MERGERS AS MONOPOLIZATION

Monopoly

BY ALLEN GRUNES[1]

1 Shareholder, Brownstein Hyatt Farber Schreck, LLP. Thanks to Spencer Waller for giving me a road map, although he doesn't bear responsibility for where I traveled. Bruce Hoffman, Jeff Wilder, Tim Wu, and Scott Hemphill have plowed the ground before and readers who want to do a deeper dive should look at their contributions. Finally, thanks to Sam Sadden who is as patient an editor as one is likely to find.

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We tend to think of mergers and monopolization as separate and distinct branches of antitrust. Using Section 2 to attack mergers raises the question of whether merger enforcement has been ineffective. But there is another explanation. The legal and economic frameworks are most developed when it comes to strategic horizontal mergers, and correspondingly less developed when it comes to mergers involving nascent competitors. Merger analysis under Hart-Scott-Rodino is a predictive exercise. The "actual potential competition" doctrine, with its stringent causation requirement, adds an additional layer of predictive difficulty. The FTC's losses in Steris/Synergy and Meta/Within are illustrative. By contrast, Section 2 of the Sherman Act gives the agencies the ability to look back at completed mergers, including those of nascent competitors. Although Section 2 requires a showing of monopoly power, its causation requirement is easier to meet than that of the actual potential competition doctrine. Hence it is understandable that both DOJ and FTC are using Section 2 to attack mergers that appear to have been anticompetitive and cemented dominance. The forthcoming revisions to the merger guidelines hopefully will address some of these issues.

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I. INTRODUCTION

At first blush, it may seem a bit odd to talk about mergers and monopolization in the same breath.

After all, merger law is generally forward-looking and predictive (at least since the 1970s, when Hart-Scott-Rodino entered the picture and required premerger notification and a waiting period). Monopoly law is backward-looking and conduct-oriented (with a focus on a single company's power in the market and the conduct used to create, maintain, or expand that power). There are different statutes involved (the Clayton Act and the Sherman Act) and different case law interpreting those statutes.

Plus, when thinking about the sort of conduct that gets challenged in a monopolization case, we don't tend to think about an acquisition that may have taken place years earlier and may have been reviewed by the antitrust authorities at the time.

While it is true Section 7 of the Clayton Act contains a reference to "monopoly," that reference just reinforces the difference between mergers and monopolization. Mergers are illegal if the effect "may be substantially to lessen competition, or to *tend to create a monopoly*." By its own terms, the merger law is supposed to kick in long before a company has achieved monopoly status.

So, if mergers have resulted in, or contributed to, monopolization, the first question one reasonably may ask is whether merger enforcement has failed in some way.

One possible answer is, of course, "yes." This is a concern we have been hearing for several years now. Just by way of example, the Thurman Arnold Project at Yale puts it this way: "The evidence overall supports the conclusions that interpretations of U.S. antitrust laws have been too lax toward consolidation and that a significant strengthening of horizontal merger enforcement is needed. Antitrust enforcers should be more aggressive in challenging mergers."[2] The Roosevelt Institute sees a relation between lax merger enforcement and increasing market power throughout the economy: "decades of lax merger review and antitrust enforcement gave way to rampant market power."[3] And Senator Amy Klobuchar has posted her concern on Twitter: "It's not just Big Tech. From cat food to caskets, monopolies are developing across markets."[4]

We don't need to go that far, however. We don't need to believe that merger enforcement, as a whole, has been a failure.

The merger framework is good at certain things. It is good at stopping some harmful mergers, especially horizontal mergers between established competitors. For such mergers there is a clear legal framework, established economic tools, and often evidence about current diversion ratios and margins. It is not so good at other things, including acquisitions of unproven startups that may or may not evolve into future competitive threats to the acquirer, and serial acquisitions of companies with little or no revenues and/or small market shares. For the former, it is hard to predict what may become of a "nascent competitor" that may not even be in the same product market as the acquirer. For the latter, it is hard to predict which small acquisition is one too many.[5]

Section 2 may be a better fit than Section 7. We can look back instead of predicting the future. We may see what actually happened after an acquisition. We also may see a pattern of acquisitions that only becomes apparent in hindsight. Documents about intent can be matched against what the acquirer actually did.

The issue is timely, as both the FTC and DOJ have monopolization cases which call into question prior mergers that were reviewed but not challenged at the time: Facebook's acquisitions of Instagram and WhatsApp and Google's acquisition of DoubleClick.

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2 Thurman Arnold Project, Yale School of Management, Modern Antitrust Enforcement, https://som.yale.edu/centers/thurman-arnold-project-at-yale/modern-antitrust-enforcement.

3 Adil Abdela & Marshall Steinbaum, Issue Brief, The United States Has a Market Concentration Problem, Reviewing Concentration Estimates in Antitrust Markets, 2000-Present, https://rooseveltinstitute.org/wp-content/uploads/2020/07/RI-US-market-concentration-problem-brief-201809.pdf.

4 https://twitter.com/amyklobuchar/status/1372254342296834050?lang=en.

5 Jeffrey M. Wilder, Acting Deputy Assistant Attorney General, Antitrust Division, U.S. Dep't of Justice, Potential Competition in Platform Markets, Remarks as Prepared for the Hal White Antitrust Conference (June 10, 2019).

II. ACTUAL POTENTIAL PROBLEMS WITH SECTION 7

Challenging a merger of a possible future competitor under Section 7 poses a number of difficulties. First, as noted, ever since Hart-Scott-Rodino, this is likely to be a predictive exercise, at least for mergers notified under the HSR Act. Prediction even under the best of circumstances is difficult. Second, the "actual potential competition" doctrine, which was developed before the HSR Act, has been interpreted to impose a stringent causation requirement. We can summarize it as follows: But for the acquisition, the target firm would have developed into a formidable enough competitor that its entry would have been procompetitive. Merely stating the causation requirement shows how high the hurdle is.

So, there is something of a double whammy here. We need to predict a merger's effect. And we need to predict what the world would look like without the merger.

The poster child may be the FTC's unsuccessful challenge to the acquisition of Synergy by Steris several years ago. In its press release announcing the filing of the complaint (the vote was unanimous), the FTC stated:

> Today, gamma radiation, generated by the radioactive isotope Cobalt 60, is considered the only feasible method of sterilizing large volumes of dense and heterogeneously packaged products. Only Steris and one other company, Sterigenics, provide contract gamma sterilization services in the United States, according to the complaint. At the time the proposed merger was announced, Synergy was implementing a strategy to open new plants that would provide contract x-ray sterilization services. These services – which currently are not available in the United States – would provide a competitive alternative to gamma radiation, according to the complaint. Because it uses electricity rather than Cobalt 60, x-ray does not raise many of the environmental and regulatory issues associated with gamma sterilization.[6]

Unfortunately for the FTC, the evidence showed that Synergy's new x-ray technology was not ready for prime time and did not meet the company's internal financial tests. The legal standard proposed by the FTC and adopted by the district court required that "the competitor 'probably' would have entered the market" and "its entry would have had pro-competitive effects."[7] The FTC could not make this showing factually. But as Scott Hemphill & Tim Wu have noted more generally, "Under this interpretation of the law, the acquisition of a nascent competitor would be nearly impossible to challenge, given the difficulty in establishing the but-for world with sufficient precision and certainty. Thus, if this approach were the exclusive avenue for challenging acquisitions of nascent competitors, effective enforcement would be impossible."[8]

The FTC brought another potential competition case in its challenge to Meta's acquisition of Within. The FTC alleged that Meta was poised to enter the virtual reality fitness market, but elected to acquire the leading player instead:

> The complaint alleges that Meta is a potential entrant in the virtual reality dedicated fitness app market with the required resources and a reasonable probability of building its own virtual reality app to compete in the space. But instead of entering, it chose to try buying Supernatural. Meta's independent entry would increase consumer choice, increase innovation, spur additional competition to attract the best employees, and yield other competitive benefits. Meta's acquisition of Within, on the other hand, would eliminate the prospect of such entry, dampening future innovation and competitive rivalry.[9]

Once again, however, the agency ran aground on the "but for" causation element. The court was not convinced that it was more likely than not that Meta would have entered this market on its own in the absence of the acquisition. The contemporaneous documents suggested that Meta saw entry as difficult. According to the court, "even more pertinent than the record of Meta's past entries into VR app markets is the evidence that Meta had consciously considered and appeared doubtful of the proposition to build its own independent VR fitness app."[10] The fact that Meta was a large company and clearly recognized the importance of a fitness app to its broader plans was not enough: "To the extent the FTC implies that—based solely on the objective evidence of Meta's resources and its excitement for VR fitness—it would have inevitably found and implemented some unspecified means to enter the market, the Court finds such a theory to be impermissibly speculative."[11]

6 Press Release, Fed. Trade Comm'n, FTC Challenges Merger of Companies That Provide Sterilization Services to Manufacturers (May 29, 2015).

7 *FTC v. Steris Corp.,* 133 F. Supp. 3d 962, 966, 978 (N.D. Ohio 2015).

8 C. Scott Hemphill & Tim Wu, *Nascent Competitors*, 168 U. PA. L. REV. 1879, 1894 (2020) (hereafter "*Nascent Competitors*").

9 Press Release, Fed. Trade Comm'n, FTC Seeks to Block Virtual Reality Giant Meta's Acquisition of Popular App Creator Within (July 27, 2022)

10 Order Denying Plaintiff's Motion for Preliminary Injunction, FTC v. Meta Platforms Inc., No. 5:22-cv-04325-EJD (N. D. Cal. Jan. 31, 2023) at 52.

11 *Id.* at 53. The FTC also tried but failed to establish the "perceived potential competition" theory.

These two cases show the difficulties of using a forward-looking approach to mergers to challenge transactions on a potential competition theory. They show the difficulty with the proving "but for" causation in the absence of an acquisition. And that is true whether, as in *Steris/Synergy*, it was the target that appeared to be on the verge of entering the market with a new and potentially better product, or, as in *Meta/Within*, it was the acquirer that appeared to be on the verge of entering the market itself.

III. THE PLUSES AND MINUSES OF SECTION 2

This brings us to Section 2. Section 2 has certain advantages. First, and most obviously, the merger or mergers have already taken place, so we can look back and see what actually happened. Was one of these mergers the "killer" acquisition? Did the merger raise entry barriers? Did the merger give the acquirer an asset that it was difficult or impossible for others to reproduce? Did the merger make business sense? Was the merger one of a series of mergers that, taken together, led to or preserved dominance?

We can start with *Mallinkrodt* which, although a settled case, is a nice illustration of the use of Section 2 to attack a past merger involving a nascent threat. The thrust of the FTC's claim was as follows:

> Questcor was a monopolist in the U.S. for a drug called Acthar that treated infantile spasms, as well as other conditions. Outside of the United States, another drug that could compete directly with Acthar was sold—Synacthen. The complaint alleged that Questcor had no legitimate business purpose for buying Synacthen, and in fact had chosen not to pursue it. But when it looked like other buyers might emerge, Questcor stepped in and outbid them. As the complaint further alleged, at that point, Synacthen was a nascent competitive threat, and there was significant uncertainty concerning whether it would ever actually mature into such a threat. Of particular note, while the conduct involved a consummated merger, the complaint alleged a violation of Section 2 of the Sherman Act. The case settled with Questcor's new owner, Mallinkrodt, agreeing to pay $100 million in civil monetary relief, and to license Synacthen to another pharmaceutical company.[12]

As this example shows, one obvious element that must be established in a Section 2 case is monopoly power. That already makes the use of Section 2 much more limited than Section 7. In *Steris/Synergy*, the largest company in the industry was a company called Sterigenics, so Section 2 would not have worked. And in *Meta/Within,* the acquirer was not even in the virtual fitness market, and to the extent that the target could be regarded as a "monopoly" (which was debatable), a target selling itself to a larger company does not seem to be an exclusionary or anticompetitive act *from the target's standpoint* (except, perhaps, in the literal sense that all acquisitions "exclude" other buyers).

Assuming monopoly power can be shown, what about causation? Here Section 2 has advantages over the actual potential competition theory in Section 7. As Bruce Hoffman pointed out in a speech when he was Director of the FTC's Bureau of Competition, Section 2 imposes a higher bar in its requirement that there be monopoly power, but a lower bar on causation:

> Now for the lower bar facing monopolization claims—causation. More specifically, Section 2 imposes a somewhat relaxed test for the causal relationship between the exclusionary conduct and the acquisition or maintenance of monopoly power. Some kind of relationship between the challenged conduct and the acquisition or maintenance of monopoly power is clearly needed. But, on the other hand, it's also clear that plaintiff does not need to show that, on the balance of probabilities, in the hypothetical world that would have existed without the challenged conduct, the defendant would not have acquired or maintained the monopoly power that it in fact now enjoys.
>
> The classic statement here is by the entire Court of Appeals for the D.C. Circuit, sitting en banc in Microsoft. The members of that court went out of their way to reject the idea that a plaintiff must strictly prove that the conduct was a but-for cause of the monopoly.[13]
>
> The Microsoft court wrote:
>
> [T]he question in this case is not whether Java or Navigator would actually have developed into viable platform substitutes, but (1) whether as a general matter the exclusion of nascent threats is the type of conduct that is reasonably capable of con-

12 D. Bruce Hoffman, Director, Bureau of Competition, Fed. Trade Comm'n, Antitrust in the Digital Economy: A Snapshot of FTC Issues, Remarks at GCR Live Antitrust in the Digital Economy (May 2019) at 6.

13 *Id.* at 10.

tributing significantly to a defendant's continued monopoly power and (2) whether Java and Navigator reasonably constituted nascent threats at the time Microsoft engaged in the anticompetitive conduct at issue.[14]

Scott Hemphill & Tim Wu concur. Quoting *Microsoft,* they write that the causation test requires merely that the "exclusion of nascent threats is the type of conduct that is reasonably capable of contributing significantly" to monopoly maintenance, and that the targets of exclusion "reasonably constituted nascent threats."[15]

Of course, there are disadvantages to using Section 2. Monopolization cases tend to consume enormous resources, ordinarily much larger than merger cases. We also need to be careful that we are not punishing success. The grocery store chain A&P was under antitrust scrutiny for much of its corporate existence. The first investigation, launched by the FTC, was terminated in 1929 without action. But, as author Marc Levinson has noted, "that reprieve would prove temporary: A&P would be under federal investigation continuously for the next quarter century."[16]

Another important question is whether this approach has application outside of digital "platforms." Hemphill & Wu suggest there are a number of industries where Section 2 could be an effective enforcement mechanism: "Nascent competition tends to be important in industries marked by rapid innovation and technological change. Software, pharmaceuticals, mobile telephony, e-commerce, search, and social network services are leading examples."[17]

What about a series of small mergers? This issue has taken prominence lately, given the sheer volume of mergers the largest tech firms have engaged in. Again, however, arguably Section 2's reach should be broader than tech. Historically, one of the examples of repeated small acquisitions used to create a monopoly was Standard Oil.[18]

Finally, returning to merger enforcement, the potential competition doctrine probably needs a makeover. As I write this, the federal antitrust agencies are preparing to issue new merger guidelines. Will the new merger guidelines help make Section 7 more effective in acquisitions of nascent competitors? It seems at a minimum that the guidelines are likely to include some discussion of this issue, and thus fill in an important blank.

The current Horizontal Merger Guidelines state that "An acquisition eliminating a maverick firm . . . . in a market vulnerable to coordinated conduct is likely to cause adverse coordinated effects." Perhaps the new guidelines should say something like "An acquisition eliminating a nascent competitor whose prospective innovation represents a serious threat to an incumbent is likely to cause adverse effects." Perhaps we will get lucky and there also will be something about mergers that "tend to create a monopoly."

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14 *United States v. Microsoft Corp.*, 253 F.3d 34, 79 (D.C. Cir. 2001). "[I]t 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 change and frequent paradigm shifts." Id.

15 *Nascent Competitors* at 1898.

16 MARC LEVINSON, THE GREAT A&P AND THE STRUGGLE FOR SMALL BUSINESS IN AMERICA 115 (2d ed. 2019). Notably, however, these investigations and cases did not interfere with A&P's growth or its ability to adapt to changes in how Americans shopped. A&P's decline came about due to a series of management missteps.

17 *Nascent Competitors* at 1887.

18 *Standard Oil Co. of New Jersey v. United States*, 221 U.S. 1, 75 (1911) (" . . . the unification of power and control over petroleum and its products which was the inevitable result of the combining in the New Jersey corporation by the increase of its stock and the transfer to it of the stocks of so many other corporations, aggregating so vast a capital, gives rise, in and of itself, in the absence of countervailing circumstances, to say the least, to the prima facie presumption of intent and purpose to maintain the dominancy over the oil industry, not as a result of normal methods of industrial development, but by new means of combination which were resorted to in order that greater power might be added than would otherwise have arisen had normal methods been followed, the whole with the purpose of excluding others from the trade, and thus centralizing in the combination a perpetual control of the movements of petroleum and its products in the channels of interstate commerce.").

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