions of the CMA were out of step with the positions of the FTC or DOJ.

The more interesting observation is that the review of these and similar cases provide important insights into how the CMA (and potentially other regulators) think about arguments offered by the merging parties, especially in the context of high tech and “nascent” rivals (the latest focus of agencies worldwide). All three deals involved large companies with high market share acquiring smaller rivals that the CMA viewed as especially innovative. In all three cases, the parties argued that the purpose of the transaction was to help the acquiring company better serve its customers. While certain customers seemed to agree, others did not.

Though there was evidence in all three cases that the motivating factor behind the deal was to improve product quality, the CMA did not accept these arguments. It is particularly striking that the CMA credited economic evidence that the merger would create incentives to increase price, but did not credit economic evidence that reduced costs, through the integration of efficiencies, would create incentives to decrease price. The CMA noted in Thermo Fisher/Roper, for example, that there may not be an economic incentive to pass on efficiencies given the alleged lack of market competition, but this contention ignores the economic evidence that “the minimum amount of marginal cost savings passed on by a monopolist in terms of lower price is one-half of the cost savings,” a point argued unsuccessfully by the economists on behalf of the parties.

This skepticism towards economic incentives to pass on efficiencies is likewise reflected by the views of U.S. regulators. The recently released draft DOJ and FTC Vertical Merger Guidelines provide that the agencies will not challenge a merger if the net effect of EDM means that the merger eliminates double marginalization, it is significant that the discussion of EDM is not included in the efficiencies section of the Draft Guidelines. This suggests perhaps that EDM may still have a place in the agencies’ equation to determine whether a price effect is likely in the first place.

Impact on Merger Agreements
The perception that the CMA raises unique deal risks is significant because the UK is a voluntary filing jurisdiction, which means that sellers will put some pressure on buyers not to have UK approval as a closing condition in deals where there is any risk of CMA review. This puts buyers in a difficult position because the CMA often investigates transactions proactively when no voluntary filing is initially submitted.

In the absence of a closing condition, the buyer may otherwise be forced to close, in all likelihood into a hold separate. This would put buyers at risk because the CMA has the ability to unwind transactions that it concludes create a SLC that cannot be otherwise remedied. Thus, it would not be advisable for the parties to neglect to put in a UK closing condition if they believe that the UK would have or assert a claim for jurisdiction, however tenuous. One possible solution is to consider a provision that states that only if the CMA contacts the parties and requests information or opens an investigation, will UK clearance become a closing condition.

Comity, Fairness, and De Novo Judicial Review
The role of the CMA also must be considered when thinking about a litigation strategy. Although it is difficult to litigate with the FTC or DOJ, it is at least possible to do so, and in some cases the merging parties have prevailed. Indeed, the U.S. agencies have not won a vertical merger challenge in over 40 years. Litigation is especially important where the agency is considering a theory that may appear novel to a court or where complainants have motivations that are different from those of consumers.

Generally, litigation is an option in a deal involving U.S. companies where there are no significant sales outside of the United States. But this is complicated by CMA review in a transaction where the parties meet a UK share of supply test, even where the target has very low (or no) sales in the UK. In such a case, even if the parties prevail in the U.S. courts, they will still need to resolve the regulatory concerns raised by the UK in order to complete their transaction.

In this context it should remembered that comity should not simply mean deference and consideration to the views of international agencies. Comity should include due consideration of the evidentiary and procedural rights of the parties. Vertical mergers and mergers involving the acquisition of an innovative company generally involve credible claims of product improvements, especially where the seller makes a complementary product or an important input. In such cases, it is very important to obtain and assess third-party discovery as to the reasons market participants oppose a deal. In
Thermo Fisher/Roper, for example, there is a fair question whether competing TEM manufacturers were genuinely concerned over input foreclosure or mostly concerned with competing against a more innovative post-merger rival.

Full discovery of all industry players is especially important in the case of two-sided markets. For example, in Sabre/Farelogix, are airlines genuinely concerned with losing negotiating leverage or are they instead concerned that the comparison shopping resulting from a GDS implementation of NDC would cause airlines to compete against each other on ancillaries? Will an independent Farelogix allow the airlines to negotiate lower rates that they will pass on to consumers or will it allow the airlines to pass costs onto travel agencies, which are ultimately passed on to consumers?

While the CMA seeks information from market participants, it is different in kind and scope than the information sought from the merging parties. In particular, it typically is a sampling of documents, as opposed to the broad document requests submitted to the parties. The view may be that the parties have an incentive to self-select documents to support their case, but the same is certainly true of competitors or, in the case of Sabre/Farelogix, airlines. Such questions can best be answered through full discovery of internal documents and cross-examination. While the U.S. process permits parties to conduct such third-party discovery, the CMA does not.

It should also be acknowledged that this concern over comity may not appear to be unique to the CMA in the sense that most jurisdictions do not have de novo judicial review. The difference is that those jurisdictions either have much higher jurisdictional thresholds or, if they have relatively low jurisdictional thresholds, do not have a history of stopping deals. It is the combination of all three factors—low jurisdictional threshold (including where the target has low, or no, sales in the UK), aggressive antitrust enforcement, and the lack of de novo judicial review—that raise issues of comity.

**Conclusion**

Regulatory clearance of mergers has become more difficult to achieve in both the UK and the United States, and this is especially true for large companies that seek to acquire smaller, innovative companies. While the CMA has been leading the charge in reviewing such deals, this role is more likely a result of procedural timing than a reflection of substantive importance of convergence between international merger control regimes, which in the United States includes the courts as well as the agencies. This concern will only increase post-Brexit as the CMA reviews more and more deals where other regulators have a stronger claim for jurisdiction.

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1. “[M]ost everyone agrees [the CMA] present[s] a growing risk to global deals that can’t be taken likely.” Curtis Eichelberger & Victoria Ibitoye, Commentary and Analysis, Comment: UK’s Competition and Markets Authority Leaving Adolescence, Becoming More Serious Threat to US Deals, MLEX Market Insight (Jan. 10, 2020).
7. Id. ¶¶ 3.14, 7.16.
10. Id. ¶ 3.
11. Id. ¶ 4(a).
12. Id. ¶ 4(a), 13.
70 Id. ¶ 4.1.
71 Id. ¶ 1.2(b) (emphasis removed) (citing Sabre Phase 2 Issues Statement, supra note 45, ¶ 5.4(b)).
74 Scheduling Order at 8, United States v. Sabre Corp. (D. Del. filed Sept. 26, 2019), ECF No. 31.
75 CMA, ME/6773/18, Thermo Fisher Scientific Inc./Roper Technologies, Inc., Merger Inquiry ¶ 1 (Jan. 21, 2019) [hereinafter Thermo Fisher Phase 1 SLC Decision], https://assets.publishing.service.gov.uk/media/5c5d2d9440f0b6255a86a422/initial_submission.pdf.
76 Thermo Fisher Scientific, Inc. and Roper Technologies, Inc., Anticipated Acquisition by Thermo Fisher Scientific Inc. of Gatan Initial Submission to CMA, Gov.UK, ¶¶ 1.2–1.3, 1.14–1.15, 6.2.2(iii) [hereinafter Thermo Fisher Phase 2 Initial Submission], https://assets.publishing.service.gov.uk/media/5c5d2d9440f0b6255a86a422/initial_submission.pdf.
78 Thermo Fisher Phase 1 SLC Decision, supra note 75, ¶¶ 10, 12.
79 Id. ¶ 11.
80 Id. ¶¶ 13–14.
81 Id. ¶ 14.
83 Id. ¶ 1. All enumerated concerns were stated with respect to sales in the UK.
84 Id. ¶¶ 33–34.
85 Id. ¶ 34.
86 Thermo Fisher Phase 2 Initial Submission, supra note 76, ¶¶ 1.1, 1.8.
87 Id. ¶ 1.8.
88 Id. ¶¶ 1.13–1.15.
89 Id. ¶ 1.11.
90 Thermo Fisher Merger Inquiry, supra note 77.
92 Id. ¶ 1.1.
94 Thermo Fisher Phase 2 Provisional Findings, supra note 82, ¶¶ 5.10–5.13.
95 Thermo Fisher Phase 2 Initial Submission, supra note 76, ¶ 1.17.
97 Thermo Fisher Phase 2 Provisional Findings, supra note 82, ¶ 13.12.
98 Id. ¶¶ 13.64–13.65.
99 Id. ¶¶ 13.39, 13.46.
100 Id. ¶ 13.57.
101 Id. ¶ 69(a).
102 Id. ¶ 13.17.
103 Thermo Fisher Phase 2 Provisional Findings, supra note 82, ¶ 13.26.
105 Id. ¶ 13.13.
106 Id.
107 Id. ¶ 13.14.
108 Id. ¶ 13.44.
109 Id. ¶ 13.38.
113 Thermo Fisher Phase 2 Provisional Findings, supra note 82, ¶ 13.17.
115 Makan Delrahim, Assistant Att’y Gen., Antitrust Div., U.S. Dep’t of Justice, Harder Better Faster Stronger: Evaluating EDM as a Defense in Vertical Mergers, Remarks at the George Mason Law Review 22nd Annual Antitrust Symposium (Feb. 15, 2019), https://www.justice.gov/opa/speech/assistant-attorney-general-makan-delrahim-delivers-remarks-george-mason-law-review-22nd. The AAG specified three types of evidence that the DOJ looks for: “First, we require evidence that the characteristics of the relevant markets caused both Parties to mark up price pre-merger. Second, the Parties should show they were unable to reach the joint profit-maximizing arrangement through contract and, therefore, would be unlikely to do so in the future absent a merger. Third, we need evidence of how much the elimination of double marginalization is likely to affect the downstream price to the consumer—that is, the profit-maximizing reduction in price given the shape of the downstream demand curve.”
117 CMA Interim Measures in Merger Investigations, supra note 3, ¶ 2.2.
IN A SERIES OF RECENT STATEMENTS, speeches, and public hearings, the U.S. antitrust agencies have made it clear that they are studying the potential competitive impact of “common ownership,” where a single investor simultaneously owns non-controlling interests in competing companies. While common ownership is not new—heavily diversified investors have long mitigated risk through broad holdings, even within a single industry—recent academic studies claim there is empirical proof that common ownership leads to reduced competition, higher prices, and a need for antitrust regulators to act.

These studies come at a time of significant concentration among stockholders. Institutional investors, which include “mutual fund and index fund management companies, other asset managers, and other firms that buy and hold equities on behalf of individual investors,”\(^1\) collectively hold a huge portion of the stock market. John Bogle, founder of the Vanguard Group and often described as the “father of index investing,”\(^2\) warned that three index funds may soon “own more than 30% of the stock market,” a development he claimed “would [not] serve the national interest.”\(^2\) Other estimates indicate that three institutional investors—BlackRock, Vanguard, and State Street—are the largest shareholders in 88 percent of S&P 500 firms.\(^3\) When looking at the S&P 1,500, there is a 90 percent probability that two randomly selected firms from the same industry will have a common shareholder that holds at least 5 percent of both firms.\(^4\) Nationally, “The fraction of U.S. public firms held by institutional investors that simultaneously hold at least 5% of the common equity of other same-industry firms has increased from below 10% in 1980 to about 60% in 2014.”\(^5\) There is no indication that this phenomenon will abate,\(^6\) leading some critics to claim common ownership is an “economic blockbuster”\(^7\) and “the major new antitrust challenge of our time.”\(^8\)

Yet critics of common ownership admit that sweeping prohibitions against the practice would challenge “the basic structure of the financial sector”\(^9\) and could undermine the low-cost, diversified investments on which many Americans lean for education and retirement saving.\(^10\) Government officials—including leaders from the Federal Trade Commission, the Department of Justice, and the Securities and Exchange Commission—consequently have urged caution when considering enforcement action or policy change. They are reluctant to condemn investing practices that are both “ubiquitous” and a “reality of the modern economy” without understanding how common ownership impacts competition across a range of industries, how specifically it causes harm, and how those harms compare to the procompetitive benefits of institutional investment.\(^11\)

Even if immediate regulatory action against common ownership is unlikely, the proposals for how to deal with it are the subject of fierce academic debate. Given the importance of the common ownership issue to capital markets, ordinary investors, and antitrust reform more generally, we believe it warrants broad and regular attention. We consequently recount the still-developing discussion around common ownership and the regulatory reactions to it. We conclude with an illustrative look at stock holdings in a range of industries. The data underscores in stark terms the scope of common ownership across markets, from high technology to heavy industry and from health insurance to household goods. Visualizing stock holdings in this way demonstrates why advocates feel strongly that common ownership is a problem, and why any rash actions would have serious implications for the economy.

The Common Ownership Debate

Arguments Driving the Common Ownership Conversation. The current debate over common ownership can largely be traced to two academic papers claiming that the practice leads to higher consumer prices. The first paper focused on the airline industry and concluded that common ownership increases U.S. airline ticket prices by 3 to 7 per-

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recommendations are the subject of fierce scrutiny from critics. Some states that common ownership incentives weakens incentives for aggressive competition. Another finds that common ownership is “positively associated with the likelihood” that a brand-name pharmaceutical company will enter a reverse-payment settlement—whereby it, as the plaintiff in patent litigation, pays a generic manufacturer to delay generic entry into the market. A third paper notes that the pricing effects of common ownership in the ready-to-eat cereal market “would be larger than those from any possible 4-to-3 merger in the industry,” which “implies that the common ownership incentives may in fact be very strong, even if firms do not seem to respond to them in that context.”

Accepting these economic conclusions, some legal commentators have argued that common ownership should be condemned under Clayton Act Section 7, which prohibits the acquisition, “directly or indirectly, [of] the whole or any part of the stock” of a company when the “effect of such acquisition may be substantially to lessen competition.” They explain that the statute “was created precisely to address stock acquisitions that create anticompetitive market structures,” rendering its “application to horizontal shareholdings . . . quite straightforward.” Specifically, common ownership does not generate any “off-setting integrative efficiencies” and is “quite parallel to the accepted point that one firm’s acquisition of a non-controlling interest in a rival can be illegal (even when passive).” Under this proposed approach, the statute’s passive investor exception does not apply if the stock acquisition actually lessens competition.

Opponents of common ownership also contend that it can be challenged under Sherman Act Section 1, which prohibits all contracts, combinations, or conspiracies in restraint of trade. They claim that a less restrictive alternative is available under the rule of reason—namely, prohibiting horizontal shareholding by institutional investors while allowing individuals to diversify through multiple asset managers. In light of these theories, commentators have proposed structural remedies ranging from divestiture to a prohibition on any common investor holding more than 1 percent of the aggregate equity in a concentrated industry.

Counter Arguments. These economic findings and legal recommendations are the subject of fierce scrutiny from critics, who raise a number of arguments against government intervention. First, critics contend that there is no proven mechanism through which common shareholders actually lessen competition, a proposition that some proponents of government intervention admit. This means: (1) the relevant studies may be attributing to common ownership price effects caused by any number of other causes; and (2) there is “little empirical evidence on which a court could rely to find antitrust liability and to reorganize the asset management industry.” Relatedly, some commentators have explained that any relationship between common ownership and higher prices is dependent on considerations like industry-specific market conditions, shareholder incentives, and management objectives, which means that any anticompetitive effects must be proven on a case-by-case basis and no economy-wide conclusions can be drawn.

Second, much of the literature on common ownership “treat[s] all shares managed by any investment manager as ‘owned’ by that manager for antitrust purposes.” In reality, an investment manager is generally the nominal owner. It holds shares as a fiduciary for the underlying economic owners, who may vote their own shares and may have divergent interests, which can keep the institutional investor from acting “monolithically” in any industry. Institutional investors, moreover, often hold interests in firms outside the relevant industry. Those firms—as downstream customers or upstream suppliers—would be impacted by any anticompetitive conduct in the relevant market, which “makes it impossible to generalize that vigorous competition necessarily harms investment managers.”

Third, critics contend that the legal theory around common ownership represents a “novel” and “dubious” application of the law because “there is no clear legal basis for antitrust liability under either § 7 of the Clayton Act or under § 1 of the Sherman Act.” They argue that “essentially all § 7 precedents address [a discrete type of factual circumstance] whereas common ownership presents a different fact pattern and involves different economic principles.” With respect to Section 1, critics claim there is no “intelligible limiting principle by which to distinguish lawful from unlawful stock ownership” for purposes of a less restrictive alternative under the rule of reason.

Finally, institutional investors have defended their investment practices. BlackRock, for instance, contends that the common ownership debate “seek[s] to fix a problem that does not exist” and that any remedies aimed at common ownership are “recklessly advance[d]” because they “would have concrete and wide-ranging harm on everyday investors and the economy as a whole.” BlackRock advanced is own econometric results suggesting that the initial common ownership literature was based on flawed assumptions and does not hold up under scrutiny. Separately, the owner of the S&P 500 has noted that airlines—the subject of the seminal
paper on common ownership—accounted for a small fraction (0.5 percent) of the float-adjusted market capitalization of the S&P 500 at the end of 2018, raising the question why institutional investors would cause airline executives to raise prices if doing so would lead to higher costs for the other 99.5 percent of companies on the S&P 500.39

Agency Perspectives

In light of this active and vociferous debate, the U.S. antitrust agencies have taken note and started to weigh in. Perhaps the most authoritative statement from the government came in November 2017, when the Department of Justice and the Federal Trade Commission submitted a joint statement about common ownership to the Organization for Economic Co-Operation and Development. That statement made clear that the government thought “the empirical literature on the competitive implications of common ownership by institutional investors is still in its early stages” and that they were “not prepared at [that] time to make any changes to their policies or practices.”40 They explained that “any antitrust enforcement or policy effort in this area should be pursued only if an inquiry reveals compelling evidence of the anticompetitive effects,” which would “not be predicated on general relationships suggested by academic papers.”41 Any other approach—including “across-the-board limitations on common ownership without sufficient evidence of anticompetitive effects”—could impose unintended real-world costs on businesses and consumers by making it more difficult to diversify risk.42

Both the DOJ and FTC continue to study the phenomenon, however, and have made a number of statements that provide additional insight into what they consider the key issues in the common ownership debate.

DOJ. In early 2016, William Baer, then-Assistant Attorney General for Antitrust, told Congress that the DOJ is “looking at” the “common ownership issue . . . in more than one industry.”43 Makan Delrahim, the current Assistant Attorney General for Antitrust, reiterated the same point in May 2019, noting the DOJ’s “interest” in common ownership, particularly “[w]hether antitrust enforcers should evaluate the effects of common ownership using existing measures, or use new approaches.”44 He noted, however, that “concerns about common ownership need to be rooted in theories of harm that can be proven in a court of law. So while [the DOJ] encourage[s] people to think creatively about these issues, remember that the Antitrust Division brings cases when we can prove that certain actions harm competition.”45 Relatedly, Delrahim made clear that the DOJ does not want to “inadvertently harm the capital markets” through enforcement actions because the “world of finance is a great example of how markets can expand choice for consumers via innovation.”46 Still, to the extent institutional investors “coordinate conduct between competing firms in which they have investments,” they would risk liability under Section 1 of the Sherman Act: “if an institutional investor has an ownership interest in multiple competitors, and its investment manager calls those competitors and discourages them from entering into price wars, there is a thin line, if any, between common ownership and collusion that violates Section 1.”47

FTC. In June 2018, Noah Phillips discussed common ownership during his first public remarks as an FTC Commissioner. He indicated that while the topic is “important,” antitrust enforcers must “tread carefully” because they do not “know enough to warrant policy changes.”48 Specifically, Commissioner Phillips noted that enforcers “need more information about other industries [beyond airlines and banking] to draw conclusions about how common ownership might affect competition across the economy as a whole.”49 They also require evidence identifying “a clear mechanism by which common shareholding actually causes a lessening of competition.”50 These uncertainties matter, Commissioner Phillips explained, because “[c]ommon ownership is a reality of today’s economy” and because there is no indication that large institutional investors are: (1) “at the apex of a massive antitrust conspiracy”; (2) “encouraging portfolio companies to lighten up on competition”; (3) “eliciting from [portfolio companies] confidential information which then is shared with other portfolio companies”; or (4) consulting with corporate managers “about whether and how not to compete with rivals.”51 Commissioner Phillips suggested that, at least for now, the common ownership “blockbuster” may be “a little light on plot.”52

In December 2018, the FTC revisited common ownership as part of its Hearings on Competition and Consumer Protection in the 21st Century, during which it heard from economists on both sides of the common ownership debate, as well as from enforcers, market participants, and practitioners.53 In opening remarks, Commissioner Phillips once again urged caution. He explained that common ownership “is a reality of the modern economy,” and that “rectonic policy shifts should not be undertaken lightly.”54 He identified four areas of research that need further development “before shifting policy on common ownership”: (1) how common ownership impacts a broad set of industries; (2) the precise mechanism through which common ownership purportedly harms competition, which is “critical to developing a coherent legal theory of antitrust harm, and ultimately to crafting an appropriate remedy”; (3) why company employees would put the interest of certain minority shareholders above other shareholders; and (4) how potential anticompetitive harms compare to the benefits of institutional investment.55 On the last point, Commissioner Phillips emphasized that “[l]arge institutional investors have, in many ways, made investing affordable for the average American” and that any enforcement in this area could upend the financial sector.56

SEC. Former SEC Commissioner Robert Jackson also spoke at the FTC’s common ownership hearing. Like Commissioner Phillips, Commissioner Jackson praised the economists who first identified common ownership as a potential competition concern but called for caution when consider-
ing enforcement and policy changes. He explained that he worries “that the evidence we have today may not carry the heavy burden that, as a Commissioner sworn to protect investors, [he] would require to impose costly limitations on diversified investments that American families count on to fund their education and retirement.” Accordingly, Commissioner Jackson made clear that “we’re at the beginning, rather than the end, of the academic debate about concentrated common ownership”—the papers raising concerns about common ownership provide policymakers with more questions than answers.

What Is at Stake
While the academic debate about common ownership initially focused on the airline and banking industries, the phenomenon is much broader. The S&P Dow Jones Indices, which owns the S&P 500 index and the Dow Jones Industrial Average, has explained that there “are 71 industries in the Global Industrial Classification Standard taxonomy, and all of them are equally subject to the effects of common ownership by index funds.” This fact raises important questions about what is at stake. How does common ownership look across industries? Are there any noteworthy trends, commonalities, or divergences?

We take no position here on whether common ownership actually leads to anticompetitive effects, generally or in a particular industry. Rather, by examining an illustrative snapshot of stock holdings across a range of industries, we seek to amplify two important themes that surround the common ownership debate: (1) the prevalence of concentrated stock holdings, and (2) how regulatory action prohibiting common ownership would impact nearly every industry and nearly every major company therein.

Given the illustrative and non-scientific nature of this discussion, we identified industries and competitors with which ordinary consumers likely are familiar, ranging from health insurance to hotels and from gas to household goods. We then looked at who held the stock of each issuer, as reported by S&P Capital IQ. If not surprising, the results are illuminating. Indeed, even when limiting ourselves to five competitors and their top ten shareholders, it is much easier to call out the firms that are not common shareholders than it is to identify common investors. The number of non-common shareholders would decrease even further if we expanded the number of competitors or looked past the top ten shareholders. Our full results appear in industry tables that can be found in the online Appendix to this article.

With these caveats and explanations—and again acknowledging that many of these firms “own” shares as fiduciaries for individual investors—there are at least three observations worth highlighting about the scope and nature of the common ownership phenomenon.

First, commonality can be extreme. In the market for household staples, for example, each competitor at which we looked—Proctor & Gamble, Colgate-Palmolive, Clorox, Kimberly-Clark, and Church & Dwight—had identical top-three shareholders: Vanguard, BlackRock, and State Street, in that order. There was, moreover, very little variation—competitor to competitor—in any of the top-three shareholder’s percentage of holdings. And each held a percentage of shares that was generally double (or more) those held by the fourth-largest shareholder. Even when such perfect symmetry is lacking, commonality still predominates. Each of the health insurers at which we looked—Aetna, Anthem, Cigna, Humana, and UnitedHealth—had top five shareholders which were also top shareholders in competitors, generally in their top five as well. Aetna, Cigna, and UnitedHealth had only one top ten shareholder that was not a top ten shareholder in a competitor. The insurers collectively had almost no unique shareholders.

Second, while common shareholders own non-controlling interests, their holdings can still top 10 percent—in some instances by a lot. This is potentially significant because the FTC’s former Bureau of Competition Director Bruce Hoffman described “double digits” shareholding as a “reasonably substantial” stake when assessing “competitive issues.” A selection of the “substantial” shareholding we encountered includes:

- Capital Research and Management Company holds 22 percent and 17 percent of mining companies Alcoa and Vale, respectively. It also holds a top four percentage of competitors Rio Tinto and BHP Group.
- Vanguard holds roughly 12 percent of household good competitors Clorox and Church & Dwight, while holding the largest percentage of shares (between 8.2 and 9 percent) in Proctor & Gamble, Colgate-Palmolive, and Kimberly-Clark.
- T. Rowe Price holds roughly 11 percent of MGM, while holding the largest percentage of shares in Hilton (9.2 percent) and a top ten percentage in Marriott. Vanguard also holds more than 10 percent in MGM and between 6.2 and 9.6 percent in Marriott, Wyndham, and Hilton.
- Capital Research holds roughly 10 to 17 percent of the shares for health insurers UnitedHealth, Humana, and Cigna, while also holding a top ten percentage in Aetna and Anthem.
- In the oil and gas industry, Vanguard holds roughly 12 percent of Marathon and is the largest shareholder for Exxon, Chevron, and Valero, each at roughly 8.3 percent.

Third, whether or not a single investor holds more than 10 percent of competing firms, a small group of the same shareholders often control 20 percent or more of each competitor’s stock. In the pharmaceutical industry, for instance, Vanguard, BlackRock, State Street, and Capital Research together hold between 23 and 25 percent of Pfizer, Johnson & Johnson, and Merck. In the hotel industry, some combination of Vanguard, BlackRock, T. Rowe Price, and Capital...
Research hold between 20 and 27 percent of MGM, Hilton, Wyndham, and Marriott. And in the health insurance industry, the top five shareholders, all of which own shares in competitors, hold roughly 25 percent of Aetna, 29 percent of Anthem, 35 percent of Cigna and UnitedHealth, and 43 percent of Humana. Other examples abound.

This reality is potentially significant when one considers how the same phenomenon is impacting competitive analyses in other jurisdictions. In its decision regarding the Bayer-Monsanto merger, for example, the European Commission studied the number of shareholders required to control a meaningful stake—between 20 and 50 percent—of competitor firms, explaining that even “passive’ investors acknowledge that they exert influence on individual firms with an industry-wide perspective.” The Commission specifically called out the fact that no more than nine investors were required to control 20 percent of each competitor in the relevant market. It concluded that, “in the presence of common shareholding,” (1) “concentration measures, such as market shares or the Herfindahl-Hirschman index (‘HHI’), are likely to underestimate the level of concentration of the market structure and, thus, the market power of the Parties,” and (2) “common shareholding in these industries are to be taken as an element of context in the appreciation of any significant impediment to effective competition.” It is conceivable—although perhaps not imminent—that similar reasoning will find its way into U.S. antitrust analysis, particularly because it often takes far fewer investors to surpass 20 percent shareholding.

**Conclusion**

As these examples make clear, common ownership—and many of the trends discussed above—arise irrespective of industry. They can be found in heavy industry or the travel industry, as well as in health insurance and household goods. The phenomenon does not discriminate. Thus, while much remains unsettled, this much is clear: the common ownership issue is not going away. Academics and practitioners on all sides of the debate continue to research and publish, and both antitrust agencies have publicly expressed their commitment to examining the phenomenon. Given the speed at which this debate is moving from academia to regulators, it is important to understand and bear in mind the true extent of common ownership and the sprawling implications of any actions against it. Institutional investors, those companies in which they invest, and ordinary Americans should stay tuned.

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6. U.S. Submission on Common Ownership, supra note 1, ¶ 1.1 (Passively managed index and exchange-traded funds doubled their assets under management between 2011 and 2014.)
10. U.S. Submission on Common Ownership, supra note 1, ¶ 15 (“Creating across-the-board limitations on common ownership without sufficient evidence of anticompetitive effects could impose unintended real-world costs on businesses and consumers by making it more difficult to diversity risk.”)
18. Elhauge, supra note 7, at 1302.
19. Id. at 1303.
20. Id. at 1305; see also Scott Morton & Hovenkamp, supra note 3, at 2027, 2034.


25 Scott Morton & Hovenkamp, supra note 3, at 2031. Some commentators, however, claim there are active mechanisms by which competition is reduced, including “shareholding voting, executive compensation, the market for corporate control, the stock market, and the labor market.” Einer Elhauge, The Causal Mechanisms of Horizontal Shareholding 3 (2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3370675. Others suggest passive mechanisms exist because the mere fact of common ownership undermines incentives for commonly-held firms to engage in vigorous competition. Martin C. Schmalz, Common Ownership and Competition: Facts, Misconceptions, and What to Do About It ¶ 20–21 (OECD Submission, 2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3176696. In response, FTC Commissioner Noah Phillips has noted: (1) these theories are not empirically tested, (2) the active mechanisms, to the extent they lead to anticompetitive harm, “are well-covered within existing antitrust jurisprudence,” and (3) the passive theory “is only a species of an incentive problem endemic to the economy, to the nature of the public corporation itself.” Phillips, supra note 11, at 6–7, 9.


28 Ginsburg & Klovers, supra note 26, at 7.

29 Id. at 8–11; see also Hemphill & Kahn, supra note 9, at 8–9.

30 Ginsburg & Klovers, supra note 26, at 13.

31 Id. at 5.

32 Id. at 5–20–27.

33 Id. at 5–6, 27–29.


38 Id. at 3–17.


40 U.S. SUBMISSION ON COMMON OWNERSHIP, supra note 1, ¶¶ 12, 15.

41 Id. ¶ 3.

42 Id. ¶ 15. For those reasons, the U.S. antitrust agencies “have not litigated a case involving common ownership by a single institutional investor.” Id. ¶ 3. As one point of reference, European antitrust enforcers have already looked to common ownership when assessing the competitive effects of mergers, noting that “in the context of innovation competition,” common shareholding likely results in “less intense [competition] as compared with an industry with no common shareholding.” See, e.g., Case M.7932—Dow/DuPont, Comm’n Decision, ¶¶ 2348–2352 (Mar. 27, 2017), http://ec.europa.eu/competition/mergers/cases/decisions/m7932_13668_3.pdf (“The presence of significant level of common shareholding tends to lower rivalry”; “as for current price competition, the presence of significant common shareholding is likely to negatively affect the benefits of innovation competition for firms subject to this common shareholding”).


45 Id.

46 Id.

47 Id.


49 Phillips, supra note 11, at 2, 12.

50 Id. at 4.

51 Id. at 12.


53 Phillips, supra note 11, at 5–6.

54 Id. at 5–6.

55 Id. at 6, 14.


57 Id.

58 Id.

59 Id.

60 Letter from Craig J. Lazzara to Fed. Trade Comm’n, supra note 39, at 2. This may not be particularly surprising because index funds seek to replicate the performance of benchmarks like the S&P 500 by “owning” portions of all the companies that make up the index.

61 The data reflects S&P Capital IQ information retrieved on December 5, 2019. Tables of all the data we discuss, and more, can be found in the online Appendix to this article.


64 The OECD estimates that the three largest institutional investors in any company on average hold 24% of the company’s capital, while the ten largest institutional investors on average hold 43% of the company’s capital. OECD, supra note 2, at 23–25.


66 Id.

67 In addition to the examples discussed above, we look at a handful of other industries in the online Appendix.
Risky Business: 
Applying the Failing Firm Defense in Private Equity Merger Reviews

BY ELISA KANTOR PERLMAN

The Private Equity (PE) industry continues to raise, invest, and distribute money at record rates. As PE M&A activity increases, so, too, has the scrutiny of the U.S. antitrust agencies. Both the Department of Justice and the Federal Trade Commission have investigated and challenged horizontal and vertical mergers involving strategic PE deals, including by filing lawsuits to enjoin anticompetitive mergers and requiring divestitures or other remedies to resolve competitive concerns.

On occasion, PE-backed deals involve a portfolio company wishing to avail itself of the “failing firm” defense to obtain clearance from the antitrust agencies. The acquisition of a company or division that meets this defense is not subject to liability under Section 7 of the Clayton Act. Because the PE configuration tends to alter the financial and management structure of portfolio companies in certain ways—for example, by inducing heavy reliance on debt financing or intense focus on short-term investor returns—unique questions may arise when determining whether these companies are entitled to invoke the failing firm defense.

How should the antitrust authorities approach these questions, and should the unusual structures under which PE-owned companies operate change way enforcers apply the failing firm defense?

The Failing Firm Defense

The failing firm defense is based on the simple proposition that a merger is not likely to enhance market power if the assets of one of the merging firms would otherwise imminently exit the relevant market. The U.S. Supreme Court first recognized the defense in *International Shoe Co. v. FTC*. There, the FTC alleged that a merger between two shoe manufacturers violated Section 7 of the Clayton Act. While the Commission and the court of appeals agreed, the Supreme Court reversed, finding the financial state of the acquired company’s operations dispositive. The Court considered the acquired company’s excessive purchase commitments, its inability to meet the terms of its debts, and its disastrous sales history, holding:

In the light of . . . a corporation with resources so depleted and the prospect of rehabilitation so remote that it faced the grave probability of a business failure . . . the purchase of its capital stock by a competitor (there being no other prospective purchaser) . . . does not substantially lessen competition or restrain commerce within the intent of the Clayton Act.

Nearly 40 years later, in *Citizen Publishing Co. v. United States*, the Supreme Court crystalized the failing firm standard. In affirming that a joint operating agreement between two competing newspaper publishers violated the Sherman and Clayton Acts, the Court focused on three factors. First, the proponent failed to demonstrate that the allegedly failing company was “on the brink of collapse” and would soon be liquidated. Second, “The prospects of reorganization” under the Bankruptcy Act “would have had to be dim or nonexistent to make the failing company doctrine applicable,” as “companies reorganized through receivership, or through . . . the Bankruptcy Act often emerge[] as strong competitive companies.” Third, the proponent failed to show that the acquirer was the “only available purchaser” because it had made no effort to find other buyers.

The antitrust agencies’ Horizontal Merger Guidelines echo the factors discussed in *Citizen Publishing*. According to the Guidelines, the antitrust agencies normally will not credit claims that the assets of one of the merging parties would imminently exit the relevant market unless all three of the following circumstances are met: (1) the company would be unable to meet its financial obligations in the near future; (2) the company would not be able to reorganize successfully under Chapter 11 of the Bankruptcy Act; and (3) the company has made unsuccessful good-faith efforts to elicit reasonable alternative offers that would keep its tangible and intangible assets in the relevant market and pose a less severe danger to competition than does the proposed merger.

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The courts and the antitrust agencies have applied the failing firm standard across a wide variety of cases and contexts and, in so doing, have clarified and explained some of its intricacies. For example, a “reasonable alternative offer” is any offer above liquidation value, even if the seller considers that offer to be unattractively low. A good-faith search for alternative offers cannot be perfunctory and must be sufficient to identify other potential buyers, allowing them an opportunity to conduct due diligence and make a binding offer. And a company cannot satisfy the failing firm defense based solely on its owners’ unhappiness with profitability or desire to exit the market.

In 2019, the FTC considered and rejected the failing firm arguments made by a manufacturer of microprocessor-equipped prosthetic knees in a Part 3 challenge to a consummated transaction. Prior to the transaction, FIH Group Holdings, LLC (Freedom), the acquired company, had been private equity-owned. Among other things, the Commission found that Freedom did not demonstrate the grave probability of business failure, pointing out that Freedom’s financial situation had been improving. The Commission rejected the argument that lenders would have liquidated the company absent the merger since “the lenders repeatedly amended [their] credit agreements rather than foreclosing.” The mere fact that Freedom had a pending debt was insufficient to demonstrate the company was insolvent, as Freedom could have refinanced or recapitalized to make loan payments. Moreover, alternatives to the challenged transaction had been available, but only “on terms that the existing shareholders did not like.” The Commission’s opinion made clear that the financial expectations of equity holders cannot be used to set an “unjustified limit on the search for offers” when seeking the protection of the failing firm defense.

Private Equity
The term “private equity” refers to the segment of the asset management industry that uses pooled capital to invest in the equity and, to a lesser extent, debt of companies that are not traded on a public exchange. PE firms, also known as “sponsors,” raise this equity capital through funds financed by wealthy individuals and institutional investors. Fund managers then invest that capital in companies that are perceived to have growth potential and work to increase the value of those companies, sometimes through operational control. Such companies are known as portfolio companies. After around five years, the PE firm usually will seek to “exit” the investment by taking the business public or selling it for a higher valuation, sometimes through “strategic” sales to corporate buyers looking to build scale and scope in a particular industry. Profits from the exit strategy are distributed to the fund’s investors, with the PE firm potentially earning a share of the profits or other fees.

PE investment strategies include contributing venture capital, investing growth capital, and executing leveraged buyouts (LBOs). Venture capital involves providing financial capital to early-stage companies with high growth potential, typically without gaining majority control. Growth capital usually takes the form of capital investment to fund expansion or development of a more mature company. In an LBO, the PE fund acquires a majority interest in the target company using a combination of equity and a significant amount of debt, with the debt secured by the assets of the target company and paid using the company’s future cash flows. In other words, the target company itself borrows much of the money used to pay out the former owner. The equity capital for an LBO typically comes from the PE fund, while the debt financing is obtained through banks or other lenders. This debt may come in a variety of forms, including a mixture of bank debt, secured and unsecured debt, and debt that is junior (or next-in-line) to the company’s general creditors in the event of default. An LBO leaves the portfolio company with a highly leveraged capital structure, meaning it has far more debt than equity.

After executing an LBO, PE firms typically increase the value of portfolio companies by steering them through a period of rapid performance growth. They may employ a number of methods to execute this strategy, including aligning management incentives, applying productivity improvements, and implementing aggressive cost-cutting measures. But PE firms’ focus on short-term gains and appetite for untraditional levels of debt has left PE ownership, and LBOs in particular, open to criticism. While some argue that PE ownership positively affects portfolio companies by ushering in a period of operational efficiency, others maintain that PE firms thrust speculative capital structures and outsized debt loads upon otherwise healthy firms, making them more susceptible to market forces and more likely to experience financial distress. A recent study found that approximately 20 percent of large LBOs resulted in bankruptcy for target firms within 10 years, versus a control group bankruptcy rate of two percent.

Applying Failing Firm Analysis to Private Equity Merger Reviews
The unique aspects of PE ownership may lend themselves to somewhat unusual failing firm arguments. For example, a portfolio company may argue it satisfies the failing firm standard because it faces imminent pressure to repay outsized debts resulting from an LBO, or because no other buyers...
PE ownership does not merit a change in the way the enforcers apply the failing firm defense.

would value the firm sufficiently to repay existing debts or net a return for investors. At the same time, PE ownership does not merit a change in the way the enforcers apply the failing firm defense. Just like any other company, a portfolio company seeking to avail itself of the defense must explain why the company should be viewed as insolvent, whether bankruptcy is a viable alternative, and what efforts the company has made to pursue alternative partners that would keep its assets in the market.

**Portfolio Companies Must Do More Than Argue That Oversized Debts Are Coming Due.** Given the high debt loads often associated with LBOs, it is not surprising that PE-owned companies sometimes take on a level of debt that becomes unsustainable. Portfolio companies in this situation may find that while they generate sufficient revenues to cover operating expenses, revenues are insufficient to make payments on those previously agreed upon debts.

Such companies may argue they meet the first prong of the failing firm test because they cannot meet their debts as they come due. But that fact is not the end of the antitrust authority’s inquiry into the firm’s financial condition. For example, the antitrust agencies may find that trends in sales or customer visits, as well as ordinary-course financial projections, indicate the firm could be in a position to repay debts in the near future. Internal cash flow models may reveal spending that the company could defer in the name of debt repayment. Ordinary-course documents may point to operational improvements that the company could make to increase the chances of solvency. The PE firm’s internal books, reports to investors, or appraisals may show that the portfolio company or its assets are worth more than liquidation value. And alternative courses of action, such as refinancing or recapitalization, may be available to help the company make future payments. All of this information is meaningful to the antitrust analysis if it demonstrates that the portfolio company could emerge from its financial distress and remain an effective competitor absent the proposed merger.

In addition, in a highly leveraged situation where the portfolio company’s assets have low liquidation value, the views and incentives of lenders can be probative, and potentially dispositive, of the availability of the failing firm defense. A lender’s assessment of the company’s health and future financial prospects is arguably more important than that of business management because it is ultimately up to the lender whether to extend the maturity date of the loan or cut its losses by accelerating the loan and forcing the company into bankruptcy or liquidation. In particular, if a lender believes the market value of the company’s assets or the amount of the debt is higher than the liquidation value of the assets, the lender is unlikely to force the company to liquidate. That is because the lender is more likely to get its money back while the company’s assets remain in the market.

Another relevant factor can be whether lenders have shown flexibility on loan repayment in the past, or whether they contemplate doing so in the future. Such flexibility may be especially likely if earnings trends or variability demonstrate that the portfolio company could repay at least some portion of its loans. If lenders are interested in offering the company less onerous debt terms that the company can actually satisfy, the company may be unlikely to fail based on its debt load alone.

In certain situations, the antitrust authorities may also examine the factors that led the portfolio company to its current financial distress. For instance, a PE owner may impose a significant debt burden on an otherwise healthy company, extracting substantial dividends even as it uses the debt burden to justify a merger with a close competitor. Under these circumstances, the financial resources of the PE owner, and the owner’s extraction of excess equity returns, may be relevant to the question of whether the portfolio company should be considered “failing” for antitrust purposes, especially if the PE owner is also capable of putting the company back on the road to financial health.

**Private Equity Ownership Does Not Necessarily Mean Bankruptcy Will Be Unsuccessful.** The second prong of the Guidelines’ failing firm test asks whether the troubled company could reorganize successfully under Chapter 11 of the Bankruptcy Act—in other words, whether easing or eliminating the company’s debt through bankruptcy could fix the company’s financial troubles. PE-owned portfolio companies cannot simply point to their complex capital structures to satisfy this element; rather, just like any other company, they must put forward proof that they would not emerge successfully from bankruptcy.

As noted above, PE-owned companies may be indebted to a variety of lenders after an LBO. These may include senior lenders, which stand first in line to be repaid, as well as junior or subordinated lenders, which are paid only after all senior debts are satisfied. Each class of stakeholders may have a different mechanism at its disposal to drive what it believes will achieve the best outcome for itself—that is, maximizing its return on investment. For instance, senior lenders may have more rights than junior lenders or equity holders, including the promise of control over the path taken in bankruptcy. Junior lenders, on the other hand, may have fewer rights to accelerate their loans and may need to wait for senior debtholders to approve material asset sales.

Although using this type of capital structure may make reaching agreement more complex, bankruptcy can still succeed. In the case of a company whose assets are worth more than liquidation value, stakeholders may still share a common goal: to ensure that the troubled portfolio company’s assets
remain in the market. If a successful plan of reorganization that keeps the company’s assets in the market will put the company in the best position to return capital to its lenders, there could be good reason for these lenders—no matter what their differences—not to get in the way.55 Lenders may even be able to come to an agreement to avoid bankruptcy altogether if other courses of action make repayment more likely, including raising additional capital, refinancing, and limited asset sales.

Thus, like other companies, a portfolio company seeking to avail itself of the failing firm defense should be prepared to address why bankruptcy is unlikely to succeed. For example, did the portfolio company initiate Chapter 11 bankruptcy proceedings, hire a banker to do an official review for bankruptcy, or create a plan for reorganization that the company or a court deemed infeasible?55 Has the portfolio company previously undergone and emerged successfully from bankruptcy? Do lenders’ actions demonstrate they are unlikely to agree to a successful reorganization plan?54 Does the liquidation value of the company exceed its value as an ongoing business?

In the same way, the antitrust enforcers will closely scrutinize subjective statements of PE owners when assessing whether bankruptcy is a viable option for the portfolio company.55 For example, if a PE owner contends that bankruptcy is likely to ruin the portfolio company’s assets, the agencies will look for concrete evidence of that fact. Whether entering into bankruptcy harms the PE owner or other stakeholders’ business interests may be irrelevant to the antitrust analysis; the failing firm standard assesses the options for the company’s assets to remain in the market absent the proposed transaction, regardless of whether those possibilities produce the optimal outcome for business owners.56

A Portfolio Company Must Make Good-Faith Efforts to Elicit Reasonable Alternative Offers. An allegedly failing company also must demonstrate that it has made unsuccessful good-faith efforts to elicit reasonable alternative offers that would keep its assets in the market and pose a less severe danger to competition than the proposed transaction.57 The PE structure does not influence the search a portfolio company must conduct to satisfy this requirement.

A portfolio company may argue before the antitrust enforcers that its outsized debt loads make it an unpalatable target for potential acquirers, rendering any attempt to elicit reasonable alternative offers futile. Although excessive leverage could mean the company will have difficulty attracting buyers, that is not always true. Indeed, a company’s capital structure may not impact its value in an efficient market.58 Therefore, even a portfolio company burdened by excessive debts must demonstrate it attempted to shop the assets for a price above liquidation value.59

Similarly, a portfolio company seeking to avail itself of the failing firm defense may argue that its proposed partner is the only available purchaser because no other potential buyers valued the company sufficiently to repay the portfolio company’s debts or net a return for investors. But the central question under the third prong of the failing firm test is whether a less anticompetitive transaction could keep the troubled company’s assets in the market, not whether the proposed transaction would be advantageous for stakeholders.60 Just like any other company, a portfolio company seeking the protection of the failing firm defense must show that it exhausted reasonable efforts to find a less anticompetitive alternative regardless of whether it accepted the best offer presented.61

“Flailing” or Weakened Competitor Arguments Are Not a Back Door. In certain circumstances, a company’s weakened financial condition arguably indicates that it is unlikely to compete effectively in the future—for example, if depleted financial reserves will prevent capital improvements necessary for the firm to remain competitive.63 If a firm is unlikely to be an effective competitor but for the merger, its future competitive significance could be less than its current market shares indicate.

Portfolio companies that cannot satisfy the failing firm standard may thus still contend that their strained financial position is relevant to the antitrust analysis of a merger.64 But just like any other company, a PE-backed portfolio company cannot simply wave the flag of deteriorating financial health to skirt the requirements of the failing firm defense. In particular, questions relevant to the availability of the failing firm defense may still apply.65 Could alternative but unexplored courses of action, such as operational improvements or refinancing, turn the company’s finances around? If bankruptcy seems imminent, is reorganization likely to improve the company’s financial outlook? And what alternatives, including alternative mergers or other types of transactions, might the company pursue to save it from its downward spiral? Answers to these questions could help the antitrust authorities determine whether the company’s financial weakness in fact undermines the predictive value of current market share statistics.66 Counsel thus should expect these or similar questions when asserting that a portfolio company is likely to be less competitive in the future than it is today.

Conclusion

The structures of PE-owned companies do not merit a change in the way the antitrust authorities apply the failing firm defense. Rather, the availability of the defense should remain firmly grounded in the principles announced in International Shoe: a firm is “flailing” for antitrust purposes only where, absent the proposed transaction, its assets face a “grave probability of business failure,” little prospect of rehabilitation, and no other reasonable alternatives.69 Whether owners, lenders, or other stakeholders would achieve their financial goals without the proposed transaction has no bearing on whether a merger is illegal. Instead, as in any other context, a portfolio company seeking to avail itself of the failing firm defense must prove it is financially insolvent and lacks practical alternatives to keep its assets in the relevant market.


6 Int’l Shoe Co. v. FTC, 280 U.S. 291 (1930).

7 Id. at 299–303.


9 Id. at 137–38.


12 Guidelines, supra note 5, § 11.

13 Id.

14 Id. § 11 n.16 (“Any offer to purchase the assets of the failing firm for a price above the liquidation value of those assets will be regarded as a reasonable alternative offer. Liquidation value is the highest value the assets could command for use outside the relevant market.”).

15 United States v. Energy Solutions, Inc., 265 F. Supp. 3d 415, 446 (D. Del. 2017) (rejecting failing firm claim where the purportedly failing company “clearly focused on obtaining what it perceived to be . . . fair value, not an offer above liquidation value”) (citing Guidelines, supra note 5, § 11).

16 See id. at 445 (provider of radioactive waste disposal services failed to conduct a good-faith search to elicite reasonable alternative offers where it “essentially engaged in a single bidder process and then agreed to several deal protection services that . . . made it impossible to entertain other offers”); Debbie Feinstein & Alexis Gilman, Power Shopping for an Alternative Buyer, FTC Competition Matters Blog (Mar. 31, 2015), https://www.ftc.gov/news-events/blogs/competition-matters/2015/03/power-shopping-alternative-buyer.

17 See United States v. Phillips Petroleum Co., 367 F. Supp. 1226, 1260 (C.D. Cal. 1973) (“The law is clear that evidence of a decline in market position and varying prices and losses cannot be elevated to the status of a ‘failing company’ by subjective statements of management intention or desire to go out of business if the acquisition had not taken place.”).


19 Id. at 6.

20 Id. at 44.

21 Id. at 46.

22 Id. at 46–47.

23 Id. at 49–51.

24 Id. at 49–50; see also id. at 50–51 (“Freedom’s executives and shareholders were focused on obtaining the highest possible offer, which is a different objective from searching for a reasonable alternative offer above Freedom’s liquidation value.”) (internal citations omitted).

25 AM. BAR ASS’N., PRIVATE EQUITY ANTITRUST HANDBOOK 3 (2016).

26 Id. In the PE industry, investors are also known as limited partners. PE firms typically create a separate entity to serve as the general partner of the fund, which usually retains authority over the purchase or sale of investments. Id. at 4–5; Bain 2019 Report, supra note 1; RICHARD A. BREALEY ET AL., PRINCIPLES OF CORPORATE FINANCE 846 (11th ed. 2014).


28 Id. (3 to 7 years of ownership); Bain 2019 Report, supra note 1, at 18 (In 2018, the median period in which funds held onto portfolio companies before exiting was 4.5 years).

29 See Bain 2019 Report, supra note 1, at 19.

30 AIC Private Equity FAQs, supra note 27; BREALEY ET AL., supra note 26.


32 Id.; AIC Private Equity FAQs, supra note 27; BREALEY ET AL., supra note 26, at 846.

33 BlackRock, supra note 31; AIC Private Equity FAQs, supra note 27.

34 BREALEY ET AL., supra note 26, at 836–40.


38 See Otto Bock Commission Opinion, supra note 18, at 46; Carl Shapiro, Competition Policy in Distressed Industries, Remarks Before the ABA Antitrust Symposium: Competition as Public Policy (May 13, 2009), https://www.justice.gov/atr/speech/competition-policy-distressed-industries (stating that it is important to “distinguish between a firm ‘merely’ facing financial distress and a firm whose fundamental ability to compete effectively in the future is in doubt . . . . The fact that a firm has been losing money does not mean that it is a ‘failing firm’ in the antitrust sense.”).

39 Compare United States v. Black & Decker Mfg. Co., 430 F. Supp. 729, 778–79 (D. Md. 1976) (finding the failing company defense had been met where, among other things, the company’s retained earnings position had deteriorated significantly, its working capital had decreased precipitously, and the company was in a severe cash flow position, manifesting in its failure to pay suppliers as those payments came due) with Otto Bock Commission Opinion, supra note 18, at 45 (“At the time of the Acquisition and during the one year leading up to it, Freedom was engaged in a turnaround that had begun to show results.”).

40 Cf. United States v. Third Nat’l Bank in Nashville, 390 U.S. 171, 189 (1968) (failing bank had “backward management” that prevented it from competing effectively, halting declining market share, recruiting new talent, and raising low salaries; failing firm defense was not available because the bank could have improved its bad management or sell to someone else).
56 Otto Bock Commission Opinion, supra note 18, at 46 (“Respondent does not argue that conditions in credit markets were extraordinary or unusually constrained, so as to preclude refinancing or recapitalization to help make the payments due at the conclusion of the term loan.”).

57 See id.

58 Cf. Phillips Petroleum, 367 F. Supp. at 1260 (“The law is clear that evidence of a decline in market position and varying profits and losses cannot be elevated to the status of a ‘failing company’ by subjective statements of management intention or desire to go out of business if the acquisition had not taken place.”).

59 Cf. Phillips Petroleum, 367 F. Supp. at 1260 (“The law is clear that evidence of a decline in market position and varying profits and losses cannot be elevated to the status of a ‘failing company’ by subjective statements of management intention or desire to go out of business if the acquisition had not taken place.”).

60 See Energy Solutions, 265 F. Supp. 3d at 446 (“Valhi was clearly focused on obtaining what it perceived to be WCS’s fair value, not an offer above liquidation value, which is likely to be less.”).


64 See, e.g., Opinion of the Commission 28–35, ProMedica Health Sys. Inc., FTC Docket No. 9346 (June 25, 2012), https://www.ftc.gov/sites/default/files/cases/documents/cases/2012/06/120625promedicaopinion.pdf (assessing argument that acquired hospital was a weakened competitor so as to rebut the structural presumption), aff’d, 749 F.3d 559 (6th Cir. 2014).

65 Compare id. at 29–34 (assessing evidence that the financially troubled hospital’s financial performance was improving significantly, that it had sufficient cash reserves to fund existing capital needs and meet financial obligations, and that it would not necessarily have made deep service cuts absent the transaction; in addition, finding the hospital could have addressed its financial difficulties by pursuing less anticompetitive courses of action, such as through an affiliation with an out-of-market hospital system) with Otto Bock Commission Opinion, supra note 18, at 43–51 (considering similar evidence when evaluating the availability of the failing firm defense).

66 See FTC v. Arch Coal, Inc., 329 F. Supp. 2d 109, 154 (D.D.C. 2004) (a company’s financial difficulties are “only relevant if [the company] demonstrates that this weakness undermines the predictive value of the government’s market share statistics”).

Bank Merger Review in the United States

Proposed bank mergers in the United States are reviewed by the Federal Reserve and the Antitrust Division of the U.S. Department of Justice. The Fed and the Antitrust Division use somewhat different approaches to analyzing bank mergers, but they are in broad agreement on many points. Both agencies typically consider two relevant product markets during a bank merger review: (1) retail banking products and services; and (2) small business banking products and services.

With respect to the geographic markets, the Fed bases its market definition on Federal Reserve banking markets, which depend upon a range of factors, including “commuting patterns, shopping patterns, interviews with local government and business leaders, and surveys of local households or small businesses.” The Antitrust Division defines geographic markets on a case-by-case basis using the tools it uses in other merger cases (e.g., the hypothetical monopolist test); it is not bound by the Federal Reserve banking markets and may define narrower or broader markets.

The Fed typically screens proposed banking mergers using FDIC data on deposits to calculate market shares. It performs this screening using the CASSIDI tool, which the St. Louis Federal Reserve Bank developed. CASSIDI displays FDIC deposit market shares and changes in concentrations for proposed bank mergers in Fed banking markets. The Federal Reserve is likely to scrutinize any market in which a proposed transaction: (1) results in a post-merger HHI of 1800 or larger and an increase in the HHI of 200 or more, or (2) increases the market share of the acquiring firm to 35 percent or more.

The Antitrust Division also uses FDIC deposit data as the basis for calculating market shares to prepare an initial screen. Following the Horizontal Merger Guidelines, the Antitrust Division generally will presume that a proposed transaction will lead to a significant reduction in competition in any market in which it will result in: (1) a post-merger HHI of 2500 or larger, and (2) an increase in the HHI of 200 or more. Note that because the Antitrust Division may define different geographic markets than the Fed, a transaction may pass the more stringent Fed screening limits and yet fail Antitrust Division screening.
If a transaction fails either the Fed or the Antitrust Division screens in a market, the agencies will review additional evidence to determine whether the presumption is rebutted and evaluate the transaction’s likely competitive effects. For example, there are several mitigating factors that may lead the Fed or the Antitrust Division to conclude that a transaction that fails screening is unlikely to have anticompetitive effects. These factors include: (1) the likelihood of entry or repositioning in the market, (2) the number of meaningful competitors, (3) whether the market is expanding or contracting, (4) the presence of broadly available credit unions, and (5) if the bank to be acquired is failing or in financial difficulty. It is noteworthy, that the official bank merger guidance does not even address the role of virtual banks. In theory, of course, at this stage of the analysis, merging parties might argue that competition from virtual banks dispels concern.

Practically, however, the finding of a presumption of anticompetitive effects based on market concentration will likely drive the review of the Fed and the Antitrust Division. Even if the presumption were “rebutted,” the agencies would likely give significant weight to an inference of effects from their view of market concentration. This stems in part from practical considerations and is reflected in the enforcement record:

In the case of a straightforward combination of banking assets, the parties often address DOJ and Federal Reserve Board concerns by agreeing to divest branches (with associated deposits, loans and personnel). If the parties refuse to divest sufficient assets, the Federal Reserve Board may deny their application or the DOJ may sue to block the transaction. As a practical matter, the parties rarely contest a government decision to require a divestiture.

The Fed is particularly wedded to the concentration analysis. For example, in a recent transaction the DOJ concluded that branch divestitures would eliminate the potential for anticompetitive effects from the transaction. The divestiture to an “out-of-market” competitor resulted in the same number of competitors with a market structure, “approximately the same both before and after consummation,” with a de minimis increase in concentration under the Horizontal Merger Guidelines. Nonetheless, because of the slight structural increase in concentration, the Fed “view[ed] the competitive effects in this market as presenting a close case.” The Fed gave no weight to the role of virtual banks in their analysis, and given the Fed’s close coordination with and consideration of DOJ’s conclusions, neither did the Antitrust Division.

The Rise of Virtual Banks
Figure 1 depicts the primary method that U.S. households used to access their bank accounts per the 2013, 2015, and 2017 editions of the FDIC National Survey of Unbanked and Underbanked Households. The percent of households that used mobile banking as their primary access method increased from 6 percent in 2013 to 10 percent in 2015 and 16 percent in 2017. This represents a growth of 174 percent in 4 years.

Use of bank tellers, ATMs, and kiosks, on the other hand, fell significantly from 2013 to 2017. If recent years’ trends continued, then online banking and mobile banking likely became the two most common access methods sometime in 2019.

Figure 1 shows that consumers are increasingly comfortable banking electronically and eschewing trips to the branch. Not surprisingly, this shift in attitudes is reflected in the share of deposits held at virtual banks in the FDIC deposit data. Virtual banks have existed since around the mid-1990s, and the FDIC data suggests that they initially grew slowly, only exceeding 1 percent in 2003. Their growth has quickened since then, however, and virtual banks now account for 5.6 percent of all FDIC deposits in the United States. This growth includes a doubling of virtual banks’ share of total deposits over the last 10 years.

The FDIC deposit data contain information on all deposits at retail banks in the United States, including virtual banks. Deposits are assigned to the branch at which they are held. For example, a customer’s deposits at a bank branch in Ann Arbor, Michigan, will be listed in the data as being in Ann Arbor.

The dataset works well for analyzing brick-and-mortar banks. It is problematic for virtual banks, however, because they do not have branches and the data do not allow for determining the geographic location of the customer. Consequently, all of a virtual bank’s deposits are instead listed in the FDIC deposit data as being located at the virtual bank’s headquarters. For example, the deposits of a Charles Schwab virtual bank customer located in Boston are listed in the FDIC deposit data as being in Reno, Nevada, where the
bank is headquartered. This means that Charles Schwab’s virtual bank will appear to have a significant share of deposits in Reno, Nevada, but no other location in the United States.

The FDIC deposit data therefore cannot be used to calculate the deposit share of virtual banks in any narrower geography. They can, however, be used to calculate the nationwide aggregate deposit share of virtual banks. And as we explain below, we believe that the Antitrust Division and the Fed should use these national shares as a rough proxy for the shares of virtual banks when calculating bank shares in local geographic market shares.

**Ignoring Virtual Banks Overstates Concentration**

When the Fed and the Antitrust Division review a proposed retail bank merger, they customarily calculate market shares using FDIC deposit data. As mentioned earlier, these data assign deposits to the branch at which they are held. Since virtual banks do not have branches, the FDIC deposit data typically assign all of a virtual bank’s deposits to a single location for (the bank’s headquarters). This is potentially problematic for merger analysis, because, as described above, the location of a virtual bank’s customers is not tied to the location of its headquarters. This treatment of the deposits of virtual banks causes regulators to underestimate the significance of virtual banks (and overstate the significance of brick-and-mortar branches) when applying market share screens.

**Ignoring Virtual Banks Biases the HHI Upwards.**

The first step in calculating an HHI value is defining a market. In this section, following the DOJ and the Fed, we take as our product market retail banking products and services. When the DOJ and the Fed calculate an HHI value in this product market, they use the FDIC deposit data. What we show below is that these calculations are biased upwards in most areas unless one explicitly takes the presence of virtual banks in the data into consideration. That is, we are not making a product market argument that virtual banks must be included—the DOJ and the Fed are already doing that. Instead, we show that their calculations are flawed because they do not recognize that virtual bank deposits are dispersed and not concentrated at the headquarters of the virtual bank.

Suppose that virtual banks have in aggregate \( \alpha \) percent of the deposits in geographic market \( m \). Suppose further that none of the virtual banks are headquartered in geographic market \( m \), and so their deposits are credited elsewhere in the FDIC deposit data. Then the true market share of brick-and-mortar bank \( i \) in market \( m \) is:

\[
S_{i,m}^{\text{True}} = (1 - \alpha_m) \times S_{i,m}^{\text{FDIC}},
\]

where \( S_{i,m}^{\text{FDIC}} \) is the observed share of bank \( i \) in the FDIC deposit data in market \( m \). In any market in which virtual banks have a positive share (i.e., \( \alpha > 0 \)) and no virtual banks are headquartered, every brick-and-mortar bank’s share will be overestimated by the FDIC data. For example, if the share of virtual banks in market \( m \) is equal to 20 percent, then the true share of every brick-and-mortar bank is only 80 percent of the share one would calculate using the FDIC data. For example, a brick-and-mortar bank with 50 percent of the FDIC deposits would have a true share of 40 percent.

This overestimate of brick-and-mortar bank market shares will distort the market’s HHI. It is straightforward to show that the true HHI in market \( m \) is given by:

\[
HHI_{m}^{\text{True}} = (1 - \alpha_m)^2 \times HHI_{m}^{\text{FDIC}} + \alpha_m^2 \times HHI_{m}^{\text{Virtual}},
\]

where \( HHI_{m}^{\text{FDIC}} \) is the HHI calculated using shares based on the deposit data in market \( m \) and \( HHI_{m}^{\text{Virtual}} \) is the HHI for virtual banks in market \( m \). For example, if the HHI calculated using the deposit data is 2,500, the share of virtual banks (\( \alpha_m \)) is equal to 5 percent, and the true HHI in market \( m \) is 10,000 (i.e., there is only one virtual bank with customers in market \( m \)), then the true HHI is actually only 2,281. The HHI calculated using the deposit data overstates the true HHI by 219 points, even with a monopolist virtual bank. This example shows that if the market share of virtual banks is 5 percent—i.e., below the actual national average share for virtual banks—incorrectly excluding them will meaningfully bias the HHI and lead one to overstate significantly the retail banking concentration in market \( m \).

Another way to show the same thing is to calculate what the deposit data HHI must equal for the true HHI to equal or exceed a particular threshold, say 2,500 (i.e., the lowest concentration level at which the DOJ considers a market to be highly concentrated). For the true HHI in market \( m \) to equal or exceed 2,500, the deposit data HHI must equal or exceed:

\[
HHI_{m}^{\text{FDIC}} \geq (2500 - \alpha_m^2 \times HHI_{m}^{\text{Virtual}}) / (1 - \alpha_m)^2
\]

Figure 2 depicts the deposit data HHI necessary for the true HHI to be exactly 2,500 for selected values of \( \alpha \) (i.e., virtual banks’ collective market share in a market). The second column corresponds to the case in which there is a monopolist virtual bank (i.e., the lower bound), while the third column corresponds to the case in which there are a lot of very small virtual banks (i.e., the upper bound). The table shows that if virtual banks collectively have even 5 percent of the deposits in a geographic market, then relying upon the deposit data HHI significantly biases concentration upwards. It also shows that the higher is the share of virtual banks in a geographic market, the higher is the bias associated with excluding them. Given that virtual banks have grown steadily over the past decade, this implies that the bias resulting from ignoring virtual banks and their deposits will likely grow worse over time.

**Increase in Concentration Associated with a Merger Will Be Biased Upwards.** Estimates of the change in concentration due to a merger in a market will also be biased if virtual banks are not accounted for properly. For any two
merging firms $A$ and $B$, the change in the HHI due to the merger in market $m$ can be calculated as:

$$\Delta \text{HHI}_m = 2 \times S^\text{True}_A \times S^\text{True}_B,$$

where $S^\text{True}_A$ is $A$’s true market share in market $m$ and $S^\text{True}_B$ is $B$’s true market share in market $m$. If instead of true market shares one uses deposit data shares, then one can calculate the true change in the HHI as:

$$\Delta \text{HHI}^\text{FDIC}_m = 2 \times (1 - \alpha)^2 \times S^\text{FDIC}_A \times S^\text{FDIC}_B = (1 - \alpha)^2 \times \text{HHI}^\text{FDIC}_m,$$

where $\Delta \text{HHI}^\text{FDIC}_m$ is the change in the HHI calculated using the deposit data. If, for example, the change in the HHI calculated using the deposit data is 200 and the aggregate share of virtual banks is 5 percent, then the true change in the HHI is 181. That is, even a virtual bank share of 5 percent—i.e., less than the current national average share for virtual banks—is sufficient for the HHI calculated using deposit data to be biased upwards to a significant degree.

Figure 2 shows the minimum increase in the HHI necessary in the deposit data for the increase in the HHI to equal 200 points. It shows that the higher is the share of virtual banks in a geographic market, the higher is the bias that results from using shares based on the deposit data if one does not account for virtual banks.

### Adjusting for Virtual Banks

The rise of virtual banks (and virtual bank deposits) has two important implications for how the Antitrust Division and the Fed should calculate market shares and concentration measures in banking markets. First, when they use FDIC data the agencies should remove deposits of virtual banks from their headquarter markets. Failure to do so will make it appear that certain virtual banks dominate the markets in which they are headquartered.

Second, the agencies should adjust market shares and concentration measures calculated with FDIC deposit data to account for the presence of virtual banks. This is more difficult because there is no publicly available data source that shows where virtual bank deposits belong. We discuss this problem and a simple way to solve it below.

### Estimating the Share of Virtual Banks in Market $m$

A central challenge in adjusting market shares and concentration measures calculated with FDIC deposit data to account for virtual banks is determining where virtual bank customers are located. Ideally, one would collect data on the locations and deposits of virtual bank customers and then account for these when constructing HHIs in particular geographic markets. Unfortunately, such data are not publicly available.

The lack of information on the locations of virtual bank customers presents two related problems for adjusting for the presence of virtual banks in a particular geographic market $m$. First, it means that one cannot determine the aggregate share that virtual banks have in market $m$. Second, it means that one cannot calculate how that aggregate virtual bank share is distributed across particular virtual banks in market $m$. In the following two sub-sections, we propose a simple solution to both these challenges.

**Estimating the Share of Virtual Banks in Market $m$.**

One solution to estimating the share that virtual banks have in geographic market $m$ is to assume that virtual banks have the same share in geographic market $m$ as they have nationally. Using this assumption (and the additional assumption discussed in the following subsection), one can adjust concentration measures to account for virtual banks using only the information contained in the FDIC deposit data. A strength of this approach is that it needs no data beyond the FDIC deposit data and simplifies calculations.

The approach is not perfect: it is likely that the share of virtual banks varies systematically by market. The FDIC survey on unbanked and underbanked consumers, for example, finds that the likelihood of relying upon online and mobile banking increases with income and education, decreases with age, and rises in metropolitan areas. This means that assuming that the market share of virtual banks equals its national average is likely an underestimate in some areas and an overestimate in others. As richer data on the prevalence of virtual banking in different banking markets become available, it will be possible to refine estimates of virtual banks’ market share.

### Estimating the Virtual Bank Concentration Level in Market $m$. Absent data from virtual banks themselves, we are not aware of a data source that would allow one to cal-
calculate the market share of a particular virtual bank in a particular market $m$. This makes it difficult to calculate an exact virtual bank HHI in market $m$. One approach to solving this data deficiency is to assume that the virtual bank HHI in market $m$ is equal to the national virtual bank HHI. This approach is simplistic, but there is no reason to believe that the virtual bank HHI in market $m$ varies systematically with the demographic (or other observable) characteristics in market $m$. Further, because virtual banks do not depend upon brick-and-mortar assets of their own, it is not clear why their appeal should vary significantly across markets, which suggests that their national share should be well correlated with their local share. Accordingly, we assume in what follows that the virtual bank HHI in a particular market $m$ is equal to the national virtual bank HHI. If more detailed data were to become available, this assumption would be straightforward to update.

Figure 4 depicts the national HHI for virtual banks over time. It shows that the virtual bank HHI fell significantly between 1994 and 2003 as virtual banks began to establish themselves. Since then, including over the past ten years, the concentration level has been fairly stable, with the national HHI typically being below 2,000. In 2018, our estimated HHI for deposits at virtual banks was 1,579.

In 2018, the two banks had overlapping branches in about 185 counties and 81 Federal Reserve banking markets. The median pre-merger HHI in these counties was 1,581, while in Fed banking markets it was 1,295. Based on the FDIC data, we expect that the Antitrust Division screen raised initial flags in 29 counties and the Fed screen raised initial flags in 11 Fed banking markets.32

However, these numbers do not account for the presence of virtual banks. In this section, we reapply the Antitrust Division and Federal Reserve screens after accounting for virtual banks. To do so, as discussed above, we assume that the share of virtual banks in each relevant market is equal to the national average.33 We assume also that the virtual bank HHI in each relevant market is equal to the national virtual bank HHI.

For markets in which there is an overlap between BB&T and SunTrust, accounting for the presence of virtual banks decreases the estimated post-merger median HHI from 1,735 to 1,550 in counties, and from 1,472 to 1,316 in Fed banking markets. We estimate that an initial screening accounting for virtual banks would raise flags in only 19 counties (as opposed to 29 if they are not accounted for) and 9 Federal Reserve banking markets (as opposed to 11). One of the two Fed banking markets that moves from failing initial screening to passing it after accounting for virtual banks is Atlanta, the country’s fifteenth-largest banking market in terms of deposits in 2018.

Thus, accounting for virtual banks could have had a significant effect on the market screening tests for the BB&T and SunTrust merger. It would have reduced the number of counties that failed screening by over one third (10 out of 29) and the number of Fed markets that fail screening by almost one fifth (2 out of 11). Further, it would have removed the large Atlanta banking market from the set of markets that failed initial screening.

Local Banking Concentration Levels Distorted by Omission of Virtual Banks

There are concerns that deregulation has led to excessive concentration in many industries, including banking.34 This concern was raised in the discussion of the merger between BB&T and SunTrust.35 One response to these concerns is the fact that at the national level banking is comparatively unconcentrated.36 This is true but misleading; antitrust banking markets are narrower than national, and banking concentration levels are higher at the local level than at the national level. For example, based on FDIC data, in 2018 the median HHI across Fed banking markets was 2,181, and across counties it was 2,738. In 2018, 41 percent of Fed banking markets and 57 percent of counties would be considered highly concentrated by DOJ guidelines (i.e., have an HHI above 2,500).

This raises the question of whether there has been a systematic increase in concentration levels in banking. When concentration is measured by FDIC deposits without adjust-
ing for virtual banks, concentration levels do appear to have increased. Figure 5, which is based on FDIC deposit data, shows that median local banking HHIs appear to have increased significantly since the Great Recession.\textsuperscript{17} Indeed, the median concentration level in Fed banking markets appears to be as high as it has been since the passage of the 1994 Riegle-Neal Interstate Banking and Branching Efficiency Act (the first year for which we have data), and the median concentration level in counties appears to be close to it highest-observed level.\textsuperscript{18}

Such metrics, however, are misleading because they do not account for the growth of virtual banks. This is illustrated in Figure 5 by the dotted lines, which show concentration levels once virtual banks are accounted for. The dotted lines show that the median HHI is close to its lowest point since 1994 in both Fed banking markets and counties. That is, rather than increasing over time, concentration in local banking markets appears to have decreased (though most of this decrease took place between 2000 and 2007) once one considers the growth of virtual banks.

\section*{Conclusion}
Virtual banks have grown steadily over the past 20 years and now account for almost six percent of all deposits. Regulatory agencies have not responded to this development and continue to base their assessment of proposed banking mergers on HHI calculations that do not account for deposits at virtual banks. This results in a systematic and increasing overestimate of local banking market HHIs and the increase in concentration associated with a merger. The practical implication is that in the evaluation of proposed mergers, too many banking markets are likely being flagged as potential-

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{Figure5.png}
\caption{Median HHI in local banking markets, 1994–2018}
\label{fig:median_hhi}
\end{figure}

\begin{table}[h]
\centering
\begin{tabular}{|c|c|c|}
\hline
\textbf{Banking} & \textbf{HHI} & \textbf{Compliance} \\
\hline
Virtual & 2.50 & 99.99 \\

\end{tabular}
\caption{HHI Compliance for Virtual Banks}
\end{table}

\textsuperscript{2} Id.
\textsuperscript{3} Id.
\textsuperscript{4} Virtual banks are also called direct banks, online banks, branchless banks, or internet-only banks. From the perspective of this article, the crucial distinction between deposits at a virtual bank and brick and mortar bank is whether the deposits at a branch come from customers who bank there or whether, as is the case for a virtual bank, the deposits come from online customers (potentially from all over the country) and there is no associated physical branch a customer can visit.
\textsuperscript{7} Id. Questions 9 and 29.
\textsuperscript{8} That is, banking products and services provided to households.
\textsuperscript{9} Banking Mergers FAQs, supra note 6, Questions 10–13, 14.
\textsuperscript{10} Id. Question 29.
\textsuperscript{11} Id. Question 11 ("The primary data used to construct market shares and HHIs for local banking markets are deposits obtained from the Federal Deposit Insurance Corporation’s Summary of Deposits (SOD, available at http://www2.fdic.gov/sod/) [FDIC SUMMARY OF DEPOSITS]. These data include the location of each branch of all FDIC-insured banking institutions and the dollar value of deposits at each branch. These branch-level deposits allow the calculation of total deposits for each institution in a local banking market. Deposits are considered a reasonable indicator of the level of activity or output of a depository institution because deposit accounts are widely held by consumers and small businesses and are held in combination with other commercial banking products. In addition, for smaller institutions, deposits may be considered a measure of a bank’s lending capacity.").
\textsuperscript{12} Id. Question 7. CASSIDI stands for Competitive Analysis and Structure Source Instrument for Depository Institutions, FEDERAL RESERVE BANK OF ST. LOUIS, WELCOME TO CASSIDI, https://cassidi.stlouisfed.org/index.
\textsuperscript{13} The HHI, or Herfindahl-Hirschman Index, is a frequently used measure of concentration. It is calculated as $\text{HHI} = \sum_{i=1}^{N} s_i^2$, where $s_i$ is the market share in percent of firm $i$ in the market, and $N$ is the number of firms; and takes on a value between 0 (all firms are infinitesimally small) and 10,000 (there is only a single firm). U.S. Dept’ of Justice & Federal Trade Comm’n, Horizontal Merger Guidelines § 5.3 (2010);http://ftc.gov/os/2010/08/100519hmg.pdf [hereinafter Horizontal Merger Guidelines].
\textsuperscript{14} Banking Mergers FAQs, supra note 6, Question 4.
\textsuperscript{15} Id. Question 29.
\textsuperscript{16} Horizontal Merger Guidelines, supra note 13.
\textsuperscript{17} Banking Mergers FAQs, supra note 6, Questions 22 and 32.
\textsuperscript{18} Id. Question 16–19.
\textsuperscript{19} ABA SECTION OF ANTitrust LAW, BANK MERGERS AND Acquisitions HANDBOOK 73 (2006).

21 Id. at 12.

22 Id. at 13.

23 2017 FDIC NATIONAL SURVEY, supra note 1, at 5, tbl.ES.4. Fourteen percent of households report not having visited a bank branch in the past year, which is close to the 16% of households the report relying primarily on mobile banking. Id. at 29, fig.4.

24 id. at 5, tbl.ES.4.


26 To calculate shares and, subsequently, HHI s we follow DOJ guidelines and weight deposits in thrifts by 50%. BANKING MERGER FAQs, supra note 6, Questions 5 and 16. However, all our results are robust to the treatment of thrifts since these now account for only around 5% of all FDIC-insured deposits. Weighting thrifts at 100% would decrease the share of virtual banks to 5.5%.

27 Our basis for calculating deposits at virtual banks is the branch type “cyber office” in the FDIC data. There are challenges in calculating the share of deposits held in virtual banks using this designation, but these are not insurmountable. For example, there is inconsistent labeling of branch type as “cyber,” i.e., deposits at a virtual bank may be labeled as belonging to a cyber branch in one year and a brick and mortar branch in the next year. Further, the acquisition of virtual banks by brick and mortar banks that are starting an online-only division, e.g., the 2011 acquisition of ING Direct by Capital One to start Capital One 360, is dealt with inconsistently in the data. Similarly, brick and mortar banks that start a distinct online-only bank label the virtual bank deposit inconsistently, i.e., sometimes these are labeled as belonging to a brick and mortar branch and sometimes as belonging to a cyber branch. In order to obtain a consistent time series we only included deposits for virtual banks where (1) we could consistently track online-only deposits over time (including through episodes of mergers, acquisitions, name changes, and bankruptcies), and (2) we could verify through an internet search that the deposits plausibly belonged to online-only banking customers. As a result, we do not include deposits for all virtual bank deposits. However, some of the virtual banks we identify may have some brick and mortar offices. This is notably true for Charles Schwab. Ultimately, we designate only around 29 percent of all branches that are “cyber branches” in the FDIC data as belonging to a virtual bank. As such, we may be underestimating the true prevalence of virtual banks.

28 2017 FDIC NATIONAL SURVEY, supra note 1, at 5, tbl.ES.4.

29 The choice is topical, but the numbers should be considered entirely illusory rather than definitive. We do not intend for this example to inform the discussion on the actual BB&T-SunTrust merger.


31 FDIC SUMMARY OF DEPOSITS, supra note 1. In 2018, according to the FDIC deposit data, BB&T had deposits of $167 billion and SunTrust of $165 billion.

32 See the discussion above for how these agencies officially conduct their initial banking merger screening.

33 We assume also that the merger results in a new bank that combines BB&T and SunTrust 2018 deposits.


37 The same is true for mean concentration levels.

Second Thoughts on Double Marginalization

BY JOHN KWOKA AND MARGARET SLADE

Vertical integration between companies can lead to numerous cost-lowering efficiencies that are due, for example, to economies of scope, eliminating contracting costs, aligning incentives, and enhancing relationship-specific investments. Nevertheless, the elimination of double marginalization (EDM) has received the most attention in antitrust literature and practice.

Economic textbooks describe a setting in which an upstream monopoly faces a downstream monopoly in a fixed proportion production process. In this case, the unintegrated downstream firm “over-prices” by marking up the already marked-up upstream product. By eliminating this double margin, or successive monopoly markups, vertical integration lowers prices and leads to benefits for both producers and consumers.

This scenario has formed a key element of competition policy for decades. To illustrate, Erik Hovenkamp and Neel Sukhatme’s analysis of vertical mergers concluded: “Almost all vertical mergers have potential procompetitive effects, the most robust of which is the elimination of double marginalization.”1 A statement by a then-senior Federal Trade Commission enforcer described the prospect of eliminating double marginalization as an “intrinsic” efficiency justification of vertical mergers.2 That view is echoed in the FTC’s recent decision to approve the vertical United Health/DaVita merger, where the majority asserted that “[a] major source of these [claimed efficiency] benefits is the elimination of double-marginalization.”3 And perhaps most recently, and famously, in the antitrust case against the AT&T/Time Warner merger, the government conceded benefits from EDM on the order of $350 million without qualification.4

In some cases the conclusions reached might be the result of correct applications of the textbook model of vertical integration. Antitrust and regulatory policy, however, has tended to apply the EDM argument uncritically, ignoring several key assumptions and issues. The result, we think, has been the widespread risk of misuse of the economic proposition and potentially erroneous policy decisions. Moreover, it has distracted attention from traditional supply-side efficiencies from vertical integration, such as economies of scope, elimination of duplicate facilities such as a head office, the ability to coordinate other aspects of the vertical chain, and the expectation of productivity growth due to knowledge transfers.

In this article we review the underlying model of double marginalization and then address its strong assumptions and other possible limitations on its use as a policy prescription.

Double Marginalization: The Simple Theory

The textbook model of double marginalization is appealingly simple. Let us suppose there is a single upstream manufacturer of a product sold to a single downstream retailer. The downstream firm in turn sells the product to final consumers. Each firm is a monopolist at its stage and, as do all monopolists, each charges a markup on the product that is above its own marginal cost, where the markups are determined by the elasticity of demand that each faces. Assuming constant marginal costs at each stage and linear demand, Figure 1 depicts a simplified demonstration of this theory.

Consider first the case of the fully integrated monopolist facing downstream demand $D_d$ and constant costs at both

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stages given by $d$ at the downstream stage and $c$ for the upstream stage. That monopolist determines its profit-maximizing point of operation by setting the marginal revenue that is associated with its demand curve—$MR_d$—equal to $c + d$, yielding $Q^*$ as the quantity to be sold and $P^*$ as the corresponding price.

Next, we analyze pricing when the successive monopolies at the two stages independently seek to maximize their own profits. The final market “downstream” monopolist maximizes its profit against the same final demand curve and the same final stage marginal cost $d$, but now faces a price for the necessary input that is higher than its marginal cost $c$. That is because the upstream stage is itself a monopoly that, in maximizing its own profit, raises the wholesale price to its buyer above its own marginal cost. As shown in Figure 1, when the independent downstream firm now maximizes its profit, it equates the same marginal revenue curve as before to the total of its own (and unchanged) marginal cost $d$ plus the upstream price that it now faces. The latter is greater than the upstream marginal cost, leading to a new lower output point $Q'$ and a corresponding higher price $P'$.

The efficiency implications of this demonstration are straightforward. Vertical integration clearly makes consumers better off since output is greater and price is lower than under successive monopoly. It is also the case that producers collectively are better off. Formal analysis proves this, but the following logic also suffices: since the integrated firm could choose any price on the final demand curve, by selecting $P^*$ rather than the $P'$ (or any other price), it follows that $P^*$ yields greatest total profit. Integration, in short, results in benefits to both producers and consumers.

This straightforward proposition has represented a powerful argument favoring vertical integration in countless industries over a considerable period of time. And where it is applicable, it is correct as it stands. But as we will discuss below, there is a series of caveats, conditions, and qualifications that affect its applicability.

**Double Marginalization: The Crucial Assumptions**

There are a number of important caveats and concerns about the core proposition that favors vertical integration. This section discusses three that are part of the core theory and must be examined in all cases.

**Fixed vs. Variable Proportions.** The simple model described in Figure 1 is crucially dependent on the assumption of a fixed proportion production process at the downstream stage. This means that the downstream firm sells exactly what it buys, a common example of which is a retailer buying a specified product from its manufacturer and then selling it to final customers. When both have market power, integration in principle does indeed avoid double marginalization.

The above description of EDM does not hold, however, when the downstream stage is subject to variable proportions, for in this case, the unintegrated downstream firm can avoid some of the adverse effects of the inflated wholesale price by substituting away from use of that product. For example, if the upstream product is steel, a downstream firm may be able to use some aluminum or plastic in the production of the same final product. Price will be lower and quantity will be greater than if no substitution were possible, and indeed, both will vary with the degree of substitutability. In any case, substitution diminishes the penalty of unintegrated operation and the gain from integration, leaving the overall impact on total surplus from integration ambiguous.

As formally demonstrated by Fred Westfield, the penalty in lost profit and surplus from unintegrated operation depends on the elasticity of substitution between inputs. That penalty increases as that elasticity decreases and is maximized in the case of fixed proportions when the elasticity is zero. Estimating elasticities of substitution between inputs is similar to estimating the demand elasticities for merger simulations, which is an economic exercise often performed in the analysis of horizontal mergers.

Even in cases where fixed proportions would seem to apply, the favorable assessment of EDM might require a bit more thought since in actual practice “substitution” might not be so straightforward. Consider the above example of replacing steel with plastic in the production of some products. Although such substitution might result in the same apparent product (e.g., a “clothes washer”), the use of plastic might also result in a less durable product. That is, substitution produces a somewhat different product and not— as the textbook case assumes—the exact identical product with an alternative input.

In reality, this may be more common than the fixed-proportion and identical-product scenarios. Consider an auto manufacturer and a dealer, where the transaction seems necessarily to involve fixed proportions. Yet to the extent that the final customer also values point of sale service as part of the transaction, the downstream retailer can offer more helpful advice or greater variety of inventory in a manner that alters the relevant transaction so that it involves not simply the identical vehicle.

Whenever this more general type of substitution is possible, the determination of the efficiency implications of vertical integration is more difficult than the simple case of fixed proportions in production. Here the full and correct analysis would also need to consider the efficiency effects of subtle changes in the product itself as the producer makes strategic business decisions resulting in products with different durability, quality, or services, and with correspondingly different consumer demand. Applying the simple fixed-proportions theory where its assumption of an unchanged product does not hold cannot yield the correct answer.

**Merger Specificity.** A second important qualification to the standard EDM model is the implicit assumption that the actual cost savings require vertical integration for their realization. In theory, this is not correct, and, in practice, it is often not the case. If vertical integration were strictly neces-
sary, then we might expect nothing but a single vertically integrated structure in most or all production processes. Instead, businesses routinely develop contractual arrangements that yield the same cost benefits as integration. The mechanism for this involves nonlinear prices, quantity minimums, or other contractual provisions that move the parties to the same equilibrium as shown in Figure 1.

To illustrate, suppose—not implausibly—that the two monopolists described above realize that the key impediment to increasing both their profit streams—not just one at the expense of the other—is the distorted wholesale price. All that would be required to reach the overall profit-maximizing point is to ensure that the wholesale price is the upstream marginal cost, since the downstream firm would then be acting on the real economic cost in making its output decision. The two firms could enter into a contract that (1) specifies the wholesale price to be the upstream marginal cost $c$, thereby maximizing total profit, and then (2) provides for a division of the now larger overall profits in a manner that increases the profits to both parties. For example, the downstream firm could pay a fixed fee—a two-part tariff—to the upstream supplier.

Such nonlinear pricing contracts are to be expected whenever the two parties recognize their interest in avoiding the pricing externality associated with independent pricing, and certainly when there is greater profit at stake. As a policy matter, therefore, vertical integration is not necessary to achieve the benefits of EDM.8 For this reason, in competition analysis the parties can be required to explain why contracting is impossible, since the default assumption could reasonably be that a simple contract would achieve the cost reduction without any of the practical difficulties and competition concerns associated with full integration. Indeed, the Department of Justice explained its position in Comcast/NBCU by declaring that “much, if not all, of any potential double marginalization is reduced, if not completely eliminated, through the course of contract negotiations between programmers and distributors over quantity and penetration discounts, tiering requirements, and other explicit and verifiable conditions.”9

It might be argued that the contracting alternative might itself be costly and cannot fully achieve the benefits of EDM. Phillip Gayle, for example, finds that codeshare agreements among airlines that price different segments in a route independently do not fully eliminate double margins when carriers also offer competing single-product alternatives.10 Where incomplete internalization can be documented, the proper antitrust calculus would be to credit integration with no more than the incremental cost savings over and above what contracting can achieve. Although determining the exact incremental cost savings may not be empirically possible, crediting integration with the full benefits would be incorrect. Moreover, this calculation needs to factor in any costs incurred in the process of integration, including the negotiations and the operational integration.

**Real vs. Pecuniary Economies.** The third broad issue with EDM concerns cognizable efficiencies. In antitrust analysis these are limited to “real” economies, that is, those that save on actual resources. By contrast, if an input is simply repriced but no fewer units of the input are used in the production process, the lower costs are termed “pecuniary” and not credited as a “real” efficiency to merging firms.11 It is worth noting that EDM by itself is only a pecuniary economy: in the model described in Figure 1 there is no unit of output that is produced with fewer resources under vertical integration than with independent operation of the two stages. By itself, therefore, EDM does not result in a “real” cognizable economic efficiency.

That said, as is also evident in Figure 1, EDM does alter the market equilibrium in a direction that improves economic efficiency. The reason is that, as a direct result of the decrease in pecuniary cost, output has increased. This output increase reduces deadweight loss while increasing total profit and surplus to consumers. But the true economic benefit derives entirely from output expansion, not from a decrease in unit input usage. In this respect, labeling EDM as a cost-reducing benefit is misleading, if not incorrect, and more importantly, it overlooks significant differences in the economic benefits that may arise. A reduction in unit input usage directly results in real cost savings that accrue to some combination of firms and consumers. By contrast, a reduction in pecuniary costs per se results in no real cost savings, although in this case it induces an output increase, a lower price, and a deadweight loss reduction. It is, however, noteworthy that the first effect works through supply whereas the second works through demand.

Does this distinction make any difference? In both cases, the new industry equilibrium entails greater efficiency, so viewed in that way it appears largely a matter of semantics. But as we discuss later, it is possible that in practice the internal transfer price to the downstream division might not equal marginal cost, and thus, the efficiency gains from the EDM in terms of the reduction in pecuniary costs may not be fully realized.

Finally, as a practical matter, antitrust authorities normally deal with horizontal pricing externalities, such as changes in markups, which could mean that they, not the parties, would deal with vertical pricing “efficiencies.”

**Double Marginalization: Variations in Specific Settings**

The above qualifications are central to the theory of EDM in the sense that they apply uniformly and should be considered in all cases where vertical integration is claimed to be justified by such cost savings. Next discussed are other more specific circumstances in which the simple model and its implications may not hold.

**Non-Monopoly Markets.** The classic model of double marginalization outlined above rests on the assumption of two-stage monopoly: an upstream monopolist sells its output...
to a downstream monopoly. While there may be such actual cases, most of the commonly cited examples and applications involve markets with imperfect competition at either or both stages, and the implications for double marginalization are quite sensitive to the market structures at both stages. Michael Salinger’s model serves to illustrate one possibility. That model posits successive Cournot competitors, so that a vertical merger reduces competition in the upstream market even as it creates a more aggressive downstream firm. The net competitive effect depends on several parameters, such as the integrated firm’s elasticity of supply of the final good and the elasticity of the residual demand facing the unintegrated final good producers. Often, those parameters are not readily available.

Other more subtle scenarios may also disrupt the conclusions of the classic model when markets are not monopolies. One such scenario involves the case of an upstream monopolist that integrates with a downstream firm that has rivals. If its margin on sales to the independent rivals exceeds the margin on its supply to its integrated downstream affiliate, the integrated firm will face an opportunity cost to supplying its affiliate. That, in turn, will reduce its internal usage of the input, limiting the gain in the total surplus that would otherwise be expected from EDM. And in the limit, of course, there will clearly be no gain from EDM if the upstream industry is competitive.

Concerns over the confounding effects of competition at either stage led Paul Joskow, in his review of the economics of vertical integration, to conclude that when vertical integration affects the intensity of competition at either stage, “This will in turn affect the incentive to vertically integrate, the distribution of profit between firms from vertical integration, and consumer prices. Moreover, the welfare effects are now more likely to be ambiguous.” The implications from the simple two-stage monopolist model are not robust to these generalizations of market competitiveness.

**Multiproduct Firms.** The basic model described above involves single-product monopolies at each stage and, subject to the other qualifications, predicts that product price will fall after vertical integration. However, Salinger has shown that this implication is in fact crucially dependent on the assumption that each firm is not only a monopoly but also a single-product firm. The case of multi-product firms, which is quite common, is considerably more ambiguous in its overall efficiency effects. Salinger cites mergers involving soft drink bottlers and cable television as examples of multi-product firms where the implications are in fact likely to differ.

Salinger’s demonstration is an application of Edgeworth’s Paradox of Taxation. Edgeworth had shown that a tax on one of two substitute goods sold by a monopolist can in fact lead to lower prices for both. In the present context, Salinger shows that the effect on the price of a good from vertical integration can be quite different when that good is a substitute in final demand for a non-integrated product of the downstream firm (as with a vertical merger between Coca-Cola and its bottlers when the bottlers also bottle the unintegrated Dr Pepper brands). Indeed, as he demonstrates, both prices can fall, both prices can rise, or the price of the now-integrated product can fall while the other one rises. In particular, the fact that the downstream demand facing the integrated firm is joint is crucial. Indeed, this fact implies that, by raising the prices of the unintegrated brands (e.g., Dr Pepper brands), demand is shifted towards the integrated substitutes (e.g., Coca Cola brands) and, if the shift is sufficiently large, all prices can rise.

Salinger analyzes the efficiency effects of a vertical merger involving such a multi-product firm and cautions that total surplus is certain to rise only if both prices fall. When only the price of the integrated product falls, total surplus could still be reduced if the price of the integrated firm’s non-integrated product rises sufficiently. For this reason, Salinger concludes, “Since some and even all prices can increase, mergers of successive monopolists in multi-product industries do not necessarily improve welfare.” The overall efficiency effect is an empirical question that can be difficult to answer, but it is not answered by appeal to theory that is designed for a different setting.

**Strategic Behavior and Opportunity Cost.** As noted previously, pure monopoly in both stages is rare, and one particular alternative market structure has been especially important in recent vertical mergers. This involves the case where the merger combines an upstream monopolist with one of its downstream customers, which means that other downstream players must now acquire a crucial input from a firm that competes with them. Having both the ability and incentive to disadvantage its direct downstream rivals, the integrated firm will predictably raise the input price in order to weaken the competitive force of its downstream rivals.

This strategy of raising rivals’ costs is well understood, but its implications for double marginalization are not. The reason is that in raising the input price to its rivals, the integrated firm—apart from any efficiencies from integration—stands to lose some revenues and profits on forgone sales to those rivals. The opportunity cost of vertical integration in this setting was recognized as an offset to the merging parties’ argument before the FCC in the proposed Comcast/NBCU merger. Steven Salop and Daniel Culley have shown how the magnitude of this opportunity cost can be factored into a broader calculation of the price effects of such a vertical merger.
Gopal Das Varma and Martino De Stefano have recently formalized this offsetting effect.20 They note that standard analysis of vertical mergers between oligopolists has involved a two-stage process: first, the competitive risk that the integrated firm will engage in a strategy of raising its rivals’ costs (RRC) is assessed, and second, if that risk is credible and the effect substantial, the cost savings from EDM is measured as an offset. They make the fundamental point that these effects are not separable. Rather, the magnitude of EDM affects the shift in demand away from the integrated firm’s downstream rivals, while the shape of their reduced demand curves in turn affects the integrated firm’s incentive to engage in a strategy of raising rivals’ costs. Indeed, depending on the shape of the demand curve for the unintegrated downstream product as a function of the upstream input price, the gains from RRC can increase or decrease and, with it, the magnitude and even the direction of the change in the upstream price charged to rivals.

In addition, they show that EDM not only affects the size of RRC, it can also change its sign. With take-it-or-leave-it price offers upstream, a sign reversal—lowering rivals’ costs—is more apt to occur when the price elasticity of rival demand is high and the diversion rate from the rival to the integrated downstream division is low. The former occurs because the monopolist loses more sales when it raises its price to its competitor and the latter occurs because the customers that leave the rival are less apt to purchase from the integrated firm.

Das Varma and De Stefano’s model is sufficiently flexible to accommodate differences in bargaining power of the upstream vis-à-vis the downstream unintegrated firm, with take-it-or-leave-it offers a special case. This flexibility, in conjunction with differences in demand curves—for example, linear vs. logit—leads to a variety of possible outcomes. They note that the price increase inflicted on rivals falls, often by a substantial amount, as the bargaining power of the upstream firm rises, with the limiting case being take-it-or-leave-it offers upstream. Moreover, increases in the price charged to a downstream rival are smaller under linear demand compared to logit. Finally, retail prices also depend on equilibrium cost pass-through. These substantial ambiguities lead Das Varma and De Stefano to conclude that “the standard technique—that does not account for the link between EDM and RRC—can significantly miss the mark when it comes to predicting price effects.”21

Internal Transfer Pricing. The efficiency gains from EDM depend critically on the assumption that an integrated firm will set an internal transfer price—the implicit price at which a unit is transferred from upstream to downstream—equal to marginal cost. In other words, full information and frictionless profit maximization is assumed. However, there are reasons why this might not always be the case.

There is a theoretical literature that argues that operating an integrated firm as a set of separate divisions can be efficient because the divisions will compete fiercely among themselves to lower costs.22 On the other hand, when separate divisions make separate pricing decisions, they might not fully internalize the cost of their pricing decisions to other divisions. Principal-agent models highlight the differences between the objectives of owners and managers of the firm that can imply deviations from cost minimization. Moreover, a related organizational literature cautions that vertical integration is responsive to verifiable costs but may impose a variety of private, non-verifiable costs that are overlooked.23

There is also some empirical evidence of these transfer pricing issues. In an empirical study of vertical integration in multi-channel television markets, Gregory Crawford and others find that divisions internalize most but not all of the profits of other units—specifically, divisions internalize $0.79 of each dollar of profit realized by other integrated units.24 In addition, Christian Michel and Stefan Weiergraeber find that, after a merger in the ready-to-eat breakfast cereal industry, it takes time for internal profit maximization to occur, but it is eventually realized.25 These studies imply that the assumption of efficient internal pricing might not be realistic or that it will not occur immediately, both of which factors lessen the size of the EDM effect.

Finally, there will be no internal transfer price, and thus no EDM, if the downstream firm does not use the upstream product. This might seem like an unusual situation. However, Enghin Atalay, Ali Hortaçsu, and Chad Syverson show that no shipments between vertically integrated firms is the rule, not the exception.26

As with the other factors discussed above, it is difficult to forecast how the integrated firm will price post-merger. At a minimum, however, a sensitivity analysis that varies the degree of internalization of cost minimization is warranted.

Conclusion

In recent years, competition and regulatory policies have finally begun to assess the possible adverse effects that can be associated with vertical integration and mergers. That concern is well founded and long overdue. But policy analysis has continued to treat the claimed benefits from EDM relatively uncritically, too often automatically crediting vertical mergers with the cost saving benefits predicted by the classic economic model.

This can be a critical policy error since the classic EDM model is based on a long list of assumptions that do not necessarily hold, including that production is characterized by fixed proportions, contracting cannot achieve similar results, pecuniary economies cause real output changes, pure monopoly exists both upstream and downstream, upstream marginal cost becomes the operative transfer price, each firm sells only a single product, and raising rivals’ costs does not offset the benefit. Although some of these are well understood, the full array of necessary assumptions tends not to be recognized.

To illustrate, in a recent speech, the Assistant Attorney General for Antitrust stated that vertical integration would eliminate double marginalization, and hence get antitrust
credit, when both firms mark-up price over marginal cost, when contracting is not possible, and when consumer demand makes the effect sizeable. This list of conditions overlooks several additional crucial assumptions.27 The Draft Vertical Merger Guidelines recently released by the Department of Justice and Federal Trade Commission similarly elevate the elimination of double marginalization as an efficiency defense for a vertical merger, again with an incomplete listing of the limitations of the proposition.28

There is no dispute that empirical studies show that vertical integration can reduce costs and yield benefits to both consumers and producers.29 However, most of these studies involve competitive or monopolistically competitive settings rather than the double monopoly structure that is the foundation of the EDM implication, and there is in fact little empirical evidence about the outcome of vertical integration in imperfect market settings where policy is most concerned. As a result, we believe that some vertical mergers do indeed warrant close scrutiny. Our concern is that, in evaluating such mergers, the calculation of EDM and its consequences is often simplistic and flawed. Moreover, we also believe that the heavy focus on EDM as the principal source of efficiency is misplaced. Rather, the efficiencies that should matter most are traditional supply-side efficiencies, such as economies of scope, elimination of duplicate facilities, and the ability to coordinate other aspects of the vertical chain.

4 Joe Palazzolo et al., Decoding Judge Leon’s AT&T-Time Warner Decision, WALL ST. J. (June 12, 2018).
6 See, e.g., id. at 688 (concluding: “Only in the case where [price] falls can we be sure that total surplus is increasing. In the opposite case, total surplus can increase or decrease.”) For a more complete analysis, see Fred M. Westfield, Vertical Integration: Does Product Price Rise or Fall?, 71 AM. ECON. REV. 334 (1981).
7 Westfield, supra note 6.
8 For this reason, industrial organization textbooks typically discuss vertical integration as one method, along with spot markets and contracting, for mediating the transaction between upstream and downstream firms. See, e.g., Dennis Carlton & Jeffrey Perloff, Modern Industrial Organization ch. 12 (4th ed. 2000).
14 Paul Joskow, Vertical Integration, 55 ANTITRUST BULL. 545, 554 (2010).
17 Salinger, supra note 15, at 545.
21 Both Das Varma and De Stefano, and Domnenko and Sibley, show how simulations can be used to forecast EDM and RRC when they are determined simultaneously. In practice, such simulation models would have to incorporate assumptions on demand and bargaining that are consistent with the structure and practices in the industry that is studied. See id. at 19; Gleb B. Domnenko & David S. Sibley, Simulating Vertical Mergers and the Vertical GUPPI Approach (2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3447687.
29 Francine Lafontaine & Margaret Slade, Vertical Integration and Firm Boundaries: The Evidence, 45 J. Econ. Literature 629 (2007). See also Margaret Slade, Vertical Mergers: Ex Post Evidence and Ex Ante Evaluation Methods (Microeconomics.ca Working Papers, Vancouver School of Economics, June 2019). In addition, the existing studies generally do not consider possible quality effects or the contracting alternative.
Differing levels of transparency across merger control jurisdictions globally can prejudice the ability of merging parties, practitioners, and other industry participants to prepare for merger control investigations and provide information and advocacy during such investigations. Transparency plays an important role in both merger control and other antitrust enforcement, by making enforcement policies known, ensuring procedural fairness, and improving the predictability of enforcement actions for particular types of transactions and conduct. But agency investigations typically are non-public, due to legal requirements to protect trade secret and other sensitive business information, and to enable enforcement staff to develop evidence and make enforcement decisions without public disclosure that may interfere with the investigative process.

Since 2010, at least the International Chamber of Commerce, the OECD Competition Committee, the American Bar Association, and the International Competition Network have examined these issues.1 The discussion below focuses on merger enforcement and compares the relative transparency of the U.S., EU, and Chinese competition authorities. We do so by analyzing the amount of information available at each stage of the proceedings to the parties and third parties, the amount of the agency’s substantive reasoning that is made available to the parties and to third parties, and the amount of information requested from and made available to other industry participants. We then offer some observations on how the key differences among these jurisdictions may impact the parties to enforcement actions, as well as other industry participants and the public in general.

What Do We Mean by Transparency?

Transparency is a fundamental attribute of a sound merger control regime that provides greater certainty for merger parties and others about transactions that are subject to review by antitrust authorities.

In this article, transparency in merger enforcement is defined as including three important components:

- the amount of information issued publicly by antitrust agencies to describe general jurisdictional standards, enforcement priorities, analytical methods/standards used for substantive analysis of transactions, and administrative standards and procedures for pre-merger notification, preparing the notification, settlements, and remedies;
- the level of information about a particular investigation that antitrust agencies share about the evidence that the agency has gathered with respect to the matter, and the agency’s enforcement intentions and positions on the matter going forward; and
- the amount of information issued publicly by antitrust agencies upon termination of an investigation to describe the rationale for the agency’s decision (including the acceptance/rejection of any remedies).

The discussion below applies these definitions to the antitrust enforcement agencies in the EU, U.S., and China, and shows significant differences among these jurisdictions in the level of transparency for merger enforcement.

Transparency in EU Merger Enforcement

In the European Union, merger control is governed by the European Union Merger Regulation 139/2004 (EUMR). The EUMR lays down the conditions under which the European Commission (Commission) will have jurisdiction over concentrations (widely defined in the EUMR to cover mergers, acquisitions of control, and full-function joint ventures). Where the concentration has an “EU dimension” (i.e., where certain turnover thresholds are met), the Commission will have jurisdiction to investigate the merger. Those transactions without an EU dimension may fall to be investigated by the National Competition Authorities (NCAs) in accordance with their domestic merger control rules. As an exception to

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this rule, there are procedures under which the parties can engage in pre-notification discussions with the authorities in order to re-allocate jurisdiction between the Commission and the NCAs (for example, if it would be more advantageous for the transaction to be reviewed at the Member State level if the only competition issues of any significance are limited to one Member State), and procedures also exist for the post-notification re-allocation of jurisdiction between the Commission and NCAs (for example, a Member State can request that a concentration notified to the Commission be referred to it, if the deal threatens to affect significantly competition in a market in that Member State which is a distinct market, or if the intervention is to protect legitimate interests of public security). This article considers only the Commission’s investigations under the EUMR.

All concentrations with an EU dimension must be notified to, and approved by, the Commission prior to their implementation. Notifications have to be made in a specific form published by the Commission by the parties acquiring control.

Once the notification is filed, the Commission’s review is, potentially, a two-stage process. During the first phase of the investigation (Phase I) the Commission has up to 25 working days in which to make its initial assessment of the proposed transaction (although this period can be extended to 35 working days if the parties offer remedies during Phase I).

The Commission must then decide whether to clear the concentration (with or without remedies), or open an in-depth (Phase I) investigation. When the Commission opens a Phase II investigation, it has a basic period of 90 working days in which to complete its investigation. This period can, however, be extended if remedies are offered, or if the parties request an extension. At the end of the Phase II investigation period the Commission will either clear the concentration (with or without remedies) or prohibit the concentration.

Commission merger decisions (whether clearances or prohibitions) can be appealed to the EU courts. An appeal may be brought by the parties to the transaction, or by any other person for whom the decision is of direct and individual concern.

Transparency is a fundamental principle governing the actions of the Commission, particularly due to its role as a supra-national institution. This is baked into the statutes governing the Commission as a whole and its merger control function. These tenets of transparency are also echoed in the EUMR, particularly in the requirements governing publication of information on notified transactions (as discussed below).

Transparency of Jurisdictional Standards, Pre-Notification and Notification Procedures. The Commission has issued comprehensive guidelines on the assessment of mergers, and the Consolidated Jurisdiction Notice which sets out how the jurisdictional thresholds will be applied. The Commission does not have a dedicated team set up to respond to informal queries but guidance can be obtained from previous Commission and General Court decisions where the Commission’s approach to analyzing jurisdictions in trickier cases is outlined, and through pre-notification discussions with the Commission staff. Parties can also apply for formal guidance from the Commission.

In the EU, the process for entering into pre-notification discussions follows a set procedure of submitting the Case Team Allocation Request, receiving requests for information, and entering into a dialogue with the case team. The Commission’s Best Practice Guidelines includes a section that details the purpose and usual procedure for pre-notification discussions, in which parties are directed to provide a background memorandum on the transaction to begin discussions, followed by a draft of the notification (the Form CO). Although the discussions, rightly, remain confidential, and the Commission does not officially publish information on when pre-notification discussions with the parties began, the Commission does occasionally reach out to third parties during pre-notification with questionnaires and/or invitations to participate in phone calls and meetings with Commission staff to assist in the review. When this occurs, some market participants, at least, will have knowledge that the Commission’s assessment has started. Particularly in these circumstances, it remains unclear why the Commission is unwilling to otherwise confirm that pre-notification discussions are underway.

The Commission uses a two-stage approach to publicizing the formal notification, which is required under Article 4(3) EUMR. Within about two to three days of receipt of the filing, the Commission’s practice is to publish on its website bare details of the transaction. At this stage, the published information will be limited to non-confidential information only, including the names of the parties, the relevant economic activity code, the date of the filing, and the provisional deadline for the Commission’s decision on the matter. Usually about one week after the Commission has received the filing, a more detailed (but still relatively brief) non-confidential statement about the transaction is published in the EU’s Official Journal (which is also accessible from the Commission’s website). The statement adopts a standard format, and the parts of it relating to the parties and the transaction are provided by the parties themselves. The statement will identify the parties and their main business activities, and will provide a very brief outline of the nature of the transaction. It will also invite interested third parties to submit their views on the transaction to the Commission within 10 days of the date of publication. This process allows for a significant degree of transparency concerning each case that is undergoing a Commission investigation, and also ensures that potentially interested third parties have adequate information to make submissions about the transaction.

The Commission’s Horizontal Merger Guidelines outline in significant detail the Commission’s approach for analyzing market shares, concentration thresholds, competitive
impact, buyer power, and efficiencies. This gives the parties to the transaction significant detail about the Commission’s analysis and insight into enforcement priorities. The Commission has also published best practice guidelines for the submission of economic evidence and data collection in competition cases, including merger cases, which contain recommendations regarding the content and presentation of economic analysis, and how best to respond to Commission requests for quantitative data. This provides additional guidance for parties concerning the Commission’s approach to analyzing data, and also gives details of data requests that parties can expect to receive during a Commission investigation.

The Commission has published notices on acceptable remedies, and best practice guidelines for the submission and negotiation of remedies. The Commission has also published an ex-post study of 96 remedies included in merger decisions adopted from 1996–2000, which provides further detail on the types of remedies that are acceptable in specific scenarios. These materials provide important guidance regarding the Commission’s analytical approach and procedure for submitting remedies, including model documents that have to be completed for the formal submission of remedies.

**Transparency of Information Shared During Investigation.** As part of the Commission’s statutory commitment to transparency, it does share information with third parties, including Member States, more extensively than other authorities. The Commission will send copies of the notification, as well as any other important documents made available during the investigation, to all the Member States. (It needs a waiver from the parties to share information with authorities outside the EEA.) Nonetheless, the Commission remains alive to confidentiality concerns. Any documents containing confidential information must be marked as such and the Commission goes through a rigorous procedure with the merging parties of identifying and redacting confidential information before non-confidential versions of key submissions can be shared with any third parties.

The Commission also proactively contacts key industry players to gather their feedback regarding the merger shortly after notification, and dialogue and engagement with third parties and key stakeholders is a very important part of the Commission’s merger review. Importantly, the merging parties also have knowledge of third parties the Commission may contact, as the Commission relies on the contact details submitted by the merging parties. Other third parties that are interested in the transaction may also approach the Commission with their views.

The Commission’s process is therefore relatively accessible to interested parties. As the investigation progresses, further key details of the Commission’s substantive concerns (such as an outline of the theories of harm that the Commission is exploring) may also be made public and will be made known to third parties. This in turn increases accountability of the Commission and maximizes the role of third parties. The Commission also updates the case timeline on its website regularly so that third parties are aware of the status of the case, including when remedies discussions are ongoing, thereby facilitating third party engagement and understanding of a Commission investigation. The Commission will also conduct a market test of any remedies that are proposed by the merging parties, by asking third-party market participants for their views on the proposed remedies.

**Transparency of Decisions and Agency Reasoning.** The European Commission’s website lists all notified transactions and reports the Commission’s disposition of each of these transactions. Even transactions that are cleared unconditionally after simplified review are the subject of a Commission statement that identifies the parties, the nature of the transaction (joint venture, acquisition of stock, etc.), and the relevant product and geographic markets. Other Phase I unconditional clearance decisions will also identify the degree of overlap of the participating firms, and other salient facts that led the Commission to conclude that no challenge was necessary.

The Commission publishes the fact of its decision to refer a merger to Phase II on its website, but not the full text of that decision (known as a 6(1)(c) decision), only the notifying parties receive a copy. However, the Commission’s public announcement provides a brief description of the Commission’s substantive concerns and reasons for the Commission’s decision to refer the case to Phase II, and the merging parties are provided with key documents relied upon in the decision to refer.

The process of a Phase II investigation also involves further questionnaires being sent to third parties. Again, the merging parties also know the majority of third parties that will be proactively contacted, as the Commission will rely on the contact details originally provided by the parties, as well as any third parties that proactively contacted the Commission during Phase I.

If, during the Phase II investigation, the Commission proceeds to issue a Statement of Objections, the notifying parties will get access to the Commission’s file. This involves the notifying parties receiving redacted copies of all the submissions and responses from third parties, as well as often receiving access to the data used by the Commission to make any economic calculations. The Statement of Objections is a document often issued during a Phase II investigation in which the Commission lays out its substantive concerns arising during the whole investigation and allows the merging parties to understand what will be required to allow the Commission to clear the deal. Third parties that have applied for and been designated by the Commission as interested third parties in the merger investigation will also receive redacted copies of key submissions from the merging parties, including a redacted copy of any Statement of Objections.

The Commission publishes details of all the decisions that it takes throughout the full merger investigation process with the notable exception of the 6(1)(c) decision to open a Phase II review. This includes providing publicly available infor-
mation on the content of the Statement of Objections, as well as publishing a full public, non-confidential version of the Commission’s final decision in all merger cases. These decisions are typically lengthy and detailed and contain significant references to the merging parties’ views as well as anonymized feedback received from third parties. This provides a high level of transparency and allows scrutiny of the Commission’s reasoning in each merger case. The publication of all Commission final decisions also increases certainty for future merging parties as it allows practitioners to fully review all precedent cases in a particular market and understand the Commission’s substantive decision regarding market definition and competitive assessment. Indeed, transparency in decision-making is considered to be particularly important since it is linked to the rights of defense enshrined in EU law which have been litigated at the Court of Justice of the European Union, and the Court has ordered the Commission to disclose more information in its decisions, particularly relating to economic reasoning.9 Frequently, the Commission decisions are also cited on issues of market definition in other jurisdictions.

It is notable however, that when it comes to appeals of Commission decisions, the appellants need to show there is a “manifest error” in the Commission’s decision. This means that, when facing court challenge, the Commission does not have to reveal all of its reasoning behind the decision but only defend itself on the points of “manifest error” raised by the appellants.

**Transparency in U.S. Merger Enforcement**

In the United States, at the federal level, mergers are reviewed by both the Federal Trade Commission and the Antitrust Division of the Department of Justice. In terms of the statutory framework, mergers are principally governed as to substantive legal standards by Section 7 of the Clayton Act, and as to premerger notification requirements by Section 7A of the Clayton Act (the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (HSR Act)), and associated Rules issued by the FTC under the HSR Act, which together form the premerger notification regime. The HSR Act requires that the parties to transactions meeting the set thresholds file HSR notification forms with the FTC and the DOJ and observe a statutory waiting period prior to closing the transaction. Filings under the HSR Act are required to be made with both agencies, which (if not cleared summarily) go through a procedure of “clearance” to allocate responsibility for review, investigation, and possible enforcement of particular transactions to one of the agencies based on the expertise or interest of the agency. In addition, several specialist agencies address competition issues as part of their own reviews, including the Federal Communications Commission, and parties to transactions may have to deal with these agencies in parallel to the FTC/DOJ. State Attorneys General also have relevant authority to investigate and often require similar advance notices.

The [European] Commission publishes details of all the decisions that it takes throughout the full merger investigation process with the notable exception of the 6(1)(c) decision to open a Phase II review. This includes providing publicly available information on the content of the Statement of Objections, as well as publishing a full public, non-confidential version of the Commission’s final decision in all merger cases.

The initial HSR waiting period is 30 days in most circumstances. A party may request early termination of this period, and these requests are often granted if the agency does not intend to investigate the transaction further. The reviewing agency may decide to further investigate the transaction beyond the initial waiting period by issuing a formal Request for Additional Information and Documentary Material (Second Request). After the issuance of a Second Request, the HSR waiting period is suspended until 30 days (or 10 days for cash tender offers) following substantial compliance with the Second Request. Upon substantial compliance, the agency may close the investigation, allow the investigation to close subject to a settlement setting out specific remedies, or challenge the transaction by seeking a preliminary injunction in a U.S. district court to block the transaction (with each of the FTC and DOJ following a slightly different procedural path to obtain an injunction). Notably, unlike the Commission in the EU, neither the FTC nor the DOJ has the power to block a transaction without getting an injunction issued by the court.

These procedural features of the U.S. premerger review process, including both the statutory regime and the requirement for a favorable court ruling to block a transaction, has an impact on the level of transparency in the U.S. merger control regime.

**Transparency of Jurisdictional Standards, Pre-Notification and Notification Procedures.** In the United States, information about the jurisdictional thresholds that determine whether the parties must notify a transaction, the process of notifying a transaction, and further detail on how the FTC and DOJ conduct the substantive assessment, are primarily available from the FTC Premerger Notification Rules, formal interpretations issued by the FTC, informal Interpretations issued by staff of the FTC Premerger Notification Office (PNO), and substantive enforcement guidelines issued by the DOJ and FTC.
The FTC PNO offers a wealth of resources, including several published guides to the HSR Act and its associated Rules, including on the jurisdictional thresholds and reportability requirements. The FTC PNO also issues substantial guidance on how to complete the HSR notification form and what information should be included in a filing. Of particular use to practitioners and parties considering if a notification is required are the FTC’s formal interpretations, and the FTC PNO’s informal interpretations. Formal interpretations are statements by the FTC, usually published following court judgments and typically endorsed by the Assistant Attorney General in charge of the DOJ, pronouncing on the correct interpretation and treatment of certain situations under the HSR Rules. Informal interpretations are published in a database from the responses that the PNO gives to the thousands of emails it receives from practitioners and parties to transactions seeking guidance on the interpretation of HSR Rules. Many PNO responses and the original letter or email containing the fact-specific enquiry are available on the searchable database on the FTC website. (Other non-published responses may be obtained through Freedom of Information Act requests.) Although the FTC cautions that the informal interpretations only provide guidance from previous staff interpretations on the applicability of the HSR rules to specific fact patterns and should not be relied upon, they are nevertheless a good example of transparency within the U.S. agencies and provide additional certainty that the Rules will be applied consistently across transactions.

Further, the DOJ and FTC have issued joint Horizontal Merger Guidelines, providing details on the approach that the agencies take to analyzing transactions, including the evidence that the agencies consider when determining if a transaction will have adverse competitive effects, the approach that is taken to market definition and how unilateral and coordinated effects are analyzed, among other issues. The agencies have also issued Vertical Merger Guidelines, including proposed new guidelines. The published commentary also provides additional detail on the approach that the agencies will take to analyzing transactions, providing additional transparency on the process and the legal principles that are applied. The agencies also publish a number of model documents, giving greater visibility of what parties to transactions can expect at various stages.

Outside of engagement with the PNO and available resources, however, the procedure for entering into pre-notification discussions with the FTC or DOJ is more of a black box, as there is no guidance issued regarding engaging in pre-notification discussions. This does not provide much certainty to the merging parties in terms of the potential benefits of such discussions or how they would be conducted. Although in practice merging parties will often make a presentation to the FTC/DOJ once they have made the decision to file with the U.S. authorities, when or why the authorities would expect such a presentation is not made clear. Such lack of transparency in the pre-notification process means that consistency in treatment between transactions—beyond the interpretation of the Rules—is not guaranteed.

The FTC and the DOJ have also issued guidelines on negotiating merger remedies, which aims to answer questions that frequently arise and detail procedural information regarding divestitures and the timing for engaging in remedies negotiations. The FTC has also published a Remedies Study, reviewing merger remedies imposed from 2006–2012, with the aim of providing insight into the FTC’s remedies processes. The FTC is also going to update its Statement for Negotiating Merger Remedies in light of what has been learned from the report. Nonetheless, the agencies do not provide updates on the current progress of remedies negotiations during ongoing cases or precise implications on timing, and precise details of how remedies market testing is conducted are very limited. There is similarly limited visibility as to which stakeholders, if any, will be contacted.

Transparency of Information Shared During Investigation. The basic rule regarding confidentiality in the HSR Act is set forth in Section 7A(h) (15 U.S.C. §18a(h)), which provides that any information filed with the DOJ or FTC under the HSR Act shall be exempt from disclosure under the Freedom of Information Act and “no such information or documentary material may be made public, except as may be relevant to any administrative or judicial action or proceeding.” The FTC and DOJ have consistently taken the position that the statute therefore prohibits disclosure of even the fact of a filing because it is information filed with the DOJ or FTC pursuant to the HSR Act. Indeed, even the HSR form states that the “information and documentary material filed in or with this Form is confidential.” This means there is a ban on disclosing the details about the parties or the transaction.

Although this contrasts with the approach in the EU, this is a statutory prohibition over which the agencies have no discretion. Therefore, by extension, disclosure of any HSR notification and other confidential materials to other independent federal agencies or other non-U.S. competition authorities is precluded unless the parties sign a waiver. In practice, signing a waiver is commonplace and uncontroversial, particularly where it facilitates coordination between international competition authorities. However, when it comes to contacting third parties during the course of an investigation to elicit market and other information to aid the investigation, the DOJ and FTC are precluded from divulging confidential information but may disclose the transaction that they are investigating. Nonetheless, the fact that the HSR Act mandates that the fact of filing is kept confidential means that the role of third parties is more limited, as third parties are not easily able to make proactive submissions to the agencies and have to wait until the FTC or DOJ contacts them before being able to express their views on a transaction. Further, there is no published guidance on when the agencies will contact third parties, the nature of the questions that may be posed, or which third parties will be contacted.
**Transparency of Decisions and Agency Reasoning.**
There is little or no disclosure when the FTC or DOJ terminates an investigation (either following the initial 30-day waiting period, or following a Second Request). Generally, any such disclosure will only stretch to a short press release that the agency has cleared the transaction, even after a significant in-depth Second Request. Further, even the decision-making process at U.S. agencies is not transparent: the FTC does not publish a list of the votes taken by the Commission in a given year or how each Commissioner voted. The DOJ and FTC issue selective closing statements for a small number of in-depth investigations that do not result in a settlement or court action to explain the agency’s decision to close the investigation.

In addition to selected closing statements, the FTC and DOJ release information publicly on merger investigations in three other circumstances.

The first is under the statutory exception to the HSR Act non-disclosure rule for the fact of filing: Section 7A(B)(2). This notice requirement has been interpreted to apply to the early termination of the initial waiting period and the early termination of the waiting period after a Second Request. The FTC fulfills this notice requirement by publishing on its website and in the Federal Register the names of the acquiring parties, acquired parties, and acquired entities, and the date on which early termination of the waiting period has been granted.

Second, where cases are settled by consent of the parties (i.e., where the case requires a negotiated remedy to be approved by the agency but before any administrative or judicial complaint is filed), details of the consent resolution are published. At the FTC, settlements take the form of an order, agreed to by the parties and issued by a vote of the Commissioners. The order is first accepted as a proposed order and released to the public for comment along with a draft Complaint and an Analysis to Aid Public Comment. There is then a 30-day public comment period, after which the Commissioners vote on whether to issue the Final Order, renegotiate, or commence litigation. After the Final Order is issued, it is enforceable by the FTC through a lawsuit. All of the documents relating to the FTC settlements are available on the FTC website and give significant insight into the parties and markets concerned, market definition, entry conditions in the market and competitive effects of the acquisition.

At the DOJ, settlements are governed by the Antitrust Procedures and Penalties Act (the Tunney Act) and take the form of a proposed Final Judgment, which describes in detail the remedies agreed by the parties and DOJ, and which is filed with a federal district court. Along with the proposed Final Judgment, the DOJ files a Complaint, a Competitive Impact Statement and, typically, a stipulated Hold Separate or Asset Preservation Order. The Competitive Impact Statement describes the competitive harm expected from the proposed transaction and how the proposed Final Judgment remedies that harm. Following a 60-day public comment period, the DOJ may file responses to public comments, after which the court issues a ruling (in rare cases following a court hearing), as to whether the Final Judgment is in the public interest and, if so, the Final Judgment becomes an enforceable court order. All documents relating to DOJ settlements are also available on the DOJ website and provide significant public transparency into the parties and markets concerned, market definition, entry conditions in the market and competitive effects of the acquisition.

Third, and most commonly, significant information related to the DOJ or FTC’s investigation is published during any litigation where the DOJ or FTC is suing to enjoin the transaction. In lawsuits filed by private parties challenging a merger transaction, the parties’ premerger notification forms and other relevant documents submitted to the reviewing agency during the premerger review process may be requested directly from the filing parties in the ordinary course of discovery (subject to the ordinary rules of privilege and confidentiality under the Federal Rules of Civil Procedure, including Protective Orders).

As noted above the DOJ and FTC publish selected closing statements explaining the agency’s decision to close a merger investigation without a settlement or enforcement action. FTC action to issue a closing statement in these circumstances requires a vote of the commissioners, and commissioners who disagree with the decision to close the investigation may issue separate statements explaining their position.

There is therefore a notable lack of transparency regarding the reasoning given by the agencies for permitting a transaction following the termination of an investigation. Typically, there are several reasons cited to justify the reluctance of agencies to make any further disclosure.

1. As the agencies are required to sue to block transactions, it is these investigations that have the most useful precedent value as they are the most complex or controversial and therefore it is justifiable only to disclose details of cases which involve court-sanctioned consent orders or litigation.

2. Confidentiality can be crucial for reaching consensus with the parties, and also ensures that there is no excessive, or poorly implemented, disclosure which could harm both the parties involved and the agencies.

3. Further disclosure of the agencies’ reasoning could make it more difficult to win court cases in the future because the agencies would have to explain why one deal was approved but another (potentially on similar facts) was blocked. The frequently cited example of such concerns is the Office Depot/OfficeMax case of 2013, and the subsequent Staples/Office Depot case in 2016. In Office Depot/OfficeMax, the FTC issued a three-page closing statement explaining the rationale for approving the deal, including reasoning around customers having multiple potential suppliers for office supplies so the merging par-
ties were not each other’s closest competitors.31 When the FTC challenged the *Staples/Office Depot* case in court three years later, the merging parties used the 2013 closing statement to attack the FTC and said that the same factors, including multiple suppliers like Amazon, continued to apply.32 Although the FTC was able to fight off the attack and the court granted a preliminary injunction, many still argue that such burdens should not be borne by the authorities in court.

(4) The cost and burden is not warranted to issue published statements for routine merger investigations that are closed without a settlement or enforcement action, given the relatively large number of such investigations (e.g., for fiscal year 2018, HSR filings were made for 2,111 transactions and the reviewing agency issued a Second Request for 45 of these transactions33). Despite the cost and burden to the DOJ and FTC, there may be benefits to merger parties, industry members, and the public that warrant more frequent and detailed published statements explaining closed merger investigations. The guidance in these statements: (1) may enable merger parties to structure transactions and propose remedies that avoid protracted court challenges, (2) help industry members to better focus their engagement with the merger review process for future transactions, and (3) provide greater insight about agency decision-making to members of the public (including legislators, state enforcers, practicing/academic economists, and other interested parties).

**Transparency in Chinese Merger Enforcement**

The Antimonopoly Law of the People’s Republic of China (AML) is the legal basis for Chinese merger control. In 2018 the State Administration for Market Regulation (SAMR) was officially inaugurated as the new regulatory authority consolidating the antimonopoly responsibilities of the National Development and Reform Commission, the Ministry of Commerce (MOFCOM), and the State Administration for Industry and Commerce.

A concentration triggers a filing requirement to SAMR if certain turnover thresholds are met. After receipt of the notification, SAMR makes supplemental information requests to the merging parties. The clock for review will not start to run until SAMR declares the materials and information submitted by the merging parties to be complete and formally accepts the case. SAMR then has 30 calendar days for an initial assessment of the merger. If SAMR cannot clear the merger (either unconditionally or conditionally with remedies) within this initial investigation period, it can initiate a more in-depth review, which may take up to 90 calendar days. The in-depth investigation can be extended for a further 60 calendar days in exceptional circumstances or with the parties’ consent. However, some conditional clearance decisions show that SAMR can in practice take a longer time than the maximum statutory review period of 180 days to finish the review. Following the in-depth investigation, SAMR will either clear the transaction (unconditionally or subject to agreed remedies) or prohibit the transaction.

Following SAMR’s decision to prohibit a transaction, parties to the transaction or interested parties can appeal the decision. Appellants must first apply to SAMR for an “administrative reconsideration,” after which, if the appellants object to the reconsideration decision, appellants may lodge an administrative lawsuit.

**Transparency of Jurisdictional Standards, Pre-Notification and Notification Procedures.** In 2018, SAMR published a set of Guiding Opinions on its merger review process, including the Guiding Opinion on the Notification of the Concentration of Undertakings, which includes some welcome transparency on the jurisdictional thresholds for notification in China. In other respects, guidance by the Chinese authorities around jurisdiction remains opaque, notably around the meaning of “control” and the investigation of transactions falling below the jurisdictional thresholds.

It is possible for parties to apply for pre-notification guidance from SAMR, particularly where clarification is required on a particular substantive or procedural aspect of the filing. However, there is very little information in the public domain regarding the process for obtaining pre-notification guidance. Moreover, the fact that parties are seeking pre-notification guidance is not made public, and typically not confirmed by the authority even if the transaction is already public knowledge, thus limiting the role that third parties can play at this stage of the process. Pre-notification is therefore much more of a black box, both from the parties’ and third parties’ perspectives.

The AML (Article 27) outlines the factors that SAMR will consider when analyzing a transaction (including, for example, market shares of the relevant undertakings, impact of the concentration on market entry and technical progress, and impact on the national economy). This provides additional detail to merging parties regarding the enforcement considerations of SAMR.

There is also some recent additional transparency around the process for submitting remedies proposals during an investigation. SAMR published the Trial Provisions on Imposing Restrictive Conditions on Concentration of Undertakings (Trial Provisions). The Trial Provisions outline a basic structure and aspects that should be followed or covered by remedies. These guidelines also provide important details to both merging parties and practitioners regarding SAMR’s approach and the expected procedure for submitting remedies. Nonetheless, there is much less transparency during the process of submitting and negotiating remedies in China: SAMR does not publish any timing updates or details of the remedy negotiations occurring in any particular cases. SAMR will market test satisfactory remedy proposals by sharing a non-confidential version with third parties. However, the exact timing and progress of remedies negotiations in ongoing cases remains quite opaque for third parties, merging parties, and practitioners.
Transparency of Information Shared During Investigation. The amount of information shared with third parties during a merger investigation is limited. Third parties in China do not have a statutory right to access merger control files but they can (and do) proactively challenge mergers at any stage of the process of review.

If the merger is subject to the simplified procedure, SAMR will release a Public Notice Form introducing the case on its website, which will remain on the website for a period of 10 days, during which time any third party can submit written comments, including regarding whether or not the case should be a simple case, providing relevant evidence. Outside the simplified procedure, SAMR may seek opinions from third parties with respect to the proposed acquisition, although no confidential information is disclosed to third parties without the prior approval of the notifying parties. There is no formal equivalent announcement for such cases, and under either procedure it is not possible for the merging parties to learn the identity of third parties with which SAMR is consulting.

SAMR has enhanced its cooperation with antitrust authorities in other jurisdictions. Due to the restriction on information sharing from the Guiding Opinion, the parties must sign a waiver before SAMR will discuss any confidential information relating to a transaction with other antitrust authorities, as is standard practice in other jurisdictions. SAMR does cooperate and actively communicate with its international counterparts on an investigation, and not only does it consult with the Commission, other Asian antitrust authorities, and the agencies in the U.S. on key aspects of merger control, but also agencies in other jurisdictions such as Turkey where there are points of common interest (e.g., remedies).

Transparency of Decisions and Agency Reasoning. In China, until recently, SAMR and its predecessor MOFCOM only published an extremely limited set of decisions, namely prohibitions and conditional clearances (which are required by the AML). However, there has been a gradual increase in transparency.

First, recent decisions provide more detailed comments that address both issues of procedure (recounting the procedure, as well as the consultation process leading to the identification of competitive concerns and adequate remedies), and of substance (relevant market definition, competitive assessment, market entry). This trend demonstrates an effort to communicate more on SAMR’s internal processes, as well as to anchor decisions in clear competition concerns using recognized substantive assessment tools, and resulting from a consultation with relevant parties.

Second, SAMR has been increasing transparency and communication of unconditional clearances. In November 2012, MOFCOM announced that it would be publishing a quarterly update on transactions that it has conditionally cleared, which commenced in January 2013. In May 2019, SAMR switched to publishing lists of mergers cleared unconditionally on a monthly basis and SAMR then switched in June 2019 to publishing weekly updates on conditional clearances. SAMR has continued to publish weekly updates ever since. The list only provides basic information about each transaction, namely the parties’ names, the type of transaction, and the clearance date. Nevertheless, it is a positive step and reveals SAMR’s resolve to communicate more extensively with stakeholders. It also validates some previously unconfirmed interpretations of the law and its implementation.

However, it remains the case that SAMR does not publish full text decisions of unconditional clearances, nor does it publish any details of non-simplified case timelines. Moreover, decisions (or reasoning) to refer a transaction for an in-depth investigation are not publicly announced.

Increased Transparency in Merger Control Reviews: Who Wins? It is clear from the above discussion that the levels of all three components of transparency differ across the three jurisdictions. When it comes to transparency about reportability of a transaction and the approach that the competition authority will take, the U.S. agencies come out as some of the most transparent, particularly due to the extensive publications and established process of answering informal questions by the FTC PNO. However, when looking at transparency of information shared during investigations and transparency of authority decisions, the European Commission appears as the gold standard, particularly due to the reasoned decisions that are published even if a transaction is cleared after the initial Phase 1 investigation. Even in China SAMR publishes minimal factual statements transactions cleared at the first phase. This is notably different than the practice in the United States, where no decision is published, except for limited information that is published when early termination of the HSR waiting period is granted, and more detailed and substantive information that is published pursuant to statutory requirements for merger investigations that are resolved through a consent order or consent decree. In merger cases that the U.S. agencies litigate in court (or that FTC enforcement staff litigate in FTC administrative proceedings), a full litigation file is available for public review, subject to any materials that are kept under seal to protect trade secret and confidential information.

Several practical arguments against increasing transparency are often raised. Most frequently, the concern that is expressed is that the financial and human resource burden on the agencies will increase significantly if agencies are required to publish fully reasoned decisions. By way of comparison of their relative caseload in the EU as of December 2019, 382 cases were notified to the Commission, with 9 cases referred to Phase 2, resulting in 9 Phase 2 decisions, including 3 prohibitions.

In China, in 2019, 432 filings were reviewed, with 427
unconditional clearances and 5 conditional clearances; and

- In the U.S. in (fiscal year) 2018, 2,111 transactions were notified, for which 45 Second Requests were issued, the DOJ challenged 17 cases (filing 9 complaints in U.S. District Court, and in 8 cases filing settlement papers simultaneously), and the FTC challenged 22 cases (with only 5 leading to administrative or federal court litigation).

There are also concerns that publishing more decisions would make it more difficult to win future litigation, or put an additional burden on authorities to justify why one case was subject to in-depth investigation when another was cleared unconditionally.

Nonetheless, increasing transparency in merger control reviews brings multiple benefits:

- **Improving pre-decision process and results:** For merging parties, it allows them to foresee how the authority will review their transaction, both procedurally and substantively, based on past precedent. This increases predictability and efficiency in transaction planning, as well as the knowledge of when and which third parties the authorities will contact and when third-party views will be taken into account in the process. It also creates an incentive for the authority to refine its fact-gathering and deliberating process before a decision is reached, because decision-makers will know that their conclusions will be open to scrutiny.

- **Increased third-party involvement:** For third parties, it allows them to see which transactions are being investigated, and when, therefore, it may make sense to send proactive comments. Transparency as to which issues the authority is looking at encourages the third parties to target the information they provide appropriately and make a more meaningful contribution, and it allows third parties to both protect their own interests and give the authorities better insight into the market.

- **Fostering agency accountability:** An explanation as to how particular decisions have been reached enables a meaningful performance check. If the authority is aware that its decisions will be scrutinized, this creates an incentive to ensure they are robust. Transparency also allows third parties and the merging parties the opportunity to challenge the conclusions of the authority and therefore discover any mistakes that may have been made and potentially change procedure and reasoning in future cases.

- **Enhancing knowledge of and confidence in the authorities and the law:** Finally, making more information available about the merger review process also clarifies policy and increases public confidence in the authority and the law. It can also help shape future enforcement policy.

With this in mind, one might expect that all agencies would aim for the maximum level of transparency possible. Indeed, these principles are enshrined in the ICN’s Recommended Practices for Merger Notification and Review Procedures.36

**How Can We Move Transparency in Merger Control Forward?**

Enforcement agencies may consider options within their control (i.e., without changes in controlling statutes and treaties), to increase three components of transparency.

In the United States, the lack of published guidance where a case ends in a terminated investigation (either after the initial 30-day waiting period or a Second Request), and does not proceed to a court-sanctioned consent order or litigation, is one of the most notable absences of transparency outlined above. Although the U.S. agencies deal with a larger number of notified transactions than either the European Commission or SAMR, they could adopt an approach similar to that of SAMR and limit publicity to very minimal factual statements for transactions cleared at or before the initial 30-day waiting period and publish more detailed factual statements where there was more intervention, in the case of a Second Request. In each situation, authorities could also allow parties to have the option to make representations regarding the confidentiality of the transaction before the publication of a notice (for example, in cases where a filing has been made based on a good faith intention to complete the transaction). These limited steps should not create the concerns seen in Staples/Office Depot nor create undue confidentiality concerns, but would dramatically increase the accountability of the agencies and the ability for third parties to participate fully in the process.

As regards the level of information shared during an investigation, in both the United States and China there is limited visibility over which third parties are contacted, and no access to submissions or responses to questionnaires that they submit to the authorities. This lack of access to file materials in the United States at the initial stages of the investigation (before litigation commences, if any), and in China, means that the ability of parties to the transaction to adequately rebut third party submissions can be reduced.

It is notable that reform around transparency in multiple jurisdictions has been investigated in the past,37 and, in particular, there have been numerous calls in the academic community for increased transparency in the decisions made by the U.S. agencies.38 SAMR’s ongoing publication of further guidance and changes to improve transparency in Chinese merger control is a step in the right direction. For the United States, it is hoped that the current DOJ administration will step beyond the current proposed reforms, which only involve releasing statistics about the duration of reviews, and publishing more guidance for merging parties.39

**Conclusion**

An increase in all three components of transparency brings significant benefits to competition law procedures. Competition authorities are seeking to promote competition; merging parties need certainty and procedural fairness; third parties are keen to express their views on pending merger reviews, and to know how future cases in the industry will be
dealt with; and practitioners want to be able to advise clients effectively with a significant degree of certainty around past cases and authority procedures.

Transparency brings such benefits. It can also pose difficulties, including the potential for increased workload and scrutiny for authorities. Nonetheless, the benefits of increasing all three components of transparency appears to outweigh such burdens, particularly in an era when antitrust is gaining more political traction and media attention.

The differing levels of transparency that merging parties, third parties, and practitioners experience in the EU, United States, and China, particularly when it comes to the publication of decisions and details of an authority’s reasoning, demonstrates that the arguments against increasing transparency are not universally agreed. This reform should come about in the form of the publication of (at least) basic details of authorities’ decisions not to challenge transactions, as well as the continued publication of additional information of those cases subjected to additional scrutiny (in cases of remedies or litigation), and increasing the merging parties’ access to the file during in-depth investigations.

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2 Consolidated Version of the Treaty on the Functioning of the European Union art. 296, 2012 O.J. (C 326) 47, 175 [hereinafter TFEU] requires that the Commission state the reasons for which its acts are based, and Article 297 TFEU requires that regulations, directives, and decisions of the Commission be published.


8 EUR, COMM’N, MERGER REMEDIES STUDY (2005).

9 See, e.g., Case C-265/17 P, Comm’n v. United Parcel Service, ECLI: EU:T:2019:23 (Jan. 16, 2019), affg T-194/13, United Parcel Service v. Comm’n, ECLI:EU:T:2017:144 (Mar. 7, 2017) (holding that the Commission had to disclose the methodology and further details of its econometric analysis model that had been previously withheld in the decision provided to the merging parties. The Court particularly stated: “The methodological basis underpinning those models must be as objective as possible in order not to prejudice the outcome of that analysis one way or another. Accordingly, those factors contribute to the impartiality and quality of the Commission’s decisions, which, ultimately, is the basis of the trust that the public and businesses place in the legitimacy of the EU’s merger control procedure.”).


13 Fed. Trade Comm’n Informal Interpretations of HSR Act Rules (last visited Jan. 19, 2020), https://www.ftc.gov/enforcement/premerger-notification-program/informal-interpretations. The PNO has also recently begun to post newly issued informal interpretations in which the PNO has changed its position from previously issued interpretations.


24 FTCWatch, U.S. Among The World’s Most Secretive Antitrust Jurisdictions (Feb. 21, 2019).

25 For the DOJ, see https://www.justice.gov/atr/public/guidelines/201888.pdf (DOJ guidelines for issuing closing statements on antitrust investigations, including merger review); https://www.justice.gov/atr/closing-statements (links to access DOJ closing statements, including 13 for merger investigations dated 2010 of later). The FTC website does not include a similar link to access all closing statements, which require a majority vote.

26 See 16 C.F.R. § 803.11(c) (providing for early termination).
30 See supra note 25.

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Antitrust Covenants in the Spotlight Following Recent Failed Mergers

BY KAREN KAZMERZAK, JAMES W. LOWE, AND JOSEPH V. CONIGLIO

When the consummation of a transaction is subject to regulatory clearances or shareholder approvals, merging parties must allocate the risks created by these conditions precedent as part of their broader merger negotiations. Risk allocation clauses can create hazards for both buyers and sellers in transactions with material antitrust issues. In practice, merger agreements among competitors can leave one or both parties exposed if the deal fails to receive antitrust clearance. Although sellers may prefer provisions that place more of the antitrust clearance risk on the buyer, and vice versa, the language on which the parties ultimately agree will depend on their relative bargaining positions, priorities, and perceptions of the risk of failing to obtain clearance.

Sellers may be able to obtain antitrust protection in the agreement for a number of reasons: it may have a particularly valuable business or set of assets, its combination with the buyer may offer substantial synergies, or it has other proposals that offer greater certainty of close relative to the proposed buyer. In other instances, the parties may agree to allocate the clearance risk to the seller if the buyer is willing to offer a higher purchase price or if the seller has few or no other options. Just as the bargaining dynamics between a buyer and seller inevitably vary by transaction, there is no “one size fits all” approach for allocating antitrust risk.

Recent Delaware Chancery Court litigation following four failed, antitrust-sensitive mergers highlight these risks. After failing to receive antitrust clearances, the antitrust efforts covenants in the Anthem/Cigna and Sinclair/Tribune merger agreements have been front and center in the parties’ disputes. The Fresenius/Akorn dispute was over whether Akorn suffered a material adverse effect that would allow Fresenius to be free of its obligation to consummate the transaction. And the Vintage/Rent-a-Center dispute addressed whether a party’s actions in pursuit of antitrust clearance could serve as the required notice to extend the outside date. These cases demonstrate the importance of counseling clients on their exposure related to these provisions and advising them on compliance once the deal is signed.

Key Antitrust Covenants

For antitrust practitioners, the key areas of risk that could thwart consummation often include feasibility of securing antitrust clearances with or without remedial conditions and the time or legal process (e.g., Second Request, litigation) necessary to address those hurdles. Parties allocate these antitrust risks using several merger agreement provisions. For example, the regulatory efforts covenant can detail the actions each party must take to receive the required clearances, including the obligation to litigate. This provision is often closely tied to other provisions, such as the general material adverse change (MAC) or material adverse effects (MAE) clause (terms often used interchangeably), which can serve as a cap on the obligations necessary to receive clearance. The termination or outside date clause often allows a party to abandon the transaction if the required clearances are not received within a set period. In certain antitrust-sensitive transactions, a buyer may also agree to pay the seller a reverse termination fee if clearances are not received by the time one or both parties terminate the agreement.

The Efforts Clause. Antitrust attorneys will often advise on the efforts a party will agree to undertake to receive antitrust clearance. This clause contains a number of elements that the parties use to allocate risk based on a standard hierarchy of effort.

- **Best efforts**: the highest standard, requiring a party to do essentially everything in its power to fulfill its obligation (for example, by expending significant amounts or management time to obtain consents).
- **Reasonable best efforts**: somewhat lesser standard, but still may require substantial efforts from a party.
- **Reasonable efforts**: still weaker standard, not requiring any action beyond what is typical under the circumstances.
- **Commercially reasonable efforts**: not requiring a party to take any action that would be commercially detrimental, including the expenditure of material unanticipated amounts or management time.
Good faith efforts: the lowest standard, which requires honesty in fact and the observance of reasonable commercial standards of fair dealing. Good faith efforts are implied as a matter of law.1

Although deal practitioners may generally follow these standards when drafting, “[c]ommentators who have surveyed the case law find little support for the distinctions that transactional lawyers draw.”2 Indeed, the Delaware Chancery Court does not distinguish between “commercially reasonable efforts” and “reasonable best efforts,” and has noted that even “best efforts” is qualified by a reasonableness test.3 Under Delaware law, to determine whether a party has satisfied the “reasonable best efforts” clause (which may also sweep in commercially reasonable efforts and best efforts), the court looks at “whether the party subject to the clause (1) had reasonable grounds to take the action it did and (2) sought to address problems with its counterparty” before filing suit.4

In addition to assigning an efforts level, in drafting such clauses, counsel may explain in varying amount of detail what actions each party must take to attempt to receive clearance. The parties often do not provide much detail about the required undertakings for a transaction unlikely to receive significant scrutiny but may include more elaborate provisions for antitrust-sensitive matters. These provisions often include detailed requirements for how each party’s counsel must cooperate with the other. The parties may also identify which party controls the strategy and include a timeline each party must follow to meet certain milestones (e.g., filing a notification within a specific number of days after signing or complying with a Second Request within a set time period after issuance).

Parties may also allocate antitrust risk by agreeing to a certain level of commitment each party must undertake in furtherance of clearance. For example, a buyer may agree to make best efforts to take all measures necessary, proper, or advisable to receive the required clearances. A provision containing these agreed-to actions without any caveats is commonly known as a “hell-or-high-water” covenant because the buyer assumes all antitrust risk by agreeing to do everything necessary to remove antitrust impediments. In other words, the hell-or-high-water obligation has no defined limit on what the buyer must do to close the transaction.

A buyer is unlikely to accept this level of risk without first seeking input from antitrust counsel as to the likely antitrust outcomes. An educated buyer may take that risk in exchange for better bargaining leverage on other covenants that it believes pose higher exposure. The buyer may also agree to the hell-or-high-water covenant if it thinks that is necessary to be selected as the superior proposal among multiple competing offers.

Alternatively, a buyer may seek to cap what it would need to undertake to satisfy its antitrust efforts obligation. Common caps include limitations on the remedies a buyer must agree to accept to receive clearance, such as a modified hell-or-high-water covenant that expressly states that the buyer will take all measures necessary, proper, or advisable to receive clearance except for making divestitures exceeding a certain value. Other provisions in the agreement may expressly disclaim either party’s requirement to engage in litigation to defend it.

Although parties utilize the efforts clause to allocate and clarify antitrust risks, specificity has its own risks. Because the merging parties produce a copy of the agreement to the antitrust agencies as part of their filing, specific provisions allocating antitrust risk may not only flag for the agencies that the parties perceive a potential antitrust risk, but also indicate how far they are willing to go before dropping the deal. As a result, some practitioners advise against detailing the obligations to avoid the chance that, in some circumstances, it could increase the overall risk of an agency investigation, challenge, or demand for settlement.5 This sometimes results in the parties relying on an MAE provision to limit exposure.

The MAE Clause. Parties negotiating a merger agreement often rely on an MAE provision to allocate the risks that arise between the signing and close of a transaction. Unless otherwise defined, an MAE refers to a sustained and severe business decline in the seller’s business during that interim period. The seller’s value may deteriorate despite its efforts to run the business in the ordinary course, including because of the uncertainty on the future of the business created by the pending transaction. In the event that the seller suffers an unforeseeable and very significant business decline that materially impairs its value, the buyer can use an MAE clause as a contractual out.

In the past, MAEs were boilerplate provisions that left out details necessary to determine which party bore important risks.6 Parties generally understood this clause to cover unforeseeable business risks, such as increased competition eroding the target’s margins or unanticipated unfavorable legal or regulatory action. This had the effect of permitting the buyer to rescind its agreement with the seller upon “any change, occurrence or state of facts . . . materially adverse to the business, financial condition, or results of operations”7 of the seller. Although parties today pay significant attention to the MAE provision, merger agreements still typically do not define what is “material.” This is likely because it can create opportunities to renegotiate the agreement or because attempts to define it can create more problems in the negotiations or subsequent litigation.8

In addition to the general MAE clause that limits a buyer’s overall risk, parties may use an MAE clause to cap the antitrust risk or use a variant that caps the divestitures as an MAE of the post-merger combined business. A cap tied to an MAE avoids specifying for agencies what the parties have agreed to undertake, but it has its own traps because of the ambiguity around what qualifies as an MAE.

The Termination Clause, Outside Date, and Antitrust Break Fees. These three clauses are equally important, but sometimes overlooked. The parties must close by a date certain as defined by the merger agreement’s outside
date. If a party fails to meet its closing conditions by that outside date, the other party may terminate the transaction and potentially recover a fee from the breaching party. Because antitrust-sensitive transactions can take several months to resolve, a party must factor in timing that allows for those clearances. Each party faces exposure if the outside date allows for a lengthy period between when they sign and ultimately close. The seller may face a declining business because of the uncertainty caused by the transaction, while the buyer may have financing secured only for a limited time. But a party also faces risk if the parties’ transaction has not been cleared by the outside date.

The outside date works closely with the termination clause. A party may terminate the transaction upon the occurrence of certain events outlined in the termination clause. For example, a party may have the right to terminate if the counter party fails to obtain termination of the mandatory Hart-Scott-Rodino (HSR)9 waiting period or other antitrust clearance by a certain date. A party might also negotiate for the right to terminate if the antitrust agency issues a Second Request, challenges the transaction, or has won (and the parties have lost) a final, non-appealable judgment. Parties frequently mitigate some of the risks by allowing either party or requiring both parties to agree to extend the outside date, usually for a set period, if antitrust clearance is still outstanding.

In certain antitrust-sensitive transactions, a buyer may also agree to pay the seller a reverse termination fee if antitrust clearances are not received by the time one or both parties terminates the agreement. This fee may provide an incentive to a risk-averse seller to enter into an antitrust-sensitive transaction and, if properly drafted, limit the buyer’s liability for the failed transaction to that fee. A buyer may also benefit from a reverse-break fee by, for example, allowing the buyer to choose to pay the fee rather than agree to a burdensome remedial order.

Recent Litigation over the Efforts Clause

The Anthem/Cigna Efforts Clause. In July 2015, Anthem entered into an agreement to purchase Cigna for more than $54 billion. The parties were well aware of the antitrust risk associated with combining two of the four national health insurers, and the merger agreement reflected this risk. Both parties agreed to undertake “reasonable best efforts” to take “any and all actions necessary” to satisfy antitrust concerns, unless doing so would result in an MAE.10 In other words, the parties agreed to a hell-or-high-water covenant subject to an MAE exception. The agreement included a $1.85 billion reverse termination fee that Anthem would owe to Cigna if Anthem failed to attain regulatory approval by the outside date so long as Cigna had not willfully breached its obligations.11

The United States—joined by 11 states and the District of Columbia—challenged the merger and, in February of 2017, the district court ordered a permanent injunction.12 Anthem appealed, but shortly thereafter Cigna sent its notice of intent to terminate the agreement and sued Anthem. In its complaint, Cigna alleged that Anthem engaged in numerous breaches of its antitrust efforts obligations with the aim to disadvantage Cigna as a competitor.13 Anthem filed its own suit, alleging that Cigna violated its best efforts obligations by: (1) refusing to assist Anthem’s efforts to secure clearance from DOJ without litigation; (2) thwarting the parties’ settlement opportunities with DOJ; and (3) failing to defend the merger before the DOJ, at trial, or on appeal.14 Cigna subsequently rebutted Anthem’s characterizations of Cigna’s breaches and explained that Anthem began building a record to avoid paying the reverse termination fee once it realized that the deal would not receive clearance.15 Cigna also asserted that, even if it had breached, its breach did not materially contribute to the failure of the merger.16

As of the time this article went to print, the Chancery Court had yet to rule on any of the claims and had urged the parties to settle their dueling lawsuits. If the case is tried rather than settled, the decision promises to be instructive in specifying what satisfies the antitrust efforts obligations in an antitrust-sensitive merger. Possible outcomes include:

1. Cigna’s breach was not material to the outcome. The court could avoid ruling on whether Cigna breached its best efforts obligation by finding that, even if Cigna did breach, its breach did not materially contribute to the failure of the merger. The court could look to the fact that both the DOJ and the district judge had available all relevant facts and materials necessary to determine whether the merger was likely to be anticompetitive. The court could conclude the outcome would have been the same regardless of whether Cigna breached.

2. Cigna’s breach was material to the outcome. The court could find that Cigna’s actions constituted a material breach. This could provide insights for future sellers about the level of cooperation required in supporting a buyer’s regulatory strategy, even where the seller may disagree with the benefits of it.

3. Cigna did not breach. The court could find that Cigna did not breach its agreement. Such an outcome would indicate that where a party has a legitimate strategic dispute, or where it perceives that certain actions could harm its business image and the procompetitive rationale for the transaction, it would not be compelled to act under a “reasonable best efforts” standard.

The Sinclair/Tribune Efforts Clause. Tribune also relied on an efforts clause breach in its claim against Sinclair stemming from the failed Sinclair/Tribune transaction. In May 2017, Sinclair agreed to purchase Tribune for approximately $3.9 billion. Both firms compete for broadcast television advertising in certain geographic markets, with Sinclair allegedly owning the largest number of local television stations of any media company in the United States.17

As the parties purportedly enjoyed a duopoly in several geographic markets and exceeded the Federal Communica-
Although an integral part of merger agreements, significant ambiguity has remained as to how, precisely, to define an MAE, and thus how to define a regulatory efforts clause capped at an MAE.

In particular, Sinclair allegedly failed to offer divestitures after the agencies made it clear what would be required to obtain a settlement. Sinclair’s alleged failure delayed DOJ clearance and also led the FCC in July 2018 to order a hearing to evaluate the legality of the deal under the Communications Act, which Tribune characterized as a “de facto merger death sentence.” In August 2018, Tribune terminated the transaction and sued Sinclair for breaching the agreement’s regulatory best efforts covenants.

In its answer, Sinclair argued that its obligation to use reasonable best efforts was not limitless. First, it was not obligated to undertake any divestitures unless required to obtain clearance from the DOJ and FCC. Second, having control of the regulatory strategy did not make it a guarantor of the regulatory outcomes.

Because the parties ultimately settled the dispute out of court in January 2020, we must wait for another dispute to shed light on what actions a buyer is required to undertake in a merger investigation and whether a reverse break fee can constitute a complete remedy for breach.

The Fresenius/Akorn Efforts Clause. The parties’ primary dispute was over the MAE clause; however, the Chancery Court also analyzed whether Fresenius breached its hell-or-high-water regulatory covenant to take all actions necessary to secure clearance and not take any action that could be expected to hinder or delay it.

This issue arose in the context of Fresenius’s pursuit of a divestiture proposal that would satisfy the FTC’s concerns over the competitive overlap in sterile-drug manufacturing. Fresenius pursued in parallel two proposed divestiture packages to address FTC concerns with different projected clearance timelines. For about a week, Fresenius adopted the proposed strategy that could have delayed clearance by two or more months relative to the other proposal. Although Fresenius’s adoption of that proposal technically breached the covenant because the action could reasonably be expected to delay HSR clearance, the court determined that it was not material because Fresenius quickly switched over to pursuing the faster-track divestiture proposal and still positioned the parties to close within the original outside date.

This decision offers some guidance as to circumstances that would not be considered a breach. For example, a party’s pursuit of two divestitures packages in parallel is not a breach nor is its pursuit of a divestiture package that could delay timing if pursued briefly and it has no apparent affect on timing. Besides offering that a few months’ delay in clearance could be a material breach, the court did not address what other strategies a buyer may take that could trigger a breach.

Recent Litigation over the MAE Clause

Although an integral part of merger agreements, significant ambiguity has remained as to how, precisely, to define an MAE, and thus how to define a regulatory efforts clause capped at an MAE. The Chancery Court’s 2001 In re IBP decision sets out the basic framework for evaluating whether an MAE has occurred. It involved the proposed acquisition by Tyson Foods, the nation’s largest chicken distributor, of IBP, the nation’s largest beef and second-largest pork producer. Tyson alleged two grounds for an MAE: (1) IBP was the subject of a costly SEC accounting-fraud investigation; and (2) IBP’s business was unlikely to meet financial projections it had provided to Tyson pre-signing due to a severe winter that increased its costs and generally poor economic conditions. Though it agreed that the accounting fraud represented the sort of foreseeable and deal-specific risk typically allocated to sellers, the Chancery Court found that industry-wide supply shocks and the SEC investigation were not sufficiently material to trigger the MAE provision.

IBP left open what benchmark should be used in evaluating long-run harm to the target’s business, as well as which fiscal periods should be compared when measuring earnings.

The Chancery Court addressed both of these open questions in its 2008 Hexion decision. Hexion, the world’s largest producer of binder, adhesive, and ink resins for industrial applications, agreed to purchase Huntsman Corporation, a manufacturer of polyurethanes and other chemical products, for $10.6 billion. Here, too, the acquisition raised antitrust concerns, with the FTC requiring divestitures. Subsequent to signing the agreement, Huntsman suffered a considerable decline in its business due to both increased crude and natural gas prices and the beginnings of the global financial crisis.
Hexion sought to get out of the deal, alleging that Huntsman had suffered an MAE. Recognizing the holding in IBP that industry-wide supply shocks would effectively be allocated to the buyer and not constitute an MAE, Hexion argued that an MAE arose from Huntsman being disproportionately adversely affected by the economic headwinds relative to other chemical manufacturers—a carve-out that it had specifically bargained for in the merger agreement.

Even though Hexion had carved out this risk from the MAE, the Chancery Court nonetheless found in favor of Huntsman, holding that its decline was not large enough to constitute an MAE. The Chancery Court held that no MAE could have occurred, as Huntsman’s 2009 projections would represent a mere 3.6% decrease in EBITDA from 2006 to 2009 and were “essentially flat from 2007 to 2009.”

Although it found that Huntsman’s decline was not sufficient to meet the threshold for materiality, the Chancery Court failed to clarify what level of decline would constitute an MAE.

The Chancery Court would resolve this last lingering issue in its 2018 Akorn, Inc. v. Fresenius Kabi AG, Inc. decision. For the first time, the court found that a seller had suffered an MAE that would permit a buyer to avoid its obligation to close. Fresenius, a German pharmaceutical company, sought to acquire Akorn, an American pharmaceutical company, for approximately $4.5 billion. After signing the merger agreement, Akorn’s business declined markedly as a result of increased competitive pressure, loss of customers, and delayed product launches. Akorn also faced regulatory challenges, including a complete response letter from the Food and Drug Administration that delayed launch of a new product, as well as whistleblower allegations sent to Fresenius questioning Akorn’s representations that it was complying with applicable FDA regulations. The parties’ attempts to investigate and resolve these issues ultimately broke down, with Fresenius filing suit alleging, among other things, that Akorn had suffered an MAE.

The Chancery Court analyzed whether Akorn suffered an MAE in two parts. First, the Chancery Court analyzed materiality. Without providing a definite threshold, the Chancery Court indicated that a 40 percent decrease in profits over a relevant time period would be presumptively material. Following Hexion, the Chancery Court noted that Akorn’s EBITDA declined by 51 percent from 2016 to 2017 and that the decline “can reasonably be expected to have durationally significant effects.”

Having found that Akorn’s decline was material, the Chancery Court next considered whether it stemmed from a risk allocated to Fresenius or Akorn. Over the objections of Akorn, the Chancery Court found that the cause of Akorn’s EBITDA decline was not “industry headwinds” allocated to Fresenius, but business risks allocated to Akorn—namely, “unexpected new market entrants who competed with Akorn’s three top products.”

The Chancery Court also considered whether Fresenius had assumed this risk by virtue of the fact that these business risks were foreseeable. Although the Chancery Court concluded that Fresenius had not foreseen Akorn’s decline, it added that, even if Fresenius had, the agreement allocated these business risks to Akorn.

The Fresenius decision provides practitioners with a helpful general framework for finding an MAE. First, the Delaware courts will ask whether a given decline in the target’s business is material. To assess materiality, Delaware courts will look at changes in the target’s EBITDA on a year-to-year and quarter-to-quarter basis. As to the diminution in value sufficient to constitute a presumptive MAE, declines in EBITDA below 15 percent appear not to be material per se, whereas a 20 percent decline could be sufficient to meet the threshold for presumptive materiality.

Second, if the reduction is material, Delaware courts will next consider whether the merger agreement allocates the cause of decline to the buyer or the seller. As a default rule of construction, Delaware courts appear to understand the standard MAE clause to allocate economy or market-wide risks to the buyer. As the Chancery Court explained in Fresenius, both IBP and Hexion held that buyers could not rely on the “manifested consequences of widely known systematic risks”—even though in IBP, unlike Hexion, these risks had not been expressly carved out and assigned to the buyer. As a further default rule, Delaware courts will allocate more deal-specific business risks to the seller.

Finally, the Delaware courts will look to see whether the parties have contracted around this default risk allocation. The Fresenius court clarified that certain arguments will not avail a seller when attempting to shift a deal-specific risk to a buyer after the fact. Specifically, that a given deal-specific risk is foreseeable does not mean it will be allocated to the buyer—potentially a change from the traditional understanding of MAE provisions. As the Fresenius court stated, had the parties wished to define an MAE as “including only unforeseeable effects, changes, events, or occurrences” they could have done so in the merger agreement. If a buyer wishes to place an economy- or market-wide risk on the seller, or the seller a deal-specific risk on the buyer, each will have to bargain for it in the merger agreement. Deal planners and their attorneys must act accordingly.

Recent Litigation over the Outside Date and Reverse Termination Fees

The outside date and antitrust reverse termination fees have also recently received scrutiny in litigation regarding Vintage’s attempted merger with Rent-a-Center for $1.36 billion. Rent-a-Center, the seller, exercised its option to terminate the merger agreement upon reaching the outside date and demanded its termination fee. The parties had agreed to use commercially reasonable efforts to obtain HSR clearance. Vintage also had agreed to pay Rent-a-Center a $126.5 million reverse termination fee if clearance was still outstanding by the outside date—set for six months from signing—so long as neither party had opted to extend it.
At the six-month mark, the transaction was still subject to FTC review, and neither party had sent formal notice to the other of its election to extend the outside date by three months. Although the parties could have continued toward closing without opting to extend, Rent-a-Center sent notice of termination and a demand for the reverse break fee. Three days later Vintage initiated litigation in the Chancery Court seeking to compel Rent-a-Center to continue its efforts to clear HSR and close the transaction.

Vintage argued that its and Rent-a-Center’s regulatory efforts, including the parties’ entry of a joint timing agreement with the FTC, were actions demonstrating notice of their intent to proceed with the transaction. The court noted, however, that the agreement contained clear language requiring express written notice of termination and a demand for the reverse break fee. Three months later the parties could have continued toward closing without opting to extend, Rent-a-Center sent notice terminating the agreement, and a demand for the reverse break fee. The court also rejected Vintage’s claims that Rent-a-Center breached an implied covenant of good faith and fair dealing because Rent-a-Center had not committed a fraud.

The court left open for further briefing the question of whether Vintage is obligated to pay the reverse break fee.

**Takeaways**

In the years ahead, both buyers and sellers should be mindful of several broader trends when negotiating antitrust deal provisions.

**The Efforts Clause.** *Fresenius* clarifies that the Delaware Chancery Court does not generally distinguish between efforts levels. Deal attorneys should therefore consider detailing the specific actions each party must (or need not) undertake during the merger review process. Moreover, while buyers who agree to a hell-or-high-water covenant may want to lead the antitrust strategy, leading the strategy exposes the buyer to the seller’s subsequent claim that a given strategy was a material breach of the merger agreement, especially for those deals subject to antitrust challenge.

**MAEs.** After *Fresenius*—and amid the pending case stemming from the failed *Anthem/Cigna* merger—sellers’ attorneys can no longer assume that no set of facts could sufficiently show that the seller would reasonably be expected to have an MAE. Attorneys on both sides should also understand the Chancery Court’s view that defendants must bargain away business risks for which they do not wish to be held responsible.

**Outside Dates.** Rent-a-Center re-affirms the need for counsel to understand the potential outs the other side may use to exit a deal. Vintage not only lost its opportunity to acquire Rent-a-Center, but now also may be forced to pay a hefty reverse termination fee, all because it failed to pay attention to the outside date, thinking that the transaction was on track for clearance. A party should not misread the other side’s cooperation in undertaking the antitrust efforts as their intent to proceed toward closing.

**Conclusion**

Antitrust practitioners need to be increasingly diligent about the language of regulatory-related provisions and covenants in transactional agreements. First, clients would benefit from having antitrust counsel work closely with the corporate counsel to ensure that covenants touching on antitrust are consistent with the prevailing law and that the client understands the obligations those provisions impose during the regulatory clearance process. Second, recent and pending litigation promises to clarify how these provisions actually work and what parties must do to satisfy their obligations. Finally, regardless of how the pending litigation is resolved, antitrust-related provisions are increasingly important going forward as means to settle disputes in failed transactions.

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2 Id. (citing LOU R. KLING & EILEEN T. NUGENT, NEGOTIATED ACQUISITIONS OF COMPANIES, SUBSIDIARIES AND DIVISIONS §§ 13.06, at 13-44 to -49 & nn. 2–9, 11 (2015 ed.) (citations omitted)).
3 Id. at 214–16.
4 Id. at 225.
5 It is not advisable to try to withhold the agreed upon obligations of the party in a side letter. If that agreement is referred to in the merger agreement or is considered an addendum to it, it must be disclosed in the HSR filing, and a letter solely between counsel that is withheld on joint defense grounds likely is not enforceable between the parties.
7 Id.
14 Id. ¶¶ 38–119; see also *Anthem’s Corrected Opening Post-Trial Brief* at 2–3, Anthem, Inc. v. Cigna Corp., No. 2017-0114-JTL (Del. Ch. Apr. 22, 2019).
15 Cigna Brief, supra note 11.
16 Id. at 82.
18 Id. ¶¶ 2–3, 52–53.
19 Id. ¶ 5.
20 Id. ¶¶ 3, 45.
Id. ¶ 7.
Id. ¶ 30.
Id. ¶ 35.
Id. ¶ 27.
Id. at 70–71.
Id. at 729; Hexion LLC, FTC Dkt. C-4235 (Nov. 14, 2008), https://www.ftc.gov/enforcement/cases-proceedings/071-0212/hexion-llc-et-al-matter (decision and order).
Hexion, 965 A.2d at 743.
Miller, supra note 29, at 153–56.

Id. at 58. The Federal Drug Administration issues a complete letter response to a company when it has concerns about a company’s data integrity in prior submissions. This letter requires a company to respond completely to those concerns.
Id. at 144.
See generally id. at 187–90.
Id. at 153–54.
Id. at 152–53.
More recently, the Chancery Court concluded that a buyer had not proven an MAE where the seller had made inaccurate representations in the merger agreement because the evidence did not support the conclusion that they would be expected to have an MAE on the seller’s business. Channel Medsys., Inc. v. Boston Scientific Corp., No. 2018-0673-AGB (Del. Ch. Dec. 18, 2019).
Id. at 66.
Interview with Margrethe Vestager, Executive Vice President and Commissioner for Competition, European Commission

**Editor’s Note:** Margrethe Vestager is Executive Vice President for A Europe Fit for the Digital Age and Commissioner for Competition in the European Commission. This is her second term in charge of European Union antitrust, merger, and state aid policy and enforcement, an unprecedented occurrence in recent times. To this, she has now added the Digital Age portfolio, a major European policy and legislative priority, separate from her competition role, a dual set of responsibilities which is also unprecedented. As Executive Vice President she is one of the three deputies to the European Commission President. Prior to joining the European Commission in 2015, she held several ministerial roles, including Deputy Prime Minister and party leader in Denmark. She holds a masters degree in economics. In this interview Executive Vice President Vestager discusses her priorities for European competition policy for the 2019–2024 Commission mandate.

This interview was conducted for **ANTITRUST** on January 24, 2020, by Associate Editor Vanessa Turner, Senior Advisor—Competition at BEUC, The European Consumer Organisation, Brussels.

**ANTITRUST:** Your appointment to two roles in the new European Commission—Executive Vice President for A Europe Fit for the Digital Age and Commissioner for Competition—is unprecedented and you have taken steps to separate your responsibilities. But you can’t put a firewall in your head, and competition law is often about shades of gray. So, the question would be: Is it a problem if a policy priority you decide on as the Digital Age Commissioner affects how you see those shades of gray in a competition case?

**MARGRETHE VESTAGER:** If it is a problem, it has always been a problem. I would rather see it as a strength, because the setup in the Commission where you have the law enforcer embedded with the rest of the Commissioners has been challenged and tested, also with our Human Rights Court, and found to be fine. So on the rule of law, rights of defense, this has all been sorted.

The thing is, what we do actually informs a lot of things. More things are coming from Competition into the rest of [the European Commissioners’] portfolios than the other way around. Because we learn so much from the specific cases, to make that available in a generalized manner—of course never in the specifics—is very helpful.

When colleagues in [the European Commission with responsibility for] Climate propose new legislation on market design for energy, as they did in the last mandate, and when colleagues are building up the framework for the Digital Single Market, to get the generalized insights from our sector inquiry in e-commerce, with all the checks and balances in place, I think it serves policies well that there is timely, real-life knowledge about how markets work.

**ANTITRUST:** To pick up on one of the points you touched on, how do you see DG Competition’s role in terms of delivering the European Green Deal [a package of measures for Europe to become “the world’s first climate-neutral continent by 2050”] and will that affect the outcome of cases?

**MARGRETHE VESTAGER:** We have had quite a number of, in particular, State Aid cases in the first five years I was here—cases on support schemes to renewable energies, launching electric buses in cities, enabling people to transition, building infrastructure—many cases to support the transition. Now we have established a strategic goal to be climate-neutral by 2050, but a lot of things have happened before that.

We have seen how [auctions have] also been helpful, not only when you want to subsidize but also to get the prices right, because we have been pushing for auctions to be held when you decide on what subsidy you want to give.

I know this firsthand because I used to be the speaker way back in the days when Denmark was establishing some of the first offshore windmill parks. We negotiated the subsidy, politicians among politicians, by desk. Then I left, and the next thing they did was to hold an auction, and I think the subsidy was more than halved.
When you use an auction instead of deciding the subsidy in a political process, you really save taxpayers a lot of money. And that we have seen work very well indeed. When you auction, you can also auction different technologies at the same time if they have a similar cost curve.

So we have already done a lot, also in the capacity mechanisms that Member States establish in order for their transition to work smoothly so that everyone will still have electricity in the grid when they need it.

That being said, we are now going through our different [State Aid] guidelines and procedures to see if there is more that we can do. For instance, we see that not many Member States are aware of the ways that they can support refitting buildings. We see that is almost undiscovered territory from our guidelines, so we want to push that to make Member States see this.

We have also had merger cases that are on the fringe of the Green Deal, where the question of innovation comes to the forefront. Obviously, it’s very important that a merger still allows for affordable prices, differences in quality and services, but also to push for innovation.

We have done quite a lot already, and we will push for more as we move forward with revision of some of our [State Aid] guidelines to make sure that we get it right as fast as possible. The frontrunner in this would be the guidelines on how to enable energy-intensive businesses to have some help on indirect costs coming from the emissions-trading scheme. That is already in public consultation.

**ANTITRUST:** In a related question, last year, the issue of European industrial policy arose in the competition enforcement context. I was wondering what role European industrial policy will play in your new mandate?

**MARGRETHE VESTAGER:** The most important thing is that competition is a driver for competitiveness. If you have markets that are open for competition, no one remains unchallenged. If you remain challenged, then you have to keep moving, you have to keep innovating, you have to keep improving your services.

What we’re thinking about in industrial policy is: First of all, it has to be for all because the European industrial fabric is very diverse—you have giant companies, you have medium-sized companies, and you have many small companies as well—so industrial policy will have to address that and the value chains coming from it.

Second, obviously, it has to be green because everything is about greening because this strategic goal of ours to be climate-neutral informs everything we do.

The third thing is that industrial policy will have to be based on fair competition because otherwise we lose the driver for competitiveness because we lose the driver for innovation.

That being said, one of the things that I have found very interesting to work with is when Member States want to establish among themselves—with many, many businesses being part of the project—what we call “important projects of common European interest.” Here we see that there are things that you really cannot expect the individual company to do because it would be way too risky and the benefits would not be for the individual company.

We also see that there are areas where we have market failures, where the market as such would simply not deliver.

A good example of things that are not in the interest of the individual business is in the battery project that has been launched by Member States and approved by us in December because that will do different things. It will work on the next generation of batteries—how should they work; on what kind of resource, because there are a lot of input restraints when it comes to more traditional batteries. But not only what should the next generation of batteries be; but also what should be the infrastructure that allows you to have the best use of batteries and what should be the circular economy part of that, how do we make sure that resources—whatever it is that goes into batteries—are fully recycled.

I think this is a good way to say when you’re in between the interests of the individual company, the sector as such, and societal priorities, then you can do something. You can authorize much more aid in order for this to happen.

**ANTITRUST:** Linked to that, my next question would be that you and other enforcers in the competition area have talked about the need to level the playing field. What do you mean by that in more concrete terms?

**MARGRETHE VESTAGER:** It can be different things. One of the things that we have on the workbench right now is trying to find a tool that will allow us to deal with what you could call “foreign direct subsidies.” Within the Union we are neutral on ownership. You can be publicly owned or privately owned—we don’t care—State Aid rules apply in the same way. But we check that, if you’re publicly owned, you are subject to the same rules, benefiting from market conform conditions or subject to State Aid control. But the thing is that, outside of Europe, we have no access to control State-owned businesses, and other jurisdictions are very different.

So what do we do if a State-owned company wants to acquire a European company and establish itself here? How do you make sure that you do not then import third-country State subsidies to the detriment of the level playing field?

This is a work in progress, but indeed very interesting. There was a gap in our approach that we identified last spring. I find it very important to address this because when you ask businesses to compete, then you also take upon yourself the challenge to make sure that they themselves are faced with fair competition. That would be a very practical, tangible example of what it would take to level the playing field.

**ANTITRUST:** That would be on the international level. Taking it slightly more down to individual markets, do you
think it’s also the enforcer’s role to open the markets up to new entrants, to smaller rivals? Is that part of the level playing field?

MARGRETHE VESTAGER: That would depend on the situation. If you have, for instance, an abuse of a dominant position that makes it very difficult for rivals in the period of time where the illegal behavior is ongoing; and if then the illegal behavior stops, but the detriment or the bad things that happened to rivals during the illegal behavior make it very difficult for them to come back into the marketplace, then you might want to consider what it will take for them to have a fair chance of getting back in because they were the first victims of the illegal behavior and also consumers suffered since they didn’t have the benefits of a competitive marketplace.

Here you can see what has been done in the Google Shopping case. You also know that a preference menu, a choice screen, will soon be offered to people buying Android phones in Europe. It is that kind of thinking—it remains to be seen what comes from it—that we will now do more often.

As you know, our decisions have three different elements: a fine to punish past illegal behavior; cease and desist orders to stop what you’re doing and not to put anything in place that has equivalent effect; but the third thing is, then what? Here we will think, also more as a matter of principle, about what kind of remedies would be good, based on the learning that we have had from previous cases.

ANTITRUST: Switching back from antitrust to State Aid, the Apple State Aid tax case is pending before the Court at this time, and we have seen some decisions by the General Court which have had a bit of a mixed outcome. How do you see time, and we have seen some decisions by the General Court

MARGRETHE VESTAGER: Obviously, case-by-case does not solve the horizontal issue. Under the leadership of my colleague Pierre Moscovici, the [European] Council adopted 14 pieces of legislation—and it is difficult because it takes unanimity—in order to enable, in particular, tax authorities to work together to know the full tax history of an individual company. Part of the 14 proposals is also the implementation of the OECD project to prevent base erosion and profits from being shifted. Now all of that is in the process of being implemented.

The specific tax cases serve a very specific purpose to make sure that when people see: Oh, I work in a business that pays its taxes, and I see other businesses that pay their taxes, but they are faced with competitors who are being allowed to get a very light touch by the tax authority, they see the unfair implications of this.

I think the two approaches together serve a sense of both a level playing field but also tax fairness because most people pay their taxes; most businesses pay their taxes.

ANTITRUST: Coming back to the advantage you have of having a second term as the Competition Commissioner along with your other role, what would you like to see in terms of change to DG Competition’s policies and procedures now?

MARGRETHE VESTAGER: Of course, I couldn’t know that I could become the Commissioner for Competition again since, as you say, it doesn’t happen. I wanted to prepare for the next Commission so that, you know, there was a smell of freshly baked bread and you could come in and get started.

We started—and I think many jurisdictions around the planet are doing this also—to figure out how to make sure that our rules are relevant and enforceable in a digital age. So we had the [Shaping competition policy in the era of digitalization] conference; we had the call for public entries; we had the special advisors. We learned a lot from that.

At the same time, we started to plan the revision of the Vertical Block Exemption Regulation, two Horizontal Block Exemption Regulations, and also [the Block Exemption] on motor vehicles. So we got started on a number of issues in order to make sure that the next mandate could be an active mandate from day one.

What we will do is look at the Notice on market definition because one of the things I did in the first mandate was to have two scholars go through 15 of our recent merger cases in order to test what they think about how we do this in practice—so not theory, but practical things—and they said: “Well, you’re on track. You use some methodology that is comparable with U.S. counterparts. But the thing is that if a lawyer sits and reads the Notice on market definition, he or she will not have a complete picture of what it is that you’re doing because the Notice is 20 years old and your methodology has improved and developed over time.” It’s a good thing if you can read it and then understand what it is that we’re doing.

The second thing is that since markets develop also with non-monetary payments—for instance, some of the tests that we use have to be supplemented, like the SSNIP [small but significant and non-transitory increase in price] test, where you look at how consumers respond to small but significant increases in price. If you do not put in your credit card anywhere, how do you see a price change? Because the changes may be that your service provider is asking more data of you or that quality is deteriorating.

ANTITRUST: Does that mean you would potentially look at the concept of consumer welfare in a broader way going forward?

MARGRETHE VESTAGER: At least we will figure out—because we have tested this already in digital cases—what it
It is important to have an eye for issues where regulation may be needed. For instance, if more data is being asked for, if quality deteriorates, what are the barriers to leave? You have to understand this if you want to see what the market is here because things may seem free, but if basically your provider can do a lot of things to you because it’s so difficult for you to move, then you have to take that into consideration, and the people we work with will have to know that we take these things into consideration. These are a couple of reasons why it’s a good idea to look at the Notice.

Then, as I said, we have the full review of our State Aid guidelines, the “fitness check.” There is a lot of activity right now.

And, of course, I am also very happy with the fact that we could use the tool of interim measures. It’s always a good thing that your toolbox is in order. I do that myself with my screwdrivers and hammers.

**ANTITRUST:** You have screwdrivers and hammers that you use at home?

**MARGRETHE VESTAGER:** Yes, because my husband lives in Denmark and sometimes I have to do something, then I take out my toolbox. I know, as a physical, practical thing, the tools that are sort of in the lower drawer, if you don’t see them, you don’t use them. Now we have taken the interim measures tool not only to the front of the toolbox but placed it on the workbench to be sure that when we vigilantly deal with cases, that we have these tools available. That of course is completely case-dependent. But the fact that you have done it once increases the probability that you will do it again.

**ANTITRUST:** Picking up on that and moving specifically into the digital markets that you mentioned, you spoke recently about “taming the dark side” of the tech giants. Previously you had said that the Commission’s approach would be based on Articles 101 and 102 [TFEU] and the case law thereunder. Do your more recent statements suggest a potential change in that view?

**MARGRETHE VESTAGER:** It’s important to see the full sentence because I think the rest of the sentence says “in order to get the full potential of tech.” I am really an optimist when it comes to the use of digital technologies under the precondition that we can control, as I said, the “dark side,” because otherwise I think that people will simply not trust technology and that will then diminish what we can do with technology. For instance, we really need technology to help us fight climate change. That is the full perspective.

I still think that the main route is Articles 101 and 102, but it is important to have an eye for issues where regulation may be needed. So our legislature passed legislation that we call “Platform-to-Business” that will give businesses that depend on a platform certain minimum rights, such as to know how they are ranked and how to solve issues quickly if issues arise. One of the things that we will now consider is how to deal with the market power of dominant companies. You can be dominant in Europe; you’re more than welcome to be successful. If customers like your products and you grow, we congratulate you. The thing is that the market power of a dominant company is a different creature in the digital era compared to what it was before because of speed and scope. What you have to do in order to be aware of the responsibility that comes with your success and your market power as a dominant company is something we want to discuss in the coming months to get a better idea if we need to refine our reasoning here.

**ANTITRUST:** Would data protection issues fall within your reasoning? In the past, you seemed to say they could be dealt with under the General Data Protection Regulation [GDPR]. Is there potential for taking more account of that in competition law as well?

**MARGRETHE VESTAGER:** It will be very case-specific. One of the things that we are discussing right now is how to better enable people to enforce their rights because that is still a challenge. It’s a good thing to have rights; even better to be able to use them. This is something in particular that we will focus on.

When it comes to privacy, we will consider in our analysis if privacy, or copyright, issues become competition issues. But we do not see a competition case everywhere there is a copyright infringement or a privacy infringement because that simply would not make any sense.

But, of course, we are very well aware that there is a gray zone where some of these issues could become competition issues. In that respect it’s important not to have overlaps so that multiple authorities throw themselves into a certain case. It is also important that we then coordinate well, and make sure that we stay off their turf when it is about privacy or copyright but also that we work well where copyright or privacy tools are being used and where you then have a competition law infringement.

**ANTITRUST:** That brings me to another point. Particularly in the digital economy, companies can potentially fall afoul of several different types of laws—competition law, data protection law, and consumer law. You touched upon it, but maybe you can expand a bit more on how you would streamline enforcement to make sure that you avoid overlaps or inconsistent results and, most importantly, to ensure the best outcome for consumers.

**MARGRETHE VESTAGER:** I think the important thing here is to coordinate among authorities and we know them very well. For instance, the unfortunately now late Giovanni Buttarelli, who was the European Data Protection Supervisor, was the first one to reach out to say, “We have to know each
other very well so that we stay off your turf and you stay off mine if cooperation is not needed; but, if cooperation is needed, that we then coordinate very closely.”

**ANTITRUST:** Talking of different turfs, in Article 102 enforcement over the last 15 years or so the Commission has focused primarily on exclusionary conduct, but more recently there have been some investigations opened looking into unfair or excessive pricing, so more exploitative cases.

**MARGRETHE VESTAGER:** Yes.

**ANTITRUST:** Is that a sign of a shift in Article 102 enforcement?

**MARGRETHE VESTAGER:** No, I wouldn’t say so. I think it is very much case-dependent. It’s not a policy shift as such.

**ANTITRUST:** Looking at enforcement on the international scale, do you see international convergence as important in today’s world, particularly when dealing with new challenges in antitrust?

**MARGRETHE VESTAGER:** We have a globalized world but we do not have a global competition authority. The only way that we can mend that is when we work very closely together. I don’t think that harmonization of competition law is anything that one could realize anytime soon or within my lifetime, but what we can do is to make full use of coming together.

I am very impressed with the work of the International Competition Network (ICN). For instance, when you see their Guiding Principles for Merger Notification and Review Procedures, it is hands-on, it is tangible, it is go do, and that I like very much. Instead of them traveling all the way to “Let’s harmonize laws and regulation,” you say, “There is a commonality that allows us in our methodology, in our procedures, to align ourselves,” and that I find to be hopefully helpful for businesses because it cuts red tape, but it will also serve citizens well no matter what jurisdiction they’re in. At the same time, it respects the fact that markets are very different—what can be a giant merger case here may have a footprint in the United States, but it’s a very small sized foot. I think that is the balance.

**ANTITRUST:** Thinking again on the international comparative front, the European competition enforcement regime is based on an administrative regime rather than being directly enforced by courts. We have seen in recent years an increase in the use of commitment decisions and settlement decisions. Are you concerned that this may lead to too little judicial oversight by our European courts, particularly in novel areas of the law?

**MARGRETHE VESTAGER:** I think the first important thing is that the Commission has the discretion to decide to do one thing or the other. That gives us a responsibility to find the best solution in a case for competition to be restored, for the market to serve consumers and customers again. We have done settlements, yes, but we have also done prohibitions. I think you have the pipeline of court cases that will allow you to have an established practice because I completely share with you that it is important, and that is always the balance.

The first responsibility for us is not to fall in love with one way of doing cases or another way of doing cases but to look at the case specifically. As far as I see, we have a pipeline of cases for the Court to deal with, including now our latest interim measures case. And here it is also very important that we get the Court’s guidance. At the same time, in other cases we have settlements that allow everyone to move on and the consumers and customers to be well served again. That is how we’re trying to do things.

**ANTITRUST:** Speaking of consumers, you mentioned the importance of consumers having choice in prices and all angles of competition. How do you think the consumer’s voice can become central to competition law enforcement in the European Union?

**MARGRETHE VESTAGER:** Good news only travels mouth to ear. I think for a long time it has been very much only for the competition community to see the benefits and the role competition can play in order for the economy as such to serve the citizens. I have tried to do my bit because I think if you have a sense that the market actually serves me—in my role as a consumer, as a business, as a customer, I am being well served by the market—then you feel more empowered. And that may rub off on the rest of society because, obviously, the market is not society; it’s just a part of it. But if you feel, I’m empowered here, then I think you also look at other things in your society in a different way.

I think this is part of the puzzle of making people feel for real that they live in societies made for them. I do a lot of public speaking and I see a lot of people come and say: “Oh, I never thought about that. Maybe that’s a good idea.”

Also now, for instance, I voice why State Aid rules are an excellent tool if you want to fight climate change. The reasoning is quite simple: When State Aid tools are well used, you get the cheapest possible option, so you can either do more or taxpayers can save money. You do not crowd out private investment. We cannot fight climate change with just public means. This is not going to happen. You need a lot of investment to change the focus and the way it’s done, so you really don’t want to crowd out private investment.

Last but not least, it ensures a level playing field, and that gives you competition as the driver for innovation. Even though we have a lot of technology that will help us fight climate change, we are not done yet. We need much more technology. So you really want that drive for innovation. Then people say, “Oh that may be so because all I really hear about
ANTITRUST: Thank you very much for your time. It has been a great pleasure to speak with you.

MARGRETHE VESTAGER: I think your questions covered a lot of ground but also you covered what is actually interesting right now.

State Aid rules is that it takes a long time and you’re being annoying.” [Laughter]

For me, it’s very important to say, “This is what we do,” to boil it down to something tangible that you can see, because otherwise you get a debate where the benefits of competition are thinly felt but the pain of competition is deeply felt by some people because their business gets into trouble or a factory will have to close because they lost out in the newest products or whatever. That I think is a very important point.

Second, in our analysis we must make sure that we understand consumer behavior by looking at the effects of it.

ANTITRUST: Are you thinking of looking more into behavioral economics? I know the Google Android decision referenced status quo bias, as a behavioral economics example.

MARGRETHE VESTAGER: I think it’s very important for us to follow the academic discussions here because this is a developing field. I don’t think that we have to understand the rationale of each and every consumer. Consumers are very different from the old-school textbooks. I don’t think there is any reason to assume that every consumer is old-school, rational, comparing everything—quality, delivery times, cost of delivery, services with the provider—because then you never get to do your shopping. At the same time, I think it’s important not to fall into the other side of things, to say, “Everything is completely irrational compared to the old approach.”

So what we try to do is to see what the effects are without feeling the need to go into the heads of each and every one to fully understand, because when we look at the effects on consumers, we learn a lot about what is working or not working in the marketplace.

ANTITRUST: I have one last question for you: Who do you most admire today and have not yet met? And I’m sure you’ve met a lot of people!

MARGRETHE VESTAGER: I have met a lot of people. Just yesterday I met an amazing, old CEO who built his company from nothing. They still exist.

The one that comes to mind would be Greta Thunberg for many reasons. What she has inspired—that young people are really hitting the streets—is important for climate change obviously. But it’s also important for claiming back democracy, to be a real thing among people. When a generation learns that it makes sense to work with other people that you don’t know but where you share a common agenda and you take the trouble to get dressed and do the science and get to the place and be there, instead of just looking at your screen and pressing a “Like” button, that in itself I find to be very, very important. If we accept democracy as a digital thing, we will have lost it.
ON THE MORNING OF JANUARY 20, 1961, the city of Washington, DC lay in a white blanket of freshly fallen snow. By noon, the sun was shining in a bright blue sky, but with a wind chill making the temperature feel near zero. When Chief Justice Earl Warren administered the oath of office to John F. Kennedy shortly after noon, the new president—who at age 43 was a quarter century younger than Warren—stood erect before the Chief Justice with his hand raised to take the oath, dressed elegantly with only a morning coat and striped trousers to protect him from the chill winds. After taking the oath, Kennedy declared in his inaugural address that “the torch has been passed to a new generation of Americans.” Photographs of the ceremony show the outgoing president, Dwight Eisenhower—who had just turned 70, making him the oldest president to serve up to that time—seated behind Kennedy, bundled in a black overcoat, with a white scarf around his neck and a top hat on his knee, seeming to underscore Kennedy’s message of generational change.2

John F. Kennedy’s inauguration came shortly before the midpoint of Earl Warren’s 15-year tenure as Chief Justice. Over the remainder of Warren’s time on the Court, Kennedy and, after his assassination, President Lyndon B. Johnson, would appoint four new justices to the Court: Byron White, Arthur Goldberg, Abe Fortas, and Thurgood Marshall. These four new justices solidified a liberal majority on the Court and provided further support for strong antitrust enforcement. As a result, during the last four years of Warren’s tenure as Chief Justice, the Court decided every single antitrust case it heard in favor of the plaintiffs—23 consecutive cases in all.

In this final article of our three-part series on the Warren Court, we will first look at the backgrounds of the two new justices who had the greatest impact on the antitrust record of the Warren Court: Byron White and Abe Fortas.3 We will then step back to examine what lessons we can take from the Warren Court’s antitrust decisions that may inform the current debate over antitrust policy in what many have termed a new Gilded Age.4

The Two New Justices: Byron White and Abe Fortas

Byron White: “The ideal New Frontier judge.”5 Prior to John F. Kennedy’s inauguration, a split had already developed on the Warren Court between the five progressive justices who supported strong antitrust enforcement—the Chief, Hugo Black, William O. Douglas, Tom Clark, and William Brennan—and the four more conservative justices—Felix Frankfurter, John Marshall Harlan II, Potter Stewart, and Charles Evans Whittaker. Justice Whittaker was the first of these more conservative justices to retire, doing so early in 1962.

To replace Whittaker, Kennedy chose Byron White, who was then serving as the Deputy Attorney General under the president’s younger brother, Bobby Kennedy.6 When he nominated White to the Court, President Kennedy described him “the ideal New Frontier judge.”7 Byron White, indeed, seemed almost a Lancelot-like figure in Kennedy’s modern-day “Camelot.”8 At the University of Colorado, White had been a star in all three major sports—football, basketball and baseball—earning the nickname “Whizzer” (which he hated) during his sophomore year.9 Not only was White the first Colorado player to be named an All-American in football, but the National Invitational Tournament, played in Madison Square Garden, was created in part to give White a chance to showcase his basketball skills to New York sports writers.10

After graduating as student body president, class valedictorian, and a star athlete in three sports in 1938, White won a Rhodes scholarship, which he deferred for a semester to play for the NFL’s Pittsburgh Pirates (now the Steelers) for a then-record salary of $15,800, which he used to fund his legal education.11 After his first season in the NFL, White studied at Oxford for a short time, until the outbreak of World War II in September 1939 forced him to return to the United States. It was in England that White first met Jack Kennedy, whose father was then serving as
the U.S. ambassador to the Court of St. James. After returning to the United States, White enrolled in Yale Law School while continuing to play football in the NFL, now for the Detroit Lions, where he led the league in rushing in 1940 and 1941. White was inducted into the College Football Hall of Fame in 1954.

After Pearl Harbor, White enlisted in the Navy, serving as a naval intelligence officer in the South Pacific where he met his future fellow justice, John Paul Stevens, who was serving there as well. While serving in the Navy, White became reacquainted with Jack Kennedy when he was assigned to write a report on the sinking of PT-109, a torpedo boat Kennedy had commanded, in which he nearly lost his life.

White returned to finish his law degree at Yale after the war, where he again graduated as the valedictorian of his class, this time with the highest grade point average at the school in more than two decades, a remarkable achievement for someone who had played professional football during most of his time there. White went on to clerk for Chief Justice Fred Vinson, making him the first Supreme Court justice to have served as a clerk on the Court.

After his clerkship, White returned to Colorado in August 1947 to practice law in Denver. He joined a four-lawyer firm that eventually grew to become Davis Graham & Stubbs—now the third largest firm in Denver, with over 141 lawyers. White’s practice there was mostly as a transactional lawyer. He tried only a handful of cases, almost all minor criminal matters, by appointment of the court. White was active in local Democratic politics, but mostly only at the neighborhood level. He did, however, support Jack Kennedy’s campaign for president from the beginning, and ended up helping to run his campaign in Colorado. White ultimately became the national chairman of Citizens for Kennedy, a nonpartisan group seeking to attract support from independents and Republicans. White’s efforts on Jack Kennedy’s behalf led to his appointment to serve as Deputy Attorney General.

From the day Justice Whittaker informed the president in March 1962 that he wished to retire from the Court because of mental exhaustion, Byron White was JFK’s first choice to replace Whittaker. Bobby Kennedy was heavily reliant on White to help manage the Department of Justice, and initially resisted White’s nomination. The younger Kennedy, therefore, sought to suggest other candidates. He was particularly enamored of the idea of appointing Judge William Hastie of the Third Circuit so that his brother could become the first president to appoint an African-American to the Supreme Court. But Bobby was chastened when he met with Chief Justice Warren to seek his advice. He later recalled that Warren “was violently opposed to having Hastie on the Court,” because he was “not a liberal” and would be “opposed to all the measures that we are interested in.”

With Hastie eliminated from consideration, President Kennedy quickly nominated his own first choice, Byron White.

The President’s nomination of White was widely praised, both by lawmakers and editorial writers across the country. His nomination sailed through the Senate Judiciary Committee after a hearing that lasted only 90 minutes, with Senator Philip Hart setting the tone by observing that “this is the first appointment of a player for the Detroit Lions to the Supreme Court.” The full Senate confirmed White by a voice vote on a motion for unanimous consent. The entire process took less than a month from the day Whittaker informed the president of his wish to retire.

Abe Fortas: The Washington Insider. When Felix Frankfurter retired a few months later in 1962, Kennedy appointed his Secretary of Labor, Arthur Goldberg, to what at the time was viewed as the “Jewish seat” on the Court. Goldberg had earned Kennedy’s gratitude by successfully mediating a labor dispute between U.S. Steel and the steelworkers union, in which he pressured the union to agree to a “non-inflationary” wage increase with an implicit understanding that the steelmakers would also hold prices steady. When U.S. Steel announced a 3.5 percent price hike two weeks later, quickly followed by the other major steel producers, President Kennedy had Bobby Kennedy convene a grand jury to investigate the steel executives. Acting at the Attorney General’s direction, FBI agents called executives at their homes at 3 a.m., tapped their phones, and subpoenaed their bank accounts and tax records. Under the threat of criminal prosecution, the steelmakers “capitulated and agreed to rescind the price increase[s].”

For Goldberg, the first in his family to go to college, an appointment to the Supreme Court was the dream of a lifetime. Unfortunately, his tenure on the Court proved to be short. After Lyndon B. Johnson became president on November 22, 1963, following Kennedy’s assassination, LBJ wanted to find a place on the Court for his long-time friend and consigliore, Abe Fortas. Believing the country was not ready for a Supreme Court with two Jewish justices, Johnson felt the only way to put Fortas on the bench was to push Goldberg off it. Johnson therefore offered Goldberg the UN ambassadorship with Adlai Stevenson’s death in July 1965. In trying to persuade Goldberg to accept, Johnson appealed to his sense of patriotic duty as a former OSS officer during World War II and led Goldberg to think he might pick him to be his running mate in 1968. The tactic worked: Goldberg agreed to make room for Fortas, hoping that by doing so he might be able to persuade Johnson not to get too deeply enmeshed in Vietnam—something he was unable to do.

Fortas, like White, had graduated from Yale Law School, where he had compiled a record almost as impressive as White’s, finishing near the top of his class and serving as editor-in-chief of the Yale Law Journal. While a student, Fortas caught the eye of three of the school’s best-known professors: Jerome Frank, William O. Douglas, and Thurman Arnold, all of whom went on to hold senior positions in New Deal agencies and played important roles in advancing Fortas’s career.

After Fortas graduated from Yale in June 1933, Jerome Frank brought him to Washington to work with him at the Agricultural Adjustment Administration. Two years later, Fortas returned to New Haven to teach at Yale, where his new wife and future law partner, Carolyn Agger, was still a student. While there, Fortas commuted back and forth to Washington to work on a study with his former professor, William Douglas, who was then serving as an SEC commissioner. When Douglas became the chair of the Commission in 1937, he brought Fortas back to Washington full-
While Byron White and Abe Fortas had always seemed the best and the brightest in all they had done, they managed to write what many now view as four of the worst U.S. antitrust opinions ever.

In 1965, when President Johnson offered to name him to the Court to replace Goldberg, Fortas tried to decline the offer—in part because it represented a substantial cut in salary. After spending weeks trying to convince Fortas to reconsider, Johnson finally forced Fortas’s hand by asking him to come to the White House for a press conference Johnson had called to announce that he was sending 50,000 more troops to Vietnam. When Fortas arrived, Johnson told Fortas he was also going to announce that he was appointing Fortas to the Court, telling him “if those fifty thousand individuals could sacrifice for their country, Fortas could too.” Feeling he had no choice, Fortas accompanied Johnson to the press conference, although he later claimed, “To the best of my knowledge and belief, I never said yes.”

As things turned out, Fortas might have been better off had he said no. Just three years later, when Earl Warren wrote to Johnson in June 1968 that he intended to resign from the Court, Johnson insisted—at the advice of his advisers—on nominating Fortas to replace Warren as the Chief Justice and an old Texas cronny, Homer Thornberry, to fill Fortas’s seat as an associate justice. Confident of their ability to retake the White House in the fall election, Republican senators objected to a lame duck president filling two seats on the Court during his last few months in office. They mounted a serious effort to block Fortas’s nomination, in which they were joined by most Democratic senators from southern states, who were upset at the Warren Court’s civil rights record.

During the Labor Day recess, the opponents to Fortas’s nomination uncovered evidence contradicting his testimony at his nomination hearings denying that he had continued serving as an adviser to LBJ while on the Court. They also found that Paul Porter had helped Fortas supplement his Supreme Court salary by securing funding from their firm’s large corporate clients to pay Fortas the “exorbitant sum” of $25,000 annually for teaching a summer law seminar at American University. Armed with this evidence, the opponents threatened to filibuster when Fortas’s nomination reached the Senate floor. Realizing they did not have the votes to override a filibuster, Johnson and Fortas agreed to withdraw his nomination.

Seven months later, revelations emerged that, as a justice, Fortas had received $20,000 for speeches from the family foundation of a former client under investigation for stock fraud. Facing potential criminal prosecution for not disclosing these payments during his confirmation hearings, Fortas resigned from the Court in May 1969. To compound his disgrace, the younger partners at the firm he had founded refused to take him back and dropped his name from the firm, which then became simply Arnold & Porter. President Johnson summed it up well when he said, following Fortas’s resignation: “I made him take the justiceship. In that way I ruined his life.”

“The Best and the Brightest.” It may be unfair, but in terms of their resumes and the antitrust opinions they wrote for the Warren Court, one cannot help but be reminded of David Halberstam’s classic book about the Kennedy-Johnson foreign policy team (in particular, Robert S. McNamara and McGeorge Bundy) whose brilliance and hubris resulted in the U.S. stumbling into an unwinnable war in Vietnam to which he gave the ironic title, The Best and the Brightest. While Byron White and Abe Fortas had always seemed the best and the brightest in all they had done, they managed to write what many now view as four of the worst U.S. antitrust opinions ever.

Utah Pie v. Continental Baking Co. In Utah Pie, the Court, in an opinion by Justice White, held that the three defendants—all large national companies—had violated the Robinson-Patman Act by selling frozen pies at discriminatorily low prices in Salt Lake City, as compared to their other markets. The Court’s decision provoked an immediate round of criticism.

The first to weigh in was Ward Bowman, an economist who taught with Robert Bork at Yale. In an article appearing shortly after the Utah Pie decision was issued, Bowman accused the Court of converting the antitrust laws, which were “designed to promote competition,” into laws that “hamper the competitive process.” Bowman explained that the local price cuts in question had been a response to the entry of a new competitor, Utah Pie, which had substantially undercut the defendants’ prices. While the defendants’ price reductions had initially enabled them to recapture a large share of the market, Utah Pie’s share had later rebounded and its sales and profits actually increased after it further reduced its own prices in response. To Bowman, this was just the type of price competition the antitrust laws should encourage because it had served to increase output and reduce prices to the benefit of consumers.

So what happened after the Court’s decision? As those of us who were practicing law at the time can remember, Utah Pie engendered more than two decades of antitrust litigation in which plaintiffs rushed to court accusing their larger rivals of
“predatory pricing.” This, in turn, led to an equally large wave of scholarly articles proposing that the courts use a cost-based test under which a plaintiff would be required to show that a defendant’s allegedly predatory prices were below some measure of its costs in order not to chill price competition altogether.\(^5\)

Over the next 20 years, the lower courts struggled with these issues until the Supreme Court finally put this debate to rest in 1993 with its decision in *Brooke Group*, in which it essentially overruled *Utah Pie*.\(^6\) Since that decision, no plaintiff has been able to win a predatory pricing case and what had been a flood of litigation was reduced to a trickle before drying up altogether.

But what happened on the ground in Salt Lake City? Well, the decision in *Utah Pie* outlived the plaintiff. Despite having won in the Supreme Court, Utah Pie began to lose sales again after its victory until it went out of business in 1972.\(^7\) The frozen pie market in Salt Lake continued, however, to be highly competitive, with two of the three defendants continuing to be active, and with at least four local frozen pie makers and several other large national frozen pie makers entering the market after the Supreme Court’s decision.\(^8\)

*Albrecht v. Herald Co.*\(^9\) In *Albrecht*, another opinion by Justice White, the Supreme Court held vertical maximum resale price maintenance agreements per se illegal. The case arose when one of the two daily newspapers in St. Louis, *The Globe-Democrat*, terminated a dealer because it had violated the ceiling the paper had set on the prices its distributors—each of which had an exclusive territory—could charge their customers.\(^10\)

Again, the Court’s decision was criticized almost from the day it was decided, this time for not having recognized that “a newspaper had a legitimate interest in subscribers not being overcharged by local monopoly delivers.”\(^11\) These criticisms continued for three full decades until 1998, when the Supreme Court finally overruled *Albrecht* in *State Oil v. Khan*,\(^12\) holding that maximum resale price maintenance could no longer be treated as per se unlawful, but needed to be evaluated under the rule of reason.

Over those three decades, *Albrecht* had perverse, but entirely predictable, real-world consequences. It caused many newspapers to move away from their pre-existing system of independent distributors and replace them with agents who would sell the papers at whatever price the publisher set.\(^13\) To the extent the decision was driven by a desire to protect the freedom of the distributors, it had the opposite effect—putting many of the distributors out of business or forcing them to become mere agents of the newspapers.

*United States v. Arnold Schwinn & Co.*\(^14\) In *Schwinn*, the Court, in an opinion by Justice Fortas, held that the vertical territorial restraints Schwinn had imposed on the resale of its bicycles by its distributors were per se illegal, while holding that identical restraints imposed on distributors who were acting as its agents in the direct sale of its products were not. In explaining this difference in treatment, Fortas pointed to what he referred to as “the ancient rule against restraints on alienation,”\(^15\) but made no effort to explain why this distinction still made sense from an antitrust perspective.

As with Justice White’s opinions in *Utah Pie* and *Albrecht*, Justice Fortas’s opinion in *Schwinn* was harshly criticized almost from the day it was issued, with the critics arguing that vertical non-price restraints are generally procompetitive because they provide an incentive for distributors to promote a manufacturer’s products and should therefore be evaluated under the rule of reason, not condemned as per se unlawful.\(^16\) Citing several of these articles, the Supreme Court, in an opinion by Justice Lewis Powell, overruled *Schwinn* just ten years later in *GTE Sylvania*,\(^17\) making it “perhaps the shortest lived Supreme Court precedent in the century-plus history of the Sherman Act.”\(^18\)

Unfortunately, before the Court’s decision in *GTE Sylvania*, Schwinn had already stopped selling bicycles through independent distributors and had constructed four regional warehouses from which bicycles could be sent to local distributors acting as its agents.\(^19\) As a result, many former Schwinn distributors went out of business and others began distributing other brands. These new warehouses and distribution systems cost Schwinn millions of dollars at a time when it faced growing competition from foreign manufacturers. For that and other reasons, Schwinn saw its market share continue to shrink over the next two decades, until it declared bankruptcy in 1992.\(^20\)

*United States v. Sealy, Inc.*\(^21\) Decided the same day as *Schwinn*, *Sealy* involved what we would today view as an efficiency-enhancing joint venture. Since the beginning of the 20th century, Sealy had built a national footprint by licensing independent mattress manufacturers to make and sell mattresses under the Sealy name and trademark, while also making them shareholders.\(^22\) By the time the government filed its action, Sealy had 30 manufacturer-licensees who collectively owned almost all of the company’s stock. Sealy’s license agreements required its licensees to follow standards promulgated by Sealy and assigned each one an exclusive territory in which they were allowed to sell Sealy brand mattresses at specified resale prices but prohibited them from selling outside that territory. The licensees were free, however, to make and sell mattresses not bearing the Sealy name without any such restrictions.

The government challenged this arrangement, alleging that it was a per se illegal horizontal price fixing and market allocation agreement because the licensees could have, but for these restrictions, competed with one another in selling Sealy mattresses. In a short opinion by Justice Fortas, the Court agreed, holding the restraints per se illegal because “they gave to each licensee an enclave in which it could and did zealously and effectively maintain resale prices, free from the danger of outside incursions.”\(^23\)

In *The Antitrust Paradox*, then-Yale law professor Robert Bork argued that the record showed that the primary purpose of this entire arrangement was to enable geographically dispersed mattress manufacturers to create a uniform product they could advertise and sell nationally.\(^24\) The restraints Sealy imposed on its licensees, he argued, were designed to give them an incentive to make the investments necessary to manufacture mattresses to Sealy’s specifications and to promote the sale of its mattresses without fear that another licensee would free ride on their efforts.\(^25\)

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\(^{5}\) See *Utah Pie v. Utah*.

\(^{6}\) See *Albrecht v. Herald Co.*

\(^{7}\) See *Utah Pie v. Utah Pie*.

\(^{8}\) See *Albrecht v. Herald Co.*

\(^{9}\) See *Schwinn v. McClung*.

\(^{10}\) See *Schwinn v. McClung*.

\(^{11}\) See *Schwinn v. McClung*.

\(^{12}\) See *Schwinn v. McClung*.

\(^{13}\) See *Schwinn v. McClung*.

\(^{14}\) See *Schwinn v. McClung*.

\(^{15}\) See *Schwinn v. McClung*.

\(^{16}\) See *Schwinn v. McClung*.

\(^{17}\) See *Schwinn v. McClung*.

\(^{18}\) See *Schwinn v. McClung*.

\(^{19}\) See *Schwinn v. McClung*.

\(^{20}\) See *Schwinn v. McClung*.

\(^{21}\) See *Schwinn v. McClung*.

\(^{22}\) See *Schwinn v. McClung*.

\(^{23}\) See *Schwinn v. McClung*.

\(^{24}\) See *Schwinn v. McClung*.

\(^{25}\) See *Schwinn v. McClung*.
by undercutting them on price. Their purpose, he maintained, could not have been to charge monopoly prices because there were many competing brands of mattresses and Sealy had only a small share of the market. Therefore, he concluded, the alleged restraints should have been reviewed under the rule of reason, not condemned as per se illegal.

Again, it is revealing to look at what happened after the Court’s ruling in Sealy. After losing in the Supreme Court, Sealy revised its licensing agreement in 1968. The new licensing agreement gave each licensee an “area of primary responsibility,” but permitted them to sell Sealy mattresses outside that area so long as it paid a higher royalty to Sealy on those sales.

Sealy’s largest licensee, the Ohio Mattress Company, filed an antitrust suit against Sealy in 1971, alleging that Sealy’s revised licensing agreement still operated as a per se illegal horizontal market allocation agreement. The lower courts agreed, awarding Ohio Mattress $77 million in damages and enjoining Sealy from enforcing its challenged license restraints. Unable to come up with the $77 million award, Sealy agreed to be acquired by Ohio Mattress. Once more, it is hard to see how forcing Sealy to be restructured in this manner, with all its smaller licensees forced to sell their interests to Sealy’s largest licensee, increased competition or otherwise protected either small business or local ownership.

“Boats Against the Current”

We discuss these four cases not to disparage Justices White and Fortas for having written the opinions, but as a reminder of what could happen if we were to depart from the consumer welfare standard the courts have used to decide antitrust cases for the last four decades, since the Supreme Court first endorsed that standard in 1979 in Reiter v. Sonotone. What is most striking about all four opinions is the complete absence of any discussion of the issues from an economic perspective. Instead, these four opinions reflected what until then had been the usual approach of the courts in antitrust cases of deciding them in the common law tradition, in which what mattered most was how courts had decided similar cases in the past, without engaging in any serious analysis of the likely effects of the conduct at issue on competition.

As a further example of this failure to consider the likely economic effects of the conduct at issue, we examine in this section what happened as a result of the highly restrictive policy the Warren Court adopted toward horizontal and vertical mergers in its decision in Brown Shoe in 1962, and its later merger decisions over the rest of Earn Warren’s tenure as Chief Justice. What we find is that despite the Warren Court’s highly restrictive merger decisions, the 1960s experienced what one historian has called “the third and greatest merger movement to that time in U.S. history,” during which 9,400 corporations were absorbed into other companies. But, whereas most mergers during the period when the Celler-Kefauver amendments were adopted in 1950 had been either horizontal or vertical, the vast majority in the 1960s were conglomerate mergers in which there was no direct horizontal or vertical overlap between the merging firms.

This conglomerate merger wave led to an increase in economic concentration much greater than that which had led to the enactment of the Celler-Kefauver amendments to Section 7. By 1968, nearly half of all manufacturing assets were controlled by only 87 companies. This conglomerate merger wave often created companies that were too large and too diverse to be managed efficiently, but not too large to fail. As measured by stock market returns, conglomerate firms, in general, badly underperformed the market as a whole in the late 1970s and early 1980s. Therefore, during the 1980s there was a reverse “wave of deconglomeration.” The general view now is that the conglomerate merger wave was “almost certainly the biggest collective error ever made by American business,” a “colossal mistake” that had left American industry uncompetitive relative to international rivals.

For me, this unintended consequence of the Warren Court’s too-restrictive merger policy is personal. My hometown, Springfield, Vermont, was a victim of the conglomerate merger wave.

Springfield sits on the west bank of the Connecticut River, which separates Vermont and New Hampshire, midway between Brattleboro and White River Junction. When I grew up there in the 1950s and 1960s, Springfield was a prosperous machine tool center in what was then known as Precision Valley. A town of just 10,000, it was home to three successful machine tool companies: Jones & Lamson, Fellows Gear Shaper, and Bryant Chucking Grinder. All three were locally owned; together, they produced nearly 10 percent of all machine tools manufactured in the United States, employing more than 3,000 people. In addition to a large unionized blue-collar work force, Springfield also had a large white-collar community made up largely of engineers and executives at the three factories and had excellent schools that produced nearly as many National Merit Finalists as the high schools in Burlington, Vermont—a city more than six times its size.

That all began to change in 1958, when the smallest of the three companies, Bryant Chucking Grinder, was acquired by a large national conglomerate, Ex-Cell-O, based in Highland, Michigan. Six years later, in 1964, Jones & Lamson, the largest of the three, was acquired by another large conglomerate, Textron, headquartered in Providence, Rhode Island. Ten years later, in 1974, the last of the three, Fellows Gear Shaper, was acquired by Emhart Corporation, a multinational conglomerate headquartered in Farmington, Connecticut.

When sales started declining in the mid-1970s, all three conglomerates stopped investing in R&D and instead began moving production lines out of Springfield to non-union states in the South. By 1990, the three companies had largely ceased machine tool production in Springfield, leaving their large facilities as decaying remnants of what had once been a thriving industry. Today, Springfield’s population is less than half what it was in 1960, and it has among the highest unemployment, poverty, and opioid addiction rates in the state.

Reflections from a Distant Mirror

So what can we learn from looking back a half-century later on the Warren Court? The main lesson is the one D.H. MacGregor,
an early disciple of Alfred Marshall, tried to teach us more than a century ago in 1906: “If there are economic tendencies, the state cannot prevent, although it can harass, them.”97 For that reason, trying to use the antitrust laws to resist powerful economic trends is, as F. Scott Fitzgerald wrote in the final sentence of The Great Gatsby, like “boats against the current, borne ceaselessly back into the past”—a past that can never be recaptured.

As we have already seen, the Warren Court’s efforts to use the antitrust laws to preserve an “economic way of life” with “fragmented industries and markets” and “viable, small, locally owned” businesses would probably have been futile even if Robert Bork had never been born.98 The economic forces pushing towards larger business units and greater concentration in the middle of the last century were just too strong. Much of what the Warren Court accomplished by its effort to use the antitrust laws to resist these trends was to force companies into alternative arrangements, some of which—such as conglomerate mergers—turned out to be affirmatively harmful to the American economy.

Using the antitrust laws to try “to preserve a way of life” composed of small businesses with local owners proved to be as futile as King Canute trying to hold back the waves, and may have ended up doing more harm than good. Not unlike Gatsby’s efforts futile as King Canute trying to hold back the waves, and may have ended up doing more harm than good. Not unlike Gatsby’s efforts, trying to use the antitrust laws to resist powerful economic trends is, as F. Scott Fitzgerald wrote in the final sentence of The Great Gatsby, like “boats against the current, borne ceaselessly back into the past”—a past that can never be recaptured.

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This is not to say that we should not be worried about the growing concentration in our economy and the evidence that it is causing Americans to pay higher prices for goods and services, slowing down innovation and new entry, and contributing to increased inequality, as well as to the hollowing out of towns like Springfield.99 We now have several recent reviews of merger retrospectives that have raised serious questions about whether our merger policy has become too relaxed.100 We should take these studies seriously, but in deciding how to address this issue, we also need to learn from the Warren Court experience so that we do not over-correct.}

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1 F. Scott Fitzgerald, The Great Gatsby 193 (Scribner 2018) (1925) (“So we beat on, boats against the current, borne back ceaselessly into the past.”).
2 Kennedy, too, had worn a top hat to the ceremony, but had removed it before taking the oath of office and delivering his Inaugural Address.
3 The other two justices the two Democratic Presidents appointed, Arthur Goldberg and Thurgood Marshall, both served on the Warren Court only briefly, during which neither wrote any opinions in antitrust cases.
5 For an excellent book-length biography of Byron White, see Dennis J. Hutchinson, The Man Who Once Was Whizzer White (1998).
7 Hutchinson, supra note 5, at 322.
8 See, e.g., Robert Dallek, Camelot’s Court: Inside the Kennedy White House 422 (2013). The comparison is generally attributed to President Kennedy’s widow, Jacqueline Kennedy, who was a fan of the Lerner & Loewe musical then playing on Broadway, entitled Camelot. See Ben Zimmer, Jackie Started the Legend of JFK ‘Camelot’, Wall St. J. (Nov. 22, 2013), https://www.wsj.com/articles/jackie-started-the-legend-of-jfk-8216-camelot8217-1385176031. The musical’s closing song ends with a lyric many of us who were alive when Kennedy was assassinated still often sing to ourselves before we go to sleep: “Don’t let it be forgot, that once there was a spot, for one brief, shining moment, that was known as Camelot.” Id.
9 See Hutchinson, supra note 5, at 35, 85.
11 See Hutchinson, supra note 5, at 85.
12 See Lane & Barnes, supra note 10.
13 See id.
14 The event was later made into a movie, entitled PT-109, starring Cliff Robertson as the future president, PT-109 (Warner Bros. 1963), https://en.wikipedia.org/wiki/PT_109. The movie was released in June 1963, just five months before Kennedy’s assassination in November of that year.
15 See Greenhouse, supra note 6. Justice John Paul Stevens clerked on the Court for Justice Wiley Rutledge two terms later, in 1947–48, giving the two of them something else in common. John Paul Stevens, The Making of a Justice 58 (2014). Not surprisingly, the two became each other’s closest friends on the Court. Id. at 98.
17 The only antitrust case White worked on was Loew’s v. Cinema Amusements in 1954, in which he represented local plaintiffs in a nationwide antitrust suit brought by Thurman Arnold on behalf of independent movie theater operators who alleged that the major studios were channeling premium films to affiliated exhibitors. See Hutchinson, supra note 5, at 26.
18 See id. at 232–33.
19 For an excellent account of White’s time as Deputy Attorney General, see id. at 232–62; see also Nicholas Katzenbach, Some of It Was Fun: Working with RFK and LBJ 29–48 (2008).
20 See Hutchinson, supra note 5, at 311.
21 See id. at 316.
22 Id. at 314.
23 Id. at 322–23.
24 Id. at 330.
26 The only Jewish Supreme Court Justices prior to Goldberg were Louis Brandeis, appointed by President Wilson; Benjamin Cardozo, appointed by President Hoover; and Felix Frankfurter, appointed by President Roosevelt.
29 In his successful race for the Senate in 1946, Johnson, who was a New Deal liberal, fought a bitter contest for the Democratic nomination with a conservative former governor of Texas, Coke Stevenson. After Johnson’s narrow victory in the Democratic primary, Stevenson obtained a temporary restraining order from a district judge in Texas forbidding the Democratic Party from placing Johnson’s name on the ballot as the Democratic nominee because of Johnson’s alleged “vote stealing.” After failing to persuade the Fifth Circuit to stay the district court’s TRO, Fortas, with help from several other former New Dealers, persuaded Justice Hugo Black to grant a stay, after which the Fifth Circuit set aside the injunction altogether, opening the way for Johnson to win the general election easily in what was then a heavily Democratic state. From that point on, Fortas remained a close friend and advisor to Lyndon Johnson, up to and after Johnson became president. See Kalman, supra note 25, at 200–02.

See Kalman, supra note 25, at 23–25.

Id. at 27–28.

Id. at 47–48.

Id. at 61.

Id. at 91.

Id. at 125–26; William Kolasky, Thurmond Arnold: An American Original, Antitrust, Summer 2013, at 89, 94–95.


See Kalman, supra note 25, at 244.

Id.

Id. at 327–28.

Id. at 329–33.

Id. at 337–39, 351.

Id. at 326–27, 351–53. That annual stipend would be the equivalent of nearly $68,000 in current dollars. At the time, $25,000 was the equivalent of two-thirds of his annual salary as a Supreme Court Justice and was nearly as much as a U.S. senator’s salary of $30,000. Judicial Compensation, United States Courts, 2019, https://www.uscourts.gov/judges-judgeships/judicial-compensation; Senate Salaries Since 1789, United States Senate, 2019, https://www.senate.gov/artandhistory/history/common/briefing/senate_salaries.htm.

Kalman, supra note 25, at 355–56.

Id. at 370–76.

Id. at 380–82; see also Diamond, supra note 37, at 281–82.

Kalman, supra note 25, at 376.


386 U.S. 685 (1967).

Ward Bowman was also the co-author with Robert Bork of an article that appeared in Fortune magazine in 1963 entitled The Crisis in Antitrust. See Robert H. Bork & Ward S. Bowman, Jr., The Crisis in Antitrust, Fortune, September 1963, at 138. The article was highly critical of the Warren Court’s antitrust decisions and later became the first chapter in The Antitrust Paradox.

Ward S. Bowman, Jr., Restraint of Trade by the Supreme Court: The Utah Pie Case, 77 Yale L.J. 70, 70 (1967).

See id. at 71.


See Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209 (1993). In Brooke Group, the Court adopted a price-cost test, in which a plaintiff must prove both that (1) defendant’s prices were below its average variable cost and (2) the defendant was likely to be able to recoup any losses it suffered during the alleged period of predation. Id. at 222–24.


See McDermott, supra note 57, at 44.


Id. at 147–48.

Clasper, supra note 50, at 23.


Id. at 380.


Continental TV, Inc. v. GTE Sylvania Inc., 433 U.S. 36 (1977). For an excellent article on the factors that contributed to the Court’s decision to overrule Schwinn so soon after it was decided, see Andrew Gavil, A First Look at the Powell Papers: Sylvania and the Process of Change in the Supreme Court, Antitrust, Fall 2002, at 8.

Grimes, supra note 66, at 145. Justice White, who had not participated in Schwinn, presumably because the case was brought by the Justice Department while he was Deputy Attorney General, concurred in the Court’s decision. He agreed that Sylvania’s territorial restrictions should be upheld under the rule of reason, but disagreed that this decision required overruling Schwinn, arguing that the two cases could be distinguished because Sylvania had “an insignificant market share” when it adopted those restrictions, whereas Schwinn still had a leading share of bicycle sales in the United States. GTE Sylvania, 433 U.S. at 59 (White, J., concurring).

See Grimes, supra note 66, at 160.

See id.


Id. at 351–52.

Id. at 356.

See Bork, supra note 50, at 270.

Id. at 273.

Id. at 274; see Richard A. Posner, Antitrust Law 187–88 (2nd ed. 2001) (estimating that Sealy’s share was only about 20%).

Bork had an opportunity to make similar arguments to the Supreme Court a year after The Antitrust Paradox was published, in an amicus brief in Broadcast Music, Inc. v. CBS, 421 U.S. 1 (1979), defending the blanket licenses offered by BMI and ASCAP. This time, the Court accepted those arguments. In an opinion by Justice White, the Court held that the restraints that are ancillary to an efficiency-enhancing joint venture—as the restraints in Sealy were—cannot be condemned as per se illegal, but should be reviewed under the rule of reason. Id. at 24.

This royalty was calculated on the basis of the lost sales of the licensee assigned the territory in which the sales were made.

See Ohio-Sealy Mattress Mfg. Co. v. Sealy, Inc., 669 F. 2d 490, 496 (7th Cir. 1982).

See Vanished Tool Makers: Jones & Lamson, Springfield, Vermont

See, e.g., United States v. Pabst Brewing Co., 384 U.S. 546 (1966) (holding that a merger giving the parties a 5.8% share of the national market for beer violated Section 7); United States v. Von’s Grocery Co., 384 U.S. 270 (1966) (holding that a merger giving the parties a 7.5% share of the Los Angeles market for grocery stores violated Section 7).

See James R. Williamson, Federal Antitrust Policy During the Kennedy-Johnson Years 80 (1995).

See, e.g., George J. Stigler, The Economic Effects of the Antitrust Laws, 9 J. L. & ECON. 225, 232 (1966) (finding that of all mergers, the percent that were horizontal had dropped from 31% during period 1948–1953 to just over 12% during the period from 1960–1964, while the percentage of conglomerate mergers had risen dramatically to 71%); see also Frederick M. Rowe, The Decline of Antitrust and the Delusions of Models: The Faustian Pact of Law and Economics, 72 GEO. L.J. 1511, 1524-35 (1984) (arguing that the Warren Court’s “[s]trict bans on horizontal acquisitions . . . turned business incentives toward conglomeramation”).

See Williamson, supra note 84, at 24.

See Gerald F. Davis et al., The Decline and Fall of the Conglomerate Firm in the 1980s: The Deinstitutionalization of an Organizational Form, 59 AM. SOC. REV. 547, 548 (1994).

Id.


See Broehl, supra note 90, at 231.


See George Stigler, The Economist as Preacher 42 (1982) (quoting D.H. Macgregor, Industrial Combination 231–32 (1913)).

The quoted phrases are from Chief Justice Warren’s opinion in Brown Shoe, 370 U.S. at 333, 344.


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