

10. Potential Competition Mergers

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Topics

- Eliminating potential competition
 - Elimination of actual potential competition
 - Elimination of perceived potential competition

Eliminating Potential Competition

Two potential competition theories

1. Elimination of actual potential competition

- ❑ This theory concerns a merger that eliminates a firm as an independent potential entrant into the relevant market
- ❑ Absent the merger, there must be a reasonable probability that the firm would enter independently¹
- ❑ That entry must offer a substantial likelihood of ultimately reducing concentration or producing other significant procompetitive effects²
- ❑ The competitive concern is that the merger eliminates future rivalry and leaves the market less competitive than it would likely have been without the merger

2. Elimination of perceived potential competition

- ❑ This theory concerns the present competitive influence of a firm that incumbents perceive as a credible potential entrant into the relevant market
- ❑ The prospect of entry may cause incumbents to compete more vigorously, including by lowering prices, improving product quality, or engaging in other procompetitive conduct
- ❑ A merger that removes this constraint may substantially lessen current competition, even without proof that the potential entrant would actually have entered independently³

¹ BOC Int'l Ltd. v. FTC, 557 F.2d 24, 27-29 (2d Cir. 1977).

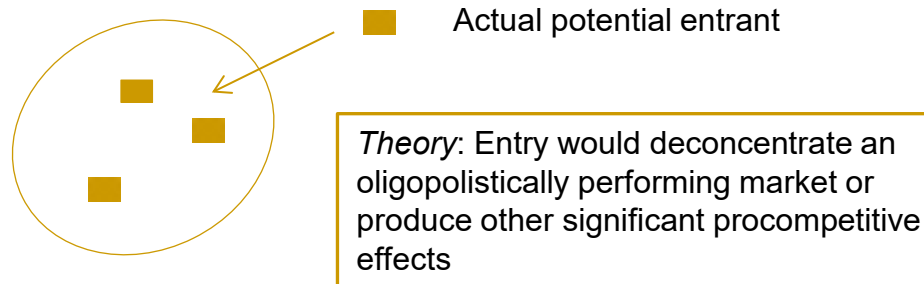
² United States v. Marine Bancorporation, Inc., 418 U.S. 602, 633 (1974); BOC Int'l Ltd. v. FTC, 557 F.2d 24, 27-29 (2d Cir. 1977).

³ United States v. Falstaff Brewing Corp., 410 U.S. 526, 531-36 (1973); Marine Bancorporation, 418 U.S. at 624-25.

Actual potential competition

■ The idea

- A merger may eliminate reasonably probable independent entry that would have reduced concentration or produced other significant procompetitive effects



- NB: The actual potential entrant may be either:
 - The target, or
 - The acquiring firm

Actual potential competition

■ *Marine Bancorp*¹

- While reserving on its viability, the Supreme Court observed that the actual potential competition doctrine:

proscribes a market extension merger solely on the ground that such a merger eliminates the prospect for long-term deconcentration of an oligopolistic market that in theory might result if the acquiring firm were forbidden to enter except through a de novo undertaking or through the acquisition of a small existing entrant (a so-called foothold or toehold acquisition).²

- The Second Circuit described the doctrine:

The theory of the doctrine is that competition in the market would be enhanced by the addition of the new competitor and therefore the elimination of such a potential competitor would substantially lessen competition within the meaning of § 7.³

¹ United States v. Marine Bancorporation, Inc., 418 U.S. 602, 625 (1974).

² *Id.* at 625.

³ United States v. Siemens Corp., 621 F.2d 499, 504 (2d Cir. 1980).

Actual potential competition

■ Acceptance by courts

□ Not yet approved by the Supreme Court

- In *Falstaff and Marine Bancorporation*, the Supreme Court reserved whether eliminating actual potential competition alone could violate Section 7¹
- *WDC*: The actual potential competition doctrine follows logically from comparing future competition with and without the acquisition
 - Section 7 prohibits mergers the effect of which “may be substantially to lessen competition”²
 - In assessing competitive effects, courts compare competition on a *going-forward basis* with and without the acquisition, so that the anticompetitive effect element is satisfied if there is a reasonable probability that competition in the market with the acquisition would be substantially less than competition without the acquisition³
 - As a result, an acquisition that satisfies the elements of the actual potential competition doctrine violates Section 7 and is a viable theory of anticompetitive harm

¹ See *United States v. Marine Bancorporation, Inc.*, 418 U.S. 602, 625-26, 633, 638-39 (1974); *United States v. Falstaff Brewing Corp.*, 410 U.S. 526, 537-38 (1973).

² Clayton Act § 7, 15 U.S.C. § 18.

³ See *Yamaha Motor Co. v. FTC*, 657 F.2d 971, 977-78 & n.7 (8th Cir. 1981).

Actual potential competition

■ Acceptance by courts (con't)

□ Lower courts

- Some lower courts recognize the elimination of actual potential competition as an anticompetitive harm under Section 7; others have assumed the doctrine's validity without deciding it. Guideline 4 of the 2023 DOJ/FTC Merger Guidelines expressly addresses the theory.¹

- Low success rates

- Of the circuit courts, only the Eighth Circuit has found the plaintiff met its burden of proof under this doctrine, upholding the FTC's finding after an administrative trial that a joint venture eliminated actual potential competition from the market for outboard motors²

□ But agencies have used the actual potential competition doctrine to obtain consent orders or decrees when—

1. The market is highly concentrated, *and*
2. The evidence supports reasonably probable independent entry with significant procompetitive effects³

¹ See, e.g., *Yamaha Motor Co. v. FTC*, 657 F.2d 971, 977-81 (8th Cir. 1981); *United States v. Siemens Corp.*, 621 F.2d 499, 506 (2d Cir. 1980) (assuming the doctrine's validity); *FTC v. Steris Corp.*, 133 F. Supp. 3d 962, 966 (N.D. Ohio 2015) (same); U.S. Dep't of Justice & Fed. Trade Comm'n, *Merger Guidelines* § 2.4.A, at 11-12 (2023).

² *Yamaha Motor Co.*, 657 F.2d at 980-81 (declining to reach the alternative actual-competition ground).

³ See, e.g., *Complaint* ¶¶ 8-10, 12(b)-(d), *Actavis, Inc.*, No. C-4414 (F.T.C. issued Sept. 27, 2013); *Decision & Order* § II.A, *Actavis, Inc.*, No. C-4414 (F.T.C. issued Dec. 4, 2013).

Actual potential competition

- Elements of the actual potential competition theory of harm
 1. The relevant market must be operating noncompetitively with room for competitive improvement
 2. The potential entrant must be relatively unique in its ability and incentive to enter the relevant market
 3. The potential entrant must have “available, feasible means” of independent entry
 4. The actual potential entrant must have a reasonable likelihood of entry into the relevant market in the near future
 5. Entry, if it were to occur, must have a reasonable probability of a substantial procompetitive effect

Actual potential competition

- Two important notes

1. Not all of these elements are specifically identified as such in the case law but are inherent in the precedent and the underlying economic theory
2. Proof: Observations/predictions
 - All five elements require evidentiary support
 - The fourth element requires a prediction of the fact and timing of independent entry
 - The fifth element requires a prediction of the procompetitive effect of entry, assuming it occurs

The following slides unpack the five elements

Actual potential competition

■ Elements of the actual potential competition theory of harm

1. Non-competitiveness

- The relevant market in which the anticompetitive effect may occur must be operating non-competitively before the acquisition:

[T]he doctrine comes into play only where there are dominant participants in the target market engaging in interdependent or parallel behavior and with the capacity effectively to determine price and total output of goods or services.¹

- If the market is already performing competitively, the traditional doctrine's concern with long-term deconcentration is absent
- When the actual potential entrant is the target, the market of concern is the market in which the buyer operates
 - This is the market that putatively would be more competitive if, absent the acquisition, the potential entrant actually entered the market
 - In some cases, the potential entrant may be the buyer, in which case the market of interest is the market in which the target (the incumbent firm) operates

¹ United States v. Marine Bancorporation, Inc., 418 U.S. 602, 630 (1974).

Actual potential competition

■ Elements of the actual potential competition theory of harm

1. Non-competitiveness (con't)

■ Proof¹

- Sufficiently high concentration can establish a prima facie showing that the market is a candidate for the potential competition doctrine
 - The case law does not establish a uniform HHI threshold; the 2023 Merger Guidelines define a concentrated market under Guideline 4 as one with an HHI greater than 1000²
- If the plaintiff makes out a prima facie case, the burden shifts to the merging parties to show that the concentration ratios do not accurately depict the economic characteristics of the relevant market
 - WDC: As a matter of modern antitrust jurisprudence following the *Baker Hughes* three-step burden-shifting approach, the burden on the merging parties should be one of production; the ultimate burden of proving non-competitiveness should rest with the plaintiffs³
 - Evidence of declining concentration does not necessarily rebut the showing if the market remains concentrated and there is no clear trend toward deconcentration⁴

¹ See *United States v. Marine Bancorporation, Inc.*, 418 U.S. 602, 630-31 (1974).

² U.S. Dep't of Justice & Fed. Trade Comm'n, Merger Guidelines § 2.4, at 10 & n.21 (2023).

³ See *United States v. Baker Hughes Inc.*, 908 F.2d 981, 982-83 (D.C. Cir. 1990).

⁴ See *Mercantile Tex. Corp. v. Bd. of Governors of the Fed. Rsrv. Sys.*, 638 F.2d 1255, 1267 (5th Cir. Unit A 1981).

Actual potential competition

■ Elements of the actual potential competition theory of harm

2. Uniqueness

- The putative potential entrant must be somewhat unique in its incentives and ability to enter the relevant market
- If there are numerous other similarly situated potential entrants, the elimination of one through acquisition is unlikely to affect the long-run level of competition in the market
- The 1984 DOJ Merger Guidelines generally provided that the Department was unlikely to challenge if three or more other firms shared the entry advantages; that historical screen is not a current numerical safe harbor¹

¹ U.S. Dep't of Justice, Merger Guidelines § 4.133 (1984) (also allowing a challenge when evidence of likely actual entry was particularly strong); see U.S. Dep't of Justice & Fed. Trade Comm'n, Merger Guidelines § 2.4.A (2023).

Actual potential competition

■ Elements of the actual potential competition theory of harm

3. “Available, feasible means” of procompetitive entry

- The putative potential entrant must have “available feasible means” of entering the relevant market other than through the challenged acquisition¹
- Courts recognize two types of procompetitive entry alternatives: de novo entry and “toehold” entry
 - For de novo entry to qualify as an “available, feasible means” of procompetitive entry, consider:
 - the potential entrant’s financial, engineering and other capabilities required to enter the market de novo, *and*
 - whether any barriers to entry into the market are so high as to be preclusive
 - For a toehold acquisition to qualify as an “available, feasible means” of procompetitive entry:
 - toehold firms must exist in the target market, which if acquired would provide a viable avenue to developing a significant market presence; and
 - such firms must be available for acquisition, presumably on objectively reasonable terms
- Proof of “available, feasible means” of procompetitive entry is an element of the plaintiff’s prima facie case and cannot be presumed solely on the basis of the potential entrant’s resources and motivation to enter²

¹ United States v. Marine Bancorporation, Inc., 418 U.S. 602, 633 (1974).

² See *id.* at 633-39; United States v. Siemens Corp., 621 F.2d 499, 507-08 (2d Cir. 1980).

Actual potential competition

■ Elements of the actual potential competition theory of harm

4. Incentive

- But for the acquisition, the putative potential entrant must have sufficient incentive to enter the market using one of the above means to make entry in the near future likely¹
- Evidence of likely entry may be objective or subjective; subjective evidence is not required if objective evidence is sufficient²
- Evidence to consider
 - The anticipated profitability of the potential entrant's independent entry³
 - The assessment must account for the entrant's costs of entry, expected competitive conditions, and alternative investment opportunities³
 - Ordinary course plans, budgets, capital requests, customer commitments, management testimony, and experience in comparable markets
- Subjective evidence
 - The weight of management testimony depends on its consistency with contemporaneous documents and objective circumstances⁴

¹ For cases requiring that the actual potential entrant be likely to enter in the "near future" absent the acquisition, see *Tenneco, Inc. v. FTC*, 689 F.2d 346, 352 (2d Cir. 1982); *United States v. Siemens Corp.*, 621 F.2d 499, 505 (2d Cir. 1980); *BOC Int'l, Ltd. v. FTC*, 557 F.2d 24, 29 (2d Cir. 1977).

² *Mercantile Tex. Corp. v. Bd. of Governors of the Fed. Rsrv. Sys.*, 638 F.2d 1255, 1269-70 (5th Cir. Unit A 1981).

³ *Id.* at 1269.

⁴ See *FTC v. Steris Corp.*, 133 F. Supp. 3d 962, 977-84 (N.D. Ohio 2015).

Actual potential competition

■ Elements of the actual potential competition theory of harm

4. Reasonable probability and timing of entry

■ Reasonable probability

- The Fifth Circuit stated: “A probability signifies that an event has a better than fifty percent chance of occurring. A ‘reasonable’ probability presumably represents an even greater likelihood of the event’s occurrence.”¹

■ “Near future”

- As a corollary to the reasonable probability requirement, courts have held that entry must be in the “near future” and that “eventual entry” without a reasonable temporal estimate makes the test one of “ephemeral possibilities”²

¹ *Mercantile Tex. Corp. v. Bd. of Governors of the Fed. Rsrv. Sys.*, 638 F.2d 1255, 1268-69 (5th Cir. Unit A 1981).

² *BOC Int’l, Ltd. v. FTC*, 557 F.2d 24, 28-29 (2d Cir. 1977) (“Thus the FTC was correct in using a ‘reasonable probability’ test here, but its accompanying reference to ‘eventual entry’ makes the overall FTC test, we believe, one based largely on ‘ephemeral possibilities.’”) (footnote omitted); see *Tenneco, Inc. v. FTC*, 689 F.2d 346, 352 (2d Cir. 1982); *United States v. Siemens Corp.*, 621 F.2d 499, 505 (2d Cir. 1980).

Actual potential competition

■ Elements of the actual potential competition theory of harm

4. Reasonable probability and timing of entry

- The Fifth Circuit has a slightly different take on the “near future” requirement:

The Board made no finding as to when Mercantile would actually enter either of the two markets. Mercantile urges that we adopt the Second Circuit's rule that independent entry must be shown likely to occur in the near future. See *Siemens*, 621 F.2d at 505; *BOC International*, 557 F.2d at 29. We agree that, as petitioner argued in *BOC International*, the “degree of uncertainty in any economic prediction becomes unacceptably high as it is projected further and further into the future.” 557 F.2d at 29. While concurring with the Second Circuit that a time limit is desirable to limit speculation, we believe that the time limit should be more directly related to the predication being made.

The amount of time needed for successful entry is relevant only if entry will be so delayed that the structure of the market will have changed by the time Mercantile actually enters. If the market has deconcentrated, Mercantile's pro-competitive efforts will no longer be required by the Clayton Act standard. At some point in the future, the degree of concentration in the market becomes so inherently unpredictable that the entire predictive enterprise should be abandoned out of fairness to the outsider firm. Accordingly, the Board should determine at what point Mercantile would be likely to enter the market. If Mercantile can enter either market within two or three years, we assume (absent contrary evidence) that each market will remain sufficiently concentrated so that Mercantile's procompetitive efforts are legally required. If Mercantile will not enter until much later, then the Board should assess the volatility of the two markets to determine the fairness of predicting whether they will still be concentrated at the time when Mercantile is likely to enter. A market's structure may or may not be predictable for five years; after that point, only the most stagnant market will support the extrapolation of previous data. As a heavily regulated industry, banking would not seem a likely candidate for the seer; regulatory change can quickly alter the structure of the market.¹

¹ *Mercantile Texas Corp. v. Bd. of Governors of Fed. Rsrv. Sys.*, 638 F.2d 1255, 1271-72 (5th Cir. 1981) (citation and footnotes omitted).

Actual potential competition

■ Elements of the actual potential competition theory of harm

5. Procompetitive effects of entry

- Assuming it occurred, entry by the actual potential entrant must have a “substantial likelihood of ultimately producing deconcentration of that market or other significant procompetitive effects”¹
 - *WDC*: In modern antitrust jurisprudence, a “substantial likelihood” should be read as a “reasonable probability”²

¹ United States v. Marine Bancorporation, Inc., 418 U.S. 602, 633 (1974).

² See *id.* at 636, 639.

Actual potential competition

■ Application

- *Typical application:* Pharmaceutical merger involving a marketed product and a competing product awaiting FDA approval or commercial launch
- *Example: Actavis/Warner Chilcott*
 - When Actavis sought to acquire Warner Chilcott, the FTC alleged that the transaction would eliminate actual potential competition against three Warner Chilcott branded pharmaceutical products: Actavis had FDA approval and was likely to be the first generic entrant for Loestrin 24 FE; for Lo Loestrin FE and Atelvia, it was one of a limited number of firms capable of entering in the near future and might be the first and only generic competitor for 180 days¹
 - The FTC also alleged elimination of existing competition in generic Femcon FE¹
 - As a remedy, the Commission accepted a consent order that required Actavis to divest all of its rights and assets relating to generic versions of all four drugs to Amneal Pharmaceuticals, a New Jersey-based generic pharmaceutical company that at the time marketed 65 products and maintained an active product development pipeline²
 - Actavis was also required to agree to supply generic versions of Femcon FE and Loestrin 24 FE to Amneal for two years, which Amneal could extend at its option for up to two additional one-year terms²

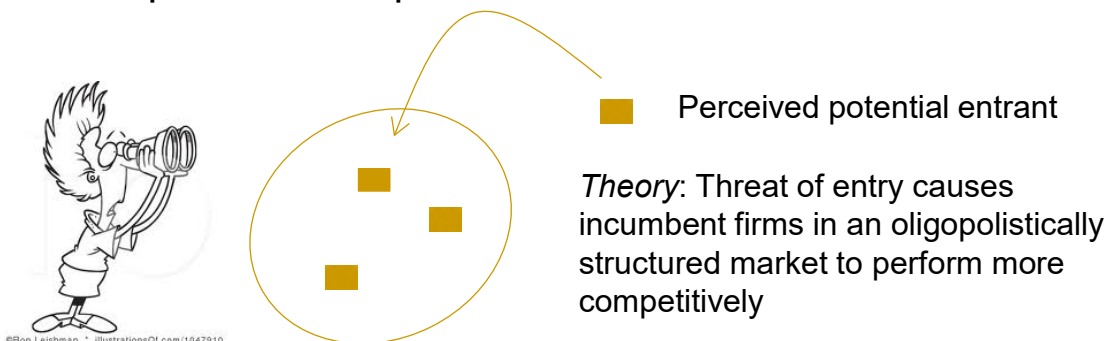
¹ Complaint ¶¶ 7-10, 12(a)-(d), Actavis, Inc., No. C-4414 (F.T.C. issued Sept. 27, 2013) (settled by consent order).

² Decision & Order §§ II.A, II.E, Actavis, Inc., No. C-4414 (F.T.C. issued Dec. 4, 2013); see Analysis of Agreement Containing Consent Orders To Aid Public Comment, at 1, 4, Actavis, Inc., No. C-4414 (F.T.C. Sept. 27, 2013).

Perceived potential competition

■ The idea

- A firm's perceived threat of entry may cause incumbents to moderate their prices ("limit pricing") or compete more vigorously in other ways
 - An acquisition that eliminates this threat of entry may remove that present competitive constraint
- Theory recognized by the Supreme Court¹
 - Guideline 4 of the 2023 Merger Guidelines expressly addresses this theory. Direct evidence of incumbents' reactions is not required; a likely influence on existing competition may be established by circumstantial evidence.²
- Relief may include enjoining the transaction or an effective divestiture that preserves or restores the lost independent competitive constraint³



¹ United States v. Falstaff Brewing Corp., 410 U.S. 526, 531-37 (1973); United States v. Marine Bancorporation, Inc., 418 U.S. 602, 624-25 (1974).

² Falstaff, 410 U.S. at 534 n.13; U.S. Dep't of Justice & Fed. Trade Comm'n, Merger Guidelines § 2.4.B, at 12 (2023).

³ See Ford Motor Co. v. United States, 405 U.S. 562, 573-77 (1972).

Perceived potential competition

■ Elements of the perceived potential competition theory of harm

1. Non-competitiveness

- In order for the elimination of perceived potential competition to have any anticompetitive effect, the market must be one in which the perceived threat of entry can constrain incumbent firms' market power
- An oligopolistic market structure can establish a prima facie showing that the market is a candidate for the doctrine, subject to rebuttal¹

2. Uniqueness

- As under the actual potential competition doctrine, the perceived potential entrant must be perceived as somewhat unique in its incentives and ability to enter the relevant market
- If there are numerous other similarly situated potential entrants in the minds of incumbent firms, the elimination of one through acquisition is unlikely to affect current competitive conditions in the market²
- The 1984 DOJ Merger Guidelines generally provided that the Department was unlikely to challenge if three or more other firms shared the entry advantages; that historical screen is not a current numerical safe harbor³

¹ United States v. Marine Bancorporation, Inc., 418 U.S. 602, 630-32 (1974); see U.S. Dep't of Justice & Fed. Trade Comm'n, Merger Guidelines § 2.4.B, at 12 (2023).

² See United States v. Falstaff Brewing Corp., 410 U.S. 526, 534 n.13 (1973).

³ U.S. Dep't of Justice, Merger Guidelines § 4.133 (1984) (also allowing a challenge when evidence of likely actual entry was particularly strong); see U.S. Dep't of Justice & Fed. Trade Comm'n, Merger Guidelines § 2.4 (2023).

Perceived potential competition

■ Elements of the perceived potential competition theory of harm

3. Perception as a likely potential entrant

- Incumbent firms must perceive the firm as a likely potential entrant
- Objective evidence of the potential entrant's capabilities and incentives to enter the relevant market is probative of the perception of the firm as a likely potential entrant¹

4. Incumbent reaction to the threat of entry

- Incumbent firms must be shown to be responding to the perceived threat of entry by maintaining lower prices, higher product quality, or other more favorable competitive terms than they otherwise would²
 - This competitive influence may be established by direct or circumstantial evidence; an observed price cut or an admission of entry-detering intent is not required²

5. Anticompetitive effect

- The acquisition must remove or weaken that competitive constraint, creating a reasonable probability of a substantial lessening of competition in the market²

■ Notes

1. Again, not all of these elements are specifically identified as such in the case law but are inherent in the precedent and the underlying economic theory

¹ United States v. Falstaff Brewing Corp., 410 U.S. 526, 533-34 & 534 n.13 (1973).

² United States v. Marine Bancorporation, Inc., 418 U.S. 602, 624-25, 639-40 (1974); Falstaff, 410 U.S. at 534 n.13; United States v. Siemens Corp., 621 F.2d 499, 505, 509 (2d Cir. 1980).

Elimination of potential competition

- Under either theory, the potential entrant may be either the target or the acquirer

