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Cos. Buying Nascent Rivals Should Beware Antitrust Scrutiny

By **Jessica Michaels** (March 18, 2021, 4:33 PM EDT)


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On Jan. 12, the U.S. Department of Justice announced that Visa Inc. and Plaid Inc. had abandoned their planned $5.3 billion merger, which the DOJ had sued to block two months earlier.[1]

The DOJ's November 2020 complaint acknowledged that Plaid, a financial technology firm, did not have existing technology that currently competed directly with Visa.[2]

Nevertheless, the DOJ alleged that the proposed transaction would "eliminate a nascent competitive threat that would likely result in substantial consumer savings and more innovative online debit services."[3] Rather than engaging in a potentially costly and lengthy legal battle, Visa and Plaid walked away from the proposed transaction.

The announcement that Visa and Plaid were abandoning their proposed merger came only one week after Procter & Gamble Co. announced that it was terminating its plan to acquire razor startup Billie Inc.

The Federal Trade Commission sued to block P&G's acquisition in December 2020, alleging that the proposed deal would "eliminate substantial and growing head-to-head competition" between P&G and so-called nascent competitor Billie in U.S. wet shave razor markets.[4]

The FTC argued in its complaint that "[c]urrent market share statistics and concentration measures understate[d] Billie's future competitive significance" and the proposed transaction was "presumptively anti-competitive" because the relevant markets were already highly concentrated.[5] When the FTC filed its complaint, Billie only sold products online.

Nonetheless, the FTC alleged that Billie was "likely to expand into brick-and-mortar stores" and this likely expansion "pose[d] a serious threat to P&G."[6]

The Visa-Plaid and P&G-Billie transactions are not the first to involve an established market participant and a nascent competitor — i.e., a firm that may become a significant competitor in the future, but is only a small participant in the market today — that the DOJ and FTC have sought to block.

In January 2020, the FTC sued to block Edgewell Personal Care Co.'s $1.37 billion proposed merger with Harry's Inc. — a predominantly direct-to-consumer men's and women's shaving company — despite the fact that Harry's reported market share at the time it entered into the agreement with Edgewell was just 2.5%.[7]

The FTC's complaint described Harry's as a "uniquely disruptive competitor" and argued that Harry's competitive significance went beyond its current market shares and market concentration measures.[8]

Although the agencies have been developing the concept of nascent competition for over a decade, these recent enforcement actions demonstrate their increased willingness to evaluate proposed transactions through a lens that emphasizes more than just market shares and market concentration.

Recent widespread criticism of the agencies' decisions to allow technology-related nascent-competitor acquisitions suggests that the agencies are likely to enjoy support from Congress to extend the analytic approach utilized in these cases to future proposed transactions in the technology sector.

There is growing consensus among lawmakers and commentators on both sides of the political aisle that federal antitrust laws need to do a better job dealing with acquisitions by large, established companies of new or small-but-growing competitors.

In a March 11 interview before a series of hearings on proposed antitrust changes, Sen. Amy Klobuchar, D-Minn., asserted that the problems associated with acquisitions by dominant firms affect every sector of the U.S. economy: "It's not just tech, it's cat food to caskets."[9]

The agencies' recent enforcement actions should serve as a warning that companies in all sectors can expect close scrutiny of deals involving nascent competitors and that the agencies can and will challenge these types of transactions with their existing statutory tools.

The Legal Framework

Section 7 of the Clayton Act prohibits mergers and acquisitions whose "effect ... may be substantially to lessen competition, or to tend to create a monopoly."[10]

Because most mergers are reviewed by the agencies prospectively, determining whether a transaction will substantially lessen competition is a necessarily predictive exercise. The agencies' 2010 horizontal merger guidelines describe the analytical framework used, and the evidence typically examined, by the agencies to determine whether a proposed transaction is likely to substantially lessen competition.[11]

According to the guidelines, a "unifying theme" in the merger review process is that a transaction "should not be permitted to create, enhance, or entrench market power or to facilitate its exercise."[12]

A merger that creates or enhances market power is likely to lead to higher prices, fewer or lower-quality goods or services, less innovation, or other harm to consumers as a result of weakened competitive constraints or incentives.[13]

Traditionally, the agencies have focused on market shares and resulting market concentration levels to determine whether a proposed transaction was likely to enhance or create market power.

The guidelines explain that the agencies view "[m]arket concentration [a]s a useful indicator of the likely potential competitive effect of a merger"; specifically, in evaluating horizontal mergers (mergers between competitors), they will consider "both the post-merger level of market concentration and the change in concentration resulting from [the] merger."[14]

The agencies presume transactions in highly concentrated markets to be anti-competitive.[15] On the other hand, the agencies consider mergers in unconcentrated markets or resulting in only a small change in concentration, even in highly concentrated markets, to be "unlikely to have an adverse competitive effects."[16]

Indeed, in most previous merger litigations, the agencies have followed a predictable approach that supports the market concentration-centric framework identified in the guidelines: (1) define a relevant market; (2) demonstrate the transaction would significantly increase concentration in the relevant market; and (3) establish, as a result of the increase in concentration, that the merger should be presumed to have anti-competitive effects.

The guidelines, however, leave room for the agencies to consider additional factors that may impact competition. More specifically, the guidelines state that "[t]he measurement of market shares and market concentration is not an end in itself, but is useful to the extent it illuminates the merger's likely competitive effects."[17]

The agencies assert that in some situations, the "market share of a particular firm [may] either understate ... or overstate ... the firm's future competitive significance."[18]

They contend that a merger may harm competition if "one of the merging firms has a strong incumbency position and the other merging firm threatens to disrupt market conditions with a new technology or business model" or if "one of the merging firms has capabilities that are likely to lead it to develop new products in the future that would capture substantial revenues from the other merging firm."[19]

The agencies' recent willingness to challenge nascent-competitor transactions suggests that market shares and market concentration may increasingly be playing a less prominent role in the agencies' overall analysis.

In each of the merger challenges discussed above, the challenging agency asserted that current market share understated the up-and-coming competitor's competitive significance in the relevant market.

In both P&G-Billie and Edgewell-Harry's, the FTC explicitly argued that market shares and market concentration were not an accurate gauge of the parties' competitive significance.

In P&G-Billie, the FTC asserted that Billie was a "fast-growing brand" whose imminent expansion into additional sales channels would have accelerated its growth absent the proposed transaction.[20]

Similarly, in Edgewell-Harry's, the FTC claimed that the proposed transaction would "arrest Harry's independent expansion" into brick-and-mortar retailers, so it was more appropriate to analyze Harry's competitive significance "by using prior entry events to project future competitive significance" than by evaluating current market shares and concentration measures.[21]

Moreover, the FTC argued that Harry's market shares did not reflect likely growth that would result from a newly launched product that was expected to take significant market share from its competitors.

The DOJ made similar arguments in Visa-Plaid. Despite the fact that Plaid did not currently compete in the relevant market, the DOJ alleged that Plaid "posed a significant threat to" and was "poised to take share away from" Visa's debit business.[22] Quoting United States v. Microsoft Corp., the DOJ argued that "[m]onopolists cannot have 'free reign to squash nascent, albeit unproven, competitors at will.'"[23]

Because the Visa-Plaid, P&G-Billie, and Edgewell-Harry's transactions were all voluntarily abandoned by the parties before litigation, it is unclear whether the agencies' theories of competitive harm would have held up in court. However, the threat of a lengthy and costly merger investigation may alone be sufficient to deter many future nascent-competitor transactions.

And, to the extent parties continue to abandon challenged transactions before litigation, the agencies' theories of competitive harm will remain untested and their own interpretation of the Clayton Act's requirements, rather than the courts', will become the default.

The Impact of Proposed Legislative Reforms

Recent calls for antitrust reform by a number of Democratic and Republican legislators suggest that focus by antitrust regulators on these types of acquisitions is not likely to wane any time soon. In October 2020, during the 116th Congress, Chairman David Cicilline, D-R.I., and his majority staff of the Antitrust Subcommittee of the House Judiciary Committee issued the Cicilline Report, which proposed changes to federal antitrust laws that would make challenges to acquisitions of nascent competitors easier.[24]

The Cicilline Report suggests amending the Clayton Act to clarify that "proving harm on potential competition or nascent competition grounds does not require providing that the potential or nascent competitor would have been a successful entrant in a but-for-world."[25]

It also suggests "codifying a presumption against acquisitions of startups by dominant firms, particularly those that serve as direct competitors as well as those operating in adjacent or related markets."[26]

In February 2021, Klobuchar introduced the Competition and Antitrust Law Enforcement Reform Act which, if passed, would fundamentally change the types of transactions that could be blocked by the agencies.[27]

The bill sets forth a number of congressional findings related to nascent-competitor mergers, including that "the acquisition of nascent or potential rivals by dominant firms can present significant long-term threats to competition" and "nascent or potential rivals—even those that are unprofitable or inefficient—can be an important source of competitive discipline for dominant firms."[28]

The bill suggests lowering the Clayton Act Section 7 liability standard to "materially" instead of "substantially" lessening competition.[29]

This change would allow the agencies to block proposed transactions where they are able to prove that there is "more than a de minimis amount of harm."[30] Because, by definition, nascent competitors are small market participants, the agencies may have a difficult time proving in court that their acquisition may "substantially lessen competition."

The lower liability standard would make it easier for the agencies to bring merger challenges (and win) against companies involved in nascent-competitor mergers.

Senate Judiciary Antitrust Subcommittee Ranking Republican Sen. Mike Lee, R-Utah, issued a statement on Feb.16, agreeing that "there appears to be a broad consensus that the status quo isn't working," but suggesting that the "radical" reforms the bill would usher in "would undermine both the economy and Congress's legislative prerogative."[31]

Although it is questionable whether these reforms will pass in a closely divided Senate — particularly given their potential significant unintended consequences on pro-competitive conduct — the agencies will undoubtedly continue to feel pressure from Congress to aggressively pursue and block acquisitions of nascent competitors by established incumbents with the enforcement tools currently available to them.

And, the recent challenges discussed above indicate that the agencies can do exactly that.

Conclusion

Recent challenges by the antitrust agencies to block acquisitions by established market participants of nascent competitors with small — or non-existent — market shares demonstrate a shift in the way the agencies are evaluating the likely competitive effects of proposed transactions.

Although the agencies traditionally emphasized market shares and market concentration as a key metric for analyzing the competitive impact of proposed mergers, the agencies are demonstrating an increasing willingness to challenge mergers by large firms, even if the change in market concentration is minimal or the acquired firm has an insignificant market share.

Given recent criticism of the agencies' decision to clear previous acquisitions by dominant technology firms of nascent competitors and ongoing debate in Congress regarding the need for significant antitrust reform to prevent similar transactions, companies should expect the heightened focus on acquisitions of nascent competitors to continue for the foreseeable future.

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[1] Press Release, U.S. Dep't of Justice, Visa and Plaid Abandon Merger After Antitrust Division's Suit to Block (Jan. 12, 2021), https://www.justice.gov/opa/pr/visa-and-plaid-abandon-merger-after-antitrust-division-s-suit-block.

[2] Complaint, United States vs. Visa Inc. and Plaid Inc., No. 3:20-cv-07810 (N.D. Cal. Nov. 5, 2020), ECF No. 1, https://www.justice.gov/opa/press-release/file/1334726/download.

[3] Press Release, U.S. Dep't of Justice, Justice Department Sues to Block Visa's Proposed Acquisition of Plaid (Nov. 5, 2020), https://www.justice.gov/opa/pr/justice-department-sues-block-visas-proposed-acquisition-plaid.

[4] Press Release, Fed. Trade Comm'n, FTC Sues to Block Procter & Gamble's Acquisition of Billie, Inc.

(Dec. 8, 2020), https://www.ftc.gov/news-events/press-releases/2020/12/ftc-sues-block-procter-gambles-acquisition-billie-inc.

[5] Complaint, In the Matter of The Procter & Gamble Co. and Billie, Inc., Comm'n File No. 2010042, at ¶ 7 (F.T.C. Dec. 8, 2020), https://www.ftc.gov/system/files/documents/cases/d09400_administrative_part_3_complaintpublic600214.pdf.

[6] Press Release, Fed. Trade Comm'n, FTC Sues to Block Procter & Gamble's Acquisition of Billie, Inc. (Dec. 8, 2020), https://www.ftc.gov/news-events/press-releases/2020/12/ftc-sues-block-procter-gambles-acquisition-billie-inc.

[7] Complaint, In the Matter of Edgewell Personal Care Co. and Harry's Inc., Comm'n File No. 1910147 (F.T.C. Feb. 3, 2020), https://www.ftc.gov/system/files/documents/cases/public_p3_complaint_-_edgewell-harrys.pdf.

[8] Id. at ¶ 67.

[9] Brent Kendall and Ryan Tracy, Congress Eyes Antitrust Changes to Counter Big Tech, Consolidation, The Wall Street Journal (Mar. 11, 2021), https://www.wsj.com/articles/congress-eyes-antitrust-changes-to-counter-big-tech-consolidation-11615458603.

[10] 15 U.S.C. § 18. Other federal antitrust laws implicated by mergers and acquisitions include Sections 1 and 2 of the Sherman Act, 15 U.S.C. § 1, 2, and Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45.

[11] U.S. Dep't. of Justice, Antitrust Div. & Fed. Trade Comm., Horizontal Merger Guidelines (August 19, 2010), https://www.ftc.gov/sites/default/files/attachments/merger-review/100819hmg.pdf [hereinafter Guidelines].

[12] Id. at Overview.

[13] Fed. Trade Comm'n, Competitive Effects, Guide to Antitrust Laws (last viewed Mar. 15, 2021), https://www.ftc.gov/tips-advice/competition-guidance/guide-antitrust-laws/mergers/competitive-effects.

[14] Guidelines at § 5.3.

[15] Id.

[16] Id.

[17] Id. at § 4.

[18] Id. at §5.3.

[19] Id. at §§ 2.1.5, 6.4.

[20] Complaint, In the Matter of The Procter & Gamble Co. and Billie, Inc., Comm'n File No. 2010042, at

¶ 7 (F.T.C. Dec. 8, 2020), https://www.ftc.gov/system/files/documents/cases/d09400_administrative_part_3_complaintpublic600214.pdf.

[21]Complaint, In the Matter of Edgewell Personal Care Co. and Harry's Inc., Comm'n File No. 1910147, at ¶ 46 (F.T.C. Feb. 3, 2020), https://www.ftc.gov/system/files/documents/cases/public_p3_complaint_-_edgewell-harrys.pdf.

[22] Complaint, United States vs Visa Inc. and Plaid Inc., No. 3:20-cv-07810, at ¶¶ 33, 42 (N.D. Cal. Nov. 5, 2020), ECF No. 1, https://www.justice.gov/opa/press-release/file/1334726/download.

[23] Id. at ¶ 13 (quoting United States v. Microsoft Corp. [etc.]).

[24] Investigation of Competition in Digital Markets: Majority Staff Report and Recommendations, Subcommittee on Antitrust, Commercial and Administrative Law of the Committee on the Judiciary, 116th Cong. (2020), https://judiciary.house.gov/uploadedfiles/competition_in_digital_markets.pdf?utm_campaign=4493-519.

[25] Id. at 394.

[26] Id.

[27] Competition and Antitrust Law Enforcement Reform Act of 2021, S. 225, 117th Congress (2021).

[28] Id. at §§ 2(a)(12), 2(a)(20).

[29] Competition and Antitrust Law Enforcement Reform Act, S. 225, § 4(b)(1), 117th Congress (2021).

[30] Id.

[31] Press Release, Senator Mike Lee (R-UT), Sen. Lee Sets Senate Republican Antitrust Agenda for 117th Congress (Feb. 16, 2021), https://www.lee.senate.gov/public/index.cfm/press-releases?ID=C99C6DA7-D8EE-42FB-B51E-A26B2A2F2A8A.