BATES WHITE
ECONOMIC CONSULTING

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Summary of panel discussions

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On June 24, Bates White hosted its annual Hal White Antitrust Conference, bringing together a distinguished group of antitrust practitioners, academics, and enforcers to hear two panels covering topics at the frontiers of antitrust enforcement. The first panel addressed agency assessment of potential competition in a proposed merger transaction, while the second focused on the implications of the 2020 Vertical Merger Guidelines. A summary of the discussion can be found below.[1]

I. POTENTIAL COMPETITION IN ANTITRUST

The first panel included Joseph Farrell, Economics Professor at University of California at Berkeley and a Partner in Bates White's Antitrust and Competition Practice; Debbie Feinstein, Partner and head of Arnold and Porter's Antitrust Group; Jenn Mellott, a Partner in Freshfield's Antitrust, Competition, and Trade Practice active in both US and EU antitrust; and Barry Nigro, Chair of Fried Frank's Global Antitrust and Competition Department. Eric Emch, a Partner in Bates White's Antitrust and Competition Practice, moderated the discussion. Key points and perspectives raised in the discussion are highlighted below.

I.A. How certain must potential competition be?

Panelists discussed what level of certainty should be required for possible future entry into an existing market, or for future competition in an entirely new market, to rise to the level of "potential competition" concern. It was noted that antitrust enforcement is generally forward looking and involves some uncertainty about the future. In all antitrust cases, opinions on competition's likely path are informed by economic evidence, customer views, and internal documents. In a potential competition case, this evidence may inherently include more uncertainty.

Panelists noted that when interpreting company documents to infer a potential competition concern, the type of document and the context matter—a statement speculating about a potential market entry from a mid-level manager may mean less than the same statement from a company CEO, which may mean less than that same statement coupled with a detailed P&L calculation of a potential entry scenario. It was also noted that the inquiry does not stop with probability of entry—it must consider ultimate effects. For instance, a merger would be condemned not just because it represents the purchase of a potential entrant, even if that entry were deemed likely, but rather due to its impact on the market, which depends on variables other than just the likelihood of one firm's entry.

Ultimately, both likelihood and impact of entry should be weighed when considering an antitrust intervention. Even if there is some uncertainty as to likelihood of entry, a potentially huge impact of entry may make antitrust intervention against actions that prevent that entry prudent. One panelist noted that this was the FTC's position in its 2015 complaint against Steris Corporation's proposed $1.9 billion acquisition of Synergy Health plc—that a potentially huge market impact should lower the relevant threshold for the likelihood of entry.[2]

[1] Views expressed by panelists represented their personal perspectives and not the views of any institutions. This summary does not attribute views to any individual panelist or other participants.
[2] The FTC ultimately withdrew its administrative complaint in that matter, which combined two providers of infection prevention and other sterilization products and services, after a district court rejected the FTC's attempt to obtain a preliminary injunction blocking the merger.

From an economic perspective, the focus may be broader than just whether a particular firm may enter. Rather, it may focus on the question of how profitable entry would be in general, which economic theory and evidence may shed light on, and how likely it would be that if one particular firm did not enter, another would.

I.B. Is there something different about potential competition in the digital economy?

Potential competition is not a new antitrust concern. The FTC has historically brought a large number of potential competition cases. But those cases have tended to be focused on pharmaceuticals and medical devices, areas where—due to the regulatory process—the pipeline of products and thus the timing of future entry may be relatively clear years in advance. Panelists discussed whether there is something new about potential competition in the digital economy that differentiates it from historical potential competition cases. It was noted that in a case involving a rapidly evolving technology market—like the DOJ's recent complaint against the acquisition of payments company Plaid by Visa[3]—the scope of future competition may be much more uncertain than in a pharmaceutical pipeline case. Yet, due to the nature of technology markets—and in particular digital platforms with strong network effects—the cost of inaction may be particularly high. That idea, along with recent re-evaluation of past mergers in the internet space, may lead to increased enforcement activity by the government against potential competition in digital markets in the coming years. In one panelist's assessment, there is already strong evidence that the government has stepped up enforcement of mergers involving potential competition issues, with lengthy investigations of mergers that would have been cleared more quickly just five years ago.

Other panelists opined, however, that the US antitrust enforcers have always been willing to consider even unconventional potential competition theories—consider the Microsoft case in the late 1990s for example—and that it has been circumstances rather than enforcement policy that have potentially changed. Another panelist noted perhaps an even greater recent concern with these types of cases in the European Union than in the United States, though differences in laws and jurisdiction may lead to idiosyncratic differences in how these cases are treated in the EU versus the United States.

I.C. Have the enforcement agencies been too lenient in assessing potential competition in recent years?

Though panelists generally agreed that that US antitrust enforcers have always brought potential competition cases—even in fast moving high-tech sectors as in the Microsoft case—some argued that recent experience with the agencies indicates an increasing interest in these sorts of cases going forward. Does that mean that the agencies have under-enforced in the past?

For example, did the FTC make a mistake in not challenging the 2014 Facebook acquisition of messaging company WhatsApp? Though it did not challenge the merger at the time, the FTC did challenge it as part of its 2020 complaint against Facebook, which alleges a pattern of anticompetitive actions designed to maintain a monopoly in personal social networking.[4] One panelist noted that the 2020 FTC complaint was against a broad set of actions, and a narrow case against the Facebook-What's App merger might never have been feasible. This panelist also noted that the courts tend to put up a high hurdle to plaintiffs speculating about potential future competition. For instance, in the FTC's 2015 Steris case, with relatively strong documents and testimony about a company's plans to enter and concrete actions it had taken toward entry, the court nonetheless considered that

[3] The acquisition was abandoned shortly after the DOJ's challenge.
[4] The FTC's complaint against Facebook centered on its alleged past anticompetitive actions to maintain a monopoly in personal social networking. These actions included its 2012 acquisition of Instagram and its 2014 acquisition of WhatsApp, as well as the imposition of certain conditions on software developers. The case was dismissed by a federal court in June 2021, though the court left open the possibility that the FTC could file an amended complaint.

the uncertainty that lingered in spite of that evidence was enough to prevent the FTC from meeting its burden of likelihood. Similarly, it was noted that the potentiality of competition in so-called "pay-for-delay" cases—where an incumbent pharmaceutical firm settles patent litigation against a new entrant with some consideration paid to the entrant as a condition of a delay in entry—has complicated courts' assessment of what perhaps should be a straightforward application of antitrust law.

One panelist noted that potential competition is a double-edged sword for the agencies: an increased emphasis on the threat posed by potential entrants to incumbent firms also logically strengthens the argument that entry may undo harm from mergers between actual competitors. The FTC dealt with this issue, for example, when it argued that potential entry from Amazon would not undo harm from the 2016 Staples-Office Depot merger.[5]

I.D. Are new laws or guidance required to more effectively address potential competition issues?

Potential competition cases could be brought under Section 2 of the Sherman Act, Section 7 of the Clayton Act, or Section 5 of the FTC Act. But each of these avenues faces a standard, based on law and precedent, that harm must be "likely" and not just "possible." Panelists discussed whether a change in law was necessary to change enforcement and whether a new legal framework would be advisable from the perspective of good public policy.

While acknowledging that courts need to do a better job of evaluating uncertainty—things that are not easily proven are not necessarily untrue—and that this might mean that laws need to be changed somewhat, panelists argued for a careful approach to changing the laws. They generally favored a multipronged strategy, whereby instead of immediately pushing to change laws, the agencies push for more research to improve their, and the courts', understanding of potential competition issues, bring cases that clarify the law and the standards, and publish guidelines to give clarity to actors and courts and define a reasonable approach for addressing these issues.

The outcome of all of this would be a greater degree of consensus and perhaps a move to change laws in narrowly tailored ways. One panelist compared this process to the FTC's pursuit of hospital mergers. Its initial poor litigation record was reversed after it conducted research on past mergers and used the results of that research to propel a new set of cases before courts, more successfully.

Several panelists cautioned against quick, dramatic changes in the antitrust laws, such as creating a legal presumption against acquisitions by dominant digital platforms, which was recommended in the recent congressional staff report on competition in digital markets.[6] One panelist noted that current laws are flexible and powerful enough to support an aggressive enforcement agenda but argued that the agencies need more resources to implement such an agenda. Another panelist noted that the UK Competition and Markets Authority stepped up its enforcement of potential competition cases after experiencing a massive increase in resources leading up to Brexit. Another noted that giving the DOJ the power to pursue merger retrospectives similar to the FTC's could improve understanding and enforcement of potential competition issues.

[5] Staples and Office Depot abandoned their merger after the district court granted the Commission's request for a preliminary injunction.
[6] Subcommittee on Antitrust, Commercial and Administrative Law of the Committee on the Judiciary, "Investigation of Competition in Digital Markets: Majority Staff Report and Recommendations," 116th Cong. (2020), 388 ("To address this concern, Subcommittee staff recommends that Congress consider shifting presumptions for future acquisitions by the dominant platforms. Under this change, any acquisition by a dominant platform would be presumed anticompetitive unless the merging parties could show that the transaction was necessary for serving the public interest and that similar benefits could not be achieved through internal growth and expansion. This process would occur outside the current Hart-Scott-Rodino Act (HSR) process, such that the dominant platforms would be required to report all transactions and no HSR deadlines would be triggered. Establishing this presumption would better reflect Congress's preference for growth through ingenuity and investment rather than through acquisition").

I.E. Are there dangers in overly aggressive enforcement of potential competition cases?

Some have argued that advocates for aggressive enforcement of potential competition cases ignore the role that the purchase of small entrants by established firms plays in motivating innovation and entry in the first place. Panelists noted that venture capitalists have made this point, not just with respect to initial startups but with respect to a firm's ability to attract capital throughout its early growth phases. It was also pointed out that there is a sense in Europe that the United States has been more successful at promoting innovation than the EU, in part due to a more favorable regulatory environment—broader than just competition regulation but perhaps encompassing competition policy enforcement as well.

On the other hand, one panelist noted that simply taking one buyout option off the table in the interests of competition does not necessarily make much difference to a firm's overall incentives to innovate.

I.F. What can economics add to the evaluation of potential competition cases?

Economists' tools for assessing harm from the merger of actual competitors, particularly in a unilateral effects framework, have advanced rapidly in recent decades, producing a fairly robust toolkit to assess likely merger harm. This toolkit makes use of commonly available data such as margins, market shares, and estimated diversion ratios. Potential competition cases, in contrast, lack the data and revealed preference information usually available in a merger of actual competitors. Panelists noted that economists nonetheless can evaluate under certain scenarios how important a particular competitor might be to the market and can conduct a rigorous analysis of entry incentives, drawing on complementarities with other parts of a firm's business.

In addition, lacking robust data on actual competition, an economist can still establish thresholds for harm and help identify parameters that would contribute to assessing the likelihood and impact of entry. It was noted that in the FTC's Steris case, an economist was able to conduct a robust analysis of the likely impact of entry if it occurred, which should have influenced the appropriate threshold for likelihood of entry (in the end, however, the judge focused on the latter divorced from the former.)

II. VERTICAL MERGER GUIDELINES

Experts on the second panel included Michael Whinston, Professor of Economics in the MIT Department of Economics and a Partner in Bates White's Antitrust & Competition Practice; Mandy Reeves, Partner in Latham & Watkins' Litigation & Trial Department and Global Chair of their Antitrust & Competition Practice; Bruce Hoffman, Partner at Cleary Gottlieb; and Sara Razi, Partner and Global Co-Chair of Simpson Thacher's Antitrust and Trade Regulation Practice. Nitin Dua, a Principal from Bates White, moderated the panel.

II.A. Background

In 2017, the AT&T/Time Warner transaction became one of the first litigated vertical mergers in more than 30 years. Since then, federal agencies have investigated a number of significant vertical mergers, including Aetna-CVS, United-DaVita, Staples-Essendant, and most recently Illumina-GRAIL. In June 2020, likely fueled by a need to communicate the agencies' approach on vertical merger enforcement and economic theories of vertical harm, the FTC and DOJ adopted the Vertical Merger Guidelines (VMG).

The guidelines have received both praise and criticism, some of which originated within the agencies. FTC Commissioner Rebecca Kelly Slaughter voted against the release of the VMG and wants the FTC to take on "more litigation risk" and worry more about the "false negatives of under-enforcement" than "false positives of over-enforcement."[7] The newly appointed Chair, Lina Khan, has also advocated for stronger regulation of vertical deals.[8]

While the guidelines provide much-needed guidance to both industry participants and antitrust practitioners, they also leave some questions unaddressed, such as the importance of behavioral versus structural remedies in vertical transactions. Main points of the panel discussion follow.

II.B. Are the guidelines excessively pro-merger?

In general, panelists did not think that the new guidelines are excessively pro-merger, and some hold the view that vertical mergers are less likely to involve anticompetitive concerns than horizontal mergers. As support, they cited the small number of vertical cases, relative to horizontal cases, that the agencies investigate every year. Panelists also think that while the guidelines are limited in detail, they do not make it difficult for agencies to litigate vertical transactions and include multiple grounds on which such transactions can be investigated.

II.C. The role of EDM in competitive analysis

Panelists were asked if efficiencies due to the elimination of double marginalization (EDM) have received a special status in the guidelines. They unanimously hold the view that EDM is inherently different than other efficiencies and that the same incentives that motivate foreclosure also motivate firms to internalize efficiencies due to EDM.

It was also stated that practitioners must think hard and carefully if EDM will happen in a given transaction, and not just presume that it will. This is because in certain situations benefits from EDM may not exist or may be too little, such as when it has been internalized premerger via contracts or when the opportunity costs of input price

[7] FTC, "Dissenting Statement of Commissioner Rebecca Kelly Slaughter," FTC-DOJ Vertical Merger Guidelines File No. P810034, June 30, 2020, https://www.ftc.gov/system/files/documents/public_statements/1577499/vmgslaughterdissent.pdf.
[8] Nell Abernathy, Mike Konczal, and Kathryn Milani, eds. "Untamed: How to Check Corporate, Financial, and Monopoly Power," Roosevelt Institute Report, June 2016, https://rooseveltinstitute.org/wp-content/uploads/2016/06/RI-Untamed-201606-1.pdf, p. 20.

decrease are too high for the upstream partner. Vertical integration can also be inefficient, as is reflected by disintegration of firms.

Overall, panelists believe that the guidelines correctly put additional emphasis on EDM benefits and that agencies should bear the onus to investigate them, along with the investigation into harms due to a vertical transaction.

II.D. Can the existing literature inform vertical merger analysis?

With respect to the relevance of existing economic literature in informing vertical analysis, it was stated that there aren't enough documented studies of EDM. A recent paper by Whinston and co-authors, however, shows that both foreclosure and EDM incentives are present in vertical mergers in multichannel TV markets.[9] Authors of the paper find that divisions of integrated firms internalize a significant fraction of the effect, both positive and negative, that they have on other divisions of the firm.

II.E. Lessons from litigation and investigation

The recent Illumina/GRAIL litigation brought by the FTC was compared with the AT&T/Time Warner litigation brought by the DOJ. Both transactions involved a litigate-the-fix strategy. As AT&T did during its merger litigation, Illumina also offered a fix to the FTC that involved "a standard contract to any US oncology customer."[10] Panelists agreed that this strategy will likely be used in future vertical merger litigations brought by the agencies. One aspect that makes the Illumina/GRAIL litigation different is that it involves potential harm in a downstream market that does not exist yet, which renders traditional vertical analyses (like vertical math) somewhat hard to implement.

With respect to the role of behavioral versus structural remedies, panelists think that while structural remedies are always preferred, there is more room for behavioral remedies in vertical transactions—especially those that involve concerns related to information sharing. As support, panelists cited the FTC's 2017 merger remedies retrospective analysis, which shows firewall remedies have often worked in such cases.

II.F. Should the guidelines be changed?

Finally, when asked how they would like the guidelines to be changed, if at all, most panelists emphasized the need for more detail and discussion on quantitative tools and screening approaches that the agencies use during investigation. Some also highlighted the need for a more nuanced discussion of pass through and procompetitive effects.

[9] Michael D. Whinston, Gregory S. Crawford, Robin S. Lee, and Ali Yurukoglu, "The Welfare Effects of Vertical Integration in Multichannel Television Markets," *Econometrica* 26 (2018): 891–954.
[10] Illumina.com, "Oncology Contract Terms," accessed July 2021, https://www.illumina.com/areas-of-interest/cancer/test-terms.html.

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