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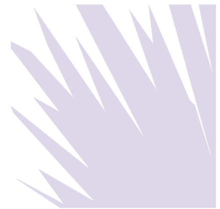

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POTENTIAL COMPETITION ANALYSIS UNDER THE 2010 MERGER GUIDELINES

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In August 2010, the Federal Trade Commission and the U.S. Department of Justice issued new Horizontal Merger Guidelines.[1] One of the less noticed revisions to the Guidelines is an explanation of how the agencies evaluate mergers involving potential competition concerns. The agencies had not provided guidance in this area since the Department of Justice issued its 1984 Merger Guidelines.[2] The 1992 Merger Guidelines were largely silent on this topic,[3] as was the Merger Guidelines Commentary.[4]

Despite the passage of twenty-six years, the analysis of potential competition concerns in the 2010 Guidelines largely tracks the approach of the 1984 Guidelines. The 2010 Guidelines nevertheless contain a number of advancements over both the 1984 Guidelines and the caselaw. Perhaps the most significant development is the recognition that mergers between potential competitors raise horizontal, not conglomerate, concerns and are therefore evaluated under horizontal merger principles. In addition, the 2010 Guidelines disregard the Supreme Court's distinction between actual and perceived potential competition claims, in favor of a unified approach for all mergers involving potential competitors.

I. POTENTIAL COMPETITION ANALYSIS UNDER THE CLAYTON ACT

The Supreme Court has held that Section 7 of the Clayton Act applies not only to mergers between actual competitors, but also to mergers between potential competitors. The courts have divided potential competition claims into two categories: perceived potential competition and actual potential competition. The courts have described the requirements for these theories somewhat differently, but both claims require a concentrated market and few other potential entrants "waiting in the wings."[5] Without these conditions,

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1 U.S. Dep't of Justice & Federal Trade Comm'n, Horizontal Merger Guidelines (2010), *available at* http://www.ftc.gov/os/2010/08/100819hmg.pdf (hereinafter 2010 Guidelines).

2 U.S. Dep't of Justice, Merger Guidelines (1984), *reprinted in* 4 Trade Reg. Rep. (CCH) Paragraph 13,103 (hereinafter 1984 Guidelines).

3 U.S. Dep't of Justice & Federal Trade Comm'n, Horizontal Merger Guidelines (1992, rev. 1997), *reprinted in* 4 Trade Reg. Rep. (CCH) Paragraph 13,104 (hereinafter 1992 Guidelines).

4 U.S. Dep't of Justice & Fed. Trade Comm'n, Commentary on the 1992 Horizontal Merger Guidelines (2006), *available at* http://www.ftc.gov/os/2006/03/CommentaryontheHorizontalMergerGuidelinesMarch2006.pdf.

5 *United States v. Marine Bancorporation, Inc.*, 418 U.S. 602, 630 (1974) ("The potential-competition doctrine has meaning only as applied to concentrated markets. That is, the doctrine comes into play only where there are dominant participants in the target markets engaging in interdependent or parallel behavior and with the capacity effectively to determine price and total output of goods or services."); *United States v. Falstaff Brewing Corp.*, 410 U.S. 526, 534 n.13 (1973); *Republic of Tex. Corp. v. Bd. of Governors of Fed. Reserve Sys.*, 649 F.2d 1026, 1048 n.39 (5th Cir. 1981) ("The perceived potential competition doctrine and the actual potential competition doctrine share some elements. Neither theory can apply to nonoligopolistic markets. … Similarly, both the perceived potential competition theory and the actual potential competition theory require a finding as to other potential entrants who may be 'waiting in the wings.'"); *see also FTC v. Procter & Gamble Co.*, 386 U.S. 568, 581 (1967) ("the number of potential entrants was not so large that the elimination of one would be insignificant").

the elimination of a potential entrant would be competitively irrelevant because there would be many other existing or potential competitors.

The *perceived* potential competition theory is premised on the idea that a firm not currently in a market may nevertheless exert a competitive influence if incumbents believe that the firm may enter. Economists refer to the idea that current producers may charge lower prices to discourage entry as limit pricing. Elimination of a potential entrant through acquisition may eliminate this competitive pressure, thus allowing current producers to raise prices, reduce quality, or otherwise harm competition.

In *Marine Bancorporation*, the Supreme Court identified the requirements for a perceived potential competition claim. In addition to the two general requirements for any potential competition claim (high concentration and few comparable entrants), a perceived potential competition plaintiff must show that one of the merging firms "has the characteristics, capabilities, and economic incentive to render it a perceived potential *de novo* entrant, and . . . [its] premerger presence on the fringe of the target market in fact tempered oligopolistic behavior on the part of existing participants in that market."[6]

Despite its moniker, the perceived potential competition doctrine in practice relies only to a limited degree on the perceptions of firms in the market. This can be seen from the requirement that the firm outside the market have the "characteristics, capabilities, and economic incentive"—all objective factors—of a potential entrant. For example, in *Marine Bancorporation*, the Court held that firms in a local banking market could not have perceived that the acquiring company might enter because incumbents would have been aware of the substantial regulatory barriers preventing entry. In reaching this conclusion, the Court did not rely on any testimony from the local banks. Likewise, in its *Falstaff Brewing* decision, the Court criticized the district court's failure to consider whether, based on "objective economic facts," rational competitors would expect a firm outside the market to enter.[7]

The *actual* potential competition theory is premised on the idea that the acquisition of a company that is on the verge of entering a market may eliminate the competitive benefits of an additional supplier. The Eighth Circuit,[8] the FTC, and the DOJ have adopted the actual potential competition doctrine, while the First,[9] Second,[10] Fourth,[11] and Fifth[12] Circuits have reserved judgment. Although the Supreme Court has twice

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6 *Marine Bancorporation*, 418 U.S. at 624-25.

7 *Falstaff*, 410 U.S. at 533-36; n.13.

8 *Ginsburg v. InBev NV/SA,* 623 F.3d 1229, 1234 (8th Cir. 2010) ("Nearly forty years ago, the Supreme Court identified [perceived potential competition and actual potential competition] as plausible theories of Section 7 liability ..."); *Yamaha Motor Co. v. FTC*, 657 F.2d 971, 977 (8th Cir. 1981) (finding liability based on loss of actual potential competition); *see also United States v. Phillips Petroleum Co.*, 367 F. Supp. 1226, 1232 (C.D. Cal. 1973) (condemning merger on both actual and perceived potential competition grounds), *aff'd mem.* 418 U.S. 906 (1974).

9 *Fraser v. Major League Soccer, L.L.C.*, 284 F.3d 47, 70-71 (1st Cir. 2002) (declining to reach validity of actual potential competition doctrine due to plaintiff's failure to establish a relevant market).

10 *Tenneco, Inc. v. FTC*, 689 F.2d 346, 355 (2d Cir. 1982) ("Because we hold that the Commission's findings and conclusions ... are unsupported by substantial record evidence, we need not reach the issue of the validity of the actual potential competition doctrine."); *United States v. Siemens Corp.*, 621 F.2d 499, 504-08 (2d Cir. 1980); *BOC Int'l Ltd. v. FTC*, 557 F.2d 24, 25 (2d Cir. 1977) ("[W]e have concluded that a fundamental 'precondition' to application of the doctrine has not been established on the record before us. We accordingly set aside the Commission's order and 'leave for another day,' the issue of the doctrine's basic validity.").

11 *FTC v. Atl. Richfield*, 549 F.2d 289, 293-94 (4th Cir. 1977).

12 *Republic of Tex. Corp. v. Bd. of Governors of Fed. Reserve Sys.*, 649 F.2d 1026, 1048 (5th Cir. Unit A 1981) ("As did the *Mercantile* court, we decline to decide in the absence of such findings whether the actual potential competition doctrine adequately describes a violation of the Clayton Act standard incorporated into section 3 of the Bank Holding Company Act."); *Mercantile Tex. Corp. v. Bd. of Governors*, 638 F.2d 1255, 1265 (5th Cir. Unit A 1981) ("We believe that the doctrine has logical force and is consonant with the language and policy of the Clayton Act. . . . In the absence of necessary findings by the Board, however, we will not decide whether the doctrine adequately describes a violation of the Clayton Act standard.").

declined to opine on the actual potential competition doctrine's validity,[13] in *Marine Bancorporation*, the Court noted that the doctrine requires, in addition to a highly concentrated market, that the acquired firm has "feasible means" of entry other than through the merger and "that those means offer a substantial likelihood of ultimately producing deconcentration of that market or other significant procompetitive effects."[14] Most courts also require that there be few other comparable potential entrants.[15]

Courts are divided over the standard of proof needed to show that a firm will enter the relevant market in an actual potential competition case. Most courts require a "reasonable probability" of entry.[16] A smaller number require "clear proof" of entry.[17] Courts generally give weight to both subjective evidence (a firm's plans for independent entry) and objective evidence (financial benefits of independent entry and the presence of entry barriers) to determine a firm's likelihood of entry; although in *Falstaff*, the Supreme Court suggested that objective evidence should be given more weight.[18] For purposes of the doctrine, entry can consist of either a de novo undertaking or a "toehold" acquisition of a small, existing competitor.[19]

Many have observed that the federal courts have not looked favorably on most potential competition claims and that the requirements described in *Marine Bancorporation* have resulted in substantial evidentiary hurdles for plaintiffs.[20] As the Eighth Circuit recently observed, "proof of liability under either theory is certain to entail expensive, uncertain litigation, even if … the acquiring firm is rich and powerful and the acquired firm's market highly concentrated."[21] Since the *Marine Bancorporation* decision, the number

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13 *Marine Bancorporation*, 418 U.S. at 639 ("[S]ince the preconditions for that theory are not present, we do not reach it, and therefore we express no view on the appropriate resolution of the question reserved in *Falstaff*."); *Falstaff*, 410 U.S. at 537-38 ("We leave for another day the question of the applicability of Section 7 to a merger that will leave competition in the marketplace exactly as it was, neither hurt nor helped, and that is challengeable under Section 7 only on grounds that the company could, but did not, enter de novo or through 'toe-hold' acquisition and that there is less competition than there would have been had entry been in such a manner. There are traces of this view in our cases, but the Court has not squarely faced the question, if for no other reason than because there has been no necessity to consider it." (citations omitted)).

14 *Marine Bancorporation*, 418 U.S. at 633.

15 *See, e.g.*, *Mercantile Tex. Corp.*, 638 F.2d at 1267 ("If there are numerous potential competitors waiting in the wings, elimination of Mercantile as one potential entrant would not be significant."); *B.A.T. Indus.*, 104 F.T.C. 852, 924 (1984) (requiring that there be "only a few equally likely actual potential entrants").

16 *Yamaha Motor*, 657 F.2d at 977-79; *Siemens*, 621 F.2d at 506-07; *BOC*, 557 F.2d at 28-29; *Republic of Texas*, 649 F.2d at 1045-46; *Mercantile Tex. Corp.*, 638 F.2d at 1268-69. Other courts appear to have applied a similar standard. *See Tenneco*, 689 F.2d at 352 (requiring that entry "would likely" have occurred in the relevant market); *see also* PHILIP W. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW Paragraph 1121b (3d ed. Supp. 2010) (suggesting that the standard should be that the potential entrant "would probably have entered the market within a reasonable period of time").

17 *Atl. Richfield*, 549 F.2d at 294-95; *B.A.T. Indus.*, 104 F.T.C. at 925-26. The clear proof standard does not appear to be consistent with language in Section 7 requiring only a showing that competition "may be" substantially lessened.

18 *Falstaff*, 410 U.S. at 533-36.

19 *Marine Bancorporation*, 418 U.S. at 625 (noting that the doctrine requires that a company would enter "through a de novo undertaking or through the acquisition of a small existing entrant (a so-called foothold or toehold acquisition)"); *Falstaff*, 410 U.S. at 537 (noting that the doctrine involves the potential for entry "de novo or through 'toe-hold' acquisition"). In contrast, the perceived potential competition doctrine is limited to the possibility of de novo entry. *See Marine Bancorporation*, 418 U.S. at 624-25.

20 *See, e.g.*, AREEDA & HOVENKAMP, *supra* note 16, Paragraph 1134 ("The potential competition merger doctrines . . . have largely fallen into disuse since the 1980s."); M. Sean Royall & Adam J. Di Vincenzo, *Evaluating Mergers Between Potential Competitors Under the New Horizontal Merger Guidelines*, ANTITRUST, Fall 2010, at 33, 35 ("Perhaps because of the Agencies' low success rate and higher burdens of proof, over the course of the ensuing three decades [after the *Marine Bancorporation* decision] there have been very few litigated merger cases involving potential competition claims."); ABA SECTION OF ANTITRUST LAW, MERGERS AND ACQUISITIONS: UNDERSTANDING THE ANTITRUST ISSUES 415 (3d ed. 2008) ("In the years since the Supreme Court's decision in *Marine Bancorporation*, the potential competition doctrine has been infrequently used in litigation, and rarely successfully."); Darren Bush & Salvatore Massa, *Rethinking the Potential Competition Doctrine*, 2004 WIS. L. REV. 1035, 1058 (2004) ("[M]any courts have become very skeptical of such claims entirely."); *id.* at 1158 ("Since the 1970s, the doctrine has found itself living in the shadows of antitrust. …"); John E. Kwoka, *Non-Incumbent Competition: Mergers Involving Constraining and Prospective Competitors*, 52 CASE W. RES. L. REV. 173 (2001) ("[A]t present, the judicial view toward nonincumbant competition is one of considerable skepticism. …"); Andrew S. Joskow, *Potential Competition: The Bell Atlantic/NYNEX Merger*, 16 REV. INDUS. ORG. 185, 189 (2000) (the actual potential competition "cases have become so rare as to make the whole notion virtually absent from antitrust"); LAWRENCE A. SULLIVAN & WARREN S. GRIMES, THE LAW OF ANTITRUST: AN INTEGRATED HANDBOOK Section 11.3b3, at 622 (2000) ("The doctrine of potential competition has fallen on hard times. … [T]he evidentiary hurdles courts have erected virtually repeal the potential competition doctrine.").

21 *Ginsburg v. InBev NV/SA,* 623 F.3d 1229, 1234 (8th Cir. 2010).

of litigated cases involving either potential competition doctrine has declined significantly. Even at the doctrine's heyday, few plaintiffs were successful, typically because of their inability to establish that the potential entrant was or could be a competitive constraint on incumbents. Indeed, one treatise claims that no court has found liability solely due to the loss of perceived potential competition.[22]

The recent challenge to the merger between beer giants InBev and Anheuser-Busch illustrates the difficulties of establishing a potential competition claim.[23] The district court acknowledged that the U.S. beer market was concentrated and that InBev had the technical and financial ability to enter, notwithstanding the industry's substantial entry barriers. Nevertheless, the district court denied plaintiffs' motion for a preliminary injunction, finding that entry by InBev would have been unprofitable, that Anheuser-Busch did not perceive InBev as a potential competitor, and that InBev did not in fact intend to enter the U.S. market. The district court, mindful of the *Falstaff* decision, identified both objective and subjective evidence in support of its findings. The Eighth Circuit affirmed, concluding that the divestiture sought by plaintiffs would have had the perverse result of "increase[ing] the cost of brewing and selling the beers Plaintiffs drink."[24]

Claims that the antitrust agencies have essentially stopped challenging mergers on potential competition grounds,[25] however, appear greatly overstated. Despite some prior skepticism expressed for the doctrine,[26] the federal antitrust agencies have relied on potential competition concerns as a basis for a number of their recent investigations and enforcement actions. Potential competition issues arise with some frequency in technology,[27] health care,[28]

22 ABA SECTION OF ANTITRUST LAW, ANTITRUST LAW DEVELOPMENTS Ch. 3.C.1.a (6th ed. 2007) ("Mergers have been found unlawful based on the theory of perceived potential competition in only three cases, all of which also based liability on the actual potential competition theory, and one of which subsequently was reversed."); *see also Lektro-Vend Corp. v. Vendo Corp.*, 500 F. Supp. 332, 362 (N.D. Ill. 1980) (observing that there has been "almost uniform rejection of potential competition theories in market extension cases subsequent to *Marine Bancorporation*"); Gregory J. Werden & Kristen C. Limarzi, *Forward-Looking Merger Analysis and the Superfluous Potential Competition Doctrine*, 77 ANTITRUST L.J. 109, 119 (2010) ("'[P]erceived potential' competition, as described by the Supreme Court, is such a rare bird that neither that Court nor any appeals court has ever seen it.").

23 *Ginsberg v. InBev SA/NV,* 2008 WL 4965859 (E.D. Mo. Nov. 18, 2008) (denying preliminary injunction), *aff'd*, 623 F.3d 1229 (8th Cir. 2010).

24 *Ginsburg*, 623 F.3d at 1236.

25 *See, e.g.*, John Kwoka, *Eliminating Potential Competition*, *in* ABA SECTION OF ANTITRUST LAW, ISSUES IN COMPETITION LAW AND POLICY 1437, 1453 (2008) (stating that the *Marine Bancorporation* decision "has caused the DOJ and FTC essentially to stop bringing cases on potential competition grounds"); *id.* at 1454 ("Over the past 30 years, the doctrine of potential competition has nearly disappeared from active antitrust enforcement policy in the United States.").

26 The FTC appears to have lost interest in pursuing actual potential competition cases in the 1980s. *See B.A.T. Indus.*, 104 F.T.C. at 919 (describing actual potential competition as a "rather peculiar theory of competitive injury"); *see also id.* at 947 (concurrence of Commissioner Bailey) ("[A]t the Commission at least, actual potential competition theory is dead."); *60 Minutes with James C. Miller*, 54 ANTITRUST L.J. 155, 174 (1985) (FTC Chairman Miller: "In theory, actual potential competition cases can be brought. But in practice, it is very difficult to secure the relevant evidence to find a law violation.").

27 *See, e.g.*, Statement of Federal Trade Commission Concerning Google/DoubleClick at 8-9, FTC File No. 071-0170, *available at* http://www.ftc.gov/os/caselist/0710170/071220statement.pdf (Dec. 20, 2007) (closing merger investigation involving Internet advertising that was premised in part on potential competition theory); ABB AB, 64 Fed. Reg. 3130 (FTC Jan. 20, 1999) (analysis to aid public comment) (process mass spectrometers).

28 An FTC staff report identifies sixteen merger enforcement actions involving potential competition concerns in the pharmaceutical industry and another three enforcement actions in the medical device industry from 2000 to 2009. *See* HEALTH CARE DIV., BUREAU OF COMPETITION, FED. TRADE COMM'N, OVERVIEW OF FTC ANTITRUST ACTIONS IN HEALTH CARE SERVICES AND PRODUCTS 91-94, 115-18 (2010), *available at* http://www.ftc.gov/bc/0610hcupdate.pdf. Other potential competition cases not identified in this report include Thoratec/Heartware and Ovation. *See infra* note 33. The DOJ has also brought healthcare cases alleging the loss of potential competition. *See, e.g.*, Complaint, *United States v. Pearson PLC*, No. 1:08-cv-00143 (D.D.C. filed Jan. 24, 2008), *available at* http://www.justice.gov/atr/cases/f229500/229561.htm (adult abnormal personality clinical tests).

telecommunications,[29] and airline mergers[30] investigated by the FTC and DOJ. An FTC report indicates that between fiscal years 1996 and 2007, the agency issued 17 second requests, representing 6 percent of the total, to investigate potential competition concerns.[31] Over the past decade, the agencies have enforced almost two dozen mergers involving potential competition concerns.[32] Most of these were resolved through a consent decree, but a few resulted in federal court or administrative litigation. Between 2008 and 2009, for example, the agencies brought four Section 7 cases premised in part on the loss of potential competition.[33]

II. POTENTIAL COMPETITION ANALYSIS UNDER THE 1984 AND 1992 MERGER GUIDELINES

The 1984 Merger Guidelines acknowledged that an acquisition involving a potential competitor could adversely affect competition and serve as the basis for an enforcement action. The 1984 Guidelines noted that harm could occur to either actual or perceived potential competition, but explained that "the Department will evaluate mergers that raise either type of potential competition concern under a single structural analysis analogous to that applied to horizontal mergers."[34] The first step in the analysis was consideration of five "objective factors designed to identify cases in which harmful effects are plausible": concentration, ease of entry, the number of firms with comparable ability to enter, the market share of the incumbent merging party, and efficiencies.[35]

Entry analysis played a key role under the 1984 Guidelines. A challenge was "unlikely" if entry into the market was generally easy or if the entry advantage of the

29 *See, e.g.*, *United States v. SBC Communications Inc. and Ameritech Corporation*, 64 Fed. Reg. 23,099, at 23,107-08 (DOJ Apr. 29, 1999) (competitive impact statement) (stating that merger injured competition by preventing Ameritech from executing its plan to provide local exchange and long distance telephone services in SBC's local telephone service area); Complaint Paragraph 24a, *United States v. Bell Atlantic Corp.,* Civil No. 1:99-cv-01119 (D.D.C. filed May 7, 1999) (alleging that merger between companies that provide local exchange and wireless telephone services would eliminate "actual and potential competition"); Complaint, *United States v. Primestar, Inc.,* Civil No. 1:98-cv-01193 (JLG) (D.D.C. filed May 12, 1998) (alleging that acquisition of satellites by cable operators would prevent entry by an independent owner of those assets).

30 *See, e.g.*, Press Release, U.S. Dep't of Justice, Department of Justice and Several States Will Sue to Stop United Airlines from Acquiring US Airways (July 27, 2001) (challenging airline merger in part on the ground that United was the most likely airline to enter seven hub-to-hub routes then served only by US Airways on a nonstop service); Amended Complaint Paragraph 32, *United States v. Northwest Airlines Corp.,* Civil Action No. 98-cv-74611 (E.D. Mich. filed Dec. 18, 1998) ("As the only airline with a hub at the other end point, Continental is the most likely potential entrant to challenge Northwest's nonstop monopoly."). Potential competition concerns were reportedly investigated in the Delta/Northwest and Northwest/Midwest transactions.

31 Fed. Trade Comm'n, Horizontal Merger Investigation Data, Fiscal Years 1996–2007, Table 1 (Dec. 1, 2008), *available at* http://www.ftc.gov/os/2008/12/081201hsrmergerdata.pdf. The six percent figure is derived from the number of second requests addressing potential competition concerns (17) and the total number of second requests that were categorized with a theory of harm (269).

32 *See* notes 27-30, 33.

33 *See* Press Release, Fed. Trade Comm'n, FTC Challenges Thoratec's Proposed Acquisition of HeartWare International (July 30, 2009), *available at* http://www.ftc.gov/opa/2009/07/thoratec.shtm (announcing challenge to medical device maker whose competing product was in clinical trials; parties abandoned transaction); Verified Complaint Paragraphs 33-36, 40-42, *United States v. Microsemi Corp.*, Case No. 8:09-cv-00275-AG-AN (C.D. Cal. Dec. 18, 2008), *available at* http://www.usdoj.gov/atr/cases/f240500/240537.htm (challenging consummated acquisition in part on the ground that the acquired company was likely to obtain qualification and compete against Microsemi for certain diodes; parties later entered into consent decree); Press Release, Fed. Trade Comm'n, FTC Sues Ovation Pharmaceuticals for Illegally Acquiring Drug Used to Treat Premature Babies with Life-Threatening Heart Condition (Dec. 16, 2008), *available at* http://www.ftc.gov/opa/2008/12/ovation.shtm (announcing challenge to acquisition of rights to competing drug for treatment of patent ductus arteriosus six months before its launch); Complaint Paragraphs 27-31, 38, Polypore Int'l, Inc., Docket No. 9327 (FTC Sept. 9, 2008) (alleging that transaction "eliminated actual, actual potential, and perceived potential competition between Daramic and Microporous").
Other recent litigated cases involving potential competition claims include Whole Foods and Staples. *See* Complaint ¶ 43h, *FTC v. Whole Foods Market, Inc.*, Case No. 1:07-cv-01021 (D.D.C. filed June 5, 2007) (merger between high-end supermarkets "will eliminate potential competition in numerous parts of the country"); *FTC v. Staples, Inc.*, 970 F. Supp. 1066, 1082 (D.D.C. 1997) ("Absent the merger, the firms are likely, and in fact have planned, to enter more of each other's markets, leading to a deconcentration of the market and, therefore, increased competition between the superstores.").

34 1984 Merger Guidelines Section 4.13. Other than explicitly adding consideration of efficiencies in the 1984 Guidelines, the treatment of potential competition claims under the 1982 and 1984 Guidelines is identical. For ease of reference, only citations to the 1984 Guidelines are provided.

35 1984 Merger Guidelines Section 4.13.

merging potential entrant was "also possessed by three or more other firms."[36] However, if there was a strong likelihood of entry by a merging party, the number of other potential competitors would not be determinative and the agency would evaluate the merger under ordinary horizontal merger principles, treating the entrant as in the market.

If the five objective factors suggested concerns, the agency would then consider evidence presented by the parties tending to show that the inference of competitive harm drawn from the objective factors was unreliable.[37] Presumably, this could include subjective evidence, such as testimony from potential entrants as to their likelihood of entry.

The 1992 Guidelines did not include a discussion of potential competition.[38] The 1992 Guidelines did, however, shift some cases from a potential competition rubric to a standard horizontal merger approach. In a departure from prior versions of the Guidelines, the 1992 Guidelines considered market participants to be not only existing producers, but also so-called uncommitted entrants, which are firms that could enter within a year without significant sunk costs in response to a small but significant, nontransitory increase in price (SSNIP).[39] Acquisitions of uncommitted entrants followed the standard analytical approach for horizontal mergers, including consideration of market shares, unilateral and coordinated effects, entry, efficiencies, and the failing firm defense. In contrast, under the 1984 Guidelines, mergers involving uncommitted entrants would have been analyzed under potential competition principles.

Thus, by 1992, the antitrust agencies treated an increasing number of mergers involving a potential entrant under ordinary horizontal merger principles. Read together, the 1984 and 1992 Guidelines applied a horizontal merger framework to mergers involving a potential entrant where (1) there was a strong likelihood of entry by the potential entrant or (2) the potential entrant could enter within a year with minimal sunk cost. As described next, the 2010 Guidelines continued this shift towards analyzing potential competition mergers under a standard horizontal merger framework.

III. POTENTIAL COMPETITION ANALYSIS UNDER THE 2010 MERGER GUIDELINES

For the first time since the 1984 Guidelines, the 2010 Guidelines explicitly discuss how the antitrust agencies evaluate potential competition concerns in their merger review. The new Guidelines note at the outset that they describe "the enforcement policy of the Department of Justice and the Federal Trade Commission with respect to mergers and acquisitions involving *actual or potential competitors* under the federal antitrust laws."[40]

The 2010 Guidelines assert that a "merger between an incumbent and a potential entrant can raise significant competitive concerns."[41] However, unlike the 1984 Guidelines, there is not a freestanding section describing how the agencies evaluate mergers involving

36 *Id.* Sections 4.132, 4.133. Consistent with the case law, the Guidelines' notion of entry included both de novo entry and toehold acquisition. *Id.* Section 4.112 ("The more procompetitive alternatives include both new entry and entry through a 'toehold' acquisition of a present small competitor.").
37 *Id.* Section 4.13. The DOJ would also consider the likelihood and magnitude of the potential harm. *Id.*
38 The 1992 Guidelines noted that the standards for evaluating potential competition concerns in the 1984 Guidelines remained operative. *See* U.S. Department of Justice and Federal Trade Commission Statement Accompanying Release of Revised Merger Guidelines (1992), *reprinted in* 4 Trade Reg. Rep. (CCH) Paragraph 13 ("Neither agency has changed its policy with respect to non-horizontal mergers. Specific guidance on non-horizontal mergers is provided in Section 4 of the Department's 1984 *Merger Guidelines*, read in the context of today's revisions to the treatment of horizontal mergers.").
39 1992 Guidelines Section 1.3. Uncommitted entrants, like other market participants, are assigned market shares to reflect their future competitive significance. *Id.* Section 1.41.
40 2010 Guidelines Section 1 (emphasis added; abbreviations omitted).
41 *Id.* Section 5.3; *see also id.* Section 1 ("[M]erger enforcement should interdict competitive problems in their incipiency. ...").

potential competitors. Instead, potential competition claims are largely reviewed along the same lines as an acquisition of a current producer.

The 2010 Guidelines apply the standard horizontal framework to acquisitions involving a potential competitor in two circumstances. The first is where the potential entrant is very likely to provide a rapid supply response in the event of a SSNIP without significant sunk costs.[42] This is similar to the 1992 Guidelines. The 2010 Guidelines also apply the standard horizontal framework to an acquisition involving a company outside the market that is "committed to entering the market in the near future."[43] This is analogous to the 1984 Guidelines, which applied a horizontal merger principles when "the evidence of likely actual entry by the acquiring firm is particularly strong."[44] In either case, the potential competitor is considered to be a market participant.[45] The agencies calculate market shares for these firms "if this can be done to reliably reflect their competitive significance."[46]

For other acquisitions involving a potential competitor, the agencies will consider the market share of the incumbent, the competitive significance of the potential entrant, and the competitive threat posed by the potential entrant relative to others.[47] In addition, the agencies may calculate the projected market share of the potential entrant, if relevant to the competitive effects analysis.[48] At that point, the analysis follows a standard Guidelines approach, including consideration of unilateral and coordinated effects, offsetting buyer power, entry barriers, and efficiencies. In particular, the Guidelines note that the agencies will consider whether, absent the merger, a potential entrant would have generated substantial head-to-head competition with the other merging party—an issue relevant to the analysis of unilateral effects—and whether a potential entrant would have functioned as a maverick—an issue relevant to the issue of coordinated effects.[49]

Given the common refrain that the 1984 Guidelines' potential competition analysis had become outdated, the 2010 Guidelines are remarkable for the modest changes in the agencies' approach to these mergers. The same five objective factors in the 1984 Guidelines—concentration, entry barriers, relative entry capabilities, market share of the incumbent, and efficiencies—remain in the 2010 Guidelines, although phrased somewhat differently and with different thresholds. In addition, the 2010 Guidelines are consistent in applying the standard horizontal merger framework to acquisitions where there is a high degree of confidence regarding the prospect of entry by a merging firm.

Still, the 2010 Guidelines advance potential competition analysis in several respects. First, the 2010 Guidelines acknowledge that acquisitions involving potential competitors are horizontal in nature.[50] Earlier versions of the Guidelines,[51] as well as some

42 *Id.* Section 5.1. The nomenclature for these firms has changed. Under the 1992 Guidelines these firms were "uncommitted entrants"; in the 2010 Guidelines they are "rapid entrants."
43 *Id.* Section 5.1; *see also id.* Section 9 ("Firms that have, prior to the merger, committed to entering the market also will normally be treated as market participants.").
44 1984 Guidelines Section 4.133. For example, a firm may "have made significant investments demonstrating an actual decision to enter." *Id.* Section 4.133 n.28.
45 Potential competition mergers falling into either of these two categories are likely to present more significant competitive concerns than other potential competition mergers because of the high degree of confidence that the firm outside the market will actually enter.
46 2010 Guidelines Section 5.2.
47 *Id.* Section 5.3.
48 *Id.*
49 *Id.* Section 2.1 (identifying forms of direct evidence considered by the agencies).
50 *Id.* Section 1 ("These Guidelines outline the principal analytical techniques, practices, and the enforcement policy of the Department of Justice and the Federal Trade Commission (the 'Agencies') with respect to mergers and acquisitions involving actual or potential competitors ('horizontal mergers') under the federal antitrust laws."); *id.* Section 1 n.1 ("These Guidelines do not cover vertical or other types of non-horizontal acquisitions."); *see also* Commission Opinion at 27 n.41, In re Polypore Int'l Inc., FTC Docket No. 9327 (2010), *available at* http://www.ftc.gov/os/adjpro/d9327/101213polyporeopinion.pdf ("The Agencies analyze acquisitions of potential competitors under the standard horizontal merger framework.").
51 1984 Guidelines Section 4 (classifying mergers raising potential competition concerns as "non-horizontal mergers").

treatises,[52] classified potential competition claims as a type of conglomerate or non-horizontal concern. The better approach—and the one reflected in the 2010 Guidelines—is to treat a merger involving potential competitors as horizontal merger, given that both raise concerns regarding the enhancement of market power and, as the 1984 Guidelines note, the analysis of potential competition concerns is "analogous to that applied in horizontal mergers."[53]

Another advancement in the 2010 Guidelines is that any remaining distinction between the actual and perceived potential competition doctrines is discarded. The 1984 Guidelines had made significant progress by applying a "single structural analysis" for all potential competition concerns, but nevertheless claimed that the two doctrines had "independent importance."[54] The 2010 Guidelines put this artificial distinction to rest and do not draw any distinction between the two doctrines.[55]

Of course, the 2010 Guidelines do not preclude the agencies from alleging an actual or perceived potential competition theory when challenging a transaction in court. The 2010 Guidelines contain an important caveat that they are not intended to describe the agencies' approach to litigation.[56] Recent practice of the agencies has been to litigate potential competition claims following the standards set forth in *Marine Bancorporation* and its progeny rather than by advocating the standards set forth in the Merger Guidelines. For example, in 2008, the Department of Justice challenged Microsemi's consummated acquisition of Semicoa based in part on an actual potential competition claim. In its preliminary injunction memorandum, the agency noted the relevance of the 1984 Guidelines but asserted that *Marine Bancorporation* set forth the requirements for the claim.[57] Likewise, in its *Polypore* decision, the Commission found that a violation in one of the markets at issue could have been premised on both the actual and perceived potential competition doctrines, relying on *Marine Bancorporation* and decisions from the court of appeals.[58]

Another advancement in the 2010 Guidelines is the abandonment of the offensive and defensive toehold doctrines.[59] The offensive toehold doctrine is based on the idea that

52 ABA SECTION OF ANTITRUST LAW, ANTITRUST LAW DEVELOPMENTS ch. 3.C (6th ed. 2007) (listing mergers between potential competitors under the category of non-horizontal mergers).

53 1984 Guidelines Section 4.13; *see also* AREEDA & HOVENKAMP, *supra,* n.16, Paragraph 1100a ("[M]ergers of potential competitors are best analogized to horizontal mergers."); Darren S. Tucker, *Seventeen Years Later: Thoughts on Revising the Horizontal Merger Guidelines*, ANTITRUST SOURCE, Oct. 2009, at 15 ("[P]otential competition theories . . . are sometimes classified as conglomerate or non-horizontal theories. However, the better approach would be to consider potential competition theories under the rubric of horizontal mergers . . . ."); Kwoka, *supra* note 20, at 181 n.31 (asserting that categorizing potential competition mergers as non-horizontal "is misleading, however, since their effect is entirely 'horizontal' in the sense of affecting pricing of the product produced or capable of being produced by the merging firms").

54 1984 Guidelines Section 4.12.

55 In practice, it is difficult to see how the perceived potential competition doctrine could be satisfied without also satisfying the actual potential competition doctrine. A successful perceived potential competition claim would, by definition, satisfy all of the requirements of an actual potential competition claim: a concentrated market, few other comparable entrants, an objective likelihood of entry by the merging firm, and procompetitive benefits from the entry. *Cf.* AREEDA & HOVENKAMP, *supra* note 16, Paragraph 1129d ("As a matter of administrative simplicity, the determination of whether the outside firm is a perceived potential entrant should presumptively be based on the same evidence . . . which determines whether actual future entry is probable."); WARREN & GRIMES, *supra* note 20, Section 11.3b1, at 621 ("[A]s a practical matter, the supposed dichotomy between perceived entrant and a nonperceived but likely actual entrant seems unrealistic.").

56 2010 Guidelines Section 1 n.2 ("These Guidelines are not intended to describe how the Agencies will conduct the litigation of cases they decide to bring. Although relevant in that context, these Guidelines neither dictate nor exhaust the range of evidence the Agencies may introduce in litigation."). *But see id.* Section 1 (The Guidelines may "assist the courts in developing an appropriate framework for interpreting and applying the antitrust laws in the horizontal merger context.").

57 Memorandum of United States in Support of Emergency Motion for a Temporary Restraining Order and Preliminary Injunction at 17-19, United States v. Microsemi Corp., Case No. 1:08-cv-1131 (E.D. Va. filed Dec. 22, 2008).

58 Commission Opinion at 27 n.41, In re Polypore Int'l Inc., FTC Docket No. 9327 (2010) (citing *Marine Bancorporation*, 418 U.S. at 624-25, 630; *Yamaha Motor*, 657 F.2d at 977-78; *Mercantile Tex. Corp*, 638 F.2d at 1265-70). The Commission's opinion, which is currently on appeal, acknowledged that the 2010 Guidelines apply a "standard horizontal merger framework" to acquisitions of potential competitors.

59 This terminology is borrowed from AREEDA & HOVENKAMP, *supra* note 16, Paragraph 1131.

a firm outside the market could have entered by acquiring a smaller firm (the toehold) than the one actually acquired. Despite reserving judgment on the actual potential competition doctrine, the Supreme Court has suggested that the feasibility of acquiring a toehold competitor would be a proper consideration under that doctrine.[60] The 1984 Guidelines adopted the toehold doctrine, explaining that a more procompetitive alternative to a merger could be "both new entry and entry through a 'toehold' acquisition of a present small competitor."[61]

The 2010 Guidelines omit the offensive toehold doctrine entirely. As Areeda and Hovenkamp point out, the basis for this doctrine appears to be nothing more than "a simple preference for smaller rather than larger acquisitions."[62] The legal and economic justifications for the doctrine appear exceedingly weak, and, as a practical matter, would appear to invalidate most product extension mergers in concentrated industries. In addition, the offensive toehold doctrine has not been applied by the courts in three decades, and only sporadically before then.[63]

Under the defensive toehold doctrine, a merger between a small existing competitor and a potential entrant should not be challenged on the grounds that the merger may create a single strong competitor, rather than two weak competitors. Some court decisions from the 1970s suggested that acquisitions involving firms with market shares below ten percent may qualify for this safe harbor. The 1984 Guidelines stated that enforcement was unlikely if the incumbent had a market share of five percent or less.[64] In contrast, the 2010 Guidelines do not mention the defensive toehold doctrine or offer a safe harbor specific to mergers between potential competitors. Instead, the 2010 Guidelines apply the usual presumptions based on pre- and post-merger concentration levels, using the potential entrant's projected revenues to estimate its market share.

One area where the 2010 Guidelines could have provided more guidance is with respect to the degree of confidence that the merging firm would have entered absent the merger. As a general matter, the agencies employ a likelihood standard when making predictions under the Guidelines.[65] However, the Guidelines do not offer any specific guidance how to determine if a firm is "likely" to enter.[66] For example, how far along must a company be in product development efforts, in securing regulatory approvals, or in obtaining customer certifications?[67] Will objective evidence be given more weight than

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60 *United States v. Conn. Nat. Bank*, 418 U.S. 656, 660-61 (1974) (stating that "the existence and economic feasibility of possible foothold acquisitions" are "appropriate considerations" in market extension mergers); *Marine Bancorporation*, 418 U.S. at 639; *Falstaff*, 410 U.S. at 537-38.

61 1984 Guidelines Section 4.112.

62 AREEDA & HOVENKAMP, *supra* note 16, Paragraph 1131a.

63 The most recent judicial application of the doctrine appears to be *Siemens*, 621 F.2d at 508 (considering "whether Siemens was likely to enter the nuclear medical equipment market through a 'toe-hold' acquisition"). However, the antitrust agencies have on at least one subsequent occasion alleged that a transaction caused a loss of actual potential competition by means of the toehold doctrine. *See, e.g.*, Complaint Paragraphs 84, 86, 87, 96, United States v. Primestar, Inc., Case No. 1:98-cv-01193 (JLG) (D.D.C. filed May 12, 1998) (alleging that ASkyB could have entered the MVPD market through a toehold acquisition of EchoStar).

64 1984 Guidelines Section 4.134. Those Guidelines also noted that enforcement was likely if the incumbent firm had a market share of 20 percent or more and the other criteria were met.

65 2010 Guidelines Section 1.0 ("Most merger analysis is necessarily predictive, requiring an assessment of what will likely happen if a merger proceeds as compared to what will likely happen if it does not."); *see also id.* Section 9 (requiring that entry be "likely" in order to alleviate competitive concerns of a merger).

66 Likewise, the Guidelines do not explain how to determine a whether a firm is "committed to entering the market," in which case, the entrant is considered a current market participant. *Id.* Section 9; *see also id.* Section 5.1.

67 *Cf. Yamaha Motor*, 657 F.2d at 978-79 (finding that Yamaha was an actual potential entrant into the U.S. market even though it lacked a dealer network because it "was close to developing a 'complete line'" of products desired by U.S. consumers, was a market leader in other countries, and had a "high degree of interest in penetrating the United States market"); *B.A.T. Indus.*, 104 F.T.C. at 926-30 (identifying sources of evidence to determine whether a firm would enter absent the merger); Werden & Limarzi, *supra* note 22, at 137 ("When entry requires extensive product development efforts, the firm must have substantially completed them. When entry requires the award of approval or qualification, the firm must have good reason to expect that award.").

subjective evidence, as suggested by *Falstaff*? The need for guidance is particularly important for products regulated by the FDA, such as pharmaceuticals and medical devices, that have a defined series of hurdles before a new product can be approved.[68] The Guidelines do not identify any particular developmental milestone, e.g., beginning critical clinical trials, at which point the agencies will be concerned about the loss of future competition.

In its *Polypore* opinion,[69] which was issued subsequent to the 2010 Guidelines, the Commission identified a number of objective and subjective considerations to help assess whether a potential competitor would enter absent the merger. In that case, the administrative law judge had concluded that Daramic entrenched its monopoly position in one market by acquiring the only firm "poised" to enter that market.[70] The Commission rejected that conclusion on the basis that potential entrant "had not developed a commercially viable" product, that no "customer had qualified or come close to qualifying" its product, that the incumbent did not perceive the potential entrant to be a "competitive threat," and that the success of the potential entrant's product development efforts was "in doubt."[71] In contrast, the Commission found that Microporous qualified as a potential competitor in another market because it "was already bidding for business," was perceived by incumbents as a "competitive threat," and incumbents responded to that threat by offering customers "more competitive terms."[72]

Another concern with the 2010 Guidelines is that the intersection between a potential competition concern and an innovation market concern appears murky. For the first time, the Guidelines state that diminished innovation competition can be a basis for an enforcement action.[73] It is not clear how early in the development of a new drug or other product the agencies will apply an innovation market analysis, rather than a potential competition analysis.

There have been suggestions that the Guidelines do not offer enough explanation of how the agencies will evaluate the risk of unilateral competitive effects in potential competition cases because the typical sources of evidence, such as win/loss reports and customer switching data, will not be available.[74] While it is undoubtedly true that evaluating the likelihood of unilateral effects is more difficult when there is no history of competition between the merging firms, the Guidelines identify several ways the agencies will seek to do so. Those include consideration of product characteristics; documents and testimony from buyers, sellers, and other industry participants as to how customers are likely to substitute among products; and natural experiments.[75] Party documents are likely to be viewed as particularly informative.[76]

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68 ABA SECTION OF ANTITRUST LAW, 2008 TRANSITION REPORT 37 (2008) ("[P]articularly in deals involving pipeline pharmaceutical and medical device products, there is not a clear basis for identifying the circumstances under which concerns should be raised when there is a great deal of uncertainty as to which products will succeed and how products are likely to compete.").

69 Commission Opinion, In re Polypore Int'l Inc., FTC Docket No. 9327 (2010).

70 *Id.* at 7, 22, 26.

71 *Id.* at 22-23, 26. The Commission identified these factors in the context of determining whether Daramic was a participant in the market; however, elsewhere in its opinion, the Commission concluded that this evidence was also insufficient to establish liability under a theory of potential competition. *Id.* at 26 n.39.

72 *Id.* at 27 n.41.

73 2010 Guidelines Section 6.4.

74 Royall & Di Vincenzo, *supra* note 20, at 35 ("The new Guidelines do not address how the Agencies will evaluate competitive effects in potential competition cases."); *id.* at 36 ("[I]t is not clear how the agencies will test whether a significant proportion of future customers would view the merging parties products or services as next-best substitutes."). Such evidence is sometimes not available even when the parties have competed for some time.

75 2010 Guidelines Section 2.1.2 (agencies consider "natural experiments"); Section 4.1.3 (agencies consider "business documents indicating sellers' informed beliefs concerning how customers would substitute among products," "information from buyers," "objective information about product characteristics," and "legal or regulatory requirements" when assessing relevant market and unilateral effects); *id.* Section 6.1 (agencies consider "documentary and testimonial evidence" in unilateral effects analysis).

76 *Id.* Section 2.2.1.

IV. CONCLUSION

The 2010 Guidelines provide the first comprehensive explanation of the antitrust agencies' approach to potential competition mergers in over twenty-five years. Given the frequency with which the agencies have raised potential competition concerns in recent years, particularly in the pharmaceutical sector, revised guidance in this area is a welcome development. The 2010 Guidelines do an admirable job updating the 1984 and 1992 Guidelines by maintaining the prior framework but jettisoning unnecessary doctrinal baggage, such as the artificial distinction between the actual and perceived potential competition theories. And while the 2010 Guidelines leave a few questions unanswered, they will likely not be the last word on the agencies' approach to potential competition claims, given the variety of other formal and informal means of keeping the private sector abreast of their thinking.