The Potential Chilling Effects of Lowering Standards for Tech M&A Enforcement

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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 acquiescent 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. 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 subject 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.

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. 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.

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. Anti-merger 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 Zhidanov 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 *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 contract 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, Achtar 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 “[g]enerally . . . 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 Mallinkrodt 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 Mallinkrodt 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 either 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 lawyer’s terms, 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, 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 valu-
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. These funds have more than $400 billion in venture capital assets under management.

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. 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. 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.”

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. 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.

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. Our own data show that acquisitions remain the most popular exit for VC-funded 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.57 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.”58

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.59 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 2018.60

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.61 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.62

**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.63 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.64 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 conglomeration 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.


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. To calculate this value, we totaled the transaction value of the mergers that would be affected by this policy change. This yielded a total of over $700 billion in value, or over 70 percent of the total value of all mergers announced in 2019.


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] brace 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.


id.

See Illumina Complaint, supra note 17.

id. ¶¶ 77–78.


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/@teamheres/heres-how-we-can-break-up-big-tech-9ad9e0da324c.


See Varian, supra note 48.


See Varian, supra note 48.


Warren, supra note 45.


Mike Swift, VC’s May Help Antitrust Regulators Peer into the ‘But-For’ World of Big Tech Acquisitions, MLex 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.”).
